

THIRD QUARTER REPORT
FOR THE 13 AND 39-WEEK PERIODS ENDED DECEMBER 31, 2011

At Indigo, we believe
in storytelling, in ideas
and in experiences that
enrich our every day.

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Enrich your life

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Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") is prepared as at February 8, 2012 and is based primarily on the unaudited interim condensed consolidated financial statements of Indigo Books & Music Inc. (the "Company" or "Indigo") for the 13 and 39-week periods ended December 31, 2011 and January 1, 2011. The Company's unaudited interim condensed consolidated financial statements and the accompanying notes are reported in Canadian dollars and have been prepared in accordance with International Financial Reporting Standards ("IFRS") and International Accounting Standard ("IAS") 34, "Interim Financial Reporting," as issued by the International Accounting Standards Board ("IASB") using the accounting policies described therein.

These unaudited interim condensed consolidated financial statements do not contain all disclosures required by IFRS for annual financial statements. This MD&A should be read in conjunction with the unaudited interim condensed consolidated financial statements and notes contained in this Quarterly Report, the audited annual consolidated financial statements and accompanying notes for the year ended April 2, 2011, the MD&A included in the Company's fiscal 2011 Annual Report and certain additional disclosures included in the Company's fiscal 2012 first quarter unaudited interim condensed consolidated financial statements and accompanying notes and related interim MD&A. The Company's fiscal 2011 Annual Report was prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP" or "CGAAP"). The Annual Report and additional information about the Company, including the Annual Information Form, can be found on SEDAR at www.sedar.com.

Overview

Indigo is Canada's largest book retailer, operating stores in all 10 provinces and one territory in Canada and offering online sales through its www.chapters.indigo.ca website. As at December 31, 2011, the Company operated 97 superstores under the banners *Chapters*, *Indigo* and the *World's Biggest Bookstore* and 147 small format stores, under the banners *Coles*, *Indigo*, *Indigospirit*, *SmithBooks*, *The Book Company*, and *Pistachio*. During the third quarter of fiscal 2012, the Company did not open or close any stores. The Company has a 50% interest in Calendar Club of Canada Limited Partnership ("Calendar Club"), which operates seasonal kiosks and year-round stores in shopping malls across Canada.

Indigo has one subsidiary, Kobo Inc. ("Kobo"). Kobo provides instant access to books, newspapers, magazines, and other digital content through its website, www.kobo.com. Kobo has launched localized instances of its website in several countries and offers its download service to users worldwide. Kobo also develops eReader devices which are sold through wholesale and retail channels. As at December 31, 2011, Indigo owned 51.4% of Kobo's outstanding common shares.

On November 8, 2011, Indigo entered into an agreement with Rakuten, Inc. ("Rakuten") for Rakuten to acquire all the outstanding shares of Kobo on a fully diluted basis for an aggregate purchase price of US\$315 million. As a result of the agreement, Kobo's assets, liabilities and operating results have been classified as held for sale and discontinued operations. The Company continued to eliminate all intercompany transactions until the sale was closed. The sale transaction was unanimously approved by the Board of Directors on November 8, 2011 and closed on January 11, 2012 following the satisfaction of all closing conditions, including approval under the *Investment Canada Act*. Indigo received net cash proceeds of US\$146.1 million from the Kobo sale. The accounting gain cannot be determined at this time as the calculation requires Kobo's closing balances as at January 11, 2012 to be finalized, but the gain is expected to range between \$153.0 million and \$163.0 million.

Indigo operates a separate registered charity under the name Indigo Love of Reading Foundation (the "Foundation"). The Foundation provides new books and learning material to high-needs elementary schools across the country through donations from Indigo, its customers, suppliers and employees.

The weighted average number of common shares outstanding for the third quarter of fiscal 2012 was 25,210,068 as compared to 24,929,208 last year. As at February 8, 2012, the number of outstanding common shares was 25,237,314 with a book value of \$203.4 million. The number of common shares reserved for issuance under the employee stock option plan is 2,273,731 as at February 8, 2012. As at December 31, 2011, there were 1,619,100 stock options outstanding of which 855,100 were exercisable.

Unless otherwise noted, all comparative prior period balances that were previously reported under CGAAP have been restated to conform with standards adopted as part of the Company's transition to IFRS.

Results of Operations

The following table summarizes the consolidated results of continuing operations for the periods indicated. The classification of financial information presented below is specific to Indigo and may not be comparable to that of other retailers. Results from continuing operations exclude Kobo results, which are reported separately as discontinued operations. Kobo results for comparative periods have been reclassified as discontinued operations.

(millions of Canadian dollars)	13-week period ended December 31, 2011		13-week period ended January 1, 2011		39-week period ended December 31, 2011		39-week period ended January 1, 2011	
	Revenues	%	Revenues	%	Revenues	%	Revenues	%
Revenues	352.9	100.0	351.2	100.0	738.1	100.0	756.3	100.0
Cost of sales	208.5	59.1	199.3	56.7	431.0	58.4	426.6	56.4
Cost of operations	82.3	23.3	84.0	23.9	214.0	29.0	213.9	28.3
Selling, administrative and other expenses	19.6	5.6	20.9	6.0	57.5	7.8	57.2	7.6
EBITDA ¹	42.5	12.0	47.0	13.4	35.6	4.8	58.6	7.7

1 Earnings before interest, taxes, impairment, depreciation and amortization. Also see "Non-IFRS Financial Measures".

Revenue from Continuing Operations Increased Slightly

Total consolidated revenues for the 13-week period ended December 31, 2011 increased \$1.7 million or 0.5% to \$352.9 million from \$351.2 million for the 13-week period ended January 1, 2011. The increase was driven by revenues from gift, lifestyle, toys, and eReaders, partially offset by declining book sales.

Comparable store sales for the quarter increased 1.8% in superstores and 2.5% in small format stores due to the same factors mentioned above. Comparable store sales are defined as sales generated by stores that have been open for more than 12 months on a 52-week basis. It is a key performance indicator for the Company as this measure excludes sales fluctuations due to store closings, permanent relocation, and chain expansion. As at December 31, 2011, the Company operated two fewer small format stores compared to January 1, 2011.

Online sales increased by \$2.9 million or 9.3% to \$34.1 million for the 13-week period ended December 31, 2011 compared to \$31.2 million last year. The increase was due to higher book sales than last year driven by Plum preferred member pricing and increased promotional activity, and to increased sales of gift, lifestyle, and toy products.

Revenues from other sources include revenues generated through loyalty card sales, gift card breakage, and revenues from Calendar Club. Revenues from other sources decreased \$5.9 million from \$25.7 million last year to \$19.8 million for the current year primarily as a result of lower gift card breakage, loyalty income, and Calendar Club sales. Loyalty card sales have decreased as members moved to the free Plum loyalty program.

On a year-to-date basis, total consolidated revenues decreased by \$18.2 million or 2.4% from \$756.3 million last year to \$738.1 million this year. Year-to-date comparable store sales were down 1.9% for superstores and down 0.8% for small format stores due to declining book sales.

Revenues by channel are highlighted below:

(millions of Canadian dollars)	13-week period ended December 31, 2011	13-week period ended January 1, 2011	% increase (decrease)	Comparable store sales % increase (decrease)
Superstores	241.7	237.5	1.8	1.8
Small format stores	57.3	56.8	0.9	2.5
Online (including store kiosks)	34.1	31.2	9.3	N/A
Other	19.8	25.7	(23.0)	N/A
	352.9	351.2	0.5	1.9

A reconciliation between total revenues and comparable store sales is provided below:

(millions of Canadian dollars)	Superstores		Small format stores	
	13-week period ended December 31, 2011	13-week period ended January 1, 2011	13-week period ended December 31, 2011	13-week period ended January 1, 2011
Total revenues	241.7	237.5	57.3	56.8
Adjustments for stores not in both fiscal periods	(3.5)	(3.4)	(2.0)	(2.8)
Comparable store sales	238.2	234.1	55.3	54.0

Cost of Sales from Continuing Operations Increased Compared to Last Year

Cost of sales includes the landed cost of goods sold, online shipping costs, inventory shrink and damage reserve, less all vendor support programs. For the 13-week period ending December 31, 2011, cost of sales increased \$9.2 million to \$208.5 million. As a percent of total revenues, cost of sales increased 2.4% to 59.1%, compared to 56.7% last year. The increase was driven by higher sales discounts due to increased promotional activities, increased sales of low margin Kobo eReaders, and shipping more products directly to stores resulting in lower margin. On a year-to-date basis, cost of sales as a percent of total revenues increased 2.0% from 56.4% last year to 58.4% this year for the same reasons outlined above and, additionally, due to the second quarter summer clearance sale.

Cost of Operations from Continuing Operations (as a Percent of Revenue) Improved versus Last Year

Cost of operations includes all store, online, distribution centre and Calendar Club costs. As a percent of total revenues, cost of operations decreased by 0.6% to 23.3% this year. In dollar terms, cost of operations decreased \$1.7 million mainly due to a reduction in retail distribution centre costs. Outbound distribution centre unit volume decreased, resulting in lower labour and freight costs. This was due to more products being shipped directly to stores to ensure efficient retail distribution centre processing of fall and holiday merchandise. On a year-to-date basis, cost of operations as a percent of revenue increased from 28.3% last year to 29.0% this year. This increase was driven by higher online shipping costs incurred during the Canada Post strike.

Selling, Administrative and Other Expenses from Continuing Operations Decreased

Selling, administrative and other expenses include all marketing and head office costs. These expenses decreased \$1.3 million compared to last year. As a percent of total revenues, selling, administrative and other expenses decreased by 0.4% to 5.6%, compared to 6.0% last year. As a result of the sale of Kobo, compensation expenses related to directors with the option to buy Kobo shares directly from Indigo increased by \$1.1 million. This was offset by a mark-to-market gain of \$1.7 million from Indigo's foreign currency forward contract and a reduction of \$0.7 million in the Company's bonus accrual based on year-to-date results.

On a year-to-date basis, selling, administrative and other expenses increased \$0.3 million. Marketing costs grew by \$0.9 million as the result of increased promotional activities, and design costs increased by \$0.8 million as the Company continued to expand its proprietary gift and lifestyle products. These increases were offset by the third quarter decrease discussed above. As a percent of total revenues, selling, administrative and other expenses increased from 7.6% last year to 7.8% this year.

EBITDA from Continuing Operations Decreased as a Percent of Revenues

EBITDA, defined as earnings before interest, taxes, impairment, depreciation and amortization decreased \$4.5 million to \$42.5 million for the 13-week period ended December 31, 2011, compared to \$47.0 million for the 13-week period ended January 1, 2011. The decrease resulted from declining book sales and a reduction in margin, as revenue growth from the sale of Kobo eReaders produces minimal margin. EBITDA as a percent of revenues decreased to 12.0% this year from 13.4% last year.

On a year-to-date basis, EBITDA decreased by \$23.0 million to \$35.6 million compared to \$58.6 million last year primarily due to the same factors mentioned above. As a percent of revenues, EBITDA decreased to 4.8% compared to 7.7% last year.

Depreciation and Amortization from Continuing Operations Increased versus Last Year

Depreciation and amortization for the 13-week period ended December 31, 2011 increased by \$0.1 million to \$6.9 million compared to \$6.8 million last year. Capital expenditures in the third quarter of fiscal 2012 totalled \$6.9 million and included \$3.8 million for store construction, renovations and equipment, \$2.2 million for intangible assets (primarily application software and internal development costs), and \$0.9 million for technology equipment. Of the \$0.9 million expenditure in technology equipment, \$0.1 million was financed through capital leases.

On a year-to-date basis, depreciation and amortization increased by \$0.9 million to \$20.1 million compared to \$19.2 million last year. Year-to-date, the Company has spent \$16.8 million on capital expenditures, including \$8.8 million for store construction, renovations and equipment, \$6.0 million for intangible assets (primarily application software and internal development costs), and \$2.0 million for technology equipment. Of the \$2.0 million expenditure in technology equipment, \$0.2 million was financed through capital leases.

Asset Impairments

The Company assesses at each reporting date whether there is any indication that capital assets may be impaired. As at December 31, 2011, the Company identified impairment indicators for certain cash generating units (“CGUs”) and groups of CGUs. For capital assets which can be reasonably and consistently allocated to individual stores, the store level is used as the CGU. As a result of identifying impairment indicators, the Company performed testing which resulted in the recognition and reversal of impairment losses. Recoverable amounts for CGUs being tested are based on value in use, which is calculated from cash flow projections over the remaining lease terms, plus any renewal options where renewal is likely. During the third quarter, the Company recognized \$4.0 million in capital asset impairments, net of \$0.8 million in impairment reversals. All of the impairment losses and reversals relate to Indigo’s continuing operations and are spread across a number of CGUs at the store level; there were no impairment losses or reversals related to Kobo. Impairment losses arose due to stores performing at lower-than-expected profitability and impairment reversals arose due to improved store performance and the likelihood of lease term renewals.

On a year-to-date basis, the Company also recorded a goodwill impairment charge. The Company assesses at each reporting date whether there is any indication that goodwill may be impaired. At the end of the second quarter, impairment indicators were identified and the Company performed a goodwill impairment test which resulted in an impairment charge of \$25.4 million. Unlike other asset impairments, goodwill impairment charges cannot be reversed once they are recorded.

Net Interest Expense Recorded from Continuing Operations

The Company recognized net interest expense of less than \$0.1 million in the third quarter of this year compared to net interest income of less than \$0.1 million in the same period last year. On a year-to-date basis, the Company recognized net

interest expense of \$0.1 million this year compared to net interest income of \$0.2 million last year. This change is the result of a lower average cash position compared to the third quarter last year and an increase in the Company's interest expense due to notes payable accretion. The Company had no notes payable in the comparative prior year period. The Company nets interest income received against interest expense.

Income Tax Expense from Continuing Operations Decreased from Last Year

The Company recognized an income tax expense of \$8.0 million this quarter compared to an income tax expense of \$13.3 million in the comparative period last year. On a year-to-date basis, the Company recognized an income tax expense of \$3.1 million this year compared to an income tax expense of \$13.4 million last year. The decrease in income tax expense in the current year is primarily due to lower earnings and corporate tax rates compared to last year.

Net Earnings from Continuing Operations Recorded for the Current Fiscal Quarter

The Company recognized net earnings from continuing operations attributable to shareholders of the Company of \$23.7 million for the 13-week period ended December 31, 2011 (\$0.94 net earnings per common share), compared to net earnings of \$27.0 million (\$1.08 net earnings per common share) last year.

Year-to-date, the Company recognized a net loss from continuing operations attributable to shareholders of the Company of \$17.1 million for the 39-week period ended December 31, 2011 (\$0.68 net loss per common share), compared to net earnings of \$26.1 million (\$1.05 net earnings per common share) last year. The decrease was primarily due to a \$23.0 million decrease in EBITDA and non-cash impairment charges to goodwill and capital assets of \$29.4 million, partially offset by a \$10.3 million reduction in income tax expense.

Net Loss from Kobo Discontinued Operations Recorded for the Current Fiscal Quarter

The Company recognized net loss from discontinued operations attributable to shareholders of the Company of \$9.3 million for the 13-week period ended December 31, 2011 (\$0.37 net loss per common share), compared to a net loss of \$6.1 million (\$0.24 net loss per common share) last year. Year-to-date, the Company recognized net loss from discontinued operations attributable to shareholders of the Company of \$21.8 million for the 39-week period ended December 31, 2011 (\$0.86 net loss per common share), compared to a net loss of \$12.4 million (\$0.50 net loss per common share) last year. The increase in net losses at Kobo were due to increased selling, general and administrative expenses.

Non-controlling Interest

As at December 31, 2011, Indigo continued to be the majority and controlling shareholder of Kobo. The Company records Kobo's results in its unaudited interim condensed consolidated financial statements as discontinued operations. The Company records a non-controlling interest to its consolidated statements of earnings (loss) and comprehensive earnings (loss) to reflect the portion of Kobo's loss that is attributable to the minority shareholders of Kobo. For the 13 weeks ended December 31, 2011, the Company recorded \$8.6 million, compared to \$4.0 million last year, in non-controlling interest for the portion of Kobo losses attributable to the minority shareholders. Year-to-date, the Company recorded \$19.9 million, compared to \$8.7 million last year, in non-controlling interest for the portion of Kobo losses attributable to the minority shareholders.

Seasonality and Third Quarter Results

Indigo's business is highly seasonal and follows quarterly sales and profit (loss) fluctuation patterns, which are similar to those of other retailers that are highly dependent on the December holiday sales season. A disproportionate amount of revenues and profits are earned in the third quarter. As a result, quarterly performance is not necessarily indicative of the Company's performance for the rest of the year. The following table sets out revenues, net earnings (loss) attributable to shareholders of the Company, basic and diluted earnings (loss) per share for the preceding eight fiscal quarters under IFRS and CGAAP.

	Fiscal quarters							Canadian
	IFRS							GAAP
	Q3 Fiscal 2012	Q2 Fiscal 2012	Q1 Fiscal 2012	Q4 Fiscal 2011	Q3 Fiscal 2011	Q2 Fiscal 2011	Q1 Fiscal 2011	Q4 Fiscal 2010
(thousands of Canadian dollars, except per share data)								
Revenues	352,858	197,248	188,005	200,160	351,225	206,332	198,732	227,476
Net earnings (loss) attributable to shareholders of the Company								
From continuing operations	23,711	(28,849)	(11,963)	(12,082)	26,950	2,219	(3,032)	2,183
From discontinued operations	(9,349)	(6,271)	(6,142)	(7,359)	(6,123)	(3,987)	(2,328)	(1,686)
Total net earnings (loss)	14,362	(35,120)	(18,105)	(19,441)	20,827	(1,768)	(5,360)	497
Basic earnings (loss) per share	\$0.57	\$(1.39)	\$(0.72)	\$(0.78)	\$0.84	\$(0.07)	\$(0.22)	\$0.02
Diluted earnings (loss) per share	\$0.56	\$(1.39)	\$(0.72)	\$(0.78)	\$0.82	\$(0.07)	\$(0.22)	\$0.02

Overview of Consolidated Balance Sheets

Total Assets

As at December 31, 2011, total assets were \$65.9 million higher than total assets at January 1, 2011. This increase was the result of an increase in Kobo's assets, offset by a decline in Indigo's assets. Kobo's total assets increased by \$91.2 million compared to last year due to higher accounts receivable, inventory, and cash. As a result of the sale to Rakuten, all of Kobo's assets have been reclassified as assets held for sale. Indigo's total assets decreased by \$25.3 million compared to last year as decreases in goodwill, inventory, property, plant and equipment and prepaid expenses were partially offset by an increase in deferred tax assets and cash. Goodwill decreased by \$25.4 million as the result of an impairment write-down in the second quarter of fiscal 2012. Inventories decreased by \$18.7 million primarily due to a reduction in book purchases. The Company's property, plant and equipment decreased \$14.3 million primarily due to impairment charges recorded in the current period and at the end of last fiscal year. Prepaid expenses decreased \$9.1 million because of the timing of quarter end. Last year, the quarter ended at the beginning of the month, which resulted in the prepayment of various costs such as rent. This year, quarter end fell at the end of the month and there were no such prepayments. Deferred tax assets increased by \$25.4 million compared to last year, primarily as the result of the Company's purchases of tax losses from a related company during the first half of fiscal 2012.

On a fiscal year-to-date basis, total assets increased by \$171.5 million compared to April 2, 2011. Kobo's total assets increased by \$77.2 million year-to-date due to higher accounts receivable and inventory balances. Indigo's total assets increased by \$94.6 million year-to-date as increases in cash and cash equivalents, accounts receivable, and deferred tax assets were offset by decreases in goodwill and property, plant and equipment. Cash and cash equivalents increased by \$88.9 million and accounts receivable increased by \$13.7 million primarily due to sales generated during the holiday period. Deferred tax assets increased by \$22.3 million primarily as the result of the Company's purchase of non-capital tax losses during the first half of the fiscal year. Goodwill decreased by \$25.4 million and property, plant and equipment decreased by \$7.1 million, as discussed above.

Total Liabilities

As at December 31, 2011, total liabilities were \$105.5 million more than total liabilities at January 1, 2011. This increase was the result of increases in both Kobo's and Indigo's liabilities. Kobo's total liabilities increased by \$95.8 million compared to last year due to a short-term loan and higher accounts payable. As a result of the sale to Rakuten, all of Kobo's liabilities have been reclassified as liabilities associated with assets held for sale. Indigo's total liabilities increased by \$9.7 million compared to last year as a result of increases in notes payable, unredeemed gift card liability, and current and long-term accounts payable and accrued liabilities. Notes payable of \$5.2 million were used to finance a portion of the Company's purchase of tax losses

from a related company. The unredeemed gift card liability increased by \$3.9 million due to an increased number of gift cards sold. The \$1.1 million increase in current and long-term accounts payable and accrued liabilities is consistent with the reduction in prepaid expenses.

On a fiscal year-to-date basis, total liabilities increased by \$198.2 million compared to April 2, 2011. Kobo's total liabilities increased by \$92.4 million year-to-date due to a short-term loan and higher accounts payable. Indigo's total liabilities increased by \$105.8 million year-to-date as the result of increases in current and long-term accounts payable and accrued liabilities, unredeemed gift card liability, and notes payable. The \$81.0 million increase in current and long-term accounts payable and accrued liabilities is consistent with the increase in the Company's inventory position. The unredeemed gift card liability is always at its highest level immediately following the Christmas holiday and increased by \$20.0 million year-to-date. Notes payable increased by \$5.2 million as discussed above.

Non-Controlling Interest

The Company records the results of Kobo in its unaudited interim condensed consolidated financial statements as discontinued operations. For the 13-week period ended December 31, 2011, the Company recorded \$14.0 million in non-controlling interest on its consolidated balance sheet compared to \$2.1 million last year. The \$14.0 million reflects the 48.6% of Kobo owned by minority shareholders, compared to 40.7% owned by minority shareholders last year. On a fiscal year-to-date basis, the value of the non-controlling interest increased \$3.6 million compared to April 2, 2011 as the result of increased investment in Kobo by third parties, offset by Kobo's year-to-date net loss.

Total Equity

Total equity at December 31, 2011 decreased \$39.6 million compared to January 1, 2011. The decrease in total equity was primarily due to the net loss of \$58.3 million in the last four quarters and an increase of \$15.0 million in retained earnings related to the purchase of tax losses from a related company in the first half of fiscal 2012, offset by \$11.1 million of dividend payments. Share capital increased by \$2.0 million mainly due to redemption of Directors' deferred share units, and contributed surplus increased \$0.9 million due to the expensing of employee stock options and Directors' deferred share units. Non-controlling interest increased by \$11.9 million compared to last year, as discussed above.

Working Capital and Leverage

The Company's working capital position usually declines from the end of its fiscal year until the third fiscal quarter due to the seasonal nature of the business. The Company relies on cash, accounts payable and its operating line of credit to fund the business before generating a disproportionate amount of cash during the December holiday season. The Company reported working capital of \$92.5 million as at December 31, 2011, compared to \$101.6 million at the end of fiscal 2011 and \$113.5 million as at January 1, 2011. The decline in the Company's working capital from the start of the fiscal year to the end of the current period is unusual and primarily resulted from a short-term loan obtained by Kobo in the current period.

The Company's leverage position (defined as Total Liabilities to Total Equity) increased to 1.8:1 at the end of the current quarter compared to 1.2:1 last year and 0.9:1 as at April 2, 2011. The increased leverage position was the result of liabilities increasing while equity decreased. The changes in liabilities and equity were primarily due to activities in Kobo.

Overview of Consolidated Statements of Cash Flows

Cash and cash equivalents increased \$125.6 million during the third quarter of fiscal 2012 compared to an increase of \$82.8 million last year. The increase in the current quarter was driven by cash flows from operating activities of \$90.6 million and from financing activities of \$47.5 million, offset by cash flows used in investing activities of \$10.1 million, along with the effect of foreign currency exchange rate changes on cash and cash equivalents of \$2.4 million. Year-to-date, cash and cash equivalents increased by \$87.4 million compared to an increase of \$40.7 million for the same period last year.

Cash Flows from Operating Activities

The Company generated cash flows of \$90.6 million from operating activities in the third quarter of fiscal 2012. This was a decrease of \$4.5 million over the same period last year, when cash flows from operating activities were \$95.1 million. Cash flows from the current quarter were primarily generated by net earnings of \$23.7 million and \$97.1 million of changes in non-cash working capital balances, offset by negative operating cash flows of \$51.9 million from Kobo discontinued operations. The \$97.1 million of changes in non-cash working capital balances were driven by increases in current and long-term accounts payable and accrued liabilities and unredeemed gift card liability.

On a year-to-date basis, cash flows from operating activities were \$53.8 million compared to cash flows from operating activities of \$80.8 million last year. The decrease in year-to-date cash flows was driven by current year negative operating cash flows of \$68.7 million from Kobo discontinued operations.

Cash Flows Used in Investing Activities

In the third quarter, net cash flows used in investing activities were \$10.1 million compared to \$11.8 million used in the same quarter last year. Total cash spent on capital projects was \$10.1 million compared to \$11.8 million spent in the comparative period as outlined below:

(millions of Canadian dollars)	13-week period ended December 31, 2011	13-week period ended January 1, 2011	39-week period ended December 31, 2011	39-week period ended January 1, 2011
Store construction, renovations and equipment	3.8	7.1	8.8	20.0
Intangible assets (primarily application software and internal development costs)	2.2	3.2	6.0	8.9
Technology equipment	0.8	0.2	1.8	1.9
Capital expenditures of discontinued operations	3.3	1.3	7.9	3.8
	10.1	11.8	24.5	34.6

On a year-to-date basis, net cash flows used in investing activities were \$35.1 million compared to \$34.6 million last year. The Company used \$10.6 million to purchase non-capital tax losses from a related company. There was no such transaction in the same period last year. Total cash spent on capital projects in the first three quarters of fiscal 2012 was \$24.5 million compared to \$34.6 million last year.

Cash Flows from Financing Activities

Net cash flows from financing activities were \$47.5 million during the third quarter compared to less than \$0.1 million used in the same period last year. In the third quarter of fiscal 2012, the Company generated \$50.6 million of financing cash flows from Kobo discontinued operations to offset \$2.8 million of cash used to pay dividends. Last year, the Company had \$7.6 million of financing cash flows from discontinued operations to offset \$5.7 million of share purchases and \$2.7 million of dividend payments.

On a year-to-date basis, net cash flows from financing activities were \$68.7 million compared to \$5.0 million of cash used last year. The year-over-year increase was driven by \$75.1 million of financing proceeds from discontinued operations and by an increase of \$5.3 million in notes payable related to the acquisition of non-capital tax losses during the first half of the current fiscal year, offset by \$8.3 million of cash used to pay dividends and \$3.0 million of share purchases. In the comparative period, financing cash flows from discontinued operations were \$12.4 million to offset \$9.3 million of share purchases and \$8.2 million of dividend payments.

Liquidity and Capital Resources

The Company has a highly seasonal business which generates the majority of its revenues and cash flows during the December holiday season. Indigo has minimal accounts receivable and it purchases certain products, including books, on trade terms with the right to return a significant portion of those products. Indigo's main sources of capital are cash flows generated from operations, long-term debt, and an operating line of credit.

Based on the Company's liquidity position and cash flow forecast, management expects cash flow generated from operations and cash from the Company's operating line of credit to be sufficient to meet its working capital needs, debt service requirements and dividend payments for fiscal 2012. In addition, Indigo has the ability to reduce capital spending to fund debt requirements if necessary; however, a long-term decline in capital expenditures may negatively impact revenues and profit growth. Future declaration of quarterly dividends and the establishment of future record and payment dates are subject to the final determination of the Company's Board of Directors. Dividends may be reduced or eliminated if required to maintain appropriate capital resources.

There can be no assurance that operating levels will not deteriorate over the ensuing fiscal year, which could result in the Company being unable to meet its current working capital and debt service requirements. In addition, other factors not presently known to management could materially and adversely affect Indigo's future cash flows. In such events, the Company would be required to obtain additional capital as is necessary to satisfy its working capital and debt service requirements from other sources. Alternative sources of capital could result in increased dilution to shareholders and may be on terms that are not favourable to the Company.

Accounting Policies

Critical Accounting Estimates and Judgments

The discussion and analysis of Indigo's operations and financial condition are based upon the unaudited interim condensed consolidated financial statements, which have been prepared in accordance with IFRS and IAS 34, "Interim Financial Reporting." The preparation of these unaudited interim condensed consolidated financial statements requires the Company to estimate the effect of several variables that are inherently uncertain. These estimates and judgments can affect the reported amounts of assets, liabilities, revenues, and expenses. Indigo bases its estimates and judgments on historical experience and other assumptions which the Company believes to be reasonable under the circumstances. The Company also evaluates its estimates and judgments on an ongoing basis. Methods used to calculate critical accounting estimates are consistent with prior periods. The significant accounting policies and critical accounting estimates and judgments of the Company are described in note 2 of the unaudited interim condensed consolidated financial statements contained in the Company's First Quarter Report.

Material estimates and judgments are made with respect to: revenue recognition from unredeemed gift cards; fair value of Plum Program points; inventory shrinkage; reserves for slow-moving or damaged products and products that have been permanently marked down; vendor settlement; fair value of share-based instruments and number of equity instruments expected to vest; identification of cash generating units ("CGUs") and expected future cash flows from CGUs; depreciation and amortization periods; lease classification; and recognition of deferred tax assets.

In the third quarter of fiscal 2012, methods for determining all material estimates and judgments were consistent with those used in prior periods.

Transition to IFRS

The Company adopted IFRS for its 2012 fiscal year as required by the Accounting Standards Board of the Canadian Institute of Chartered Accountants. These financial statements, including the fiscal 2011 comparative figures, are prepared in accordance with IFRS and IAS 34, "Interim Financial Reporting." Reconciliations prepared in accordance with IFRS 1, "First-time Adoption of International Financial Reporting Standards," are provided in note 18 to the unaudited interim condensed consolidated financial statements.

New Accounting Pronouncements

Financial Instruments: Presentation (“IAS 32”)

The IASB has issued amendments to IAS 32 that clarify its requirements for offsetting financial instruments. These amendments are effective for annual periods beginning on or after January 1, 2014 and are required to be applied retrospectively. The Company will apply these amendments beginning in the first quarter of fiscal 2015. The Company does not expect implementation of the amendments to have a significant impact on its presentation.

Financial Instruments: Disclosures (“IFRS 7”)

The IASB has issued amendments to IFRS 7 that increase the disclosure requirements for transactions involving transfers of financial assets. This amendment is effective for annual periods beginning on or after July 1, 2011. The Company will apply this amendment beginning in the first quarter of fiscal 2013. The IASB has also issued amendments regarding the offsetting of financial instruments. These amendments are effective for annual periods beginning on or after January 1, 2013 and interim periods within those annual periods. The Company will apply these amendments beginning in the first quarter of fiscal 2014. The Company does not expect implementation of the IFRS 7 amendments to have a significant impact on its disclosures.

Income Taxes (“IAS 12”)

The IASB has issued an amendment to IAS 12 that introduces an exception to the general measurement requirements of IAS 12 in respect of investment properties measured at fair value. The amendment is effective for annual periods beginning on or after January 1, 2012. The Company will apply this amendment beginning in the first quarter of fiscal 2013. The Company currently has no investment properties and, as such, does not expect the implementation of the amendment to have an impact on its consolidated financial statements.

Financial Instruments (“IFRS 9”)

The IASB has issued a new standard, IFRS 9, which will ultimately replace IAS 39, “Financial Instruments: Recognition and Measurement” (“IAS 39”). The replacement of IAS 39 is a multi-phase project with the objective of improving and simplifying the reporting for financial instruments. Issuance of IFRS 9 is part of the first phase of the IAS 39 replacement project. IFRS 9 had an original effective date of January 1, 2013, which has been deferred by the IASB to January 1, 2015. The Company has yet to assess the impact of the new standard on its consolidated financial statements.

Other Standards

On May 12, 2011, the IASB issued four new standards along with amendments to two standards, all of which are effective for annual periods beginning on or after January 1, 2013. Early adoption is permitted, but the new standards and amendments must all be adopted concurrently, with the exception of IFRS 12, “Disclosure of Interests in Other Entities,” which may be early adopted on its own. The Company has yet to fully assess the impact of the new standards and amendments on its consolidated financial statements. The Company expects to adopt these new standards and amendments in the first quarter of fiscal 2014. The following is a list and description of these new standards and amendments:

- Consolidated Financial Statements (“IFRS 10”) establishes the standards for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. IFRS 10 establishes a single control model that applies to all entities. Kobo is the only entity which would have been consolidated by the Company under this standard and the sale of Kobo closed on January 11, 2012. As such, this standard is not expected to apply to the Company;
- Joint Arrangements (“IFRS 11”) replaces IAS 31, “Interests in Joint Ventures” (“IAS 31”) and SIC-13, “Jointly-controlled Entities – Non-monetary Contributions by Venturers,” and requires that a party in a joint arrangement assess its rights and obligations to determine the type of joint arrangement and account for those rights and obligations accordingly. IFRS 11 removes the option to account for jointly controlled entities using proportionate consolidation. Instead, jointly controlled

entities that meet the definition of a joint venture must be accounted for using the equity method. Currently, the Company accounts for its interest in Calendar Club under IAS 31 using proportionate consolidation. However, based on a preliminary analysis completed by the Company, its interest in Calendar Club will meet the definition of a joint venture under IFRS 11 and will need to be accounted for using the equity method beginning in fiscal 2014;

- Disclosure of Interests in Other Entities (“IFRS 12”) includes all of the disclosures that were previously in IAS 27, “Separate Financial Statements,” IAS 31 and IAS 28, “Investments in Associates.” These disclosures relate to an entity’s interests in subsidiaries, joint arrangements, associates and structured entities. Under IFRS 12, an entity is required to disclose the judgments made to determine whether it controls another entity. This new standard is expected to increase disclosures related to Calendar Club;
- Fair Value Measurement (“IFRS 13”) provides guidance to improve consistency and comparability in fair value measurements and related disclosures through a fair value hierarchy. This standard applies when another IFRS requires or permits fair value measurements or disclosures. IFRS 13 does not apply for share-based payment transactions, leasing transactions and measurements that are similar to, but are not, fair value. The Company currently has one foreign currency forward contract measured at fair value. The Company entered into this contract to partially manage the foreign exchange risk related to U.S. dollar proceeds from the sale of Kobo. This contract had a settlement date in January 2012 and the Company does not expect to enter into any other forward contracts. As such, this standard is not expected to have a significant impact on the Company’s consolidated financial statements;
- Separate Financial Statements (“IAS 27”) has been amended to remove all requirements relating to consolidated financial statements. Prior to this amendment, the Company applied IAS 27 to the preparation of its consolidated financial statements. However, as Indigo does not prepare separate financial statements, the amended IAS 27 will no longer be applicable to the Company; and
- Investments in Associates and Joint Ventures (“IAS 28”) has been amended for conforming changes based on the issuance of IFRS 10 and IFRS 11. The amendments to IAS 28 relate to accounting for associates and joint ventures held for sale, and to changes in interests held in associates and joint ventures. Currently, neither of these scenarios applies to the Company and, as such, these amendments are not expected to have a significant impact on the Company’s consolidated financial statements.

General Development of the Business

The Company’s strategic objectives are substantially the same as those disclosed in the MD&A section of its fiscal 2011 Annual Report.

Risks and Uncertainties

The sale of Kobo to Rakuten closed on January 11, 2012. Upon closing, the Company received US\$146.1 million of sale proceeds. To partially manage the foreign exchange risk of this transaction, the Company entered into a foreign currency forward contract with a Canadian bank in December 2011. This is a short-term contract with a settlement date in January 2012. The Company does not expect to enter into any other foreign currency forward contracts.

All other risks and uncertainties faced by the Company are substantially the same as those disclosed in the MD&A section of its fiscal 2011 Annual Report.

Disclosure Controls and Procedures

Management is responsible for establishing and maintaining a system of disclosure controls and procedures to provide reasonable assurance that all material information relating to the Company is gathered and reported on a timely basis to senior management, including the Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), so that appropriate decisions can be made by them regarding public disclosure.

Internal Controls over Financial Reporting

Management is also responsible for establishing and maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with IFRS.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to consolidated financial statement preparation and presentation. Additionally, management is necessarily required to use judgment in evaluating controls and procedures.

Changes in Internal Controls over Financial Reporting

Management has also evaluated whether there were changes in the Company's internal controls over financial reporting that occurred during the period beginning on October 2, 2011 and ended on December 31, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting. The Company has determined that no material changes in internal controls over financial reporting have occurred in this period.

Cautionary Statement Regarding Forward-Looking Statements

The above discussion includes forward-looking statements. All statements other than statements of historical facts included in this discussion that address activities, events or developments that the Company expects or anticipates will or may occur in the future are forward-looking statements. These statements are based on certain assumptions and analysis made by the Company in light of its experience, analysis and its perception of historical trends, current conditions and expected future developments as well as other factors it believes are appropriate in the circumstances. However, whether actual results and developments will conform to the expectations and predictions of the Company is subject to a number of risks and uncertainties, including the general economic, market or business conditions; competitive actions by other companies; changes in laws or regulations; and other factors, many of which are beyond the control of the Company. Consequently, all of the forward-looking statements made in this discussion are qualified by these cautionary statements and there can be no assurance that results or developments anticipated by the Company will be realized or, even if substantially realized, that they will have the expected consequences to, or effects on, the Company.

Non-IFRS Financial Measures

The Company prepares its unaudited interim condensed consolidated financial statements in accordance with International Financial Reporting Standards. In order to provide additional insight into the business, the Company has also provided non-IFRS data, including comparable store sales and EBITDA, in the discussion and analysis section above. These measures are specific to Indigo and have no standardized meaning prescribed by IFRS. Therefore, these measures may not be comparable to similar measures presented by other companies.

Comparable stores sales and EBITDA are key indicators used by the Company to measure performance against internal targets and prior period results. Both measures are commonly used by financial analysts and investors to compare Indigo to other retailers. Comparable store sales are defined as sales generated by stores that have been open for more than 12 months on a 52-week basis. It is a key performance indicator for the Company as this measure excludes sales fluctuations due to store closings, permanent relocation, and chain expansion. EBITDA is defined as earnings before interest, taxes, impairment, depreciation and amortization. The method of calculating EBITDA is consistent with that used in prior periods.

A reconciliation between comparable store sales and revenues (the most comparable IFRS measure) was included earlier in this report. A reconciliation between EBITDA and earnings (loss) before income taxes (the most comparable IFRS measure) is provided below:

(millions of Canadian dollars)	13-week period ended December 31, 2011	13-week period ended January 1, 2011	39-week period ended December 31, 2011	39-week period ended January 1, 2011
EBITDA	42.5	47.0	35.6	58.6
Depreciation of property, plant and equipment	4.8	4.8	13.8	13.4
Amortization of intangible assets	2.1	2.0	6.3	5.8
Impairment of capital assets	4.0	0.0	4.0	0.0
Impairment of goodwill	0.0	0.0	25.4	0.0
Interest on long-term debt and financing charges	0.0	0.1	0.1	0.1
Interest income on cash and cash equivalents	0.0	(0.1)	0.0	(0.3)
Earnings (loss) before income taxes	31.6	40.2	(14.0)	39.6

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NOTICE OF NO AUDITOR REVIEW OF INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

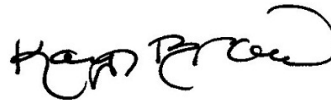
Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim condensed consolidated financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim condensed consolidated financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these interim condensed consolidated financial statements.



Heather Reisman
Chair & Chief Executive Officer



Kay Brekken
Chief Financial Officer

Dated as of the 8th day of February, 2012.

Consolidated Balance Sheets

(Unaudited)

(thousands of Canadian dollars)	As at December 31, 2011	As at January 1, 2011	As at April 2, 2011
ASSETS			
Current			
Cash and cash equivalents (note 5)	148,610	144,643	83,661
Accounts receivable	21,690	26,007	12,684
Inventories (note 6)	234,705	255,750	232,694
Income taxes recoverable	–	899	–
Prepaid expenses	3,915	13,729	7,941
Derivatives (note 15)	1,747	–	–
Assets held for sale (note 17)	117,551	–	–
Total current assets	528,218	441,028	336,980
Property, plant and equipment (note 7)	70,409	85,722	78,777
Intangible assets (note 7)	22,333	28,359	30,614
Deferred tax assets	60,290	34,847	38,004
Goodwill (note 8)	1,216	26,632	26,632
Total assets	682,466	616,588	511,007
LIABILITIES AND EQUITY			
Current			
Accounts payable and accrued liabilities	241,553	256,432	180,899
Unredeemed gift card liability	60,959	57,094	40,991
Provisions	–	33	–
Deferred revenue	12,110	12,639	11,528
Income taxes payable	310	–	657
Notes payable (note 16)	5,224	–	–
Current portion of long-term debt	1,163	1,302	1,290
Liabilities associated with assets held for sale (note 17)	114,400	–	–
Total current liabilities	435,719	327,500	235,365
Long-term accrued liabilities	4,820	6,822	6,284
Long-term debt	1,327	2,081	1,995
Total liabilities	441,866	336,403	243,644
Equity			
Share capital (note 9)	203,254	201,294	202,220
Contributed surplus (note 10)	6,860	5,986	6,066
Retained earnings	16,468	70,825	48,629
Total equity attributable to shareholders of the Company	226,582	278,105	256,915
Non-controlling interest	14,018	2,080	10,448
Total equity	240,600	280,185	267,363
Total liabilities and equity	682,466	616,588	511,007

See accompanying notes

On behalf of the Board:



Heather M. Reisman
Director



Michael Kirby
Director

Consolidated Statements of Earnings (Loss) and Comprehensive Earnings (Loss)

(Unaudited)

(thousands of Canadian dollars, except per share data)	13-week period ended December 31, 2011	13-week period ended January 1, 2011	39-week period ended December 31, 2011	39-week period ended January 1, 2011
Revenues	352,858	351,225	738,111	756,289
Cost of sales (note 6)	208,456	199,335	431,035	426,615
Gross profit	144,402	151,890	307,076	329,674
Cost of operations (note 11)	82,277	84,041	213,986	213,948
Selling and administrative expenses	21,376	20,838	58,708	56,846
Foreign currency translation	(1,780)	75	(1,167)	339
Operating earnings before the following	42,529	46,936	35,549	58,541
Depreciation of property, plant and equipment	4,810	4,801	13,826	13,424
Amortization of intangible assets	2,082	1,955	6,266	5,793
Impairment of capital assets (note 7)	3,956	–	3,956	–
Impairment of goodwill (note 8)	–	–	25,416	–
Interest on long-term debt and financing charges	34	72	117	115
Interest income on cash and cash equivalents	(25)	(122)	(40)	(295)
Earnings (loss) before income taxes	31,672	40,230	(13,992)	39,504
Income tax expense	7,961	13,280	3,109	13,367
Earnings (loss) and comprehensive earnings (loss) from continuing operations	23,711	26,950	(17,101)	26,137
Loss and comprehensive loss from discontinued operations (net of taxes) (note 17)	(17,906)	(10,107)	(41,679)	(21,151)
Net earnings (loss) and comprehensive earnings (loss) for the period	5,805	16,843	(58,780)	4,986
Net earnings (loss) and comprehensive earnings (loss) attributable to:				
Shareholders of the Company	14,362	20,827	(38,863)	13,699
Non-controlling interest	(8,557)	(3,984)	(19,917)	(8,713)
Total net earnings (loss) and comprehensive earnings (loss) for the period	5,805	16,843	(58,780)	4,986
Net earnings (loss) per common share (note 12)				
Basic	\$0.57	\$0.84	\$(1.54)	\$0.55
Diluted	\$0.56	\$0.82	\$(1.54)	\$0.54

See accompanying notes

Consolidated Statements of Changes in Equity

(Unaudited)

(thousands of Canadian dollars)	Share Capital	Contributed Surplus	Retained Earnings	Total	Non-controlling Interest	Total Equity
Balance, April 4, 2010	198,635	5,633	65,496	269,764	6,925	276,689
Earnings (loss) for the 39-week period ended January 1, 2011	–	–	13,699	13,699	(8,713)	4,986
Exercise of options (note 10)	2,809	(535)	–	2,274	–	2,274
Directors' deferred stock units converted (note 9)	60	(60)	–	–	–	–
Shares repurchased under NCIB (note 9)	(210)	–	(177)	(387)	–	(387)
Stock-based compensation (note 10)	–	532	–	532	773	1,305
Directors' compensation (note 10)	–	416	–	416	–	416
Dividends paid	–	–	(8,193)	(8,193)	–	(8,193)
Issuance of equity securities by subsidiary to non-controlling interest	–	–	–	–	3,095	3,095
Balance, January 1, 2011	201,294	5,986	70,825	278,105	2,080	280,185
Balance, April 2, 2011	202,220	6,066	48,629	256,915	10,448	267,363
Loss for the 39-week period ended December 31, 2011	–	–	(38,863)	(38,863)	(19,917)	(58,780)
Exercise of options (note 10)	742	(164)	–	578	–	578
Directors' deferred stock units converted (note 9)	292	(292)	–	–	–	–
Shares repurchased under NCIB (note 9)	–	–	–	–	–	–
Stock-based compensation (note 10)	–	866	–	866	2,142	3,008
Directors' compensation (note 10)	–	384	–	384	–	384
Dividends paid	–	–	(8,315)	(8,315)	–	(8,315)
Acquisition of non-capital tax losses (note 16)	–	–	15,017	15,017	–	15,017
Issuance of equity securities by subsidiary to non-controlling interest	–	–	–	–	21,345	21,345
Balance, December 31, 2011	203,254	6,860	16,468	226,582	14,018	240,600

See accompanying notes

Consolidated Statements of Cash Flows

(Unaudited)

(thousands of Canadian dollars)	13-week period ended December 31, 2011	13-week period ended January 1, 2011	39-week period ended December 31, 2011	39-week period ended January 1, 2011
CASH FLOWS FROM OPERATING ACTIVITIES				
Net earnings (loss) from continuing operations for the period	23,711	26,950	(17,101)	26,137
Add (deduct) items not affecting cash				
Depreciation of property, plant and equipment	4,810	4,801	13,826	13,424
Amortization of intangible assets	2,082	1,955	6,266	5,793
Impairment of capital assets (note 7)	3,956	–	3,956	–
Impairment of goodwill (note 8)	–	–	25,416	–
Loss on disposal of capital assets	50	4	65	73
Stock-based compensation (note 10)	196	243	866	532
Directors' compensation (note 10)	117	100	384	416
Deferred tax assets	7,961	13,280	3,109	13,367
Interest on long-term debt and financing charges	34	72	117	115
Interest income on cash and cash equivalents	(25)	(122)	(40)	(295)
Other	2,453	363	43	494
Net change in non-cash working capital balances related to continuing operations (note 13)	97,121	56,514	85,620	32,325
Operating cash flows of discontinued operations (note 17)	(51,874)	(9,102)	(68,687)	(11,587)
Cash flows from operating activities	90,592	95,058	53,840	80,794
CASH FLOWS FROM INVESTING ACTIVITIES				
Acquisition of non-capital tax losses (note 16)	–	–	(10,559)	–
Purchase of property, plant and equipment	(4,682)	(7,382)	(10,530)	(21,878)
Addition of intangible assets	(2,152)	(3,182)	(6,040)	(8,893)
Investing cash flows of discontinued operations (note 17)	(3,289)	(1,267)	(7,936)	(3,789)
Cash flows used in investing activities	(10,123)	(11,831)	(35,065)	(34,560)
CASH FLOWS FROM FINANCING ACTIVITIES				
Note payable (note 16)	–	–	5,280	–
Repayment of long-term debt	(335)	(356)	(1,047)	(1,983)
Interest received	15	54	109	177
Proceeds from share issuances (note 9)	–	1,093	578	2,274
Repurchase of common shares	–	–	–	(387)
Purchase of shares in subsidiary	–	(5,714)	(3,009)	(9,286)
Dividends paid	(2,776)	(2,742)	(8,315)	(8,193)
Financing cash flows of discontinued operations (note 17)	50,604	7,628	75,082	12,401
Cash flows from (used in) financing activities	47,508	(37)	68,678	(4,997)
Effect of foreign currency exchange rate changes on cash and cash equivalents	(2,422)	(369)	(68)	(492)
Net decrease in cash and cash equivalents during the period	125,555	82,821	87,385	40,745
Cash and cash equivalents, beginning of period	45,491	61,822	83,661	103,898
Cash and cash equivalents, end of period	171,046	144,643	171,046	144,643
Cash and cash equivalents attributable to:				
Continuing operations	148,610	136,648	148,610	136,648
Discontinued operations	22,436	7,995	22,436	7,995
	171,046	144,643	171,046	144,643

See accompanying notes

Notes to Interim Condensed Consolidated Financial Statements

December 31, 2011

(Unaudited)

1. CORPORATE INFORMATION

Indigo Books & Music Inc. (the “Company” or “Indigo”) is a corporation domiciled and incorporated under the laws of the Province of Ontario in Canada. The Company’s registered office is located at 468 King Street West, Toronto, Ontario, M5V 1L8, Canada. The unaudited interim condensed consolidated financial statements of the Company as at and for the 13 and 39 weeks ended December 31, 2011 comprise the Company, its subsidiary, Kobo Inc. (“Kobo”) and its joint venture interest in Calendar Club of Canada Limited Partnership (“Calendar Club”). The Company is the ultimate parent of the consolidated organization.

On November 8, 2011, Indigo entered into an agreement with Rakuten, Inc. (“Rakuten”) for Rakuten to acquire all the outstanding shares of Kobo on a fully diluted basis, subject to certain customary adjustments on closing. The transaction was unanimously approved by the Board of Directors on November 8, 2011 and closed on January 11, 2012. All closing conditions have been satisfied, including regulatory approval under the *Investment Canada Act*.

2. BASIS OF PREPARATION

As a result of the agreement to sell Kobo to Rakuten, Kobo’s assets, liabilities and operating results have been classified as held for sale and discontinued operations. The Company continued to eliminate all intercompany transactions in the period, but certain comparative figures have been reclassified to conform to the current period’s unaudited interim condensed consolidated financial statements.

Statement of compliance

These unaudited interim condensed consolidated financial statements have been prepared in compliance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

The unaudited interim condensed consolidated financial statements for the 13 and 39-week periods ended December 31, 2011 were prepared in accordance with IAS 34, “Interim Financial Reporting”. The same accounting policies and methods of computation were followed in the preparation of these unaudited interim condensed consolidated financial statements as those used in the preparation of the unaudited interim condensed consolidated financial statements for the 13-week period ended July 2, 2011. In addition, the unaudited interim condensed consolidated financial statements for the 13-week period ended July 2, 2011 contain certain incremental annual IFRS disclosures not included in the audited annual financial statements for the year ended April 2, 2011 prepared in accordance with previous Canadian GAAP. Accordingly, these unaudited interim condensed consolidated financial statements for the 13 and 39-week periods ended December 31, 2011 should be read together with the audited annual consolidated financial statements for the year ended April 2, 2011 prepared in accordance with previous Canadian GAAP as well as the unaudited interim condensed consolidated financial statements for the 13-week period ended July 2, 2011.

These unaudited interim condensed consolidated financial statements were approved by the Board of Directors on February 8, 2012.

Significant estimates and judgments

The preparation of these unaudited interim condensed consolidated financial statements in conformity with IFRS requires management to undertake a number of estimates and judgments about the recognition and measurement of assets, liabilities, income, and expenses. These estimates and judgments are based on management's historical experience and other assumptions which the Company believes to be reasonable under the circumstances. Actual results may differ from the estimates and judgments made by management, and actual results will seldom equal estimates.

Material estimates and judgments are made with respect to: revenue recognition from unredeemed gift cards; fair value of Plum Program points; inventory shrinkage; reserves for slow-moving or damaged products and products that have been permanently marked down; vendor settlement; fair value of share-based instruments and number of equity instruments expected to vest; identification of cash generating units ("CGUs") and expected future cash flows from CGUs; depreciation and amortization periods; lease classification; and recognition of deferred tax assets.

3. NEW ACCOUNTING PRONOUNCEMENTS

Financial Instruments: Presentation ("IAS 32")

The IASB has issued amendments to IAS 32 that clarify its requirements for offsetting financial instruments. These amendments are effective for annual periods beginning on or after January 1, 2014 and are required to be applied retrospectively. The Company will apply these amendments beginning in the first quarter of fiscal 2015. The Company does not expect implementation of the amendments to have a significant impact on its presentation.

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Income Taxes ("IAS 12")

The IASB has issued an amendment to IAS 12 that introduces an exception to the general measurement requirements of IAS 12 in respect of investment properties measured at fair value. The amendment is effective for annual periods beginning on or after January 1, 2012. The Company will apply this amendment beginning in the first quarter of fiscal 2013. The Company currently has no investment properties and, as such, does not expect the implementation of the amendment to have an impact on its consolidated financial statements.

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The IASB has issued a new standard, IFRS 9, which will ultimately replace IAS 39, "Financial Instruments: Recognition and Measurement" ("IAS 39"). The replacement of IAS 39 is a multi-phase project with the objective of improving and simplifying the reporting for financial instruments. Issuance of IFRS 9 is part of the first phase of the IAS 39 replacement project. IFRS 9 had an original effective date of January 1, 2013, which has been deferred by the IASB to 2015. The Company has yet to assess the impact of the new standard on its consolidated financial statements.

Other Standards

On May 12, 2011, the IASB issued four new standards along with amendments to two standards, all of which are effective for annual periods beginning on or after January 1, 2013. Early adoption is permitted, but the new standards and amendments must all be adopted concurrently, with the exception of IFRS 12, "Disclosure of Interests in Other Entities," which may be

early adopted on its own. The Company has yet to fully assess the impact of the new standards and amendments on its consolidated financial statements. The Company expects to adopt these new standards and amendments in the first quarter of fiscal 2014. The following is a list and description of these new standards and amendments:

- Consolidated Financial Statements (“IFRS 10”) establishes the standards for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. IFRS 10 establishes a single control model that applies to all entities. Kobo is the only entity which would have been consolidated by the Company under this standard and the sale of Kobo closed on January 11, 2012. As such, this standard is not expected to apply to the Company;
- Joint Arrangements (“IFRS 11”) replaces IAS 31, “Interests in Joint Ventures” (“IAS 31”) and SIC-13, “Jointly-controlled Entities – Non-monetary Contributions by Venturers,” and requires that a party in a joint arrangement assess its rights and obligations to determine the type of joint arrangement and account for those rights and obligations accordingly. IFRS 11 removes the option to account for jointly controlled entities using proportionate consolidation. Instead, jointly controlled entities that meet the definition of a joint venture must be accounted for using the equity method. Currently, the Company accounts for its interest in Calendar Club under IAS 31 using proportionate consolidation. However, based on a preliminary analysis completed by the Company, its interest in Calendar Club will meet the definition of a joint venture under IFRS 11 and will need to be accounted for using the equity method beginning in fiscal 2014;
- Disclosure of Interests in Other Entities (“IFRS 12”) includes all of the disclosures that were previously in IAS 27, “Separate Financial Statements,” IAS 31 and IAS 28, “Investments in Associates.” These disclosures relate to an entity’s interests in subsidiaries, joint arrangements, associates and structured entities. Under IFRS 12, an entity is required to disclose the judgments made to determine whether it controls another entity. This new standard is expected to increase disclosures related to Calendar Club;
- Fair Value Measurement (“IFRS 13”) provides guidance to improve consistency and comparability in fair value measurements and related disclosures through a fair value hierarchy. This standard applies when another IFRS requires or permits fair value measurements or disclosures. IFRS 13 does not apply for share-based payment transactions, leasing transactions and measurements that are similar to, but are not, fair value. The Company currently has one foreign currency forward contract measured at fair value. The Company entered into this contract to partially manage the foreign exchange risk related to U.S. dollar proceeds from the sale of Kobo. This contract had a settlement date in January 2012 and the Company does not expect to enter into any other forward contracts. As such, this standard is not expected to have a significant impact on the Company’s consolidated financial statements;
- Separate Financial Statements (“IAS 27”) has been amended to remove all requirements relating to consolidated financial statements. Prior to this amendment, the Company applied IAS 27 to the preparation of its consolidated financial statements. However, as Indigo does not prepare separate financial statements, the amended IAS 27 will no longer be applicable to the Company; and
- Investments in Associates and Joint Ventures (“IAS 28”) has been amended for conforming changes based on the issuance of IFRS 10 and IFRS 11. The amendments to IAS 28 relate to accounting for associates and joint ventures held for sale, and to changes in interests held in associates and joint ventures. Currently, neither of these scenarios applies to the Company and, as such, these amendments are not expected to have a significant impact on the Company’s consolidated financial statements.

4. SEASONALITY OF OPERATIONS

The business of Indigo follows a seasonal pattern, with sales of merchandise being highest in the third fiscal quarter due to consumer holiday buying patterns. As a result, a disproportionate portion of total annual revenues are typically earned in the third fiscal quarter. Therefore, the results of operations for the 13 and 39-week periods ended December 31, 2011 and January 1, 2011 are not indicative of the results of other periods.

5. CASH AND CASH EQUIVALENTS

As at December 31, 2011, the Company had no cash equivalents. Cash consists of the following:

(thousands of Canadian dollars)	December 31, 2011	January 1, 2011	April 2, 2011
Cash	148,040	144,335	83,021
Restricted cash	570	308	640
Cash and cash equivalents	148,610	144,643	83,661

Restricted cash represents cash pledged as collateral for letter of credit obligations issued to support the Company's purchases of offshore merchandise.

6. INVENTORIES

Inventories consist of finished goods. The cost of inventories recognized as an expense for the 13 and 39-week periods ended December 31, 2011 were \$241.2 million and \$475.7 million, respectively (13 and 39-week periods ended January 1, 2011 – \$231.2 million and \$468.1 million, respectively). The amount of inventory write-downs as a result of net realizable value lower than cost was \$2.7 million during the 13-week period ended December 31, 2011 (January 1, 2011 – \$2.1 million), and there were no reversals of inventory write-downs that were recognized in prior periods. The amount of inventory with net realizable value equal to cost was \$0.5 million as at December 31, 2011 (January 1, 2011 – \$1.4 million).

7. IMPAIRMENT OF CAPITAL ASSETS

Cash generating units ("CGUs") and groups of CGUs are tested for impairment if impairment indicators exist at the reporting date. For capital assets which can be reasonably and consistently allocated to individual stores, the store level is used as the CGU. Recoverable amounts for CGUs being tested are based on value in use, which is calculated from cash flow projections over the remaining lease terms, plus any renewal options where renewal is likely. The key assumptions from the value in use calculations are those regarding growth rates and discount rates. The cash flow projections are based on both past and forecasted performance and are extrapolated using long-term growth rates which are calculated separately for each CGU being tested. Average long-term growth rates range from 0.0% to 3.0%. Management's estimate of the discount rate reflects the current market assessment of the time value of money and the risks specific to the Company. The pre-tax discount rate used to calculate value in use was 22.0%.

Impairment indicators existed at December 31, 2011 and, accordingly, the Company performed impairment testing which resulted in the recognition and reversal of impairment losses. Impairment losses recognized during the 13 and 39-week periods ended December 31, 2011 were \$4.8 million (13 and 39-week periods ended January 1, 2011 – nil) and are spread across a number of CGUs. The impairment losses relate to CGUs whose carrying amounts exceed their recoverable amounts. In all cases, impairment losses arose due to stores performing at lower-than-expected profitability. Impairment reversals recognized during the 13 and 39-week periods ended December 31, 2011 were \$0.8 million (13 and 39-week periods ended January 1, 2011 – nil). Impairment reversals arose due to improved store performance and the likelihood of lease term renewals. All of the impairment losses and reversals relate to Indigo's continuing operations; there were no impairment losses or reversals related to Kobo.

8. GOODWILL

The Company performed a goodwill impairment test as at October 1, 2011 which resulted in a full write-down of goodwill allocated to Indigo's continuing operations. There was no impairment identified for the goodwill allocated to Kobo's operations. Unlike other asset impairments, goodwill impairment charges cannot be reversed once they are recorded.

For purposes of goodwill impairment testing, the carrying value of goodwill is allocated as follows:

(thousands of Canadian dollars)	December 31, 2011	January 1, 2011	April 2, 2011
Indigo operations	–	25,416	25,416
Kobo operations	1,216	1,216	1,216
Total goodwill	1,216	26,632	26,632

9. SHARE CAPITAL

Share capital consists of the following:

	39-week period ended December 31, 2011		39-week period ended January 1, 2011		52-week period ended April 2, 2011	
	Number of shares	Amount C\$ (thousands)	Number of shares	Amount C\$ (thousands)	Number of shares	Amount C\$ (thousands)
Balance, beginning of period	25,140,540	202,220	24,742,915	198,635	24,742,915	198,635
Issued during the period						
Directors' deferred share units converted	30,095	292	4,283	60	4,283	60
Options exercised	58,000	742	315,442	2,809	419,442	3,735
Repurchase of common shares	–	–	(26,100)	(210)	(26,100)	(210)
Balance, end of period	25,228,635	203,254	25,036,540	201,294	25,140,540	202,220

On October 27, 2009, the Company announced its intent to make a normal course issuer bid ("NCIB"), which was approved by the Toronto Stock Exchange. Under the NCIB, Indigo was allowed to purchase up to 1,227,229 of its common shares, representing approximately 5% of its total outstanding common shares. During the 39-week period ended January 1, 2011, the Company repurchased 26,100 common shares at an average price of \$14.79 per share for a total cash consideration of \$0.4 million under the NCIB. The repurchased shares were cancelled and returned to treasury. The cash consideration exceeded the carrying value of the shares repurchased by \$0.2 million and the amount was charged to retained earnings. The NCIB expired on November 1, 2010.

10. SHARE-BASED COMPENSATION

As at December 31, 2011, 1,619,100 stock options were outstanding with exercise prices ranging from \$4.45 to \$16.75. Of these outstanding stock options, 855,100 were exercisable. As at January 1, 2011, there were 1,858,100 stock options outstanding of which 714,100 were exercisable.

The Company uses the fair value method of accounting for stock options, which estimates the fair value of the stock options granted on the date of grant, net of estimated forfeitures, and expenses this value over the vesting period. During the 13-week period ended December 31, 2011, the pre-forfeiture fair value of options granted was less than \$0.1 million (January 1, 2011 – \$1.4 million).

The fair value of the employee stock options is estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions during the periods presented:

	13-week period ended December 31, 2011	13-week period ended January 1, 2011
Risk-free interest rate	1.5%	2.3%
Expected volatility	36.2%	33.4%
Expected time until exercise	5.9 years	5.3 years
Expected dividend yield	5.3%	2.9%
Forfeiture rate	24.7%	23.7%

Directors' compensation

The Company has established a Directors' Deferred Share Unit Plan ("DSU Plan"). Under the DSU Plan, Directors receive their annual retainer fees and other Board-related compensation in the form of deferred share units ("DSUs"). The number of shares reserved for issuance under this plan is 250,000. The Company issued 15,806 DSUs with a value of \$0.1 million during the 13-week period ended December 31, 2011 (January 1, 2011 – \$0.1 million). The number of DSUs to be issued to each Director is based on a set fee schedule. The fair value of the outstanding DSUs as at December 31, 2011 was \$2.5 million (January 1, 2011 – \$2.2 million) and was recorded in contributed surplus. The fair value of DSUs is equal to the traded price of the Company's common shares on grant date.

The Company has entered into agreements to allow one Indigo Director and one Kobo Director to purchase shares of Kobo. These agreements allow for the purchase of up to 470,000 Kobo shares directly from Indigo. Exercise prices range from \$1.00 – \$3.86 per share and the agreements expire on January 25, 2020 and July 5, 2021. As a result of the sale of Kobo to Rakuten, the agreements are estimated to have an intrinsic value of \$1.7 million as at December 31, 2011 (January 1, 2011 – nil). Upon exercise of the agreements, the holders will be entitled to a cash payout and, as such, the Company has recorded \$1.7 million as a liability relating to these agreements (January 1, 2011 – \$0.2 million).

11. EMPLOYEE BENEFITS EXPENSE

(thousands of Canadian dollars)	13-week period ended December 31, 2011	13-week period ended January 1, 2011	39-week period ended December 31, 2011	39-week period ended January 1, 2011
Wages, salaries and bonuses	48,362	45,587	131,278	120,113
Short-term benefits expense	4,840	4,707	14,094	13,756
Termination benefits expense	302	590	902	972
Retirement benefits expense	322	327	939	971
Stock-based compensation	817	507	3,008	1,305
Total employee benefits expense	54,643	51,718	150,221	137,117

12. EARNINGS PER SHARE

Earnings per share is calculated based on the weighted average number of common shares outstanding during the period. In calculating diluted earnings per share amounts under the treasury stock method, the numerator remains unchanged from the basic earnings per share calculations as the assumed exercise of the Company's stock options and Directors deferred share units ("DSUs") do not result in adjustment to net earnings. The reconciliation of the denominator in calculating diluted earnings per share amounts for the 13 and 39-week periods ended December 31, 2011 and January 1, 2011 is as follows:

	13-week period ended December 31, 2011	13-week period ended January 1, 2011	39-week period ended December 31, 2011	39-week period ended January 1, 2011
Weighted average number of common shares outstanding, basic	25,210	24,929	25,190	24,816
Effect of dilutive securities				
Stock options	20	198	36	275
Deferred stock units	235	213	235	213
Weighted average number of common shares outstanding, diluted	25,465	25,340	25,461	25,304

13. CASH FLOW STATEMENT

Supplemental cash flow information:

(thousands of Canadian dollars)	13-week period ended December 31, 2011	13-week period ended January 1, 2011	39-week period ended December 31, 2011	39-week period ended January 1, 2011
Net change in non-cash working capital balances related to continuing operations				
Accounts receivable	(13,907)	(8,446)	(13,713)	(9,225)
Inventories	12,616	13,890	(2,251)	(30,212)
Prepaid expenses	11,060	660	1,898	(6,790)
Derivatives	(1,747)	–	(1,747)	–
Income taxes payable (recoverable)	(326)	–	(324)	–
Accounts payable and accrued liabilities	64,376	26,069	80,961	60,320
Unredeemed gift card liability	24,667	24,256	19,968	19,278
Provisions	–	(97)	–	(145)
Deferred revenue	382	182	828	(901)
Assets acquired under capital lease	85	–	218	2,329

14. CAPITAL MANAGEMENT

The Company's main objectives when managing capital are to safeguard the entity's ability to continue as a going concern while maintaining adequate financial flexibility to invest in new business opportunities that will provide attractive returns to shareholders. The primary activities engaged by the Company to generate attractive returns include construction and related leasehold improvements of stores, the development of new business concepts, and investment in information technology and distribution capacity to support the online and retail networks. The Company's main sources of capital are cash flows generated from operations, a revolving line of credit, and long-term debt. This cash flow is used to fund its working capital needs, capital expenditures, debt service requirements, and dividend distribution to shareholders.

In January 2012, the Company received US\$146.1 million from the proceeds of the sale of Kobo to Rakuten. To partially manage the foreign exchange risk related to this future cash flow, the Company entered into a foreign currency forward contract in December 2011 with a settlement date in January 2012. This type of transaction is not expected to recur and the Company does not expect to enter into any other forward contracts.

The Company monitors its capital structure principally through measuring its total debt to equity ratio and ensures its ability to service its debt obligation by tracking its interest and other fixed charge coverage ratios. Total debt is defined as the total of long-term debt (including the current portion) and notes payable.

The following table summarizes selected capital structure information for the Company:

(thousands of Canadian dollars)	December 31, 2011	January 1, 2011	April 2, 2011
Current portion of long-term debt	1,163	1,302	1,290
Long-term debt	1,327	2,081	1,995
Notes payable	5,224	–	–
Total debt	7,714	3,383	3,285
Total equity	240,600	280,185	267,363
Total debt : Total equity	0.03:1	0.01:1	0.01:1

15. FINANCIAL INSTRUMENTS

In December 2011, the Company entered into a foreign currency forward contract with a Canadian bank to partially manage the foreign exchange risk related to U.S. dollar proceeds from the sale of Kobo. This contract has been classified as a financial asset and has been categorized as a Level 2 financial instrument. The fair value of the foreign currency forward contract is calculated by the bank using a valuation model and mid-market rates and is recorded in the Consolidated Statements of Earnings (Loss) and Comprehensive Earnings (Loss).

For the 13-week period ended December 31, 2011, the Company recognized a net gain on the contract of \$1.7 million as the result of fluctuations in foreign exchange rates. This is a short-term contract with a settlement date in January 2012. The Company has no other financial instruments measured at fair value.

16. RELATED PARTY TRANSACTIONS

The Company's related parties include its key management personnel, shareholders, defined contribution retirement plan, joint venture, and subsidiary. Unless otherwise stated, none of the transactions incorporate special terms and conditions and no guarantees were given or received. Outstanding balances are usually settled in cash.

Transactions with key management personnel

Key management of the Company includes members of the Board of Directors as well as members of the Executive Committee. Key management personnel remuneration includes the following expenses:

(thousands of Canadian dollars)	13-week period ended December 31, 2011	13-week period ended January 1, 2011	39-week period ended December 31, 2011	39-week period ended January 1, 2011
Wages, salaries, bonus and consulting	1,052	871	3,614	2,571
Short-term benefits expense	47	61	169	172
Retirement benefits expense	11	20	42	59
Stock-based compensation	78	98	491	320
Directors' compensation	117	100	384	416
Total remuneration	1,305	1,150	4,700	3,538

Transactions with shareholders

In the 39-week period ended December 31, 2011, Indigo purchased two companies, the sole assets of which are certain tax losses, from a public company controlled by Mr. Gerald W. Schwartz, who is also the controlling shareholder of Indigo. Indigo acquired these companies with a total of \$100.3 million of non-capital tax losses in exchange for total net cash consideration of \$5.3 million and two notes payable totalling \$5.3 million. The notes payable are non-interest bearing and are both due on March 31, 2012. The acquisitions included transaction costs shared between the two companies. As a result, the Company has recorded a total deferred tax asset of \$25.4 million and the difference of \$15.0 million between the total net cash consideration and the total deferred tax asset was recorded directly to retained earnings.

Transactions with defined contribution retirement plan

The Company's transactions with the defined contribution retirement plan include contributions paid to the retirement plan as disclosed in note 11. The Company has not entered into other transactions with the retirement plan.

Transactions with joint venture

The Company's Calendar Club joint venture is a seasonal operation which is dependent on the December holiday sales season to generate revenues. During the year, the Company loans cash to Calendar Club for working capital requirements and Calendar Club repays the loans once profits are generated in the third quarter. The net amount of these transactions for the 13 and 39-week periods ended December 31, 2011 is \$4.3 million received by Indigo and nil, respectively (13 and 39-week periods ended January 1, 2011 – \$7.7 million received by Indigo and nil, respectively).

Transactions with subsidiaries

During the quarter, the Company earned revenue from Kobo through a revenue-sharing agreement, provided back office management services to Kobo, and purchased inventory from Kobo. For Indigo gift cards which are redeemed on Kobo's website, the Company pays Kobo for the value of the gift card, less a commission fee. All related party transactions were recorded in the Consolidated Statements of Earnings (Loss) and Comprehensive Earnings (Loss). The net amount of these transactions for the 13 and 39-week periods ended December 31, 2011 was \$16.3 million and \$37.7 million, respectively, paid by Indigo (13 and 39-week periods ended January 1, 2011 – \$11.4 million and \$19.7 million, respectively).

17. HELD FOR SALE AND DISCONTINUED OPERATIONS

On November 8, 2011, Indigo entered into an agreement with Rakuten, Inc. ("Rakuten") for Rakuten to acquire all the outstanding shares of Kobo on a fully diluted basis for an aggregate purchase price of US\$315 million. As a result of the agreement, Kobo's assets, liabilities and operating results have been classified as held for sale and discontinued operations. The Company continued to eliminate all intercompany transactions until the sale was closed.

The transaction was unanimously approved by the Board of Directors on November 8, 2011 and closed on January 11, 2012 following the satisfaction of all closing conditions, including approval under the *Investment Canada Act*. Indigo received net cash proceeds of US\$146.1 million for the Kobo sale. The accounting gain cannot be determined at this time as the calculation requires Kobo's closing balances as at January 11, 2012 to be finalized, but the gain is expected to range between \$153.0 million and \$163.0 million.

Below is a summary of Kobo's assets, liabilities and operating results that are included in the consolidated financial statements during the following periods:

(thousands of Canadian dollars)	December 31, 2011
Assets	
Cash	22,436
Accounts receivable	60,250
Inventory	22,152
Prepaid expenses	326
Property, plant and equipment	2,432
Intangible assets	9,955
Total Kobo assets held for sale	117,551
Liabilities	
Short-term loan	50,850
Accounts payable and accrued liabilities	60,925
Deferred revenue	1,504
Other liabilities	1,121
Total Kobo liabilities associated with assets held for sale	114,400

(thousands of Canadian dollars)	13-week period ended December 31, 2011	13-week period ended January 1, 2011	39-week period ended December 31, 2011	39-week period ended January 1, 2011
Revenues	44,525	36,417	79,837	50,403
Expenses	62,431	46,524	121,516	71,554
Loss from discontinued operations (net of taxes)	(17,906)	(10,107)	(41,679)	(21,151)
Loss from discontinued operations attributable to:				
Shareholders of the Company	(9,349)	(6,123)	(21,762)	(12,438)
Non-controlling interest	(8,557)	(3,984)	(19,917)	(8,713)
	(17,906)	(10,107)	(41,679)	(21,151)
Earnings (loss) from continuing operations attributable to:				
Shareholders of the Company	23,711	26,950	(17,101)	26,137
Non-controlling interest	—	—	—	—
	23,711	26,950	(17,101)	26,137
Loss per common share from discontinued operations				
Basic	\$(0.37)	\$(0.24)	\$(0.86)	\$(0.50)
Diluted	\$(0.37)	\$(0.24)	\$(0.86)	\$(0.50)
Earnings (loss) per common share from continuing operations				
Basic	\$0.94	\$1.08	\$(0.68)	\$1.05
Diluted	\$0.93	\$1.06	\$(0.68)	\$1.04

18. ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Company has adopted IFRS effective April 3, 2011, with a transition date of April 4, 2010 (“transition date”). Prior to the adoption of IFRS, the Company presented its consolidated financial statements in accordance with Canadian generally accepted accounting principles (“Canadian GAAP” or “CGAAP”). The Company’s audited annual consolidated financial statements for the 52 weeks ended March 31, 2012 will be the first audited annual consolidated financial statements prepared in accordance with the requirements of IFRS. Accordingly, the Company will make an unreserved statement of compliance with IFRS beginning with its fiscal 2012 annual financial statements.

The Company’s significant accounting policies presented in note 2 of the Company’s First Quarter Report have been applied in preparing the unaudited interim condensed consolidated financial statements for the 13 and 39-week periods ended December 31, 2011, the comparative consolidated financial statements for the 13 and 39-week periods ended January 1, 2011, and the 52-week period ended April 2, 2011.

IFRS 1, “First-time Adoption of International Financial Reporting Standards,” (“IFRS 1”) generally requires that an entity apply all IFRS standards effective at the end of its first IFRS reporting year retrospectively. However, IFRS 1 does include certain mandatory exemptions and limited optional exemptions from this general requirement. The Company has provided a detailed explanation of the impacts of its IFRS transition, including a discussion of IFRS 1 exemptions, in note 16 of its First Quarter Report.

An explanation of how the transition from CGAAP to IFRS has affected the Company’s financial position, financial performance and cash flows as at January 1, 2011 and for the 13 and 39 weeks ended January 1, 2011 is set out in the following reconciliations and in the notes accompanying the reconciliations.

Reconciliation of Equity from CGAAP to IFRS

The following is a reconciliation of the Company’s total shareholders’ equity reported in accordance with CGAAP to its total equity in accordance with IFRS as at January 1, 2011:

(thousands of Canadian dollars)	Notes	Share Capital	Contributed Surplus	Retained Earnings	Total	Non-controlling Interest	Total Equity
Total shareholders’ equity as reported under Canadian GAAP		201,280	5,025	70,359	276,664	–	276,664
Differences increasing (decreasing) reported amount:							
Deferred credit	1	–	–	3,440	3,440	–	3,440
Impairment of capital assets	2	–	–	(2,229)	(2,229)	–	(2,229)
Stock-based compensation	3	14	961	(1,161)	(186)	–	(186)
Future tax asset	4	–	–	587	587	–	587
Non-controlling interest	5	–	–	(171)	(171)	171	–
Reclassification of non-controlling interest to total equity under IFRS	7	–	–	–	–	1,909	1,909
		14	961	466	1,441	2,080	3,521
Total equity as reported under IFRS		201,294	5,986	70,825	278,105	2,080	280,185

See accompanying notes

Reconciliation of consolidated earnings and comprehensive earnings from CGAAP to IFRS

The following are reconciliations of the Company's total consolidated earnings and comprehensive earnings reported in accordance with CGAAP to its total consolidated earnings and comprehensive earnings in accordance with IFRS for the following periods:

Reconciliation of Consolidated Statements of Earnings and Comprehensive Earnings for the 13 Weeks Ended January 1, 2011

(thousands of Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balance	IFRS adjustments	IFRS reclassifications	IFRS balance	IFRS accounts
Revenues		351,225	–	–	351,225	Revenues
Cost of sales, operations, selling and administration	8	304,260	–	(104,925)	199,335	Cost of sales
		46,965	–	104,925	151,890	Gross profit
	8	–	–	84,041	84,041	Cost of operations
	3,8	–	29	20,809	20,838	Selling and administrative expenses
	8	–	–	75	75	Foreign currency translation
		46,965	(29)	–	46,936	Operating earnings before the following
Depreciation of property, plant and equipment	2	5,062	(261)	–	4,801	Depreciation of property, plant and equipment
Amortization of intangible assets		1,955	–	–	1,955	Amortization of intangible assets
Interest on long-term debt and financing charges		72	–	–	72	Interest on long-term debt and financing charges
Interest income on cash and cash equivalents		(122)	–	–	(122)	Interest income on cash and cash equivalents
Earnings before income taxes and non-controlling interest		39,998	232	–	40,230	Earnings before income taxes
Income tax expense	1,4	3,707	9,573	–	13,280	Income tax expense
Net earnings and comprehensive earnings for the period from continuing operations		36,291	(9,341)	–	26,950	Net earnings and comprehensive earnings for the period from continuing operations
Net loss and comprehensive loss for the period from discontinued operations (net of taxes)	5	(10,085)	(22)	–	(10,107)	Net loss and comprehensive loss for the period from discontinued operations (net of taxes)
Net earnings and comprehensive earnings for the period		26,206	(9,363)	–	16,843	Net earnings and comprehensive earnings for the period

See accompanying notes

Reconciliation of Consolidated Statements of Earnings and Comprehensive Earnings for the 39 Weeks Ended January 1, 2011

(thousands of Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balance	IFRS adjustments	IFRS reclassifications	IFRS balance	IFRS accounts
Revenues		756,289	–	–	756,289	Revenues
Cost of sales, operations, selling and administration	8	697,632	–	(271,017)	426,615	Cost of sales
		58,657	–	271,017	329,674	Gross profit
	8	–	–	213,948	213,948	Cost of operations
	3,8	–	116	56,730	56,846	Selling and administrative expenses
	8	–	–	339	339	Foreign currency translation
		58,657	(116)	–	58,541	Operating earnings before the following
Depreciation of property, plant and equipment	2	13,874	(450)	–	13,424	Depreciation of property, plant and equipment
Amortization of intangible assets		5,793	–	–	5,793	Amortization of intangible assets
Interest on long-term debt and financing charges		115	–	–	115	Interest on long-term debt and financing charges
Interest income on cash and cash equivalents		(295)	–	–	(295)	Interest income on cash and cash equivalents
Earnings before income taxes and non-controlling interest		39,170	334	–	39,504	Earnings before income taxes
Income tax expense	1,4	3,744	9,623	–	13,367	Income tax expense
Net earnings and comprehensive earnings for the period from continuing operations		35,426	(9,289)	–	26,137	Net earnings and comprehensive earnings for the period from continuing operations
Net loss and comprehensive loss for the period from discontinued operations (net of taxes)	5	(21,020)	(131)	–	(21,151)	Net loss and comprehensive loss for the period from discontinued operations (net of taxes)
Net earnings and comprehensive earnings for the period		14,406	(9,420)	–	4,986	Net earnings and comprehensive earnings for the period

See accompanying notes

Reconciliation of balance sheets from CGAAP to IFRS

The following are reconciliations of the Company's consolidated balance sheets reported in accordance with CGAAP to its consolidated balance sheets in accordance with IFRS for the following periods:

Reconciliation of Consolidated Balance Sheet as at January 1, 2011

(thousands of Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balance	IFRS adjustments	IFRS reclassifications	IFRS balance	IFRS accounts
ASSETS						ASSETS
Current						Current
Cash and cash equivalents	9	144,335	–	308	144,643	Cash and cash equivalents
Restricted cash	9	308	–	(308)	–	
Accounts receivable		26,007	–	–	26,007	Accounts receivable
Inventories		255,750	–	–	255,750	Inventories
Income taxes recoverable		899	–	–	899	Income taxes recoverable
Prepaid expenses		13,729	–	–	13,729	Prepaid expenses
Future tax assets	9	5,146	–	(5,146)	–	
Total current assets		446,174	–	(5,146)	441,028	Total current assets
Property, plant and equipment	2	87,950	(2,228)	–	85,722	Property, plant and equipment
Intangible assets	2	28,360	(1)	–	28,359	Intangible assets
Future tax assets	4,9	29,114	587	5,146	34,847	Deferred tax assets
Goodwill		26,632	–	–	26,632	Goodwill
Total assets		618,230	(1,642)	–	616,588	Total assets
LIABILITIES AND SHAREHOLDERS' EQUITY						LIABILITIES AND EQUITY
Current						Current
Accounts payable and accrued liabilities	1,3,9,10	316,813	(3,254)	(57,127)	256,432	Accounts payable and accrued liabilities
	9	–	–	57,094	57,094	Unredeemed gift card liability
	10	–	–	33	33	Provisions
Deferred revenue		12,639	–	–	12,639	Deferred revenue
Current portion of long-term debt		1,302	–	–	1,302	Current portion of long-term debt
Total current liabilities		330,754	(3,254)	–	327,500	Total current liabilities
Long-term accrued liabilities		6,822	–	–	6,822	Long-term accrued liabilities
Long-term debt		2,081	–	–	2,081	Long-term debt
Total liabilities		339,657	(3,254)	–	336,403	Total liabilities
Shareholders' equity						Equity
Share capital	3	201,280	14	–	201,294	Share capital
Contributed surplus	3	5,025	961	–	5,986	Contributed surplus
Retained earnings	1-7	70,359	466	–	70,825	Retained earnings
Total shareholders equity		276,664	1,441	–	278,105	Total equity attributable to shareholders of the Company
Non-controlling interest	5,7	1,909	171	–	2,080	Non-controlling interest
					280,185	Total equity
Total liabilities and shareholders' equity		618,230	(1,642)	–	616,588	Total liabilities and equity

See accompanying notes

Reconciliation of Consolidated Balance Sheet as at April 2, 2011

(thousands of Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balance	IFRS adjustments	IFRS reclassifications	IFRS balance	IFRS accounts
ASSETS						
Current						
Cash and cash equivalents	9	83,021	–	640	83,661	Cash and cash equivalents
Restricted cash	9	640	–	(640)	–	
Accounts receivable		12,684	–	–	12,684	Accounts receivable
Inventories		232,694	–	–	232,694	Inventories
Prepaid expenses		7,941	–	–	7,941	Prepaid expenses
Future tax assets	9	5,393	–	(5,393)	–	
Total current assets		342,373	–	(5,393)	336,980	Total current assets
Property, plant and equipment	2	85,736	(6,959)	–	78,777	Property, plant and equipment
Intangible assets	2	30,620	(6)	–	30,614	Intangible assets
Future tax assets	4,9	30,819	1,792	5,393	38,004	Deferred tax assets
Goodwill		26,632	–	–	26,632	Goodwill
Total assets		516,180	(5,173)	–	511,007	Total assets
LIABILITIES AND EQUITY						
Current						
Accounts payable and accrued liabilities	1,3,9,10	224,959	(3,069)	(40,991)	180,899	Accounts payable and accrued liabilities
	9	–	–	40,991	40,991	Unredeemed gift card liability
	10	–	–	–	–	Provisions
Deferred revenue		11,528	–	–	11,528	Deferred revenue
Income taxes payable		657	–	–	657	Income taxes payable
Current portion of long-term debt		1,290	–	–	1,290	Current portion of long-term debt
Total current liabilities		238,434	(3,069)	–	235,365	Total current liabilities
Long-term accrued liabilities		6,284	–	–	6,284	Long-term accrued liabilities
Long-term debt		1,995	–	–	1,995	Long-term debt
Total liabilities		246,713	(3,069)	–	243,644	Total liabilities
Shareholders' equity						
Share capital	3	202,196	24	–	202,220	Share capital
Contributed surplus	3	5,039	1,027	–	6,066	Contributed surplus
Retained earnings	1-7	55,885	(7,256)	–	48,629	Retained earnings
Total shareholders' equity		263,120	(6,205)	–	256,915	Total equity attributable to shareholders of the Company
Non-controlling interest	5,6,7	6,347	4,101	–	10,448	Non-controlling interest
					267,363	Total equity
Total liabilities and shareholders' equity		516,180	(5,173)	–	511,007	Total liabilities and equity

See accompanying notes

Notes to the reconciliations

1. Framework for the Preparation and Presentation of Financial Statements (the “Framework”)

Under CGAAP, Indigo acquired a company with non-capital tax losses and recorded a related future tax asset. The difference between the future tax asset and the net cash consideration paid by Indigo was recorded as a deferred credit and amortized into earnings over the same period as the related future tax asset.

Under the IFRS Framework, the difference between the net cash consideration and the deferred tax asset does not have the characteristics of a liability and therefore cannot be recorded as a deferred credit and amortized into earnings. Under IFRS, the difference must be immediately recognized in retained earnings.

As a result, the Company has reclassified the CGAAP deferred credit and related amortization into retained earnings under IFRS.

2. Impairment of Capital Assets (“IAS 36”)

CGAAP uses a two-step approach to capital asset impairment testing: first comparing asset carrying values with undiscounted future cash flows to determine whether impairment exists; and then measuring any impairment by comparing asset carrying values with fair values. Impairment testing for Indigo was performed at a Company-wide level and reversal of impairment losses was prohibited.

IFRS uses a one-step approach in both testing for and measurement of impairment, with CGU carrying values compared directly with value in use. Capital asset impairment testing for Indigo is performed at the store level and previously recognized impairment losses will be reversed where circumstances have changed.

The Company has revised its impairment testing model to comply with the requirements of IAS 36. Under the IFRS testing model, the Company recognized increased impairment of capital assets with a corresponding decrease to retained earnings. The estimates used for this analysis were consistent with the estimates used under CGAAP at the same date, adjusted for accounting policy differences where necessary. CGAAP amortization related to the impaired capital assets was also adjusted as part of the IFRS transition. The Company did not identify any reversals of previously recorded impairment losses.

3. Share-based Payments (“IFRS 2”)

Under CGAAP, share-based payment expenses were recognized on a straight-line basis over the vesting period, forfeitures were accounted for as they occurred, and the fair values of cash-settled share-based payment awards were measured by reference to market value of the related shares.

Under IFRS, each tranche of a share-based payment is considered a separate grant with a different vesting date and fair value, and each tranche is accounted for separately using graded vesting. Forfeitures must be estimated and recognized in the current period, with revisions for actual forfeitures in subsequent periods. The fair value of cash-settled share-based compensation awards is measured using a valuation model, with the offset recorded as a liability.

The methodology of calculating the Company’s share-based payment expense was revised in conformity with IFRS requirements. Under IFRS guidance, adjustments made to the Company’s total share-based payment expense resulted in a net decrease to retained earnings.

4. Tax Impact of IFRS Transition

Impairment of capital assets recorded as part of the Company’s IFRS transition resulted in a temporary difference for income tax purposes.

5. Kobo IFRS Impact

Kobo converted to IFRS using the same transition date as Indigo. As the result of IFRS transition adjustments impacting Kobo’s financial position and financial performance, Indigo adjusted for the impact on the Company’s portion of Kobo’s financial position and financial performance and the impact on non-controlling interest.

6. Consolidated and Separate Financial Statements (“IAS 27”)
Under CGAAP, when the issue of shares by a subsidiary results in the reduction of a parent’s ownership of the subsidiary without a loss of control, the difference between the net consideration paid by the parent and the change in the parent’s share of the subsidiary’s net identifiable assets is accounted for as a gain.
Under IAS 27, changes in a parent’s ownership interest in a subsidiary which do not result in a loss of control are accounted for as equity transactions.
As part of the Company’s transition to IFRS, the CGAAP dilution gain has been reversed, resulting in a reduction to earnings and a corresponding increase to non-controlling interest.
7. Presentation of Non-controlling Interest
A difference exists between CGAAP and IFRS with respect to the presentation of non-controlling interest. Under CGAAP, non-controlling interest was presented as a separate line item and excluded from total shareholders’ equity while under IFRS, non-controlling interest is included as part of total equity.
8. Presentation of Consolidated Statements of Earnings (Loss) and Comprehensive Earnings (Loss)
The Company classifies expenses according to their function and under IFRS, the Company is required to disclose its cost of sales separately from other expenses.
9. Presentation of Consolidated Balance Sheets
Restricted cash: IFRS does not require presentation of restricted cash as a separate line item on the face of the balance sheets. Following a review of the Company’s cash disclosure requirements under IFRS, management has chosen to disclose restricted cash as part of note disclosures instead of on the face of the balance sheets.
Deferred income tax: Under IFRS terminology, future tax assets have been renamed to deferred tax assets. IFRS does not separately present deferred tax assets as current and non-current. As such, CGAAP current future tax assets have been reclassified as IFRS non-current deferred tax assets on the Company’s consolidated balance sheets.
Unredeemed gift card liability: IFRS requires separate presentation of certain liabilities. As such, amounts have been reclassified from current accounts payable and accrued liabilities to unredeemed gift card liability.
10. Provisions, Contingent Liabilities and Contingent Assets (“IAS 37”)
Under CGAAP, a provision was recorded based on the likely probability that payment or surrender of assets would be required to fulfill the obligation. However, under IAS 37, a provision must be recorded when it is probable or more likely than not, which is a lower threshold for recognition than CGAAP.
IAS 37 requires an entity to recognize a provision when a contract becomes onerous (i.e., when it has a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it). The unavoidable costs under a contract reflect the lowest net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it. If an entity has a contract that is onerous, the present obligation under the contract shall be recognized and measured as a provision. CGAAP only requires the recognition of such a liability in certain prescribed situations. IFRS also requires separate presentation of provisions.
In conformity with IFRS presentation requirements, amounts were reclassified between accounts payable and accrued liabilities and provisions, as they met IFRS criteria for recognition as a provision. The Company has reviewed its obligations at transition date, including a full review of store leases, and did not recognize any new provisions.

Statement of cash flows

Under CGAAP, income taxes, interest expense and related amounts paid or received were not disclosed on the face of the cash flow statement. Under IFRS, disclosure of these balances is required on the cash flow statement instead of as a supplementary note disclosure. There have been no material adjustments to the consolidated cash flow statements. The components of cash and cash equivalents under CGAAP are consistent with those presented under IFRS.

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