

FIRST QUARTER REPORT
FOR THE 13-WEEK PERIOD ENDED JULY 2, 2011

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

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Table of Contents

- 3.** Management's Discussion and Analysis
- 16.** Interim Condensed Consolidated Financial Statements and Notes
- 52.** Investor Information

Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") is prepared as at August 9, 2011 and is based primarily on the unaudited interim condensed consolidated financial statements of Indigo Books & Music Inc. (the "Company" or "Indigo") for the 13-week periods ended July 2, 2011 and July 3, 2010. 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 and the MD&A included in the Company's fiscal 2011 Annual Report. The Company's fiscal 2011 Annual Report was prepared in accordance with Canadian generally accepted accounting principles ("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 July 2, 2011, the Company operated 97 superstores under the banners *Chapters*, *Indigo* and the *World's Biggest Bookstore* and 149 small format stores, under the banners *Coles*, *Indigo*, *Indigospirit*, *SmithBooks*, *The Book Company*, and *Pistachio*. During first quarter of fiscal 2012, the Company closed one small format store. 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 July 2, 2011, Indigo owned 51.4% of Kobo's outstanding common shares.

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 first quarter of fiscal 2012 was 25,160,364 as compared to 24,742,761 last year. As at August 9, 2011, the number of outstanding common shares was 25,198,540 with a book value of \$203.0 million. The number of common shares reserved for issuance under the employee stock option plan is 2,269,854 as at August 9, 2011. As at July 2, 2011, there were 1,929,100 stock options outstanding of which 803,100 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. As part of the IFRS transition, the Company implemented changes to its internal controls over financial reporting and disclosure controls and procedures where needed. No material change in internal controls over financial reporting or disclosure controls resulted from the adoption and implementation of IFRS.

Results of Operations

The following table summarizes the consolidated results of 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.

(millions of Canadian dollars)	13-week period ended July 2, 2011	%	13-week period ended July 3, 2010	%
		Revenues		Revenues
Revenues	202.1	100.0	204.3	100.0
Cost of sales	125.4	62.0	117.8	57.7
Cost of operations	65.7	32.5	64.6	31.6
Selling, administrative and other expenses	30.9	15.3	22.7	11.1
EBITDA ¹	(19.9)	(9.8)	(0.8)	(0.4)

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

Revenue Decreased Slightly

Total consolidated revenues for the 13-week period ended July 2, 2011 decreased \$2.2 million or 1.1% to \$202.1 million from \$204.3 million for the 13-week period ended July 3, 2010. The decrease was driven by declining book sales, partially offset by revenues from Kobo and Kobo eReaders.

Comparable store sales for the fiscal year decreased 5.4% in superstores and decreased 5.2% in small format stores primarily due to lower book sales. 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 July 2, 2011, the Company operated one additional superstore and one fewer small format store compared to July 3, 2010.

Online sales decreased by \$1.0 million or 5.2% to \$18.1 million for the 13-week period ended July 2, 2011 compared to \$19.1 million last year. The decrease in the online channel was also due to lower book sales.

Revenues from other sources include revenues generated through loyalty card sales, gift card breakage, and revenues from Calendar Club and Kobo. Revenues from other sources increased \$7.7 million from \$11.9 million last year to \$19.6 million for the current year primarily as a result of Kobo eBook and eReader sales.

Revenues by channel are highlighted below:

(millions of Canadian dollars)	13-week period ended July 2, 2011	13-week period ended July 3, 2010	% increase (decrease)	Comparable store sales % increase (decrease)
Superstores	136.2	142.9	(4.7)	(5.4)
Small format stores	28.2	30.4	(7.2)	(5.2)
Online (including store kiosks)	18.1	19.1	(5.2)	N/A
Other	19.6	11.9	64.7	N/A
	202.1	204.3	(1.1)	(5.3)

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

	Superstores		Small format stores	
	13-week period ended July 2, 2011	13-week period ended July 3, 2010	13-week period ended July 2, 2011	13-week period ended July 3, 2010
(millions of Canadian dollars)				
Total revenues	136.2	142.9	28.2	30.4
Adjustments for stores not in both fiscal periods	(3.3)	(2.5)	(2.2)	(2.9)
Comparable store sales	132.9	140.4	26.0	27.5

Cost of Sales 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 July 2, 2011, cost of sales increased \$7.6 million to \$125.4 million. The increase was driven by the high cost of goods sold for the Kobo eReaders, less vendor support from book publishers, and higher inventory write-downs due to the summer clearance sale compared to the same period last year. In the current quarter, the Company established a \$3.2 million inventory provision for its annual summer clearance sale as a result of more aggressive initial discounting expected to clear some of its products compared to prior year. As a percent of total revenues, cost of sales increased 4.3% to 62.0% in the first quarter of fiscal 2012, compared to 57.7% last year.

Cost of Operations (as a Percent of Revenues) Increased from Last Year

Cost of operations includes all store, online, distribution centre and Calendar Club costs. Cost of operations increased \$1.1 million primarily due to an increase in retail distribution centre and online costs. Retail distribution centre costs increased by \$0.5 million as higher unit volume resulted in higher labour and freight costs. Online costs increased \$0.4 million due to the opening of a new online distribution centre in the second quarter of last fiscal year. As a percent of total revenues, cost of operations increased by 0.9% to 32.5% this year.

Selling, Administrative and Other Expenses Increased due to Expenses Incurred by Kobo

Selling, administrative and other expenses include all marketing, head office and Kobo administrative costs. These expenses increased \$8.2 million compared to last year. The Company recorded \$7.2 million more in operating expenses for Kobo compared to last year. In the first quarter of fiscal 2012, expenses related to the operation of Kobo totalled \$10.4 million compared to \$3.2 million last year. Kobo has experienced significant worldwide growth, resulting in an increase to operating expenses. As a percent of total revenues, selling, administrative and other expenses increased by 4.2% to 15.3%, compared to 11.1% of total revenues last year.

EBITDA Decreased as a Percent of Revenues

EBITDA, defined as earnings before interest, taxes, depreciation and amortization decreased \$19.1 million to a loss of \$19.9 million for the 13-week period ended July 2, 2011, compared to a loss of \$0.8 million for the 13-week period ended July 3, 2010. The decrease was driven by lower EBITDA in both the Indigo core business and the Kobo business. The Indigo core business experienced declining trade book sales and a reduction in margin as revenue growth from the sale of Kobo eReaders has minimal margin. This, combined with increasing cost of operations in the areas mentioned above, led to lower EBITDA in the core business. The EBITDA loss of the Kobo business is higher because the Company spent more in operating expenses as a result of international expansion, as discussed above. EBITDA as a percent of revenues decreased to a loss of 9.8% this year from a loss of 0.4% last year.

Depreciation and Amortization Increased versus Last Year

Depreciation and amortization for the 13-week period ended July 2, 2011 increased by \$1.3 million to \$8.2 million compared to \$6.9 million last year. Capital expenditures in the first quarter of fiscal 2012 totalled \$6.0 million and included \$1.8 million on store construction, renovations and equipment, \$3.6 million on intangible assets (primarily application software and internal development costs) and \$0.6 million on technology equipment. The Company did not finance any capital expenditures through capital leases in the current quarter.

Net Interest Income Recorded

The Company recognized net interest income of \$0.1 million in the first quarter of this year compared to net interest income of less than \$0.1 million in the same period last year. The Company nets interest income received against interest expense. The interest income received was higher this year due to an increase in market interest rates.

Income Tax Recovery Increased from Last Year

The Company recognized income tax recovery of \$3.8 million this year compared to an income tax recovery of \$0.4 million last year. The increase in income tax recovery in the current year is primarily due to a larger net loss compared to last year.

Non-controlling Interest

On April 19, 2011, Kobo issued 6,743,486 shares to a syndicate of investors comprised of both existing shareholders and new investors. Indigo purchased 779,361 common shares for \$3.0 million while the rest of the syndicate members purchased a total of 5,964,125 common shares for \$23.0 million. As a result of these transactions, Indigo's ownership of Kobo decreased from 58.3% to 51.4%, but Indigo continues to retain control over Kobo.

As the majority and controlling shareholder of Kobo, the Company fully consolidates its results in its unaudited interim condensed consolidated financial statements. 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 earnings or loss that is attributable to the minority shareholders of Kobo. For the 13 weeks ended July 2, 2011, the Company recorded \$6.1 million, compared to \$1.9 million last year, in non-controlling interest for the portion of Kobo losses attributable to the minority shareholders.

Net Loss Recorded for the Current Quarter

The Company recognized a net loss attributable to shareholders of the Company of \$18.1 million for the quarter or \$0.72 net loss per common share, compared to a net loss attributable to shareholders of the Company of \$5.4 million or \$0.22 net loss per common share last year. The decrease was primarily due to the decrease in EBITDA, partially offset by an increase in income tax recovery.

Seasonality and First 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.

(thousands of Canadian dollars, except per share data)	Fiscal quarters							
	Q1 Fiscal 2012	IFRS				Canadian GAAP		
		Q4 Fiscal 2011	Q3 Fiscal 2011	Q2 Fiscal 2011	Q1 Fiscal 2011	Q4 Fiscal 2010	Q3 Fiscal 2010	Q2 Fiscal 2010
Revenues	202,093	210,633	387,642	214,764	204,286	228,191	340,195	206,990
Net earnings (loss) attributable to shareholders of the Company	(18,105)	(19,441)	20,827	(1,768)	(5,360)	497	34,530	2,200
Basic earnings (loss) per share	\$(0.72)	\$(0.78)	\$0.84	\$(0.07)	\$(0.22)	\$0.02	\$1.41	\$0.09
Diluted earnings (loss) per share	\$(0.72)	\$(0.78)	\$0.82	\$(0.07)	\$(0.22)	\$0.02	\$1.38	\$0.09

Overview of Consolidated Balance Sheets

Total Assets

As at July 2, 2011, total assets were \$8.3 million higher than total assets at July 3, 2010. The increase in assets was primarily due to increases in the Company's deferred tax assets, intangible assets, and accounts receivable, offset by decreases in the Company's cash and cash equivalents and inventories. Deferred tax assets increased by \$17.5 million compared to last year, primarily as the result of the Company's purchase of tax losses from a related company during the first quarter of fiscal 2012. Intangible assets increased by \$5.8 million primarily due to expenditures for technology-related projects, including development costs at Kobo. Accounts receivable increased by \$3.6 million primarily due to Kobo's sales of eReaders to other resellers on standard payment terms. Cash and cash equivalents decreased \$12.1 million primarily due to the Company's purchase of tax losses from a related company, purchase of capital assets, and the payment of dividends, offset by an increase of \$21.3 million from the issuance of equity securities by Kobo. The Company's inventory position decreased \$8.1 million primarily due to a reduction in book purchases.

On a fiscal year-to-date basis, total assets decreased by \$0.8 million compared to April 2, 2011. The decrease in total assets was primarily due to decreases in cash and cash equivalents and inventories, offset by an increase in deferred tax assets. The decrease of \$10.3 million in cash and cash equivalents is consistent with the seasonal nature of the business while the decrease of \$16.9 million in inventories is primarily due to a reduction in book purchases as the result of declining book sales. Deferred tax assets increased by \$28.1 million primarily as the result of the Company's purchase of non-capital tax losses during the current quarter.

Total Liabilities

As at July 2, 2011, total liabilities were \$2.7 million less than total liabilities at July 3, 2010. The decrease in liabilities was primarily due to decreases in deferred revenue and current and long-term accounts payable, offset by increases in notes payable and unredeemed gift card liability. Deferred revenue decreased \$3.4 million as a result of a decline in the Company's fee-based loyalty card program following the introduction of the free Plum loyalty program. The decrease of \$9.1 million in current and long-term accounts payable and accrued liabilities is consistent with the decrease in the Company's inventory position, as noted above. Notes payable of \$4.9 million arose from the Company's purchase of tax losses from a related company and unredeemed gift card liability increased by \$4.1 million due to an increased number of gift cards sold.

On a fiscal year-to-date basis, total liabilities decreased by \$11.4 million compared to April 2, 2011. The decrease in total liabilities was primarily due to a \$16.5 million decrease in current and long-term accounts payable and accrued liabilities, offset by an increase of \$4.9 million in notes payable. The decrease in current and long-term accounts payable and accrued liabilities is consistent with the reduction in book purchases, as mentioned above. The increase in notes payable was the result of the Company's purchase of non-capital tax losses during the current quarter.

Non-Controlling Interest

The Company fully consolidates the results of Kobo in its unaudited interim condensed consolidated financial statements. For the 13-week period ended July 2, 2011, the Company recorded \$26.3 million in non-controlling interest on its consolidated

balance sheet compared to \$5.3 million last year. The \$26.3 million reflects the 48.6% of Kobo owned by minority shareholders, compared to 42.3% owned by minority shareholders last year. On a fiscal year-to-date basis, the value of the non-controlling interest increased \$15.8 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 July 2, 2011 decreased \$10.9 million compared to July 3, 2010. The decrease in total equity was primarily due to the net loss of \$18.5 million in the last four quarters and \$11.0 million of dividend payments, offset by an increase of \$14.4 million in retained earnings related to the purchase of tax losses from a related company. Share capital increased by \$4.4 million mainly due to employees exercising their stock options and contributed surplus increased \$0.7 million due to the expensing of employee stock options and Directors' deferred share units.

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 \$85.1 million as at July 2, 2011, compared to \$101.6 million at the end of fiscal 2011 and \$100.2 million as at July 3, 2010.

The Company's leverage position (defined as Total Liabilities to Total Equity) decreased slightly at 0.8:1 at the end of the current quarter compared to 0.9:1 last year and 0.9:1 as at April 2, 2011.

Overview of Consolidated Statements of Cash Flows

Cash and cash equivalents decreased \$10.3 million during the first quarter of fiscal 2012 compared to a decrease of \$18.4 million last year. The decrease in the current quarter was driven by cash flows used in operating activities of \$18.3 million and in investing activities of \$16.1 million, offset by cash flows from financing activities of \$24.1 million and the effect of foreign currency exchange rate changes on cash and cash equivalents of \$0.1 million.

Cash Flows Used in Operating Activities

The Company used cash flows of \$18.3 million in operating activities in the first quarter of fiscal 2012. This was an increase of \$10.1 million used over the same period last year, when cash flows used in operating activities were \$8.2 million. Cash flows used in the current quarter were primarily due to the net loss of \$24.2 million, which was offset by non-cash depreciation and amortization of \$8.2 million.

Cash Flows Used in Investing Activities

In the first quarter, net cash flows used in investing activities were \$16.1 million compared to \$7.8 million used in the same quarter last year. In the current quarter, total cash spent on capital projects was \$6.0 million compared to \$7.8 million spent in the comparative period as outlined below:

(millions of Canadian dollars)	13-week period ended July 2, 2011	13-week period ended July 3, 2010
Store construction, renovations and equipment	1.8	3.8
Intangible assets (primarily application software and internal development costs)	3.6	3.5
Technology equipment	0.6	0.5
	6.0	7.8

The Company also paid \$10.1 million during the first quarter of fiscal 2012 to purchase non-capital tax losses from a related company. There was no such transaction in the same period last year.

Cash Flows from Financing Activities

Net cash flows generated from financing activities were \$24.1 million during the first quarter compared to \$3.6 million used in the same period last year. The increase in cash flows from financing activities was driven by \$21.3 million received from third-party Kobo investors in the first quarter of the current fiscal year and a \$5.1 million note payable relating to the acquisition of non-capital tax losses. There were no such financing activities in the first quarter of last year. These cash receipts were offset by \$2.8 million of dividends paid during the current quarter and a \$0.3 million repayment of long-term debt. The Company paid \$2.7 million in dividends and repaid \$0.7 million of long-term debt in the same period last year.

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. The Company does not invest in asset-backed commercial paper.

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 Notes 2 and 4 of the unaudited interim condensed consolidated financial statements contained in this Quarterly Report.

In the first quarter of fiscal 2012, there were no significant changes to the method used to determine reserves for slow-moving and damaged products, reserves for gift and paper products which have been marked down and deferred tax assets. The method of determining gift card breakage and sales returns is also consistent with that used in prior periods.

As part of the Company's transition to IFRS, changes were made to the methodology used to assess impairment of property, plant and equipment and intangible assets. Under CGAAP, the Company assessed impairment of property, plant and equipment and intangible assets at a Company-wide level. However, under IFRS, impairment was assessed at the store level. The IFRS methodology has been applied to all periods reported in this Quarterly Report.

Accounting Standards Adopted in the First Quarter of Fiscal 2012

Transition to IFRS

The Company has 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."

During the first quarter of fiscal 2012, the Company finalized its IFRS accounting policy choices. Except as noted below, these accounting policies are consistent with those disclosed in the 2011 Annual Report and have been approved by the Company's Audit Committee. The Company has provided a detailed explanation of the impacts of its IFRS transition in Note 16 of the fiscal 2012 first quarter unaudited interim condensed consolidated financial statements. This note includes reconciliations prepared in accordance with IFRS 1, "First-Time Adoption of International Financial Reporting Standards." The conversion to IFRS resulted in an increase of \$9.8 million to retained earnings as at April 4, 2010 and a decrease of \$7.3 million to retained earnings as at April 2, 2011.

In the IFRS opening balance sheet reconciliation presented in the Company's fiscal 2010 annual report, the Company disclosed restricted cash on the face of the balance sheet. However, IFRS does not require presentation of restricted cash as a separate line item on the face of the balance sheet. During the review of the Company's cash disclosure requirements under IFRS, management decided to disclose restricted cash as part of note disclosures instead of on the face of the balance sheet. In addition, the future tax assets line has been renamed to deferred tax assets in conformity with IFRS terminology.

The following IFRS transition adjustments had the most significant impacts on the Company's retained earnings:

Framework for the Preparation and Presentation of Financial Statements (the "Framework")

During fiscal 2010, Indigo acquired a company with \$69.6 million of non-capital tax losses in exchange for net cash consideration of \$7.7 million. As a result, Indigo recorded a future tax asset of \$20.7 million and under CGAAP, the difference of \$13.0 million between the net cash consideration and the future tax asset was recorded as a deferred credit, included in accounts payable and accrued liabilities.

However, based on the IASB Framework, the difference between the net cash consideration and the future tax asset does not have the characteristics of a liability. The calculated difference of \$13.0 million does not result in a present obligation for Indigo and, as such, cannot be recorded as a liability under the Framework.

Therefore, the Company reclassified the deferred credit of \$13.0 million as a decrease to liabilities and an increase to April 4, 2010 retained earnings. During fiscal 2011, the Company utilized \$9.9 million of the deferred credit and had a remaining deferred credit of \$3.1 million as at April 2, 2011 under CGAAP. Therefore, the Company reclassified the remaining deferred credit of \$3.1 million as a decrease to liabilities and an increase to April 2, 2011 retained earnings.

Impairment of Capital Assets (“IAS 36”)

Canadian GAAP

- Two-step approach to 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.
- Reversal of impairment losses is prohibited.

IFRS

- One-step approach in both testing for and measurement of impairment, with asset carrying values compared directly with value in use.
- Impairment testing for Indigo will be performed at the store level.
- Except for goodwill, previously recognized impairment losses should be reversed where circumstances have changed.

As part of its IFRS transition, the Company revised its capital asset impairment testing model to comply with the requirements of IAS 36. The changes made to the capital asset impairment testing model resulted in the recognition of an impairment of \$2.7 million of capital assets on transition, which correspondingly decreased April 4, 2010 retained earnings. The fiscal 2011 capital asset impairment test resulted in the recognition of an impairment of \$4.9 million of capital assets, which correspondingly decreased April 2, 2011 retained earnings.

The Company did not identify any reversals of previously recorded impairment losses. The Company expects earnings volatility to increase under IFRS due to an increased likelihood of asset impairment, the possible reversal of previously recorded impairment losses, and the corresponding effects on depreciation and amortization.

Consolidated and Separate Financial Statements (“IAS 27”)

During fiscal 2011, Kobo issued shares to both Indigo and external investors. This round of financing resulted in a reduction to Indigo’s percentage ownership of Kobo, but Indigo continued to control Kobo. Under CGAAP, the difference between the financing proceeds and the change in Indigo’s share of Kobo’s net identifiable assets was accounted for as a gain of \$3.9 million.

However, based on IAS 27 guidance, 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. This accounting difference had no impact on April 4, 2010 retained earnings but did result in the reduction of April 2, 2011 retained earnings by \$3.9 million with a corresponding increase to non-controlling interest.

Share-based Payments (“IFRS 2”)

Canadian GAAP

- The fair value of a share-based payment with graded vesting is recognized on a straight-line basis over the vesting period.
- Award forfeitures are recognized as they occur.
- Cash-settled share-based compensation awards are measured by reference to market value of the related shares.

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.
- Fair value of cash-settled share-based compensation awards is measured using a valuation model.

As part of its IFRS transition, the Company revised its methodology for calculating share-based payment expense. The revised methodology resulted in the recognition of \$1.0 million in additional expense on transition, which decreased April 4, 2010 retained earnings and increased contributed surplus and accrued liabilities. For fiscal 2011, the revised methodology resulted in the recognition of \$0.2 million in additional expense, which decreased April 2, 2011 retained earnings and increased contributed surplus and accrued liabilities.

The tax impact of all IFRS transition adjustments was a \$1.8 million increase to deferred tax assets and corresponding increase to April 2, 2011 retained earnings. Refer to Notes 16 and 17 of the Company's fiscal 2012 first quarter unaudited interim condensed consolidated financial statements for an explanation of its IFRS transition impacts.

New Accounting Pronouncements

Financial Instruments: Disclosures (“IFRS 7”)

The IASB has issued amendments to IFRS 7 which 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 Company does not expect implementation to have a significant impact on the Company's 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 has no investment properties and, as such, does not expect the implementation of the amendment to have a significant 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 is expected to be 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 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. The Company has yet to assess the impact of the new standard on its consolidated financial statements;
- 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. This new standard is expected to impact the accounting for the Company's Calendar Club joint venture;

- 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, “Investment 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 judgements made to determine whether it controls another entity. This new standard may impact disclosures related to Calendar Club and Kobo;
- 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 has yet to assess the impact of the new standard on its consolidated financial statements;
- Separate Financial Statements (“IAS 27”) has been amended to remove all requirements relating to consolidated financial statements. The Company has yet to assess the impact of this amendment on its consolidated financial statements; 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 Company has yet to assess the impact of this amendment on its 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 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 April 3, 2011 and ended on July 2, 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 material changes in internal controls over financial reporting have occurred in this period.

During this period, Indigo launched the Plum loyalty program (the “Plum Program”) which allows members to earn points on their purchases from the Company and redeem points for discounts. The launch of the Plum Program resulted in changes to the IT systems to support the maintenance of loyalty points data. It also resulted in changes to revenue recognition as the Company has to estimate the fair value of the points that were issued to the customers.

Also during this period, Kobo implemented a new accounting software system. As a result of this implementation, certain shared accounting services which were previously managed by Indigo have migrated to Kobo. When the accounting services were shared with Indigo, Kobo relied on the internal controls that were put in place by Indigo. Once these accounting services were transferred to Kobo, Kobo established their own set of internal controls for these processes.

Management has designed internal controls over financial reporting to mitigate the related risks of the above material changes for the Company.

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 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, 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 loss before income taxes (the most comparable IFRS measure) is provided below:

(millions of Canadian dollars)	13-week period ended July 2, 2011	13-week period ended July 3, 2010
EBITDA	(19.9)	(0.8)
Depreciation of property, plant and equipment	4.6	4.5
Amortization of intangible assets	3.6	2.4
Interest income on cash and cash equivalents	(0.1)	(0.1)
Loss before income taxes	(28.0)	(7.6)

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NOTICE OF NO AUDITOR REVIEW OF INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

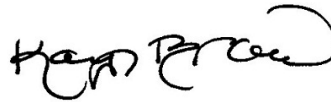
Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim condensed consolidated financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

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 9th day of August, 2011.

Consolidated Balance Sheets

(Unaudited)

(thousands of Canadian dollars)	As at July 2, 2011	As at July 3, 2010	As at April 2, 2011	As at April 4, 2010
ASSETS				
Current				
Cash and cash equivalents (note 6)	73,385	85,510	83,661	103,898
Accounts receivable	14,380	10,827	12,684	8,455
Inventories (note 7)	215,746	223,836	232,694	224,406
Income taxes recoverable	–	899	–	899
Prepaid expenses	6,840	5,948	7,941	6,771
Total current assets	310,351	327,020	336,980	344,429
Property, plant and equipment (notes 17a and 17c)	76,532	74,831	78,777	74,800
Intangible assets (notes 17b and 17c)	30,620	24,860	30,614	23,793
Deferred tax assets	66,093	48,625	38,004	48,214
Goodwill (note 17d)	26,632	26,632	26,632	26,632
Total assets	510,228	501,968	511,007	517,868
LIABILITIES AND EQUITY				
Current				
Accounts payable and accrued liabilities	165,382	172,965	180,899	179,063
Unredeemed gift card liability	41,600	37,460	40,991	37,816
Provisions (note 17g)	–	130	–	178
Deferred revenue	11,467	14,849	11,528	12,882
Income taxes payable	649	–	657	–
Notes payable (note 15)	4,896	–	–	–
Current portion of long-term debt	1,281	1,460	1,290	1,863
Total current liabilities	225,275	226,864	235,365	231,802
Long-term accrued liabilities	5,275	6,841	6,284	8,203
Long-term debt	1,685	1,198	1,995	1,174
Total liabilities	232,235	234,903	243,644	241,179
Equity				
Share capital (note 8)	202,962	198,569	202,220	198,635
Contributed surplus (notes 9 and 17f)	6,646	5,939	6,066	5,633
Retained earnings	42,135	57,270	48,629	65,496
Total equity attributable to shareholders of the Company	251,743	261,778	256,915	269,764
Non-controlling interest (note 15)	26,250	5,287	10,448	6,925
Total equity	277,993	267,065	267,363	276,689
Total liabilities and equity	510,228	501,968	511,007	517,868

See accompanying notes

On behalf of the Board:



Heather M. Reisman
Director



Michael Kirby
Director

Consolidated Statements of Loss and Comprehensive Loss

(Unaudited)

(thousands of Canadian dollars, except per share data)	13-week period ended July 2, 2011	13-week period ended July 3, 2010
Revenues	202,093	204,286
Cost of sales (note 7)	125,395	117,755
Gross profit	76,698	86,531
Cost of operations (note 10)	65,656	64,603
Selling and administrative expenses (note 10)	30,766	22,954
Foreign currency translation	144	(192)
Operating loss before the following	(19,868)	(834)
Depreciation of property, plant and equipment	4,594	4,466
Amortization of intangible assets	3,625	2,412
Interest on long-term debt and financing charges	44	33
Interest income on cash and cash equivalents	(159)	(80)
Loss before income taxes	(27,972)	(7,665)
Income tax recovery	(3,778)	(411)
Net loss and comprehensive loss for the period	(24,194)	(7,254)
Net loss and comprehensive loss attributable to:		
Shareholders of the Company	(18,105)	(5,360)
Non-controlling interest (note 15)	(6,089)	(1,894)
Total net loss and comprehensive loss for the period	(24,194)	(7,254)
Net loss per common share (note 11)		
Basic	\$(0.72)	\$(0.22)
Diluted	\$(0.72)	\$(0.22)

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
Loss for the 13-week period ended July 3, 2010	–	–	(5,360)	(5,360)	(1,894)	(7,254)
Exercise of options (note 9)	103	(29)	–	74	–	74
Shares repurchased under NCIB (note 8)	(169)	–	(144)	(313)	–	(313)
Stock-based compensation (note 9)	–	223	–	223	256	479
Directors' compensation (note 9)	–	112	–	112	–	112
Dividends paid	–	–	(2,722)	(2,722)	–	(2,722)
Balance, July 3, 2010	198,569	5,939	57,270	261,778	5,287	267,065
Balance, April 2, 2011	202,220	6,066	48,629	256,915	10,448	267,363
Loss for the 13-week period ended July 2, 2011	–	–	(18,105)	(18,105)	(6,089)	(24,194)
Exercise of options (note 9)	742	(164)	–	578	–	578
Shares repurchased under NCIB (note 8)	–	–	–	–	–	–
Stock-based compensation (note 9)	–	595	–	595	546	1,141
Directors' compensation (note 9)	–	149	–	149	–	149
Dividends paid	–	–	(2,767)	(2,767)	–	(2,767)
Acquisition of non-capital tax losses (note 15)	–	–	14,378	14,378	–	14,378
Issuance of equity securities by subsidiary to non-controlling interest (note 15)	–	–	–	–	21,345	21,345
Balance, July 2, 2011	202,962	6,646	42,135	251,743	26,250	277,993

See accompanying notes

Consolidated Statements of Cash Flows

(Unaudited)

(thousands of Canadian dollars)	13-week period ended July 2, 2011	13-week period ended July 3, 2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss for the period	(24,194)	(7,254)
Add (deduct) items not affecting cash		
Depreciation of property, plant and equipment	4,594	4,466
Amortization of intangible assets	3,625	2,412
Loss on disposal of capital assets	4	67
Stock-based compensation (note 9)	595	223
Directors' compensation (note 9)	149	112
Deferred tax assets	(3,602)	(411)
Interest on long-term debt and financing charges	44	33
Interest income on cash and cash equivalents	(159)	(80)
Other	261	(871)
Net change in non-cash working capital balances related to operations		
Accounts receivable	(1,696)	(2,372)
Inventories	16,948	570
Prepaid expenses	1,101	823
Income taxes payable (recoverable)	(8)	–
Accounts payable and accrued liabilities	(16,526)	(7,460)
Unredeemed gift card liability	609	(356)
Provisions	–	(48)
Deferred revenue	(61)	1,967
Cash flows used in operating activities	(18,316)	(8,179)
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of non-capital tax losses (note 15)	(10,109)	–
Purchase of property, plant and equipment	(2,353)	(4,277)
Addition of intangible assets	(3,631)	(3,479)
Cash flows used in investing activities	(16,093)	(7,756)
CASH FLOWS FROM FINANCING ACTIVITIES		
Note payable (note 15)	5,055	–
Repayment of long-term debt	(319)	(666)
Interest received	172	50
Proceeds from share issuances (note 8)	578	74
Repurchase of common shares	–	(313)
Issuance of equity securities by subsidiary to non-controlling interest (note 15)	21,345	–
Dividends paid	(2,767)	(2,722)
Cash flows from (used in) financing activities	24,064	(3,577)
Effect of foreign currency exchange rate changes on cash and cash equivalents	69	1,124
Net decrease in cash and cash equivalents during the period	(10,276)	(18,388)
Cash and cash equivalents, beginning of period	83,661	103,898
Cash and cash equivalents, end of period	73,385	85,510

See accompanying notes

Notes to Interim Condensed Consolidated Financial Statements

July 2, 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 weeks ended July 2, 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.

2. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies that have been applied in the preparation of these unaudited interim condensed consolidated financial statements are summarized below.

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”). As these unaudited interim condensed consolidated financial statements represent the Company’s initial presentation of its results and financial position under IFRS, they were prepared in accordance with IAS 34, “Interim Financial Reporting,” and with IFRS 1, “First Time Adoption of IFRS.” These unaudited interim condensed consolidated financial statements have been prepared in accordance with the accounting policies the Company expects to adopt in its annual consolidated financial statements for the 52-week period ended March 31, 2012.

These unaudited interim condensed consolidated financial statements should be read in conjunction with the Company’s fiscal 2011 Annual Report with consideration given to the IFRS transitional and selected annual disclosures included in Notes 16 and 17 to these unaudited interim condensed consolidated financial statements.

The unaudited interim condensed consolidated financial statements for the 13-week period ended July 2, 2011 (including comparatives) were approved by the Board of Directors on August 9, 2011.

Basis of preparation

The Company’s unaudited interim condensed consolidated financial statements are prepared on the historical cost basis of accounting, except as disclosed in the accounting policies set out below.

Basis of consolidation

The unaudited interim condensed consolidated financial statements comprise the financial statements of the Company and entities controlled by the Company (its subsidiary). Control is achieved when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. When the Company does not own all of the equity in a subsidiary, the non-controlling interest is disclosed as a separate line item in the consolidated balance sheets and the earnings accruing to non-controlling interest holders is disclosed as a separate line item in the consolidated statements of earnings and comprehensive earnings.

The financial statements of the subsidiary are prepared for the same reporting period as the parent company, using consistent accounting policies. Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Company obtains control, and continue to be consolidated until the date that such control ceases. All intercompany balances and transactions and any unrealized income and expenses arising from intercompany transactions are eliminated in preparing these consolidated financial statements.

Investment in joint venture

The Company has an interest in a joint venture which is a jointly controlled entity, whereby the venturers have a contractual arrangement that establishes joint control over the economic activities of the entity. The Company recognizes its interest in the joint venture using the proportionate consolidation method. The Company combines its proportionate share of the assets, liabilities, income, and expenses of the joint venture with similar items, line by line, in its consolidated financial statements. The financial statements of the joint venture are prepared for the same reporting period and follow the same accounting policies as the Company.

Adjustments are made in the consolidated financial statements to eliminate the Company's share of intercompany balances and transactions and any unrealized income and expenses arising from transactions between the Company and its jointly controlled entity. The joint venture is proportionately consolidated until the date on which the Company ceases to have joint control over the joint venture.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances with banks, and highly liquid investments that are readily convertible to known amounts of cash with less than three months to maturity at the date of acquisition. Cash is considered to be restricted when it is subject to contingent rights of a third-party customer, vendor, or government agency.

Inventories

Inventories are valued at the lower of cost, determined on a moving average cost basis, and market, being net realizable value. Costs include all direct and reasonable expenditures that are incurred in bringing inventories to their present location and condition. Net realizable value is the estimated selling price in the ordinary course of business. When the Company permanently reduces the retail price of an item and the markdown incurred brings the retail price below the cost of the item, there is a corresponding reduction in inventory recognized in the period. Vendor rebates are recorded as a reduction in the price of the products, and corresponding inventories are recorded net of vendor rebates.

Prepaid expenses

Prepaid expenses include store supplies, rent, license fees, maintenance contracts, and insurance. Store supplies are expensed as they are used while other costs are amortized over the term of the contract. Prepaid expenses also include advance payments for inventory for which title has not yet passed to the Company.

Income taxes

Current income tax is the expected tax payable or receivable on the taxable earnings or loss for the period. Current income tax is payable on taxable earnings for the period as calculated under Canadian taxation guidelines, which differs from taxable earnings under IFRS. Calculation of current income tax is based on tax rates and tax laws that have been enacted, or substantively enacted, by the end of the reporting period. Current income tax relating to items recognized directly in equity is recognized in equity and not in the consolidated statements of earnings and comprehensive earnings.

Deferred income tax is calculated at the reporting date using the liability method based on temporary differences between the carrying amounts of assets and liabilities and their tax bases. However, deferred tax assets and liabilities on temporary differences arising from the initial recognition of goodwill, or of an asset or liability in a transaction that is not a business combination, will not be recognized when neither accounting nor taxable profit or loss are affected at the time of the transaction.

Deferred tax assets arising from temporary differences associated with investments in subsidiaries and interests in joint ventures are provided for if it is probable that the differences will reverse in the foreseeable future and taxable profit will be available against which the tax assets may be utilized. Deferred tax assets on temporary differences associated with investments in subsidiaries and interests in joint ventures are not provided for if the timing of the reversal of these temporary differences can be controlled by the Company and it is probable that reversal will not occur in the foreseeable future.

Deferred tax assets and liabilities are calculated, without discounting, at tax rates that are expected to apply to their respective periods of realization, provided they are enacted or substantively enacted by the end of the reporting period. Deferred tax assets and liabilities are offset only when the Company has the right and intention to set off current tax assets and liabilities from the same taxable entity and the same taxation authority.

Property, plant and equipment

All items of property, plant and equipment are initially recognized at cost, which includes any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Subsequent to initial recognition, property, plant and equipment is shown at cost less accumulated depreciation and any impairment in value.

Depreciation of an asset begins once it becomes available for use and ceases at the earlier of the date the asset is disposed of, classified as held for sale, or included in a discontinued operation. The depreciable amount of an asset, being the cost of an asset less the residual value, is allocated on a straight-line basis over the estimated useful life of the asset. Residual value is estimated to be zero unless the Company expects to dispose of the asset at a value that exceeds the estimated disposal costs. The residual values, useful lives and depreciation methods applied to assets are reviewed annually based on relevant market information and management considerations.

The following useful lives are applied:

Furniture, fixtures and equipment	5 – 10 years
Computer equipment	3 – 5 years
Equipment under capital lease	3 – 5 years
Leasehold improvements	over the lease term to a maximum of 10 years

Items of property, plant and equipment are assessed for impairment as detailed in the accounting policy note on impairment and are derecognized either upon disposal or when no future economic benefits are expected from their use. Any gain or loss arising on derecognition is included in earnings when the asset is derecognized.

Leased assets

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards related to ownership of the leased asset to the Company. At lease inception, the related asset is recognized at the lower of the fair value of the leased asset or the present value of the lease payments. The corresponding liability amount is recognized as long-term debt.

Depreciation methods and useful lives for assets held under finance lease agreements correspond to those applied to comparable assets which are legally owned by the Company. If there is no reasonable certainty that the Company will obtain ownership of the financed asset at the end of the lease term, the asset is depreciated over the shorter of its estimated useful life or the lease term. The corresponding long-term debt is reduced by lease payments less interest paid. Interest payments are expensed as part of interest on long-term debt and financing charges on the consolidated statements of earnings and comprehensive earnings over the period of the lease.

All other leases are treated as operating leases. Payments on operating lease agreements are recognized as an expense on a straight-line basis over the lease term. Associated costs, such as maintenance and insurance, are expensed as incurred.

Leased premises

The Company conducts all of its business from leased premises. Leasehold improvements are depreciated over the lesser of their economic life or the initial lease term plus renewal periods where renewal has been determined to be reasonably assured (“lease term”). Leasehold improvements are reviewed annually for impairment and impairment losses are measured as described in the accounting policy note on impairment. Leasehold improvement allowances are depreciated over the lease term. Other inducements, such as rent-free periods, are amortized into earnings over the lease term. As at July 2, 2011 and July 3, 2010, all of the Company’s leases on premises were accounted for as operating leases.

Intangible assets

Intangible assets are initially recognized at cost, if acquired separately, or at fair value, if acquired as part of a business combination. After initial recognition, intangible assets are carried at cost less accumulated amortization and impairment losses.

Amortization commences when the intangible assets are available for their intended use and ceases at the earlier of the date that the asset is disposed of, classified as held for sale, or included in a discontinued operation. The useful lives of intangible assets are assessed as either finite or indefinite. Intangible assets with finite lives are amortized over their useful economic life. Intangible assets with infinite lives are not amortized but are reviewed at each reporting date to determine whether the indefinite life continues to be supportable. If not, the change in useful life from indefinite to finite is made on a prospective basis. Residual value is estimated to be zero unless the Company expects to dispose of the asset at a value that exceeds the estimated disposal costs. The residual values, useful lives and amortization methods applied to assets are reviewed annually based on relevant market information and management considerations.

The following useful lives are applied:

Computer application software	3 – 5 years
Internal development costs	2 – 3 years
Domain name	Indefinite useful life – not amortized

Intangible assets are assessed for impairment as detailed in the accounting policy note on impairment. An intangible asset is derecognized either upon disposal or when no future economic benefits are expected from their use. Any gain or loss arising on derecognition is included in earnings when the asset is derecognized.

Computer application software

When computer application software is not an integral part of a related item of computer hardware, the software is treated as an intangible asset. Computer application software that is integral to the use of related computer hardware is recorded as property, plant and equipment.

Internal development costs

Costs that are directly attributable to internal development are recognized as intangible assets provided they meet the definition of an intangible asset. Development costs not meeting these criteria are expensed as incurred. Capitalized development costs include external direct costs of materials and services and the payroll and payroll-related costs for employees who are directly associated with the projects.

Domain name

There are no legal, regulatory, contractual, competitive, economic or other factors which limit the useful life of the Kobo domain name to the Company. Therefore, useful life is deemed to be indefinite.

Goodwill

Goodwill represents the excess of the purchase price of an acquired business over the value assigned to the net identifiable assets, including intangible assets, acquired at the date of acquisition. Goodwill is carried at cost less any disposals or accumulated impairment losses. Goodwill is not amortized, but is subject to review for impairment on an annual basis and at any other time if events occur or if circumstances change that suggest goodwill may be impaired. Goodwill is assessed for impairment as detailed in the accounting policy note on impairment.

Impairment testing

Property, plant and equipment and intangible assets

For the purposes of assessing impairment, property, plant and equipment and intangible assets (collectively, “capital assets”) are grouped at the lowest levels for which there are largely independent cash inflows and for which a reasonable and consistent allocation basis can be identified (“cash generating unit” or “CGU”). For capital assets which can be reasonably and consistently allocated to individual stores, the store level is used as the CGU for impairment testing. For all other capital assets, the operating segment level is used as the group of CGUs. Capital assets and related CGUs or groups of CGUs are tested for impairment at each reporting date and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Events or changes in circumstances which may indicate impairment include: a significant change to the Company’s operations; a significant decline in performance; or a change in market conditions which adversely affects the Company.

An impairment loss is recognized for the amount by which a CGU’s or group of CGUs’ carrying amount exceeds its recoverable amount. To determine the recoverable amount, management determines the present value of the expected future cash flows from each CGU or group of CGUs based on the Company’s estimated growth rate. The Company’s growth rate and future cash flows are based on historical data. Impairment losses are charged pro rata to the capital assets in the CGU or group of CGUs. Capital assets and CGUs or groups of CGUs are subsequently reassessed for indicators that a previously recognized impairment loss may no longer exist. An impairment charge is reversed if the capital asset’s, CGU’s, or group of CGUs’ recoverable amount exceeds its carrying amount.

Goodwill

Goodwill is allocated at the operating segment level, which represents the lowest level within the Company at which management monitors goodwill. Goodwill is tested for impairment at each reporting date and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Events or changes in circumstances which may indicate impairment include: a significant change to the Company’s operations; a significant decline in performance; or a change in market conditions which adversely affects the Company.

An impairment loss is recognized for the amount by which the carrying amount of the operating segment exceeds its recoverable amount. To determine the recoverable amount, management determines the present value of the expected future cash flows from each reporting unit based on the Company’s estimated growth rate. The Company’s growth rate and future cash flows are based on historical data. Previously recognized goodwill impairment losses are not subsequently reversed if conditions change.

Financial assets

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics. Financial assets are tested for impairment at each reporting date and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Evidence of impairment may include: indications that a debtor or a group of debtors are experiencing significant financial difficulty; default or delinquency in interest or principal payments; and observable data indicating that there is a measureable decrease in the estimated future cash flows.

A financial asset is deemed to be impaired if there is objective evidence that one or more loss events having a negative effect on future cash flows of the financial asset occurs after initial recognition and the loss can be reliably measured. The

impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of the estimated future cash flows, discounted at the original effective interest rate. The impairment loss is recorded as an allowance and recognized in net earnings. If the impairment loss decreases as the result of subsequent events, the previously recognized impairment loss is reversed.

Provisions

Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events, for which it is probable that the Company will be required to settle the obligation and a reliable estimate of the settlement can be made. The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account risks and uncertainty of cash flow. Where the effect of discounting to present value is material, provisions are adjusted to reflect the time value of money. Examples of provisions include legal claims, onerous leases, asset retirement obligations, and restructuring costs.

Deferred financing fees

Financing fees relate to the Company's line of credit and are amortized on a straight-line basis, which approximates the effective yield method, over the term of the respective indebtedness. The Company's line of credit is presented on the consolidated balance sheet net of financing fees.

Borrowing costs

Borrowing costs primarily comprise interest on the Company's long-term debt and line of credit. Borrowing costs are capitalized to the extent that they are directly attributable to the acquisition, production, or construction of qualifying assets that require a substantial period of time to get ready for their intended use or sale. All other borrowing costs are expensed as incurred and reported in the consolidated statements of earnings and comprehensive earnings as part of interest on long-term debt and finance charges.

Equity attributable to shareholders of the Company

Share capital represents the nominal value of shares that have been issued. Retained earnings include all current and prior period retained profits. Dividend distributions payable to equity shareholders are recorded as dividends payable when the dividends have been approved by the Board of Directors prior to the reporting date.

Share-based awards

The Company has established an employee stock option plan for key employees. The fair value of each tranche of options granted is estimated on grant date using the Black-Scholes option pricing model. The grant date fair value, net of estimated forfeitures, is recognized as an expense with a corresponding increase to contributed surplus, over the vesting period. Estimates are subsequently revised if there is an indication that the number of stock options expected to vest differs from previous estimates. Any consideration paid by employees on exercise of stock options is credited to share capital, with a corresponding reduction to contributed surplus.

The Company has also granted share-based awards which allow the counterparty to choose whether the awards will be settled in cash or in shares. At grant date, the Company measures the fair value of these awards using the Black-Scholes option pricing model, and fair value is remeasured at each reporting date and at settlement date. The fair value of settlement in cash is the same as the fair value of settlement in shares. The fair value is recognized as an expense with a corresponding increase in liabilities over the period that the counterparties become unconditionally entitled to the awards. If the Company issues equity instruments on settlement instead of paying cash, the liability shall be transferred directly to share capital as consideration for the equity instruments issued.

Revenue

The Company recognizes revenue when the substantial risks and rewards of ownership pass to the customer. Revenue is measured at the fair value of consideration received or receivable by the Company for goods supplied, net of sales discounts and returns, and is inclusive of amounts invoiced for shipping. Return allowances are estimated using historical experience. Revenue is recognized when: the amount can be measured reliably; it is probable that economic benefits associated with the transaction will flow to the Company; the costs incurred or to be incurred can be measured reliably; and the criteria for each of the Company's activities (as described below) have been met.

Retail and Kobo sales

Revenue for retail and Kobo customers is recognized at the time of purchase.

Online sales

Revenue for online customers is recognized when the product is shipped.

Multiple deliverable arrangements

Revenue arrangements with multiple deliverables are divided into separate units, and revenue is allocated using estimated selling prices if the Company does not have vendor-specific objective evidence or third-party evidence of the selling prices of the deliverables.

Kobo sales of eReader devices are considered to include multiple deliverables consisting of the device, software updates, and telephone support. Software updates are similar to updates that are provided for free to users of the Kobo eReading application software. As such, software updates have a nil estimated selling price. Telephone support is primarily used shortly after a device is purchased and, due to the short timeframe between the device purchase and telephone support, revenue related to telephone support is recognized at the same time as the device sale.

Gift cards

The Company sells gift cards to its customers and recognizes the revenue as gift cards are redeemed. The Company also recognizes revenue from unredeemed gift cards ("gift card breakage") if the likelihood of gift card redemption by the customer is considered to be remote. The Company determines its average gift card breakage rate based on historical redemption rates. Once the breakage rate is determined, the resulting revenue is recognized over the estimated period of redemption based on historical redemption patterns, commencing when the gift cards are sold. Gift card breakage is included in revenues in the Company's consolidated statements of earnings and comprehensive earnings.

eReader deposits

Prepayments received from other retailers for eReader devices are recorded as deferred revenue. This deferred revenue is recognized into earnings when the devices are shipped.

Indigo irewards loyalty program

For an annual fee, the Company offers loyalty cards to customers that entitle the cardholder to receive discounts on purchases. Each card is issued with a 12-month expiry period. The fee revenue related to the issuance of a card is deferred and amortized into earnings over the expiry period, based upon historical sales volumes.

Indigo Plum loyalty program

The Indigo Plum loyalty program (the "Plum Program") is a free program that allows members to earn points on their purchases in the Company's stores. Members can then redeem points for discounts on future purchases of store merchandise.

When a Plum Program member purchases merchandise, the Company allocates the payment received between the merchandise and the points. The payment is allocated based on the residual method, where the amount allocated to the

merchandise is the total payment less the fair value of the points. The portion of revenue attributed to the merchandise is recognized at the time of purchase. Revenue attributed to the points is recorded as deferred revenue and recognized when points are redeemed.

The fair value of the points is calculated by multiplying the number of points issued by the estimated cost per point. The estimated cost per point is determined based on a number of factors, including the expected future redemption patterns and associated costs. On an ongoing basis, the Company monitors trends in redemption rates (points redeemed as a percentage of points issued) and net cost per point redeemed, adjusting the estimated cost per point based upon expected future activity. To the extent that estimates differ from actual experience, the Plum Program costs could be higher or lower.

Interest income

Interest income is reported on an accrual basis using the effective interest method.

Vendor rebates

The Company records cash consideration received from vendors as a reduction to the price of vendors' products. This is reflected as a reduction in cost of goods sold and related inventories when recognized in the consolidated financial statements. Certain exceptions apply where the cash consideration received is either a reimbursement of incremental selling costs incurred by the Company or a payment for services delivered to the vendor, in which case the cash received is reflected in selling and administrative expenses.

Comprehensive earnings

Other comprehensive earnings include income and expense items that, in accordance with primary sources of IFRS, are recognized in comprehensive earnings, but excluded from net earnings. Examples of such items are gains and losses on remeasuring available-for-sale financial assets and the effective portion of gains and losses on the hedging instrument in a cash flow hedge. Any accumulated other comprehensive earnings (i.e., the portion of comprehensive earnings not already included in net earnings) will be presented as a separate line item in total equity.

Earnings per share

Basic earnings per share are determined by dividing the net earnings attributable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share are calculated in accordance with the treasury stock method and are based on the weighted average number of common shares and dilutive common share equivalents outstanding during the period. The weighted average number of shares used in the computation of both basic and fully diluted earnings per share may be the same due to the anti-dilutive effect of securities or due to a net loss in the period.

Financial instruments

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions of the financial instrument. Financial assets are derecognized when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and all substantial risks and rewards are transferred. A financial liability is derecognized when it is extinguished, discharged, cancelled, or expires. Where a legally enforceable right to offset exists for recognized financial assets and financial liabilities and there is an intention to settle the liability and realize the asset simultaneously, or to settle on a net basis, such related financial assets and financial liabilities are offset.

For the purposes of ongoing measurement, financial assets and liabilities are classified according to their characteristics and management's intent. All financial instruments are initially recognized at fair value. The following methods and assumptions were used to estimate the initial fair value of each type of financial instrument by reference to market data and other valuation techniques, as appropriate:

- (i) The fair values of cash and cash equivalents, accounts receivable, and accounts payable and accrued liabilities approximate their carrying values given their short maturities; and
- (ii) The fair values of long-term debt and notes payable are estimated based on the discounted cash payments of the debt at the Company's estimated incremental borrowing rates for debt of the same remaining maturities. The fair values of long-term debt and notes payable approximate their carrying values.

Embedded derivatives are separated and measured at fair values if certain criteria are met. Management has reviewed all material contracts and has determined that the Company does not currently have any significant embedded derivatives that require separate accounting and disclosure.

After initial recognition, financial instruments are subsequently measured as follows:

Financial assets

- (i) Loans and receivables – These are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These assets are measured at amortized cost, less impairment charges, using the effective interest method. Gains and losses are recognized in earnings through the amortization process or when the assets are derecognized.
- (ii) Financial assets at fair value through profit or loss – These assets are held for trading if acquired for the purpose of selling in the near term or are designated to this category upon initial recognition. These assets are measured at fair value, with gains or losses recognized in earnings.
- (iii) Held-to-maturity investments – These are non-derivative financial assets with fixed or determinable payments and fixed maturities which the Company intends, and is able, to hold until maturity. These assets are measured at amortized cost, less impairment charges, using the effective interest method. Gains and losses are recognized in earnings through the amortization process or when the assets are derecognized.
- (iv) Available-for-sale financial assets – These are non-derivative financial assets that are either designated to this category upon initial recognition or do not qualify for inclusion in any of the other categories. These assets are measured at fair value, with unrealized gains and losses recognized in equity until the asset is derecognized or determined to be impaired. If the asset is derecognized or determined to be impaired, the cumulative gain or loss previously reported in equity is included in earnings.

Financial liabilities

- (i) Other liabilities – These liabilities are measured at amortized cost using the effective interest rate method. Gains and losses are recognized in earnings through the amortization process or when the liabilities are derecognized.
- (ii) Financial liabilities at fair value through profit or loss – These liabilities are held for trading if acquired for the purpose of selling in the near term or are designated to this category upon initial recognition. These liabilities are measured at fair value, with gains or losses recognized in earnings.

The Company's financial assets and financial liabilities are generally classified and measured as follows:

Financial Asset/Liability	Category	Measurement
Cash and cash equivalents	Loans and receivables	Amortized cost
Accounts receivable	Loans and receivables	Amortized cost
Accounts payable and accrued liabilities	Other liabilities	Amortized cost
Long-term debt	Other liabilities	Amortized cost
Notes payable	Other liabilities	Amortized cost

All other balance sheet accounts are not financial instruments.

All financial instruments measured at fair value after initial recognition are categorized into one of three hierarchy levels for disclosure purposes. Each level reflects the significance of the inputs used in making the fair value measurements.

Level 1: Fair value is determined by reference to quoted prices in active markets.

Level 2: Valuations use inputs based on observable market data, either directly or indirectly, other than the quoted prices.

Level 3: Valuations are based on inputs that are not based on observable market data.

As at July 2, 2011, there are no financial instruments classified into these levels. The Company measures all financial instruments at amortized cost.

Retirement benefits

The Company provides retirement benefits through a defined contribution retirement plan. A defined contribution retirement plan is a retirement plan under which the Company pays fixed contributions to an independent entity. The Company has no legal or constructive obligations to pay further contributions after its payment of the fixed contribution.

Foreign currency translation

The consolidated financial statements are presented in Canadian dollars, which is the functional currency of the Company. Sales transacted in foreign currencies are aggregated monthly and translated using the average exchange rate. Transactions in foreign currencies are translated at rates of exchange at the time of the transaction. Monetary assets and liabilities denominated in foreign currencies which are held at the reporting date are translated at the closing consolidated balance sheet rate. Non-monetary items are measured at historical cost and are translated using the exchange rates at the date of the transaction. Non-monetary items measured at fair value are translated using exchange rates at the date when fair value was determined. The resulting exchange gains or losses are included in earnings.

3. NEW ACCOUNTING PRONOUNCEMENTS

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 Company does not expect implementation to have a significant impact on the Company’s 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 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 is expected to be 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 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. The Company has yet to assess the impact of the new standard on its consolidated financial statements;
- 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. This new standard is expected to impact the accounting for the Company’s Calendar Club joint venture;
- 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, “Investment 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 may impact disclosures related to Calendar Club and Kobo;
- 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 has yet to assess the impact of the new standard on its consolidated financial statements;
- Separate Financial Statements (“IAS 27”) has been amended to remove all requirements relating to consolidated financial statements. The Company has yet to assess the impact of this amendment on its consolidated financial statements; 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 Company has yet to assess the impact of this amendment on its consolidated financial statements.

4. SIGNIFICANT ESTIMATES AND JUDGMENTS IN APPLYING ACCOUNTING POLICIES

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. Actual results may differ from the estimates and judgments made by management, and actual results will seldom equal estimates. Information about significant estimates and judgments that have the most significant effect on recognition and measurement of assets, liabilities, income, and expenses are discussed below.

Revenue

The Company recognizes revenue from unredeemed gift cards (“gift card breakage”) if the likelihood of gift card redemption by the customer is considered to be remote. The Company estimates its average gift card breakage rate based on historical redemption rates. Commencing when the gift cards are sold, the resulting revenue is recognized over the estimated period of redemption based on historical redemption patterns.

The fair value of Plum Program points is calculated by multiplying the number of points issued by the estimated cost per point. The estimated cost per point is based on many factors, including the expected future redemption patterns and associated costs. On an ongoing basis, the Company monitors trends in redemption rates and net cost per point redeemed, adjusting the estimated cost per point based upon expected future activity.

Inventories

The future realization of the carrying amount of inventory is affected by future sales demand, inventory levels, and product quality. The Company reduces inventory for estimated shrinkage that has occurred between physical inventory counts and records reserves for slow-moving or damaged products and for products that have been permanently marked down based on these assumptions. Management reviews the reserves regularly and assesses whether they are appropriate based on actual experience. In addition, the Company records a vendor settlement accrual to cover any disputes between the Company and its vendors. Management estimates this reserve based on historical experience of settlements with its vendors.

Share-based payments

The cost of equity-settled or cash-settled transactions with counterparties is based on the Company's estimate of the fair value of the share-based instruments, the number of equity instruments that will eventually vest, and other estimates as outlined in Note 9.

Impairment

An impairment loss is recognized for the amount by which an asset's or CGU's carrying amount exceeds its recoverable amount. Management uses judgement when identifying CGUs. To determine the recoverable amount, management estimates expected future cash flows from each CGU and determines a suitable interest rate in order to calculate the present value of those cash flows. In the process of measuring expected future cash flows, management makes assumptions about future sales, gross margin rates, expenses, capital expenditures, and working capital investment which are based upon past and expected performance. Determining the applicable discount rate involves estimating appropriate adjustments to market risk and to asset-specific risk factors.

Property, plant and equipment

Property, plant and equipment is depreciated over its useful life, taking into account residual values where appropriate. Assessments of useful lives and residual values are performed annually and take into consideration factors such as: technological innovation; maintenance programs; relevant market information; and management judgement. In assessing residual values, the Company considers the remaining life of the asset, its projected disposal value, and future market conditions.

Intangible assets

Initial capitalization of intangible asset costs is based on management's judgment that technological and economical feasibility are confirmed and the project will generate future economic benefits. Capitalization typically begins when a development project has reached a defined milestone according to an established project management model. This process involves significant estimates and judgments regarding technological feasibility, expected future cash generation of the project, and the expected period of benefits of the project.

Leases

Management uses judgment in determining whether a lease qualifies as a finance lease arrangement that transfers substantially all the risks and rewards incidental to ownership.

Deferred tax assets

The recognition of deferred tax assets is based on management's judgement. The assessment of the probability of future taxable income in which deferred tax assets can be utilized is based on the Company's latest approved budget forecast, which is adjusted for significant non-taxable income and expenses and specific limits to the use of any unused tax loss or credit. If a positive forecast of taxable income indicates the probable use of a deferred tax asset, especially when it can be utilized without a time limit, that deferred tax asset is usually recognized in full. The recognition of deferred tax assets that are subject to certain legal or economic limits or uncertainties are assessed individually by management based on the specific facts and circumstances.

5. 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-week periods ended July 2, 2011 and July 3, 2010 are not indicative of the results of other periods.

6. CASH AND CASH EQUIVALENTS

As at July 2, 2011, the Company had no cash equivalents. Cash consists of the following:

(thousands of Canadian dollars)	July 2, 2011	July 3, 2010	April 2, 2011	April 4, 2010
Cash	71,589	84,314	83,021	103,489
Restricted cash	1,796	1,196	640	409
Cash and cash equivalents	73,385	85,510	83,661	103,898

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

7. INVENTORIES

Inventories consist of finished goods. The cost of inventories recognized as an expense during the period was \$109.9 million (2010 – \$116.3 million). The amount of inventory write-downs as a result of net realizable value lower than cost was \$2.0 million during the period (2010 – \$0.5 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 \$1.9 million as at July 2, 2011 (2010 – \$1.1 million).

8. SHARE CAPITAL

Share capital consists of the following:

	13-week period ended July 2, 2011		13-week period ended July 3, 2010		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	–	–	–	–	4,283	60
Options exercised	58,000	742	10,000	103	419,442	3,735
Repurchase of common shares	–	–	(21,000)	(169)	(26,100)	(210)
Balance, end of period	25,198,540	202,962	24,731,915	198,569	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 13-week period ended July 3, 2010, the Company repurchased 21,000 common shares at an average price of \$14.89 per share for a total cash consideration of \$0.3 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 \$0.1 million and the amount was charged to retained earnings. The NCIB expired on November 1, 2010.

9. SHARE-BASED COMPENSATION

As at July 2, 2011, 1,929,100 stock options were outstanding with exercise prices ranging from \$4.45 to \$16.75. Of these outstanding stock options, 803,100 were exercisable. As at July 3, 2010, there were 1,814,542 stock options outstanding of which 861,542 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. There were \$0.4 million stock options granted during the 13-week period ended July 2, 2011 (2010 – \$0.2 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 July 2, 2011
Risk-free interest rate	2.2%
Expected volatility	31.0%
Expected time until exercise	3.2 years
Expected dividend yield	3.4%
Forfeiture rate	23.0%

There were no stock options granted during the 13-week period ended July 3, 2010.

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 11,637 DSUs with a value of \$0.1 million (2010 – \$0.1 million) during the 13-week period ended July 2, 2011. 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 July 2, 2011 was \$2.5 million (2010 – \$2.1 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.

In fiscal 2010, the Company 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 200,000 Kobo shares directly from Indigo at an exercise price of \$1.00 per share. The agreements may either be exercised upon fulfilment of specified performance conditions or entitle the holders to a cash payout, depending on share price, upon expiry. These agreements expire on January 25, 2020. As at July 2, 2011, Kobo’s share price was \$3.86 and the Company has recorded \$0.6 million as a liability relating to these options (2010 – \$0.1 million). These options have a nil intrinsic value as at July 2, 2011 (2010 – nil).

10. EMPLOYEE BENEFITS EXPENSE

(thousands of Canadian dollars)	13-week period ended July 2, 2011	13-week period ended July 3, 2010
Wages, salaries and bonuses	42,436	37,336
Short-term benefits expense	4,801	4,881
Termination benefits expense	302	159
Retirement benefits expense	315	320
Stock-based compensation	595	223
Total employee benefits expense	48,449	42,919

11. LOSS PER SHARE

Loss per share is calculated based on the weighted average number of common shares outstanding during the period. The Company's stock options and DSUs were anti-dilutive as the Company reported a loss and, therefore, were not included in the July 2, 2011 and July 3, 2010 diluted loss per share calculations.

12. CASH FLOW STATEMENT

Supplemental cash flow information:

(thousands of Canadian dollars)	13-week period ended July 2, 2011	13-week period ended July 3, 2010
Assets acquired under capital lease	–	287

13. CAPITAL MANAGEMENT

The Company's 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, including Kobo, 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. There were no changes to these objectives during the 13 weeks ended July 2, 2011.

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 for the periods indicated:

(thousands of Canadian dollars)	13-week period ended July 2, 2011	13-week period ended July 3, 2010
Current portion of long-term debt	1,281	1,460
Long-term debt	1,685	1,198
Notes payable	4,896	–
Total debt	7,862	2,658
Total equity	277,993	267,065
Total debt : Total equity	0.03:1	0.01:1

14. SEGMENT REPORTING

The Company has two reportable segments for which separate financial information is available that is evaluated regularly by management in deciding how to allocate resources and to assess performance. The Indigo segment derives its revenues from retail bookstores and from *www.chapters.indigo.ca*, an e-commerce retail destination selling books, lifestyle products, toys, DVDs, and music. The Kobo segment derives revenues from eReader sales, by providing back-end operations for corporate eBook stores, and from *www.kobo.com*, an e-commerce retail destination selling eBooks.

(thousands of Canadian dollars)	13-week period ended July 2, 2011	13-week period ended July 3, 2010
Reconciliation of Assets		
Assets		
Indigo	461,163	486,502
Kobo	49,105	15,809
Intercompany eliminations	(40)	(343)
Total assets	510,228	501,968
Reconciliation of Liabilities		
Liabilities		
Indigo	214,173	231,147
Kobo	18,062	4,099
Intercompany eliminations	–	(343)
Total liabilities	232,235	234,903
Reconciliation of Revenues		
Revenues		
Indigo	188,005	198,732
Kobo	16,982	9,487
Intercompany eliminations	(2,894)	(3,933)
Total revenues	202,093	204,286
Reconciliation of Loss		
Loss before income taxes		
Indigo	(15,741)	(3,443)
Kobo	(12,528)	(4,222)
Intercompany eliminations	297	–
Loss before income taxes	(27,972)	(7,665)
Income tax recovery	(3,778)	(411)
Net loss and comprehensive loss for the periods	(24,194)	(7,254)

(thousands of Canadian dollars)	13-week period ended July 2, 2011	13-week period ended July 3, 2010
Selected Supplementary Information		
Depreciation and amortization expense		
Indigo	6,540	6,336
Kobo	1,679	542
Total depreciation and amortization expense	8,219	6,878
Net interest		
Indigo	(27)	(42)
Kobo	(88)	(5)
Total net interest income	(115)	(47)
Capital expenditures		
Indigo	3,825	6,434
Kobo	2,159	1,322
Total capital expenditures	5,984	7,756

15. 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 July 2, 2011	13-week period ended July 3, 2010
Wages, salaries, bonus and consulting	1,488	1,141
Short-term benefits expense	63	56
Retirement benefits expense	18	19
Stock-based compensation	463	124
Directors' compensation	149	112
Total remuneration	2,181	1,452

Transactions with shareholders

On May 30, 2011, Indigo purchased a company, the sole asset of which is certain tax losses, from a public company controlled by Mr. Gerald W. Schwartz, who is also the controlling shareholder of Indigo. Indigo acquired this company with \$96.0 million of non-capital tax losses in exchange for net cash consideration of \$5.1 million and a note payable of \$5.1 million. The note payable is non-interest bearing and will be due on March 31, 2012. The transaction included transaction costs shared between the two companies. As a result, the Company has recorded a deferred tax asset of \$24.3 million and the difference of \$14.4 million between the net cash consideration and the deferred tax asset was recorded directly to retained earnings. There was no such transaction in the first quarter of fiscal 2011.

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 10. 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 first quarter is \$1.0 million paid by Indigo (2010 – \$1.7 million).

Transactions with subsidiaries

On April 19, 2011, Kobo issued 6,743,486 shares to a syndicate of investors comprised of both existing shareholders and new investors. Indigo purchased 779,361 common shares for \$3.0 million while the rest of the syndicate members purchased a total of 5,964,125 common shares for \$23.0 million. As a result of these transactions, Indigo's ownership of Kobo decreased from 58.3% to 51.4%. Indigo continues to maintain control over Kobo. There was no such transaction in the first quarter of fiscal 2011.

During the quarter, the Company earned commission revenue from Kobo for referring Indigo customers to www.kobo.com, 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 Loss and Comprehensive Loss using the accounting policies disclosed in Note 2. The net amount of these transactions in the first quarter was \$3.3 million paid by Indigo (2010 – \$3.9 million).

16. 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 ("CGAAP"). The Company's audited annual 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 have been applied in preparing the unaudited interim condensed consolidated financial statements for the 13-week period ended July 2, 2011, the comparative consolidated financial statements for the 13-week period ended July 3, 2010, and the 52-week period ended April 2, 2011 and the opening consolidated balance sheet as at transition date.

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 following mandatory exemptions apply to the Company:

(i) Estimates

Estimates made in accordance with IFRS at transition date are consistent with those determined under CGAAP, except where they were impacted by a difference in accounting policy.

(ii) Non-controlling Interests

Certain requirements of IAS 27, "Consolidated and Separate Financial Statements," were applied on a prospective basis beginning on transition date.

The Company has applied certain of these optional exemptions as described below:

(i) Share-based Payments (“IFRS 2”)

This exemption allows the Company not to apply IFRS 2 to equity instruments granted on or before November 7, 2002 or to equity instruments granted after November 7, 2002 that had vested by the transition date. The Company has elected to apply this exemption on the transition date.

(ii) Borrowing Costs (“IAS 23”)

This exemption allows the Company to prospectively adopt IAS 23, which requires the capitalization of borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to ready for its intended use or sale. The Company has elected to apply the requirements of IAS 23 prospectively beginning on the transition date.

(iii) Business Combinations (“IFRS 3”)

This exemption allows the Company to elect not to apply IFRS 3 to business combinations that occurred prior to the transition date. Under this exemption, any goodwill arising on such business combinations remains at the carrying value determined under CGAAP. The Company has elected not to restate historic business combinations which occurred prior to the transition date.

(iv) Fair Value or Revaluation as Deemed Cost

IFRS 1 provides a choice between measuring property, plant and equipment at its fair value on transition date and using those amounts as deemed cost, or using the historical valuation under the previous GAAP. The Company has elected not to apply this exemption. The Company will continue to apply the cost model for property, plant and equipment and will not restate property, plant and equipment to fair value under IFRS.

(v) Arrangements Containing Leases

This exemption applies to first-time adopters who have made a determination of whether an arrangement contained a lease in accordance with a previous GAAP. If the determination made under the first-time adopter’s previous GAAP would have resulted in the same outcome as application of IAS 17, “Leases,” and IFRIC 4, “Determining Whether an Arrangement Contains a Lease,” then the first-time adopter is not required to reassess that determination when it adopts IFRS. The Company has elected to apply this exemption.

An explanation of how the transition from CGAAP to IFRS has affected the Company’s financial position, financial performance and cash flows 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 equity in accordance with IFRS for the following dates:

(thousands of Canadian dollars)	Notes	July 3, 2010	April 2, 2011	April 4, 2010
Total shareholders' equity as reported under Canadian GAAP		250,987	263,120	258,969
Differences increasing (decreasing) reported amount:				
Deferred credit	1	12,945	3,092	12,945
Impairment of capital assets	2	(2,640)	(6,965)	(2,679)
Stock-based compensation	3	(82)	(23)	(82)
Future tax asset	4	695	1,792	705
Indigo portion of changes in Kobo	5	(127)	(186)	(94)
Dilution gain	6	–	(3,915)	–
Reclassification of non-controlling interest to total equity under IFRS	7	5,160	6,347	6,831
Adjustments to non-controlling interest	5	127	4,101	94
Total equity as reported under IFRS		267,065	267,363	276,689

See accompanying notes

Reconciliation of consolidated earnings (loss) and comprehensive earnings (loss) from CGAAP to IFRS

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

Reconciliation of Consolidated Statements of Loss and Comprehensive Loss for the 13 Weeks Ended July 3, 2010

(thousands of Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balance	IFRS adjustments	IFRS reclassifications	IFRS balance	IFRS accounts
Revenues		204,286	–	–	204,286	Revenues
Cost of sales, operations, selling and administration	8	205,014	–	(87,259)	117,755	Cost of sales
		(728)	–	87,259	86,531	Gross profit
	8	–	–	64,603	64,603	Cost of operations
	3,5,8	–	106	22,848	22,954	Selling and administrative expenses
	8	–	–	(192)	(192)	Foreign currency translation
		(728)	(106)	–	(834)	Operating loss before the following
Depreciation of property, plant and equipment	2	4,505	(39)	–	4,466	Depreciation of property, plant and equipment
Amortization of intangible assets		2,412	–	–	2,412	Amortization of intangible assets
Interest on long-term debt and financing charges		33	–	–	33	Interest on long-term debt and financing charges
Interest income on cash and cash equivalents		(80)	–	–	(80)	Interest income on cash and cash equivalents
Loss before income taxes and non-controlling interest		(7,598)	(67)	–	(7,665)	Loss before income taxes
Income tax recovery	4	(421)	10	–	(411)	Income tax recovery
Loss before non-controlling interest		(7,177)	(77)	–	(7,254)	Net loss and comprehensive loss for the period
Non-controlling interest	5,7	(1,869)	(25)	–	(1,894)	Net loss and comprehensive loss attributable to non-controlling interest
Net loss and comprehensive loss for the period		(5,308)	(52)	–	(5,360)	Net loss and comprehensive loss attributable to shareholders of the Company

See accompanying notes

Reconciliation of Consolidated Statements of Earnings (Loss) and Comprehensive Earnings (Loss) for the 52 Weeks Ended April 2, 2011

(thousands of Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balance	IFRS adjustments	IFRS reclassifications	IFRS balance	IFRS accounts
Revenues		1,017,325	–	–	1,017,325	Revenues
Cost of sales, operations, selling and administration	8	991,155	–	(387,107)	604,048	Cost of sales
		26,170	–	387,107	413,277	Gross profit
	8	–	–	282,785	282,785	Cost of operations
	3,5,8	–	185	103,408	103,593	Selling and administrative expenses
	8	–	–	914	914	Foreign currency translation
		26,170	(185)	–	25,985	Operating profit before the following
Depreciation of property, plant and equipment	2	19,311	(596)	–	18,715	Depreciation of property, plant and equipment
Amortization of intangible assets		10,679	–	–	10,679	Amortization of intangible assets
	2	–	4,877	–	4,877	Impairment of property, plant and equipment
	2	–	5	–	5	Impairment of intangible assets
Interest on long-term debt and financing charges		212	–	–	212	Interest on long-term debt and financing charges
Interest income on cash and cash equivalents		(567)	–	–	(567)	Interest income on cash and cash equivalents
Dilution gain on reduction of ownership in subsidiary	6	(3,915)	3,915	–	–	
Earnings before income taxes and non-controlling interest		450	(8,386)	–	(7,936)	Loss before income taxes
Income tax expense						Income tax expense
Current		1,237	–	–	1,237	Current
Future	1,4	1,445	8,766	–	10,211	Deferred
		2,682	8,766	–	11,448	
Loss before non-controlling interest		(2,232)	(17,152)	–	(19,384)	Net loss and comprehensive loss for the period
Non-controlling interest	5,7	(13,578)	(64)	–	(13,642)	Net loss and comprehensive loss attributable to non-controlling interest
Net earnings and comprehensive earnings for the period		11,346	(17,088)	–	(5,742)	Net loss and comprehensive loss attributable to shareholders of the Company

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 July 3, 2010

(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	84,314	–	1,196	85,510	Cash and cash equivalents
Restricted cash	9	1,196	–	(1,196)	–	
Accounts receivable		10,827	–	–	10,827	Accounts receivable
Inventories		223,836	–	–	223,836	Inventories
Income taxes recoverable		899	–	–	899	Income taxes recoverable
Prepaid expenses		5,948	–	–	5,948	Prepaid expenses
Future tax assets	9	7,036	–	(7,036)	–	
Total current assets		334,056	–	(7,036)	327,020	Total current assets
Property, plant and equipment	2	77,470	(2,639)	–	74,831	Property, plant and equipment
Intangible assets	2	24,861	(1)	–	24,860	Intangible assets
Future tax assets	4,9	40,894	695	7,036	48,625	Deferred tax assets
Goodwill		26,632	–	–	26,632	Goodwill
Total assets		503,913	(1,945)	–	501,968	Total assets
LIABILITIES AND SHAREHOLDERS' EQUITY						LIABILITIES AND EQUITY
Current						Current
Accounts payable and accrued liabilities	1,3,9,10 9 10	223,418	(12,863)	(37,590)	172,965	Accounts payable and accrued liabilities
		–	–	37,460	37,460	Unredeemed gift card liability
		–	–	130	130	Provisions
Deferred revenue		14,849	–	–	14,849	Deferred revenue
Current portion of long-term debt		1,460	–	–	1,460	Current portion of long-term debt
Total current liabilities		239,727	(12,863)	–	226,864	Total current liabilities
Long-term accrued liabilities		6,841	–	–	6,841	Long-term accrued liabilities
Long-term debt		1,198	–	–	1,198	Long-term debt
Total liabilities		247,766	(12,863)	–	234,903	Total liabilities
Shareholders' equity						Equity
Share capital	3	198,561	8	–	198,569	Share capital
Contributed surplus	3	4,936	1,003	–	5,939	Contributed surplus
Retained earnings	1-7	47,490	9,780	–	57,270	Retained earnings
Total shareholders equity		250,987	10,791	–	261,778	Total equity attributable to shareholders of the Company
Non-controlling interest	5,7	5,160	127	–	5,287	Non-controlling interest
					267,065	Total equity
Total liabilities and shareholders' equity		503,913	(1,945)	–	501,968	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 9 10	224,959	(3,069)	(40,991)	180,899	Accounts payable and accrued liabilities
			–	40,991	40,991	Unredeemed gift card liability
			–	–	–	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

Reconciliation of Consolidated Balance Sheet as at April 4, 2010

(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	103,489	–	409	103,898	Cash and cash equivalents
Restricted cash	9	409	–	(409)	–	
Accounts receivable		8,455	–	–	8,455	Accounts receivable
Inventories		224,406	–	–	224,406	Inventories
Income taxes recoverable		899	–	–	899	Income taxes recoverable
Prepaid expenses		6,771	–	–	6,771	Prepaid expenses
Future tax assets	9	6,615	–	(6,615)	–	
Total current assets		351,044	–	(6,615)	344,429	Total current assets
Property, plant and equipment	2	77,478	(2,678)	–	74,800	Property, plant and equipment
Intangible assets	2	23,794	(1)	–	23,793	Intangible assets
Future tax assets	4,9	40,894	705	6,615	48,214	Deferred tax assets
Goodwill		26,632	–	–	26,632	Goodwill
Total assets		519,842	(1,974)	–	517,868	Total assets
LIABILITIES AND SHAREHOLDERS' EQUITY						
Current						
Accounts payable and accrued liabilities	1,3,9,10	229,920	(12,863)	(37,994)	179,063	Accounts payable and accrued liabilities
	9		–	37,816	37,816	Unredeemed gift card liability
	10		–	178	178	Provisions
Deferred revenue		12,882	–	–	12,882	Deferred revenue
Current portion of long-term debt		1,863	–	–	1,863	Current portion of long-term debt
Total current liabilities		244,665	(12,863)	–	231,802	Total current liabilities
Long-term accrued liabilities		8,203	–	–	8,203	Long-term accrued liabilities
Long-term debt		1,174	–	–	1,174	Long-term debt
Total liabilities		254,042	(12,863)	–	241,179	Total liabilities
Shareholders' equity						
Share capital	3	198,635	–	–	198,635	Share capital
Contributed surplus	3	4,670	963	–	5,633	Contributed surplus
Retained earnings	1-7	55,664	9,832	–	65,496	Retained earnings
Total shareholders' equity		258,969	10,795	–	269,764	Total equity attributable to shareholders of the Company
Non-controlling interest	5, 7	6,831	94	–	6,925	Non-controlling interest
					276,689	Total equity
Total liabilities and shareholders' equity		519,842	(1,974)	–	517,868	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.

17. SELECTED ANNUAL DISCLOSURES

These unaudited interim condensed consolidated financial statements are the Company's first financial statements prepared using IFRS and as such, certain disclosures that are required to be included in annual financial statements prepared in accordance with IFRS were not included in the Company's most recent annual financial statements prepared in accordance with CGAAP. Selected annual disclosures for fiscal 2011 prepared in accordance with IFRS have been included below as notes 17a – 17h.

17a. PROPERTY, PLANT AND EQUIPMENT

(thousands of Canadian dollars)	Furniture, fixtures and equipment	Computer equipment	Leasehold improvements	Equipment under capital lease	Total
Gross carrying amount					
Balance, April 4, 2010	57,061	17,825	47,022	14,023	135,931
Additions	10,519	2,913	12,068	2,321	27,821
Transfers/reclassifications	(76)	(324)	365	–	(35)
Disposals	(69)	(2)	(179)	–	(250)
Assets with zero net book value	(8,428)	(2,077)	(3,271)	(9,789)	(23,565)
Balance, April 2, 2011	59,007	18,335	56,005	6,555	139,902
Accumulated depreciation and impairment					
Balance, April 4, 2010	27,185	6,913	16,647	10,386	61,131
Depreciation	5,679	3,699	6,895	2,442	18,715
Disposals	(14)	–	(19)	–	(33)
Impairment loss	1,941	181	2,755	–	4,877
Assets with zero net book value	(8,428)	(2,077)	(3,271)	(9,789)	(23,565)
Balance, April 2, 2011	26,363	8,716	23,007	3,039	61,125
Net carrying amount					
April 4, 2010	29,876	10,912	30,375	3,637	74,800
April 2, 2011	32,644	9,619	32,998	3,516	78,777

17 b. INTANGIBLE ASSETS

(thousands of Canadian dollars)	Computer application software	Development costs	Domain name	Total
Gross carrying amount				
Balance, April 4, 2010	25,187	11,706	–	36,893
Additions	11,247	5,910	303	17,460
Transfers/reclassifications	44	1	–	45
Assets with zero net book value	(4,385)	(2,601)	–	(6,986)
Balance, April 2, 2011	32,093	15,016	303	47,412
Accumulated amortization and impairment				
Balance, April 4, 2010	8,209	4,891	–	13,100
Amortization	6,904	3,775	–	10,679
Impairment loss	5	–	–	5
Assets with zero net book value	(4,385)	(2,601)	–	(6,986)
Balance, April 2, 2011	10,733	6,065	–	16,798
Net carrying amount				
April 4, 2010	16,978	6,815	–	23,793
April 2, 2011	21,360	8,951	303	30,614

17c. IMPAIRMENT OF CAPITAL ASSETS

Capital assets are assessed for impairment at the CGU level, except for those capital assets which are either considered to be corporate assets or capital assets which belong to Kobo or Calendar Club. As corporate assets cannot be allocated on a reasonable and consistent basis to individual CGUs, they have been allocated to the Indigo segment for impairment testing. Separate impairment tests are performed for Kobo and Calendar Club.

A CGU has been defined as an individual retail store as each store generates cash flows that are largely independent from the cash flows of other stores. CGUs and groups of CGUs are tested for impairment if impairment indicators exist at the reporting date.

Recoverable amounts for CGUs 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, of the applicable stores. 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 discount rate used to calculate value in use was 13.0%.

Impairment losses recognized during the 52-week period ended April 2, 2011 were \$4.9 million 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. All impairment losses relate to the Indigo segment.

17d. GOODWILL

As at April 2, 2011, the Company has \$26.6 million of goodwill and there were no goodwill impairments identified as a result of the Company's annual goodwill impairment testing in fiscal 2011. Goodwill arose through acquisitions and is not amortized. For purposes of goodwill impairment testing, the carrying value of goodwill has been allocated as follows:

(thousands of Canadian dollars)	April 2, 2011
Indigo segment	25,416
Kobo segment	1,216
Total goodwill	26,632

The goodwill impairment test consisted of comparing the carrying value of assets within each CGU or group of CGUs to the recoverable amount of the CGU or group of CGUs. The recoverable amount of the Indigo segment is measured by discounting the future cash expected to be generated. Cash flows were projected over one year plus a terminal value. The discounted cash flow model was based on actual operating results, detailed sales and cost forecasts, and long-term growth rates which are consistent with industry averages. The key assumptions from the Indigo discounted cash flow model are those regarding growth rates and discount rates. Average growth rate used was 2.0% and discount rate was 13.0%. The recoverable amount of the Kobo segment is based on the market capitalization of Kobo using Kobo's share price as at April 2, 2011 of \$3.86.

17e. EMPLOYEE BENEFITS EXPENSE

Employee benefits expense included in cost of operations and selling and administrative expenses is as follows:

(thousands of Canadian dollars)	52-week period ended April 2, 2011
Wages, salaries and bonuses	157,902
Short-term benefits expense	18,746
Termination benefits expense	2,122
Retirement benefits expense	1,282
Stock-based compensation	671
Total employee benefits expense	180,723

17f. SHARE-BASED COMPENSATION

The Company has established an employee stock option plan (the "Plan") as remuneration for key employees. The number of common shares reserved for issuance under the Plan is 2,264,054. Most options granted since May 21, 2002 have one fifth of the options granted exercisable one year after the date of issue, with the remainder exercisable in equal instalments on the anniversary date over the next four years. A small number of options have special vesting schedules that were approved by the Board. All employee remuneration under the Plan is settled in equity. The Company has no legal or constructive obligation to repurchase or settle the options.

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. The pre-forfeiture fair value of stock options that were granted in fiscal 2011 was \$1.8 million. The weighted-average fair value of options issued in fiscal 2011 was \$3.66 per option.

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 period presented:

(thousands of Canadian dollars)	52-week period ended April 2, 2011
Risk-free interest rate	2.3%
Expected volatility	33.4%
Expected time until exercise	5.3 years
Expected dividend yield	2.9%
Forfeiture rate	23.7%

In fiscal 2010, the Company 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 200,000 Kobo shares directly from Indigo at an exercise price of \$1.00 per share. The agreements may either be exercised upon fulfilment of specified performance conditions or entitle the holders to a cash payout, depending on share price, upon expiry. The agreements expire on January 25, 2020. As at April 2, 2011, Kobo's share price was \$3.86 and the Company recorded \$0.6 million as a liability relating to these options. These options had a nil intrinsic value as at April 2, 2011.

17g. PROVISIONS

A continuity of the Company's provisions is as follows:

(thousands of Canadian dollars)	Provisions
April 4, 2010	178
Utilized / released in the year	(178)
April 2, 2011	—

17h. RELATED PARTY TRANSACTIONS

The Company's related parties include its key management personnel, shareholders, joint venture, and defined contribution retirement plan as well as companies under common control. Unless otherwise stated, none of these 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)	52-week period ended April 2, 2011
Wages, salaries, bonus and consulting	3,696
Short-term benefits expense	376
Termination benefits	42
Retirement benefits	78
Stock-based compensation	470
Directors' compensation	554
Total remuneration	5,216

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 52-week period ended April 2, 2011 is nil, as all loans have been fully repaid.

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 17e. The Company has not entered into other transactions with the retirement plan.

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