SECOND QUARTER REPORT

FOR THE 13 AND 26-WEEK PERIODS ENDED OCTOBER 1, 2011

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

Indigo

Enrich your life

Chapters Indigo COLES indigo.ca

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Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") is prepared as at November 8, 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 and 26-week periods ended October 1, 2011 and October 2, 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, the MD&A included in the Company's fiscal 2011 Annual Report and certain additional disclosures included in the Company's fiscal 2012 first quarter unaudited interim condensed consolidated financial statements and accompanying notes and related interim MD&A. The Company's fiscal 2011 Annual Report was prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP" or "CGAAP"). The Annual Report and additional information about the Company, including the Annual Information Form, can be found on SEDAR at *www.sedar.com*.

Overview

Indigo is Canada's largest book retailer, operating stores in all 10 provinces and one territory in Canada and offering online sales through its *www.chapters.indigo.ca* website. As at October 1, 2011, the Company operated 97 superstores under the banners *Chapters*, *Indigo* and the *World's Biggest Bookstore* and 147 small format stores, under the banners *Coles*, *Indigo*, *Indigospirit*, *SmithBooks*, *The Book Company*, and *Pistachio*. During the second quarter of fiscal 2012, the Company closed two small format stores. The Company has a 50% interest in Calendar Club of Canada Limited Partnership ("Calendar Club"), which operates seasonal kiosks and year-round stores in shopping malls across Canada.

Indigo has one subsidiary, Kobo Inc. ("Kobo"). Kobo provides instant access to books, newspapers, magazines, and other digital content through its website, *www.kobo.com*. Kobo has launched localized instances of its website in several countries and offers its download service to users worldwide. Kobo also develops eReader devices which are sold through wholesale and retail channels. As at October 1, 2011, Indigo owned 51.4% of Kobo's outstanding common shares.

On November 8, 2011, Indigo entered into an agreement with Rakuten, Inc. ("Rakuten") for Rakuten to acquire all the outstanding shares of Kobo for an aggregate purchase price of approximately US$315 million, on a fully diluted basis, subject to certain customary adjustments on closing. The transaction is also subject to relevant regulatory approval, including *Investment Canada Act*, and is expected to close in Q4 of Indigo's fiscal 2012. Upon the sale of Kobo, Indigo is expected to receive net cash proceeds of US$140 million to US$150 million. The accounting gain cannot be determined at this time. The transaction was unanimously approved by the Board of Directors on November 8, 2011.

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 second quarter of fiscal 2012 was 25,198,540 as compared to 24,775,067 last year. As at November 8, 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 November 8, 2011. As at October 1, 2011, there were 1,646,600 stock options outstanding of which 733,100 were exercisable.

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

Results of Operations

The following table summarizes the consolidated results of 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 October 1, 2011**	**% Revenues**	13-week period ended October 2, 2010	% Revenues	**26-week period ended October 1, 2011**	**% Revenues**	26-week period ended October 2, 2010	% Revenues
Revenues	**218.5**	**100.0**	214.8	100.0	**420.6**	**100.0**	419.1	100.0
Cost of sales	**130.1**	**59.5**	124.4	57.9	**255.5**	**60.7**	242.1	57.8
Cost of operations	**66.1**	**30.3**	65.3	30.4	**131.7**	**31.3**	129.9	31.0
Selling, administrative and other expenses	**29.7**	**13.6**	22.5	10.5	**60.7**	**14.4**	45.3	10.8
EBITDA[1]	**(7.4)**	**(3.4)**	2.6	1.2	**(27.3)**	**(6.5)**	1.8	0.4

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

Revenue Increased Slightly

Total consolidated revenues for the 13-week period ended October 1, 2011 increased $3.7 million or 1.7% to $218.5 million from $214.8 million for the 13-week period ended October 2, 2010. The increase was driven by revenues from Kobo and the latest Kobo Touch eReaders, partially offset by declining book sales.

Comparable store sales for the fiscal year decreased 4.3% in superstores and decreased 2.9% 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 October 1, 2011, the Company operated one additional superstore and two fewer small format stores compared to October 2, 2010.

Online sales increased slightly by $0.2 million or 1.1% to $18.8 million for the 13-week period ended October 1, 2011 compared to $18.6 million last year. The increase was due to higher book sales driven by Plum preferred member pricing and increased sales of gift, toy and paper products.

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 $10.5 million from $16.7 million last year to $27.2 million for the current year primarily as a result of Kobo eBook and eReader sales. This increase was partially offset by a decrease in loyalty card sales as members switch to the free Plum loyalty program.

On a year-to-date basis, total consolidated revenues increased by $1.5 million or 0.4% from $419.1 million last year to $420.6 million this year. Year-to-date comparable store sales were down 4.8% for superstores and down 4.0% for small format stores.

Revenues by channel are highlighted below:

(millions of Canadian dollars)	**13-week period ended October 1, 2011**	13-week period ended October 2, 2010	% increase (decrease)	Comparable store sales % increase (decrease)
Superstores	**142.1**	147.5	(3.7)	(4.3)
Small format stores	**30.4**	32.0	(5.0)	(2.9)
Online (including store kiosks)	**18.8**	18.6	1.1	N/A
Other	**27.2**	16.7	62.9	N/A
	218.5	214.8	1.7	(4.1)

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

(millions of Canadian dollars)	Superstores		Small format stores	
	13-week period ended October 1, 2011	13-week period ended October 2, 2010	**13-week period ended October 1, 2011**	13-week period ended October 2, 2010
Total revenues	**142.1**	147.5	**30.4**	32.0
Adjustments for stores not in both fiscal periods	**(3.5)**	(2.6)	**(2.1)**	(2.8)
Comparable store sales	**138.6**	144.9	**28.3**	29.2

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 October 1, 2011, cost of sales increased $5.7 million to $130.1 million. As a percent of total revenues, cost of sales increased 1.6% to 59.5% in the second quarter of fiscal 2012, compared to 57.9% last year. The increase was driven by the summer clearance sale, higher sales discounts due to increased promotional activities, and a shift in product mix to low margin Kobo eReaders. On a year-to-date basis, cost of sales as a percent of total revenues increased 2.9% from 57.8% last year to 60.7% this year, for the same reasons outlined above.

Cost of Operations (as a Percent of Revenue) Increased Slightly Compared to Last Year

Cost of operations includes all store, online, distribution centre and Calendar Club costs. Cost of operations increased $0.8 million as higher online and store expenses were slightly offset by a reduction in retail distribution centre costs. Online costs increased $0.8 million as the result of planned marketing activities and because the online distribution centre was operational for the entire quarter. In fiscal 2011, the online distribution centre was newly opened midway through the second quarter and therefore only generated expenses for a partial quarter. Store expenses increased by $0.3 million due to earlier receipts of holiday store supplies compared to the same period last year. These increases were offset by a decrease of $0.5 million in retail distribution centre costs as outbound unit volume decreased, resulting in lower labour and freight costs. This was due to more products being shipped directly to stores to ensure efficient retail distribution centre processing of fall and holiday merchandise. As a percent of total revenues, cost of operations decreased by 0.1% to 30.3% this year. On a year-to-date basis, cost of operations increased by 0.3% to 31.3% of total revenues this year from 31.0% last 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 $7.2 million compared to last year. As a percent of total revenues, selling, administrative and other expenses increased by 3.1% to 13.6%, compared to 10.5% of total revenues last year. The Company recorded $6.4 million more in operating expenses for Kobo compared to last year. In the second quarter of fiscal 2012, expenses related to the operation of Kobo totalled $12.3 million compared to $5.9 million last year. Kobo has experienced worldwide growth, resulting in an increase to operating expenses. The Company also recorded $0.5 million more in marketing expenses compared to last year as a result of increased promotional activities.

On a year-to-date basis, selling, administrative and other expenses increased $15.4 million due to the same factors mentioned above. As a percent of total revenues, selling, administrative and other expenses increased from 10.8% last year to 14.4% this year.

EBITDA Decreased as a Percent of Revenues

EBITDA, defined as earnings before interest, taxes, depreciation and amortization decreased $10.0 million to a loss of $7.4 million for the 13-week period ended October 1, 2011, compared to a profit of $2.6 million for the 13-week period ended

October 2, 2010. The decrease was driven by lower EBITDA in both the Indigo business and the Kobo business. The Indigo 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 in the areas mentioned above, led to lower EBITDA in the Indigo 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 negative 3.4% this year from positive 1.2% last year.

On a year-to-date basis, EBITDA decreased by $29.1 million to a loss of $27.3 million compared to a profit of $1.8 million last year due to the same factors mentioned above. As a percent of revenues, EBITDA decreased to negative 6.5% for the year-to-date compared to positive 0.4% last year.

Depreciation and Amortization Increased versus Last Year

Depreciation and amortization for the 13-week period ended October 1, 2011 increased by $1.8 million to $8.6 million compared to $6.8 million last year. Due to growth in the business, Kobo increased capital expenditures, which resulted in higher amortization. Capital expenditures in the second quarter of fiscal 2012 totalled $8.7 million and included $3.2 million on store construction, renovations and equipment, $4.5 million on intangible assets (primarily application software and internal development costs) and $1.0 million on technology equipment. Of the $1.0 million expenditure in technology equipment, $0.3 million was financed through capital leases.

On a year-to-date basis, depreciation and amortization increased by $3.1 million to $16.8 million compared to $13.7 million last year for the same reasons discussed above. Year-to-date, the Company has spent $14.6 million on capital expenditures, including $5.0 million on store construction, renovations and equipment, $8.1 million on intangible assets (primarily application software and internal development costs) and $1.5 million on technology equipment. Of the $1.5 million expenditure in technology equipment, $0.3 million was financed through capital leases.

Impairment of Goodwill

The Company performs goodwill impairment testing annually and assesses at each reporting date whether there is any indication that goodwill may be impaired. The most recent goodwill impairment test as at April 2, 2011 resulted in no identification of goodwill impairment. However, business conditions have deteriorated since year end and during the second quarter, Indigo segment performance was significantly lower than expected and the Company's market capitalization had declined significantly from year end. These conditions, among other factors, indicated that goodwill may be impaired. As a result, the Company performed a goodwill impairment test as at October 1, 2011 which resulted in a full write-down of goodwill allocated to the Indigo segment. Unlike other asset impairments, goodwill impairment charges cannot be reversed once they are recorded.

The goodwill impairment test consisted of comparing the carrying value of Indigo segment assets to the recoverable amount of the Indigo segment. The recoverable amount of the Indigo segment is measured by discounting the future cash expected to be generated. 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 inflation and general retail industry averages. The carrying value of the Indigo segment exceeded its recoverable amount and resulted in a $25.4 million goodwill impairment charge.

The key assumptions from the Indigo discounted cash flow model are those regarding growth rates and discount rates. Average growth rate used for the October 1, 2011 goodwill impairment test was 2.0% and the discount rate was 14.0%. Average growth rate used for the goodwill impairment test performed at April 2, 2011 was 2.0% and the discount rate was 13.0%.

Net Interest Expense Recorded

The Company recognized net interest expense of $0.1 million in the second quarter of this year compared to net interest income of $0.1 million in the same period last year. This change is the result of a lower cash position compared to last year and an increase in the Company's interest expense due to notes payable accretion. The Company had no notes payable in the comparative prior year period. On a year-to-date basis, the Company recognized net interest income of $0.1 million this year compared to net interest income of $0.1 million last year. The Company nets interest income received against interest expense.

Income Tax Expense Decreased from Last Year

The Company recognized an income tax recovery of $1.1 million this quarter compared to an income tax expense of $0.5 million in the comparative period last year. On a year-to-date basis, the Company recognized an income tax recovery of $4.9 million this year compared to an income tax expense of less than $0.1 million last year. The decrease in income tax expense in the current year is primarily due to lower profits compared to last year.

Non-controlling Interest

As at October 1, 2011, Indigo is the majority and controlling shareholder of Kobo. The Company fully consolidates Kobo's results in its unaudited interim condensed consolidated financial statements. The Company records a non-controlling interest to its consolidated statements of loss and comprehensive loss to reflect the portion of Kobo's loss that is attributable to the minority shareholders of Kobo. For the 13 weeks ended October 1, 2011, the Company recorded $5.3 million, compared to $2.8 million last year, in non-controlling interest for the portion of Kobo losses attributable to the minority shareholders. Year-to-date, the Company recorded $11.4 million, compared to $4.7 million last year, in non-controlling interest for the portion of Kobo losses attributable to the minority shareholders.

Net Loss Recorded for the Current Fiscal Quarter

The Company recognized a net loss attributable to shareholders of the Company of $35.1 million for the 13-week period ended October 1, 2011 ($1.39 net loss per common share), compared to a net loss attributable to shareholders of the Company of $1.8 million ($0.07 net loss per common share) last year. Year-to-date, the Company recognized a net loss attributable to shareholders of the Company of $53.2 million for the 26-week period ended October 1, 2011 ($2.11 net loss per common share), compared to a net loss attributable to shareholders of the Company of $7.1 million ($0.29 net loss per common share) last year. The decrease was primarily due to the decrease in EBITDA and a non-cash charge to goodwill, partially offset by an increase in income tax recovery.

Seasonality and Second Quarter Results

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

	Fiscal quarters							
	IFRS						Canadian GAAP	
(thousands of Canadian dollars, except per share data)	**Q2 Fiscal 2012**	Q1 Fiscal 2012	Q4 Fiscal 2011	Q3 Fiscal 2011	Q2 Fiscal 2011	Q1 Fiscal 2011	Q4 Fiscal 2010	Q3 Fiscal 2010
Revenues	**218,472**	202,093	210,633	387,642	214,764	204,286	228,191	340,195
Net earnings (loss) attributable to shareholders of the Company	**(35,120)**	(18,105)	(19,441)	20,827	(1,768)	(5,360)	497	34,530
Basic earnings (loss) per share	**$(1.39)**	$(0.72)	$(0.78)	$0.84	$(0.07)	$(0.22)	$0.02	$1.41
Diluted earnings (loss) per share	**$(1.39)**	$(0.72)	$(0.78)	$0.82	$(0.07)	$(0.22)	$0.02	$1.38

Overview of Consolidated Balance Sheets

Total Assets

As at October 1, 2011, total assets were $24.1 million lower than total assets at October 2, 2010. The decrease in assets was primarily due to decreases in the Company's goodwill, cash and cash equivalents, property, plant and equipment, and prepaid

expenses, offset by increases in the Company's deferred tax assets and accounts receivable. Goodwill decreased by $25.4 million as a result of a non-cash impairment charge, as discussed above. Cash and cash equivalents decreased $16.3 million as the Company used its cash to purchase tax losses, capital assets, and pay dividends. This decrease was partially offset when Kobo issued equity securities for cash. The Company's property, plant and equipment decreased $7.1 million primarily due to a reduction in capital expenditures compared to last year. Prepaid expenses decreased $6.9 million as Kobo did not make any prepayments to its eReader manufacturer this year compared to the second quarter last year. Deferred tax assets increased by $20.1 million compared to last year, primarily as the result of the Company's purchases of tax losses from a related company during the first half of fiscal 2012. Accounts receivable increased by $11.3 million primarily due to Kobo's sales of eReaders to other resellers on standard payment terms.

On a fiscal year-to-date basis, total assets increased by $12.3 million compared to April 2, 2011. The increase in total assets was primarily due to increases in inventories and deferred tax assets, offset by decreases in goodwill and cash and cash equivalents. The Company's inventory position increased $31.2 million mainly due to advance purchases made in preparation for the holiday season. Deferred tax assets increased by $30.2 million primarily as the result of the Company's purchase of non-capital tax losses during the first half of the fiscal year. Goodwill decreased by $25.4 million as a result of impairment testing, as previously discussed. The decrease of $38.2 million in cash and cash equivalents is consistent with the increased inventory purchases.

Total Liabilities

As at October 1, 2011, total liabilities were $1.8 million more than total liabilities at October 2, 2010. The increase in liabilities was primarily due to a $4.6 million increase in current and long-term accounts payable and $5.2 million increase in notes payable, offset by an $11.2 million decrease in deferred revenue. The increase in current and long-term accounts payable is consistent with the increase in the Company's inventory position, as noted above. Notes payable of $5.2 million arose from the Company's purchase of tax losses from a related company. At this time last year, Kobo was accepting deposits on pre-orders for its wireless eReader from other retailers, but there was no such activity in the current fiscal quarter, which is the primary cause of the decrease in deferred revenue for fiscal 2012.

On a fiscal year-to-date basis, total liabilities increased by $43.0 million compared to April 2, 2011. The increase in total liabilities was primarily due to a $42.0 million increase in current and long-term accounts payable and accrued liabilities and a $5.2 million increase in notes payable, offset by a decrease of $4.7 million in unredeemed gift card liability. As mentioned above, the increase in current and long-term accounts payable and accrued liabilities is consistent with the increase in the Company's inventory position and the increase in notes payable was the result of the Company's purchase of non-capital tax losses during the year. Unredeemed gift card liability decreased, as gift cards redemptions increased due to the seasonal nature of the business.

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 October 1, 2011, the Company recorded $22.0 million in non-controlling interest on its consolidated balance sheet compared to $3.9 million last year. The $22.0 million reflects the 48.6% of Kobo owned by minority shareholders, compared to 40.7% owned by minority shareholders last year. On a fiscal year-to-date basis, the value of the non-controlling interest increased $11.5 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 October 1, 2011 decreased $25.8 million compared to October 2, 2010. The decrease in total equity was primarily due to the net loss of $51.8 million in the last four quarters and $11.0 million of dividend payments, offset by an increase of $15.0 million in retained earnings related to the purchase of tax losses from a related company in the last two

quarters. Share capital increased by $3.0 million mainly due to employees exercising their stock options and contributed surplus increased $0.9 million due to the expensing of employee stock options and Directors' deferred share units. Non-controlling interest increased by $18.1 million compared to last year, as discussed above.

Working Capital and Leverage

The Company's working capital position usually declines from the end of its fiscal year until the third fiscal quarter due to the seasonal nature of the business. The Company relies on cash, accounts payable and its operating line of credit to fund the business before generating a disproportionate amount of cash during the December holiday season. The Company reported working capital of $66.6 million as at October 1, 2011, compared to $101.6 million at the end of fiscal 2011 and $87.2 million as at October 2, 2010.

The Company's leverage position (defined as Total Liabilities to Total Equity) increased to 1.2:1 at the end of the current quarter compared to 1.1:1 last year and increased from 0.9:1 as at April 2, 2011.

Overview of Consolidated Statements of Cash Flows

Cash and cash equivalents decreased $27.9 million during the second quarter of fiscal 2012 compared to a decrease of $23.7 million last year. The decrease in the current quarter was driven by cash flows used in operating activities of $18.4 million, in investing activities of $8.8 million, and in financing activities of $2.9 million, along with the effect of foreign currency exchange rate changes on cash and cash equivalents of $2.3 million. Year-to-date, cash and cash equivalents decreased by $38.2 million compared to a decrease of $42.1 million for the same period last year.

Cash Flows Used in Operating Activities

The Company used cash flows of $18.4 million in operating activities in the second quarter of fiscal 2012. This was an increase of $12.4 million used over the same period last year, when cash flows used in operating activities were $6.1 million. Cash flows used in the current quarter were primarily due to an increase of $48.2 million in inventory and the net loss of $40.4 million, which were offset by growth in accounts payable of $58.5 million, non-cash goodwill impairment of $25.4 million, and non-cash depreciation and amortization of $8.6 million. On a year-to-date basis, cash flows used in operating activities were $36.8 million compared to cash flows used in operating activities of $14.3 million last year.

Cash Flows Used in Investing Activities

In the second quarter, net cash flows used in investing activities were $8.8 million compared to $15.0 million used in the same quarter last year. In the current quarter, total cash spent on capital projects was $8.4 million compared to $15.0 million spent in the comparative period as outlined below:

(millions of Canadian dollars)	**13-week period ended October 1, 2011**	13-week period ended October 2, 2010	**26-week period ended October 1, 2011**	26-week period ended October 2, 2010
Store construction, renovations and equipment	**3.2**	9.4	**5.0**	13.2
Intangible assets (primarily application software and internal development costs)	**4.5**	4.4	**8.1**	7.9
Technology equipment	**0.7**	1.2	**1.2**	1.7
	8.4	15.0	**14.3**	22.8

The Company also paid $0.5 million during the second 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.

On a year-to-date basis, net cash flows used in investing activities were $24.9 million compared to $22.7 million last year. Of that, $10.6 million was paid to purchase non-capital tax losses from a related company. There was no such transaction in the same period last year. Total cash spent on capital projects in the first two quarters of fiscal 2012 was $14.3 million compared to $22.8 million last year.

Cash Flows Used in Financing Activities

Net cash flows used in financing activities were $2.9 million during the second quarter compared to $1.4 million used in the same period last year. During the second quarter of last year, the Company had cash inflows of $1.2 million from the issuance of equity securities by Kobo and $1.1 million of proceeds from common share issuances to offset $2.7 million of dividend payments. There were no such cash receipts in the second quarter of fiscal 2012 to offset $2.8 million of cash used to pay dividends.

On a year-to-date basis, net cash flows from financing activities were $21.2 million compared to $5.0 million of cash used last year. The year-over-year increase was driven by $21.3 million received from third-party Kobo investors in the first quarter of the current fiscal year and by an increase of $5.3 million in notes payable related to the acquisition of non-capital tax losses during the first half of the current fiscal year.

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 note 2 of the unaudited interim condensed consolidated financial statements contained in the Company's First Quarter Report.

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

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

Transition to IFRS

The Company adopted IFRS for its 2012 fiscal year as required by the Accounting Standards Board of the Canadian Institute of Chartered Accountants. These financial statements, including the fiscal 2011 comparative figures, are prepared in accordance with IFRS and IAS 34, "Interim Financial Reporting." Reconciliations prepared in accordance with IFRS 1, "First-time Adoption of International Financial Reporting Standards," are provided in note 16 to the unaudited interim condensed consolidated financial statements.

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 its disclosures as the Company does not generally perform transfers of financial assets.

Income Taxes ("IAS 12")

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

Financial Instruments ("IFRS 9")

The IASB has issued a new standard, IFRS 9, which will ultimately replace IAS 39, "Financial Instruments: Recognition and Measurement" ("IAS 39"). The replacement of IAS 39 is a multi-phase project with the objective of improving and simplifying the reporting for financial instruments. Issuance of IFRS 9 is part of the first phase of the IAS 39 replacement project. IFRS 9 had an original effective date of January 1, 2013 which 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 Company expects to adopt these new standards and amendments in the first quarter of fiscal 2014. The following is a list and description of these new standards and amendments:

- Consolidated Financial Statements ("IFRS 10") establishes the standards for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. IFRS 10 establishes a single control model that applies to all entities. 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. Currently, the Company accounts for its interest in Calendar Club under IAS 31 using proportionate consolidation. However, based on a preliminary analysis completed by the Company, its interest in Calendar Club will meet the definition of a joint venture under IFRS 11 and will need to be accounted for using the equity method beginning in fiscal 2014;
- Disclosure of Interests in Other Entities ("IFRS 12") includes all of the disclosures that were previously in IAS 27, "Separate Financial Statements," IAS 31 and IAS 28, "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 is expected to increase 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 currently has no financial or non-financial items which are measured at fair value. As such, this standard is not expected to have a significant impact on the Company's consolidated financial statements;
- Separate Financial Statements ("IAS 27") has been amended to remove all requirements relating to consolidated financial statements. Prior to this amendment, the Company applied IAS 27 to the preparation of its consolidated financial statements. However, as Indigo does not prepare separate financial statements, the amended IAS 27 will no longer be applicable to the Company; and
- Investments in Associates and Joint Ventures ("IAS 28") has been amended for conforming changes based on the issuance of IFRS 10 and IFRS 11. The amendments to IAS 28 relate to accounting for associates and joint ventures held for sale, and to changes in interests held in associates and joint ventures. Currently, neither of these scenarios applies to the Company and, as such, these amendments are not expected to have a significant impact on the Company's consolidated financial statements.

General Development of the Business

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

Risks and Uncertainties

The 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 July 3, 2011 and ended on October 1, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting. The Company has determined that no material changes in internal controls over financial reporting have occurred in this period.

Cautionary Statement Regarding Forward-Looking Statements

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

Non-IFRS Financial Measures

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

Comparable stores sales and EBITDA are key indicators used by the Company to measure performance against internal targets and prior period results. Both measures are commonly used by financial analysts and investors to compare Indigo to other retailers. Comparable store sales are defined as sales generated by stores that have been open for more than 12 months on a 52-week basis. It is a key performance indicator for the Company as this measure excludes sales fluctuations due to store closings, permanent relocation, and chain expansion. EBITDA is defined as earnings before interest, taxes, 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 October 1, 2011**	13-week period ended October 2, 2010	**26-week period ended October 1, 2011**	26-week period ended October 2, 2010
EBITDA	**(7.4)**	2.6	**(27.3)**	1.8
Depreciation of property, plant and equipment	**4.7**	4.3	**9.3**	8.8
Amortization of intangible assets	**3.9**	2.5	**7.5**	4.9
Impairment of goodwill	**25.4**	0.0	**25.4**	0.0
Interest on long-term debt and financing charges	**0.0**	0.0	**0.1**	0.0
Interest income on cash and cash equivalents	**0.0**	(0.1)	**(0.1)**	(0.2)
Loss before income taxes	**(41.4)**	(4.1)	**(69.5)**	(11.7)

Indigo Books & Music Inc.
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Phone: (416) 364-4499 Fax: (416) 364-0355

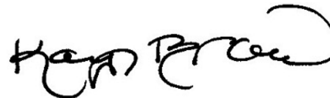
NOTICE OF NO AUDITOR REVIEW OF INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

Heather Reisman
Chair & Chief Executive Officer



Kay Brekken
Chief Financial Officer

Dated as of the 8th day of November, 2011.

Consolidated Balance Sheets

(Unaudited)

(thousands of Canadian dollars)	**As at October 1, 2011**	As at October 2, 2010	As at April 2, 2011
ASSETS			
Current			
Cash and cash equivalents (note 5)	**45,491**	61,822	83,661
Accounts receivable	**21,831**	10,535	12,684
Inventories (note 6)	**263,918**	267,316	232,694
Income taxes recoverable	**–**	899	–
Prepaid expenses	**15,285**	22,152	7,941
Total current assets	**346,525**	362,724	336,980
Property, plant and equipment	**76,031**	83,091	78,777
Intangible assets	**31,251**	26,780	30,614
Deferred tax assets	**68,250**	48,127	38,004
Goodwill (note 7)	**1,216**	26,632	26,632
Total assets	**523,273**	547,354	511,007
LIABILITIES AND EQUITY			
Current			
Accounts payable and accrued liabilities	**224,159**	217,587	180,899
Unredeemed gift card liability	**36,292**	32,838	40,991
Provisions	**–**	130	–
Deferred revenue	**12,401**	23,619	11,528
Income taxes payable	**650**	–	657
Notes payable (note 15)	**5,168**	–	–
Current portion of long-term debt	**1,305**	1,392	1,290
Total current liabilities	**279,975**	275,566	235,365
Long-term accrued liabilities	**5,038**	6,962	6,284
Long-term debt	**1,623**	2,347	1,995
Total liabilities	**286,636**	284,875	243,644
Equity			
Share capital (note 8)	**202,962**	199,914	202,220
Contributed surplus (note 9)	**6,839**	5,930	6,066
Retained earnings	**4,882**	52,740	48,629
Total equity attributable to shareholders of the Company	**214,683**	258,584	256,915
Non-controlling interest	**21,954**	3,895	10,448
Total equity	**236,637**	262,479	267,363
Total liabilities and equity	**523,273**	547,354	511,007

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 October 1, 2011**	13-week period ended October 2, 2010	**26-week period ended October 1, 2011**	26-week period ended October 2, 2010
Revenues	**218,472**	214,764	**420,565**	419,050
Cost of sales (note 6)	**130,064**	124,362	**255,459**	242,117
Gross profit	**88,408**	90,402	**165,106**	176,933
Cost of operations (note 10)	**66,053**	65,304	**131,709**	129,907
Selling and administrative expenses (note 10)	**29,056**	21,894	**59,822**	44,848
Foreign currency translation	**715**	570	**859**	378
Operating earnings (loss) before the following	**(7,416)**	2,634	**(27,284)**	1,800
Depreciation of property, plant and equipment	**4,700**	4,315	**9,294**	8,781
Amortization of intangible assets	**3,874**	2,518	**7,499**	4,930
Impairment of goodwill (note 7)	**25,416**	–	**25,416**	–
Interest on long-term debt and financing charges	**39**	10	**83**	43
Interest expense (income) on cash and cash equivalents	**20**	(104)	**(139)**	(184)
Loss before income taxes	**(41,465)**	(4,105)	**(69,437)**	(11,770)
Income tax expense (recovery)	**(1,074)**	498	**(4,852)**	87
Net loss and comprehensive loss for the period	**(40,391)**	(4,603)	**(64,585)**	(11,857)
Net loss and comprehensive loss attributable to:				
Shareholders of the Company	**(35,120)**	(1,768)	**(53,225)**	(7,128)
Non-controlling interest	**(5,271)**	(2,835)	**(11,360)**	(4,729)
Total net loss and comprehensive loss for the period	**(40,391)**	(4,603)	**(64,585)**	(11,857)
Net loss per common share (note 11)				
Basic	**$(1.39)**	$(0.07)	**$(2.11)**	$(0.29)
Diluted	**$(1.39)**	$(0.07)	**$(2.11)**	$(0.29)

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 26-week period ended October 2, 2010	–	–	(7,128)	(7,128)	(4,729)	(11,857)
Exercise of options (note 9)	1,429	(248)	–	1,181	–	1,181
Directors' deferred stock units converted	60	(60)	–	–	–	–
Shares repurchased under NCIB (note 8)	(210)	–	(177)	(387)	–	(387)
Stock-based compensation (note 9)	–	289	–	289	509	798
Directors' compensation (note 9)	–	316	–	316	–	316
Dividends paid	–	–	(5,451)	(5,451)	–	(5,451)
Issuance of equity securities by subsidiary	–	–	–	–	1,190	1,190
Balance, October 2, 2010	199,914	5,930	52,740	258,584	3,895	262,479
Balance, April 2, 2011	**202,220**	**6,066**	**48,629**	**256,915**	**10,448**	**267,363**
Loss for the 26-week period ended October 1, 2011	**–**	**–**	**(53,225)**	**(53,225)**	**(11,360)**	**(64,585)**
Exercise of options (note 9)	**742**	**(164)**	**–**	**578**	**–**	**578**
Directors' deferred stock units converted	**–**	**–**	**–**	**–**	**–**	**–**
Shares repurchased under NCIB (note 8)	**–**	**–**	**–**	**–**	**–**	**–**
Stock-based compensation (note 9)	**–**	**670**	**–**	**670**	**1,521**	**2,191**
Directors' compensation (note 9)	**–**	**267**	**–**	**267**	**–**	**267**
Dividends paid	**–**	**–**	**(5,539)**	**(5,539)**	**–**	**(5,539)**
Acquisition of non-capital tax losses (note 15)	**–**	**–**	**15,017**	**15,017**	**–**	**15,017**
Issuance of equity securities by subsidiary to non-controlling interest	**–**	**–**	**–**	**–**	**21,345**	**21,345**
Balance, October 1, 2011	**202,962**	**6,839**	**4,882**	**214,683**	**21,954**	**236,637**

See accompanying notes

Consolidated Statements of Cash Flows

(Unaudited)

(thousands of Canadian dollars)	**13-week period ended October 1, 2011**	13-week period ended October 2, 2010	**26-week period ended October 1, 2011**	26-week period ended October 2, 2010
CASH FLOWS FROM OPERATING ACTIVITIES				
Net loss for the period	**(40,391)**	(4,603)	**(64,585)**	(11,857)
Add (deduct) items not affecting cash				
Depreciation of property, plant and equipment	**4,700**	4,315	**9,294**	8,781
Amortization of intangible assets	**3,874**	2,518	**7,499**	4,930
Impairment of goodwill (note 7)	**25,416**	–	**25,416**	–
Loss on disposal of capital assets	**11**	2	**15**	69
Stock-based compensation (note 9)	**75**	66	**670**	289
Directors' compensation (note 9)	**118**	204	**267**	316
Deferred tax assets	**(1,250)**	498	**(4,852)**	87
Interest on long-term debt and financing charges	**39**	10	**83**	43
Interest expense (income) on cash and cash equivalents	**20**	(104)	**(139)**	(184)
Other	**(1,148)**	1,510	**(887)**	639
Net change in non-cash working capital balances related to operations				
Accounts receivable	**(7,451)**	292	**(9,147)**	(2,080)
Inventories	**(48,172)**	(43,480)	**(31,224)**	(42,910)
Prepaid expenses	**(8,445)**	(16,204)	**(7,344)**	(15,381)
Income taxes payable (recoverable)	**1**	–	**(7)**	–
Accounts payable and accrued liabilities	**58,540**	44,743	**42,014**	37,283
Unredeemed gift card liability	**(5,308)**	(4,622)	**(4,699)**	(4,978)
Provisions	**–**	–	**–**	(48)
Deferred revenue	**934**	8,770	**873**	10,737
Cash flows used in operating activities	**(18,437)**	(6,085)	**(36,753)**	(14,264)
CASH FLOWS FROM INVESTING ACTIVITIES				
Acquisition of non-capital tax losses (note 15)	**(450)**	–	**(10,559)**	–
Purchase of property, plant and equipment	**(3,893)**	(10,535)	**(6,246)**	(14,812)
Addition of intangible assets	**(4,505)**	(4,438)	**(8,136)**	(7,917)
Cash flows used in investing activities	**(8,848)**	(14,973)	**(24,941)**	(22,729)
CASH FLOWS FROM FINANCING ACTIVITIES				
Note payable (note 15)	**225**	–	**5,280**	–
Repayment of long-term debt	**(393)**	(961)	**(712)**	(1,627)
Interest received	**46**	84	**218**	134
Proceeds from share issuances (note 8)	**–**	1,107	**578**	1,181
Repurchase of common shares	**–**	(74)	**–**	(387)
Issuance of equity securities by subsidiary to non-controlling interest	**–**	1,190	**21,345**	1,190
Dividends paid	**(2,772)**	(2,729)	**(5,539)**	(5,451)
Cash flows from (used in) financing activities	**(2,894)**	(1,383)	**21,170**	(4,960)
Effect of foreign currency exchange rate changes on cash and cash equivalents	**2,285**	(1,247)	**2,354**	(123)
Net decrease in cash and cash equivalents during the period	**(27,894)**	(23,688)	**(38,170)**	(42,076)
Cash and cash equivalents, beginning of period	**73,385**	85,510	**83,661**	103,898
Cash and cash equivalents, end of period	**45,491**	61,822	**45,491**	61,822

See accompanying notes

Notes to Interim Condensed Consolidated Financial Statements

October 1, 2011

(Unaudited)

1. CORPORATE INFORMATION

Indigo Books & Music Inc. (the "Company" or "Indigo") is a corporation domiciled and incorporated under the laws of the Province of Ontario in Canada. The Company's registered office is located at 468 King Street West, Toronto, Ontario, M5V 1L8, Canada. The unaudited interim condensed consolidated financial statements of the Company as at and for the 13 and 26 weeks ended October 1, 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. BASIS OF PREPARATION

Statement of compliance

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

The unaudited interim condensed consolidated financial statements for the three and six-month periods ended October 1, 2011 were prepared in accordance with IAS 34, "Interim Financial Reporting". The same accounting policies and methods of computation were followed in the preparation of these unaudited interim condensed consolidated financial statements as those used in the preparation of the unaudited interim condensed consolidated financial statements for the three-month period ended July 2, 2011. In addition, the unaudited interim condensed consolidated financial statements for the three-month period ended July 2, 2011 contain certain incremental annual IFRS disclosures not included in the audited annual financial statements for the year ended April 2, 2011 prepared in accordance with previous Canadian GAAP. Accordingly, these unaudited interim condensed consolidated financial statements for the three and six-month periods ended October 1, 2011 should be read together with the audited annual consolidated financial statements for the year ended April 2, 2011 prepared in accordance with previous Canadian GAAP as well as the unaudited interim condensed consolidated financial statements for the three-month period ended July 2, 2011.

These unaudited interim condensed consolidated financial statements were approved by the Board of Directors on November 8, 2011.

Significant estimates and judgments

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

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

3. NEW ACCOUNTING PRONOUNCEMENTS

Financial Instruments: 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 its disclosures as the Company does not generally perform transfers of financial assets.

Income Taxes ("IAS 12")

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

Financial Instruments ("IFRS 9")

The IASB has issued a new standard, IFRS 9, which will ultimately replace IAS 39, "Financial Instruments: Recognition and Measurement" ("IAS 39"). The replacement of IAS 39 is a multi-phase project with the objective of improving and simplifying the reporting for financial instruments. Issuance of IFRS 9 is part of the first phase of the IAS 39 replacement project. IFRS 9 had an original effective date of January 1, 2013 which 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 Company expects to adopt these new standards and amendments in the first quarter of fiscal 2014. The following is a list and description of these new standards and amendments:

- Consolidated Financial Statements ("IFRS 10") establishes the standards for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. IFRS 10 establishes a single control model that applies to all entities. 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. Currently, the Company accounts for its interest in Calendar Club under IAS 31 using proportionate consolidation. However, based on a preliminary analysis completed by the Company, its interest in Calendar Club will meet the definition of a joint venture under IFRS 11 and will need to be accounted for using the equity method beginning in fiscal 2014;
- Disclosure of Interests in Other Entities ("IFRS 12") includes all of the disclosures that were previously in IAS 27, "Separate Financial Statements," IAS 31 and IAS 28, "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 is expected to increase 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 currently has no financial or non-financial items which are measured at fair value. As such, this standard is not expected to have a significant impact on the Company's consolidated financial statements;
- Separate Financial Statements ("IAS 27") has been amended to remove all requirements relating to consolidated financial statements. Prior to this amendment, the Company applied IAS 27 to the preparation of its consolidated financial statements. However, as Indigo does not prepare separate financial statements, the amended IAS 27 will no longer be applicable to the Company; and
- Investments in Associates and Joint Ventures ("IAS 28") has been amended for conforming changes based on the issuance of IFRS 10 and IFRS 11. The amendments to IAS 28 relate to accounting for associates and joint ventures held for sale, and to changes in interests held in associates and joint ventures. Currently, neither of these scenarios applies to the Company and, as such, these amendments are not expected to have a significant impact on the Company's consolidated financial statements.

4. SEASONALITY OF OPERATIONS

The business of Indigo follows a seasonal pattern, with sales of merchandise being highest in the third fiscal quarter due to consumer holiday buying patterns. As a result, a disproportionate portion of total annual revenues are typically earned in the third fiscal quarter. Therefore, the results of operations for the 13 and 26-week periods ended October 1, 2011 and October 2, 2010 are not indicative of the results of other periods.

5. CASH AND CASH EQUIVALENTS

As at October 1, 2011, the Company had no cash equivalents. Cash consists of the following:

(thousands of Canadian dollars)	**October 1, 2011**	October 2, 2010	April 2, 2011
Cash	**43,859**	59,350	83,021
Restricted cash	**1,632**	2,472	640
Cash and cash equivalents	**45,491**	61,822	83,661

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

6. INVENTORIES

Inventories consist of finished goods. The cost of inventories recognized as an expense for the 13 and 26-week periods ended October 1, 2011 were $124.6 million and $234.5 million, respectively (2010: 13 weeks – $120.6 million; 26 weeks – $236.9 million). The amount of inventory write-downs as a result of net realizable value lower than cost was $1.2 million during the period (2010 – $1.1 million), and there were no reversals of inventory write-downs that were recognized in prior periods. The amount of inventory with net realizable value equal to cost was $0.9 million as at October 1, 2011 (2010 – $1.1 million).

7. GOODWILL

The Company performs goodwill impairment testing annually and assesses at each reporting date whether there is any indication that goodwill may be impaired. The most recent goodwill impairment test as at April 2, 2011 resulted in no identification of goodwill impairment. However, business conditions have deteriorated since year end and during the second quarter, Indigo segment performance was significantly lower than expected and the Company's market capitalization had declined significantly from year end. These conditions, among other factors, indicated that goodwill may be impaired. As a result, the

Company performed a goodwill impairment test as at October 1, 2011 which resulted in a full write-down of goodwill allocated to the Indigo segment. Unlike other asset impairments, goodwill impairment charges cannot be reversed once they are recorded.

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 group of CGUs used by the Company for impairment testing was at the segment level. 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 inflation and general retail industry averages. The carrying value of Indigo segment assets exceeded its recoverable amount, which resulted in the goodwill impairment charge.

The key assumptions from the Indigo discounted cash flow model are those regarding growth rates and discount rates. Average growth rate used for the October 1, 2011 impairment test was 2.0% and the discount rate was 14.0%. Average growth rate used for the goodwill impairment test performed at April 2, 2011 was 2.0% and the 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 from the most recent financing round in April 2011 of $3.86. There was no impairment identified for the goodwill allocated to the Kobo segment and there are no reasonably possible changes to Kobo's market capitalization that would result in a write-down of allocated goodwill.

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

(thousands of Canadian dollars)	**October 1, 2011**	October 2, 2010	April 2, 2011
Indigo segment	**–**	25,416	25,416
Kobo segment	**1,216**	1,216	1,216
Total goodwill	**1,216**	26,632	26,632

8. SHARE CAPITAL

Share capital consists of the following:

	26-week period ended October 1, 2011		26-week period ended October 2, 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	4,283	60
Options exercised	**58,000**	**742**	148,442	1,429	419,442	3,735
Repurchase of common shares	**–**	**–**	(26,100)	(210)	(26,100)	(210)
Balance, end of period	**25,198,540**	**202,962**	24,869,540	199,914	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 26-week period ended October 2, 2010, the Company repurchased 26,100 common shares at an average price of $14.79 per share for a total cash consideration of $0.4 mil-

lion under the NCIB. The repurchased shares were cancelled and returned to treasury. The cash consideration exceeded the carrying value of the shares repurchased by $0.2 million and the amount was charged to retained earnings. The NCIB expired on November 1, 2010.

9. SHARE-BASED COMPENSATION

As at October 1, 2011, 1,646,600 stock options were outstanding with exercise prices ranging from $4.45 to $16.75. Of these outstanding stock options, 733,100 were exercisable. As at October 2, 2010, there were 1,645,100 stock options outstanding of which 800,100 were exercisable.

The Company uses the fair value method of accounting for stock options, which estimates the fair value of the stock options granted on the date of grant, net of estimated forfeitures, and expenses this value over the vesting period. There were no stock options granted during the 13-week period ended October 1, 2011 (2010 – $0.1 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 October 2, 2010
Risk-free interest rate	2.3%
Expected volatility	33.7%
Expected time until exercise	5.3 years
Expected dividend yield	3.2%
Forfeiture rate	24.2%

Directors' compensation

The Company has established a Directors' Deferred Share Unit Plan ("DSU Plan"). Under the DSU Plan, Directors receive their annual retainer fees and other Board-related compensation in the form of deferred share units ("DSUs"). The number of shares reserved for issuance under this plan is 250,000. The Company issued 15,867 DSUs with a value of $0.1 million (2010 – $0.1 million) during the 13-week period ended October 1, 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 October 1, 2011 was $2.7 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.

The Company has entered into agreements to allow one Indigo Director and one Kobo Director to purchase shares of Kobo. These agreements allow for the purchase of up to 470,000 Kobo shares directly from Indigo. Exercise price ranges from $1.00 – $3.86 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 and July 5, 2021. Kobo's share price based on the most recent financing round in April 2011 was $3.86 and the Company has recorded $0.9 million as a liability relating to these options (2010 – $0.2 million). These options have a nil intrinsic value as at October 1, 2011 (2010 – nil).

10. EMPLOYEE BENEFITS EXPENSE

(thousands of Canadian dollars)	**13-week period ended October 1, 2011**	13-week period ended October 2, 2010	**26-week period ended October 1, 2011**	26-week period ended October 2, 2010
Wages, salaries and bonuses	**40,480**	37,190	**82,916**	74,526
Short-term benefits expense	**4,453**	4,168	**9,254**	9,049
Termination benefits expense	**298**	223	**600**	382
Retirement benefits expense	**302**	324	**617**	644
Stock-based compensation	**1,596**	575	**2,191**	798
Total employee benefits expense	**47,129**	42,480	**95,578**	85,399

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 October 1, 2011 and October 2, 2010 diluted loss per share calculations.

12. CASH FLOW STATEMENT

Supplemental cash flow information:

(thousands of Canadian dollars)	**13-week period ended October 1, 2011**	13-week period ended October 2, 2010	**26-week period ended October 1, 2011**	26-week period ended October 2, 2010
Assets acquired under capital lease	**317**	2,042	**317**	2,329

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 October 1, 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:

(thousands of Canadian dollars)	**October 1, 2011**	October 2, 2010	April 2, 2011
Current portion of long-term debt	**1,305**	1,392	1,290
Long-term debt	**1,623**	2,347	1,995
Notes payable	**5,168**	–	–
Total debt	**8,096**	3,739	3,285
Total equity	**236,637**	262,479	267,363
Total debt : Total equity	**0.03:1**	0.01:1	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)	**October 1, 2011**	October 2, 2010
Reconciliation of Assets		
Assets		
Indigo	**454,764**	522,946
Kobo	**69,246**	27,415
Intercompany eliminations	**(737)**	(3,007)
Total assets	**523,273**	547,354
Reconciliation of Liabilities		
Liabilities		
Indigo	**238,564**	270,368
Kobo	**48,072**	17,514
Intercompany eliminations	**–**	(3,007)
Total liabilities	**286,636**	284,875

(thousands of Canadian dollars)	**13-week period ended October 1, 2011**	13-week period ended October 2, 2010	**26-week period ended October 1, 2011**	26-week period ended October 2, 2010
Reconciliation of Revenues				
Revenues				
Indigo	**197,248**	206,332	**385,253**	405,064
Kobo	**40,920**	12,816	**57,902**	22,303
Intercompany eliminations	**(19,696)**	(4,384)	**(22,590)**	(8,317)
Total revenues	**218,472**	214,764	**420,565**	419,050
Reconciliation of Loss				
Loss before income taxes				
Indigo	**(29,923)**	2,717	**(45,664)**	(726)
Kobo	**(10,845)**	(6,822)	**(23,373)**	(11,044)
Intercompany eliminations	**(697)**	–	**(400)**	–
Loss before income taxes	**(41,465)**	(4,105)	**(69,437)**	(11,770)
Income tax expense (recovery)	**(1,074)**	498	**(4,852)**	87
Net loss and comprehensive loss for the periods	**(40,391)**	(4,603)	**(64,585)**	(11,857)

(thousands of Canadian dollars)	**13-week period ended October 1, 2011**	13-week period ended October 2, 2010	**26-week period ended October 1, 2011**	26-week period ended October 2, 2010
Selected Supplementary Information				
Depreciation and amortization expense				
Indigo	**6,660**	6,124	**13,200**	12,460
Kobo	**1,914**	709	**3,593**	1,251
Total depreciation and amortization expense	**8,574**	6,833	**16,793**	13,711
Net interest				
Indigo	**96**	(88)	**68**	(130)
Kobo	**(37)**	(6)	**(124)**	(11)
Total net interest expense (income)	**59**	(94)	**(56)**	(141)
Capital expenditures				
Indigo	**5,911**	13,616	**9,736**	20,050
Kobo	**2,487**	1,357	**4,646**	2,679
Total capital expenditures	**8,398**	14,973	**14,382**	22,729

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 October 1, 2011**	13-week period ended October 2, 2010	**26-week period ended October 1, 2011**	26-week period ended October 2, 2010
Wages, salaries, bonus and consulting	**1,074**	559	**2,562**	1,700
Short-term benefits expense	**59**	55	**122**	111
Retirement benefits expense	**13**	20	**31**	39
Stock-based compensation	**(50)**	98	**413**	222
Directors' compensation	**118**	204	**267**	316
Total remuneration	**1,214**	936	**3,395**	2,388

Transactions with shareholders

On August 31, 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 $4.3 million of non-capital tax losses in exchange for net cash consideration of $0.2 million and a note payable of $0.2 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 $1.1 million and the difference of $0.6 million between the net cash consideration and the deferred tax asset was recorded directly to retained earnings. There was no such transaction in the second 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 13 and 26-week periods ending October 1, 2011 is $3.3 million and $4.3 million, respectively, paid by Indigo (2010: 13-week period – $6.0 million; 26-week period – $7.7 million).

Transactions with subsidiaries

During the quarter, the Company earned revenue from Kobo through a revenue-sharing agreement, provided back office management services to Kobo, and purchased inventory from Kobo. For Indigo gift cards which are redeemed on Kobo's website, the Company pays Kobo for the value of the gift card, less a commission fee. All related party transactions were recorded in the Consolidated Statements of Loss and Comprehensive Loss. The net amount of these transactions for the 13 and 26-week periods was $18.1 million and $21.4 million, respectively, paid by Indigo (2010: 13-week period – $4.4 million; 26-week period – $8.3 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 ("Canadian GAAP" or "CGAAP"). The Company's audited annual consolidated financial statements for the 52 weeks ended March 31, 2012 will be the first audited annual consolidated financial statements prepared in accordance with the requirements of IFRS. Accordingly, the Company will make an unreserved statement of compliance with IFRS beginning with its fiscal 2012 annual financial statements.

The Company's significant accounting policies presented in note 2 of the Company's First Quarter Report have been applied in preparing the unaudited interim condensed consolidated financial statements for the 13 and 26-week periods ended October 1, 2011, the comparative consolidated financial statements for the 13 and 26-week periods ended October 2, 2010, and the 52-week period ended April 2, 2011.

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

An explanation of how the transition from CGAAP to IFRS has affected the Company's financial position, financial performance and cash flows as at October 2, 2010 and for the 13 and 26 weeks ended October 2, 2010 is set out in the following reconciliations and in the notes accompanying the reconciliations.

Reconciliation of Equity from CGAAP to IFRS

The following is a reconciliation of the Company's total shareholders' equity reported in accordance with CGAAP to its total equity in accordance with IFRS as at October 2, 2010:

(thousands of Canadian dollars)	Notes	Share Capital	Contributed Surplus	Retained Earnings	Total	Non-controlling Interest	Total Equity
Total shareholders' equity as reported under Canadian GAAP		199,906	4,992	42,919	247,817	–	247,817
Differences increasing (decreasing) reported amount:							
Deferred credit	1	–	–	12,945	12,945	–	12,945
Impairment of capital assets	2	–	–	(2,490)	(2,490)	–	(2,490)
Stock-based compensation	3	8	938	(1,132)	(186)	–	(186)
Future tax asset	4	–	–	655	655	–	655
Non-controlling interest	5	–	–	(157)	(157)	157	–
Reclassification of non-controlling interest to total equity under IFRS	7	–	–	–	–	3,738	3,738
		8	938	9,821	10,767	3,895	14,662
Total equity as reported under IFRS		199,914	5,930	52,740	258,584	3,895	262,479

See accompanying notes

Reconciliation of consolidated loss and comprehensive loss from CGAAP to IFRS

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

Reconciliation of Consolidated Statements of Loss and Comprehensive Loss for the 13 Weeks Ended October 2, 2010

(thousands of Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balance	IFRS adjustments	IFRS reclassifications	IFRS balance	IFRS accounts
Revenues		214,764	–	–	214,764	**Revenues**
Cost of sales, operations, selling and administration	8	212,040	–	(87,678)	124,362	Cost of sales
		2,724	–	87,678	90,402	**Gross profit**
	8	–	–	65,304	65,304	Cost of operations
	3,5,8	–	90	21,804	21,894	Selling and administrative expenses
	8	–	–	570	570	Foreign currency translation
		2,724	(90)	–	2,634	**Operating profit before the following**
Depreciation of property, plant and equipment	2	4,465	(150)	–	4,315	Depreciation of property, plant and equipment
Amortization of intangible assets		2,518	–	–	2,518	Amortization of intangible assets
Interest on long-term debt and financing charges		10	–	–	10	Interest on long-term debt and financing charges
Interest income on cash and cash equivalents		(104)	–	–	(104)	Interest income on cash and cash equivalents
Loss before income taxes and non-controlling interest		(4,165)	60	–	(4,105)	**Loss before income taxes**
Income tax expense	4	458	40	–	498	Income tax expense
Loss before non-controlling interest		(4,623)	20	–	(4,603)	**Net loss and comprehensive loss for the period**
Non-controlling interest	5,7	(2,814)	(21)	–	(2,835)	Net loss and comprehensive loss attributable to non-controlling interest
Net loss and comprehensive loss for the period		(1,809)	41	–	(1,768)	Net loss and comprehensive loss attributable to shareholders of the Company

See accompanying notes

Reconciliation of Consolidated Statements of Loss and Comprehensive Loss for the 26 Weeks Ended October 2, 2010

(thousands of Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balance	IFRS adjustments	IFRS reclassifications	IFRS balance	IFRS accounts
Revenues		419,050	–	–	419,050	**Revenues**
Cost of sales, operations, selling and administration	8	417,054	–	(174,937)	242,117	Cost of sales
		1,996	–	174,937	176,933	**Gross profit**
	8	–	–	129,907	129,907	Cost of operations
	3,5,8	–	196	44,652	44,848	Selling and administrative expenses
	8	–	–	378	378	Foreign currency translation
		1,996	(196)	–	1,800	**Operating profit before the following**
Depreciation of property, plant and equipment	2	8,970	(189)	–	8,781	Depreciation of property, plant and equipment
Amortization of intangible assets		4,930	–	–	4,930	Amortization of intangible assets
Interest on long-term debt and financing charges		43	–	–	43	Interest on long-term debt and financing charges
Interest income on cash and cash equivalents		(184)	–	–	(184)	Interest income on cash and cash equivalents
Loss before income taxes and non-controlling interest		(11,763)	(7)	–	(11,770)	**Loss before income taxes**
Income tax expense	4	37	50	–	87	Income tax expense
Loss before non-controlling interest		(11,800)	(57)	–	(11,857)	**Net loss and comprehensive loss for the period**
Non-controlling interest	5,7	(4,683)	(46)	–	(4,729)	Net loss and comprehensive loss attributable to non-controlling interest
Net loss and comprehensive loss for the period		(7,117)	(11)	–	(7,128)	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 October 2, 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	59,350	–	2,472	61,822	Cash and cash equivalents
Restricted cash	9	2,472	–	(2,472)	–	
Accounts receivable		10,535	–	–	10,535	Accounts receivable
Inventories		267,316	–	–	267,316	Inventories
Income taxes recoverable		899	–	–	899	Income taxes recoverable
Prepaid expenses		22,152	–	–	22,152	Prepaid expenses
Future tax assets	9	6,578	–	(6,578)	–	
Total current assets		369,302	–	(6,578)	362,724	**Total current assets**
Property, plant and equipment	2	85,580	(2,489)	–	83,091	Property, plant and equipment
Intangible assets	2	26,781	(1)	–	26,780	Intangible assets
Future tax assets	4,9	40,894	655	6,578	48,127	Deferred tax assets
Goodwill		26,632	–	–	26,632	Goodwill
Total assets		549,189	(1,835)	–	547,354	**Total assets**
LIABILITIES AND SHAREHOLDERS' EQUITY						**LIABILITIES AND EQUITY**
Current						**Current**
Accounts payable and accrued liabilities	1,3,9,10	263,314	(12,759)	(32,968)	217,587	Accounts payable and accrued liabilities
	9	–	–	32,838	32,838	Unredeemed gift card liability
	10	–	–	130	130	Provisions
Deferred revenue		23,619	–	–	23,619	Deferred revenue
Current portion of long-term debt		1,392	–	–	1,392	Current portion of long-term debt
Total current liabilities		288,325	(12,759)	–	275,566	**Total current liabilities**
Long-term accrued liabilities		6,962	–	–	6,962	Long-term accrued liabilities
Long-term debt		2,347	–	–	2,347	Long-term debt
Total liabilities		297,634	(12,759)	–	284,875	**Total liabilities**
Shareholders' equity						**Equity**
Share capital	3	199,906	8	–	199,914	Share capital
Contributed surplus	3	4,992	938	–	5,930	Contributed surplus
Retained earnings	1-7	42,919	9,821	–	52,740	Retained earnings
Total shareholders equity		247,817	10,767	–	258,584	**Total equity attributable to shareholders of the Company**
Non-controlling interest	5,7	3,738	157	–	3,895	Non-controlling interest
					262,479	Total equity
Total liabilities and shareholders' equity		549,189	(1,835)	–	547,354	**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						**ASSETS**
Current						**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						**LIABILITIES AND EQUITY**
Current						**Current**
Accounts payable and accrued liabilities	1,3,9,10	224,959	(3,069)	(40,991)	180,899	Accounts payable and accrued liabilities
	9	–	–	40,991	40,991	Unredeemed gift card liability
	10	–	–	–	–	Provisions
Deferred revenue		11,528	–	–	11,528	Deferred revenue
Income taxes payable		657	–	–	657	Income taxes payable
Current portion of long-term debt		1,290	–	–	1,290	Current portion of long-term debt
Total current liabilities		238,434	(3,069)	–	235,365	**Total current liabilities**
Long-term accrued liabilities		6,284	–	–	6,284	Long-term accrued liabilities
Long-term debt		1,995	–	–	1,995	Long-term debt
Total liabilities		246,713	(3,069)	–	243,644	**Total liabilities**
Shareholders' equity						**Equity**
Share capital	3	202,196	24	–	202,220	Share capital
Contributed surplus	3	5,039	1,027	–	6,066	Contributed surplus
Retained earnings	1-7	55,885	(7,256)	–	48,629	Retained earnings
Total shareholders' equity		263,120	(6,205)	–	256,915	**Total equity attributable to shareholders of the Company**
Non-controlling interest	5,6,7	6,347	4,101	–	10,448	Non-controlling interest
					267,363	**Total equity**
Total liabilities and shareholders' equity		516,180	(5,173)	–	511,007	**Total liabilities and equity**

See accompanying notes

Notes to the reconciliations

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

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

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

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

2. Impairment of Capital Assets ("IAS 36")

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

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

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

3. Share-based Payments ("IFRS 2")

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

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

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

4. Tax Impact of IFRS Transition

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

5. Kobo IFRS Impact

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

6. Consolidated and Separate Financial Statements ("IAS 27")

   Under CGAAP, when the issue of shares by a subsidiary results in the reduction of a parent's ownership of the subsidiary without a loss of control, the difference between the net consideration paid by the parent and the change in the parent's share of the subsidiary's net identifiable assets is accounted for as a gain.

   Under IAS 27, changes in a parent's ownership interest in a subsidiary which do not result in a loss of control are accounted for as equity transactions.

   As part of the Company's transition to IFRS, the CGAAP dilution gain has been reversed, resulting in a reduction to earnings and a corresponding increase to non-controlling interest.

7. Presentation of Non-controlling Interest

   A difference exists between CGAAP and IFRS with respect to the presentation of non-controlling interest. Under CGAAP, non-controlling interest was presented as a separate line item and excluded from total shareholders' equity while under IFRS, non-controlling interest is included as part of total equity.

8. Presentation of Consolidated Statements of Earnings (Loss) and Comprehensive Earnings (Loss)

   The Company classifies expenses according to their function and under IFRS, the Company is required to disclose its cost of sales separately from other expenses.

9. Presentation of Consolidated Balance Sheets

   Restricted cash: IFRS does not require presentation of restricted cash as a separate line item on the face of the balance sheets. Following a review of the Company's cash disclosure requirements under IFRS, management has chosen to disclose restricted cash as part of note disclosures instead of on the face of the balance sheets.

   Deferred income tax: Under IFRS terminology, future tax assets have been renamed to deferred tax assets. IFRS does not separately present deferred tax assets as current and non-current. As such, CGAAP current future tax assets have been reclassified as IFRS non-current deferred tax assets on the Company's consolidated balance sheets.

   Unredeemed gift card liability: IFRS requires separate presentation of certain liabilities. As such, amounts have been reclassified from current accounts payable and accrued liabilities to unredeemed gift card liability.

10. Provisions, Contingent Liabilities and Contingent Assets ("IAS 37")

    Under CGAAP, a provision was recorded based on the likely probability that payment or surrender of assets would be required to fulfill the obligation. However, under IAS 37, a provision must be recorded when it is probable or more likely than not, which is a lower threshold for recognition than CGAAP.

    IAS 37 requires an entity to recognize a provision when a contract becomes onerous (i.e., when it has a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it). The unavoidable costs under a contract reflect the lowest net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it. If an entity has a contract that is onerous, the present obligation under the contract shall be recognized and measured as a provision. CGAAP only requires the recognition of such a liability in certain prescribed situations. IFRS also requires separate presentation of provisions.

In conformity with IFRS presentation requirements, amounts were reclassified between accounts payable and accrued liabilities and provisions, as they met IFRS criteria for recognition as a provision. The Company has reviewed its obligations at transition date, including a full review of store leases, and did not recognize any new provisions.

Statement of cash flows

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

17. SUBSEQUENT EVENT

On November 8, 2011, Indigo entered into an agreement with Rakuten, Inc. ("Rakuten") for Rakuten to acquire all the outstanding shares of Kobo for an aggregate purchase price of approximately US$315 million, on a fully diluted basis, subject to certain customary adjustments on closing. The transaction is also subject to relevant regulatory approval, including *Investment Canada Act*, and is expected to close in Q4 of Indigo's fiscal 2012. Upon the sale of Kobo, Indigo is expected to receive net cash proceeds of US$140 million to US$150 million. The accounting gain cannot be determined at this time. The transaction was unanimously approved by the Board of Directors on November 8, 2011.

Below is a summary of Kobo's assets and liabilities and segment results that are included in the consolidated results during the periods presented:

(thousands of Canadian dollars)	**October 1, 2011**	October 2, 2010
Assets		
Current assets	**58,685**	20,602
Long-term assets	**10,561**	6,813
Total assets	**69,246**	27,415
Liabilities		
Current liabilities	**47,949**	17,514
Long-term liabilities	**123**	–
Total liabilities	**48,072**	17,514

(thousands of Canadian dollars)	**13-week period ended October 1, 2011**	13-week period ended October 2, 2010	**26-week period ended October 1, 2011**	26-week period ended October 2, 2010
Revenues	**40,920**	12,816	**57,902**	22,303
Expenses	**51,765**	19,638	**81,275**	33,347
Segment loss	**(10,845)**	(6,822)	**(23,373)**	(11,044)

Kobo's segment will be retroactively restated as a discontinued operation commencing in the third quarter of fiscal 2012.

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