As the **story** changes, a **new** chapter **unfolds**.

Indigo

Enrich your life™

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Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") is prepared as at November 6, 2012 and is based primarily on the unaudited interim condensed consolidated financial statements of Indigo Books & Music Inc. (the "Company" or "Indigo") for the 13 and 26-week periods ended September 29, 2012 and October 1, 2011. The Company's unaudited interim condensed consolidated financial statements and the accompanying notes are reported in Canadian dollars and have been prepared in accordance with International Financial Reporting Standards ("IFRS") and International Accounting Standard ("IAS") 34, "Interim Financial Reporting," as issued by the International Accounting Standards Board ("IASB") using the accounting policies described therein.

These unaudited interim condensed consolidated financial statements do not contain all disclosures required by IFRS for annual financial statements. This MD&A should be read in conjunction with the unaudited interim condensed consolidated financial statements and notes contained in this Quarterly Report, the audited annual consolidated financial statements and accompanying notes for the 52-week period ended March 31, 2012 and the MD&A included in the Company's fiscal 2012 Annual Report. 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, gift and specialty toy 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 September 29, 2012, the Company operated 97 superstores under the banners *Chapters*, *Indigo* and the *World's Biggest Bookstore* and 140 small format stores, under the banners *Coles*, *Indigo*, *Indigospirit*, *SmithBooks*, and *The Book Company*. During the second quarter of fiscal 2013, the Company closed one small format store. The Company has a 50% interest in Calendar Club of Canada Limited Partnership ("Calendar Club"), which operates seasonal kiosks and year-round stores in shopping malls across Canada.

The Company had one subsidiary last year, Kobo Inc. ("Kobo"). On November 8, 2011, Indigo entered into an agreement with Rakuten, Inc. ("Rakuten") for Rakuten to acquire all the outstanding shares of Kobo on a fully diluted basis for an aggregate purchase price of US$315.0 million. The Company continued to eliminate all intercompany transactions until the sale was closed.

The sale transaction was unanimously approved by the Board of Directors on November 8, 2011 and closed on January 11, 2012 following the satisfaction of all closing conditions. Indigo received net cash proceeds of US$146.1 million from the Kobo sale and recorded a pre-tax accounting gain of $164.5 million as part of discontinued operations.

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 2013 was 25,264,420 as compared to 25,198,540 last year. As at November 6, 2012, the number of outstanding common shares was 25,276,889 with a book value of $203.7 million. The number of common shares reserved for issuance under the employee stock option plan is 2,177,689 as at November 6, 2012. As at September 29, 2012, there were 1,512,500 stock options outstanding of which 594,500 were exercisable.

Results of Operations

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

(millions of Canadian dollars)	**13-week period ended September 29, 2012**	**% Revenues**	13-week period ended October 1, 2011	% Revenues	**26-week period ended September 29, 2012**	**% Revenues**	26-week period ended October 1, 2011	% Revenues
Revenues	**185.6**	**100.0**	197.2	100.0	**372.1**	**100.0**	385.3	100.0
Cost of sales	**100.5**	**54.1**	111.5	56.5	**206.9**	**55.6**	222.6	57.8
Cost of operations	**65.7**	**35.4**	66.1	33.5	**131.0**	**35.2**	131.8	34.2
Selling, administrative and other expenses	**18.5**	**10.0**	17.3	8.8	**36.0**	**9.7**	37.9	9.8
EBITDA[1]	**0.9**	**0.5**	2.3	1.2	**(1.8)**	**(0.5)**	(7.0)	(1.8)

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

Revenues from Continuing Operations Decreased

Total consolidated revenues for the 13-week period ended September 29, 2012 decreased $11.6 million or 5.9% to $185.6 million from $197.2 million for the 13-week period ended October 1, 2011. The decrease was primarily driven by lower Kobo eReader sales when compared to the strong sales of the Kobo Touch in the same period last year, declining book sales due to consumers shifting to reading digitally, and by the Company operating seven fewer small format stores than last year. These decreases were partially offset by lower sales discounts and irewards discounts. The Company continues to transform its business to sell more gift, lifestyle and toy product to offset the effect of declining book sales.

Comparable store sales for the fiscal quarter decreased 6.5% in superstores and 2.2% in small format stores. 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 September 29, 2012, the Company operated seven fewer small format stores compared to October 1, 2011.

Online sales decreased slightly by $0.2 million or 1.1% to $18.1 million for the 13-week period ended September 29, 2012 compared to $18.3 million last year. The decrease in revenues was the result of lower eReader sales, partially offset by growth in the gift, lifestyle and toys business.

Revenues from other sources include revenues generated through irewards card sales, gift card breakage, plum rewards program ("Plum") point breakage, Calendar Club, and a revenue-sharing agreement with Kobo. Revenues from other sources decreased $0.4 million or 6.3% to $6.0 million for the 13-week period ended September 29, 2012, compared to $6.4 million last year primarily as a result of lower irewards membership income as members moved to the free plum rewards program. The lower irewards membership also drove the reduction in irewards discounts discussed above. This decrease has been partially offset by higher revenues earned from the Kobo revenue-sharing agreement as more people choose to read digitally.

On a year-to-date basis, total consolidated revenues decreased by $13.2 million or 3.4% to $372.1 million compared to $385.3 million last year. Year-to-date comparable store sales decreased 3.8% for superstores and increased 1.8% in small format stores. The comparable store sales increase in small format was driven by the success of the *Fifty Shades* and *Hunger Games* trilogies, as hit titles tend to impact small format sales more than superstores.

Revenues by channel are highlighted below:

(millions of Canadian dollars)	**13-week period ended September 29, 2012**	13-week period ended October 1, 2011	% increase (decrease)	Comparable store sales % increase (decrease)
Superstores	**132.7**	142.1	(6.6)	(6.5)
Small format stores	**28.8**	30.4	(5.3)	(2.2)
Online (including store kiosks)	**18.1**	18.3	(1.1)	N/A
Other	**6.0**	6.4	(6.3)	N/A
	185.6	197.2	(5.9)	(5.8)

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

	Superstores		Small format stores	
(millions of Canadian dollars)	**13-week period ended September 29, 2012**	13-week period ended October 1, 2011	**13-week period ended September 29, 2012**	13-week period ended October 1, 2011
Total revenues	**132.7**	142.1	**28.8**	30.4
Adjustments for stores not in both fiscal periods	**(2.3)**	(2.6)	**(1.4)**	(2.4)
Comparable store sales	**130.4**	139.5	**27.4**	28.0

Cost of Sales (as a Percent of Revenues) from Continuing Operations Showed Improvement

Cost of sales includes the landed cost of goods sold, online shipping costs, inventory shrink, and damage reserve, less all vendor support programs. As a percent of total revenues, cost of sales decreased 2.4% to 54.1% in the second quarter of fiscal 2013 compared to 56.5% last year. The improvement as a percent of revenues was driven by four main factors: (i) increased net revenues resulting from lower sales discounts; (ii) a shift in sales mix from low margin eReaders to higher margin gift and lifestyle products; (iii) a reduction in inventory write-downs due to better sell-through of summer clearance product in the second quarter than anticipated; and (iv) shipping more products through the Company's distribution centres as the Company received better margin from vendors for products that were shipped through its distribution centres. In dollar terms, cost of sales decreased $11.0 million to $100.5 million compared to $111.5 million last year. The decrease was primarily due to lower sales volumes, which in turn resulted in lower levels of vendor support.

On a year-to-date basis, cost of sales as a percent of total revenues decreased 2.2% to 55.6% compared to 57.8% last year, due to the same factors mentioned above. In dollar terms, cost of sales decreased $15.7 million to $206.9 million this year compared to $222.6 million last year.

Cost of Operations from Continuing Operations Decreased Slightly Compared to Last Year

Cost of operations includes all store, online, distribution centre and Calendar Club costs. Cost of operations decreased $0.4 million to $65.7 million this year compared to $66.1 million last year. The decrease was primarily due to the benefits realized under the Galileo productivity initiative that was put in place in the later part of fiscal 2012. The Company also operated fewer stores in the period compared to last year. As a percent of total revenues, cost of operations increased by 1.9% to 35.4% this year compared to 33.5% last year.

On a year-to-date basis, cost of operations decreased $0.8 million to $131.0 million from $131.8 million last year due to the same factors mentioned above. As a percent of total revenues, cost of operations increased by 1.0% to 35.2% for the year-to-date compared to 34.2% last year.

Selling, Administrative and Other Expenses from Continuing Operations Increased Compared to Last Year

Selling, administrative and other expenses include all marketing and head office costs. These expenses increased $1.2 million to $18.5 million compared to $17.3 million last year. Last year, the Company's year-to-date earnings were lower than expected and resulted in a reduction to the Company's bonus accrual; this year, there was no such reduction recorded, resulting in higher bonus expense. This increased expense was partially offset by the Galileo productivity initiatives discussed above. As a percent of total revenues, selling, administrative and other expenses increased by 1.2% to 10.0% compared to 8.8% last year.

On a year-to-date basis, selling, administrative and other expenses decreased $1.9 million to $36.0 million from $37.9 million last year as a result of the Galileo productivity initiatives, and a $0.2 million gain on foreign exchange. As a percent of total revenues, selling, administrative and other expenses decreased by 0.1% to 9.7% for the year-to-date period compared to 9.8% last year.

EBITDA from Continuing Operations Decreased Versus Last Year

EBITDA, defined as earnings before interest, taxes, depreciation, amortization and impairment, decreased $1.4 million to $0.9 million for the 13-week period ended September 29, 2012, compared to $2.3 million for the 13-week period ended October 1, 2011. The decrease was driven by the higher bonus expense mentioned above. EBITDA as a percent of revenues decreased 0.7% to 0.5% this year from 1.2% last year.

On a year-to-date basis, EBITDA improved by $5.2 million to a loss of $1.8 million this year compared to a loss of $7.0 million last year. The improvement was driven by an improvement in cost of sales, reduction in all expense areas, and lower inventory write-downs compared to last year. As a percent of revenues, EBITDA improved 1.3% to a loss of 0.5% year-to-date compared to a loss of 1.8% last year.

Capital Asset Activity from Continuing Operations Increased Compared to Last Year

Depreciation and amortization for the 13-week period ended September 29, 2012 increased by $0.1 million to $6.8 million compared to $6.7 million last year. Capital expenditures in the second quarter of fiscal 2013 totalled $5.6 million and included $1.8 million on store construction, renovations and equipment, $2.8 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, $0.1 million was funded through finance leases.

On a year-to-date basis, depreciation and amortization increased by $0.8 million to $14.0 million compared to $13.2 million last year. Year-to-date, the Company has spent $8.5 million on capital expenditures, including $2.4 million on store construction, renovations and equipment, $4.6 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, $0.4 million was funded through finance leases. The Company also recorded $0.3 million of capital asset impairment in the first quarter of this year as the result of a store performing at a lower-than-expected profitability.

Net Interest Income from Continuing Operations Increased Versus Last Year

The Company recognized net interest income of $0.5 million in the second quarter of this year compared to net interest expense of $0.1 million in the same period last year. The Company nets interest income received against interest expense. The interest income received was higher this year due to an increase in the Company's cash balance as a result of the Kobo sale in January 2012.

On a year-to-date basis, the Company recognized net interest income of $1.1 million this year compared to net interest expense of $0.1 million in the same period last year.

Income Tax Recovery from Continuing Operations Increased from Last Year

The Company recognized an income tax recovery of $1.3 million this year compared to an income tax recovery of $1.1 million last year. The Company's effective tax rate was 24.6% in the current quarter compared to 3.6% in the same period last year. The increase in effective tax rate was due to the goodwill impairment charge last year, which reduced accounting income and the effective tax rate. The goodwill impairment charge was not deductible for income tax purposes.

On a year-to-date basis, the Company recognized an income tax recovery of $5.4 million this year compared to an income tax recovery of $4.9 million last year.

Net Loss Narrows Significantly

The Company recognized a net loss from continuing operations of $4.0 million for the quarter or $0.16 net loss per common share, compared to a net loss from continuing operations of $28.8 million or $1.14 net loss per common share last year. Year-to-date, the Company recognized a net loss from continuing operations of $9.5 million or $0.38 net loss per common share, compared to a net loss of $40.8 million or $1.62 net loss per common share last year. Last year the Company recorded a full write-down of the $25.4 million goodwill allocated to the Indigo segment while this year there was no such impairment charge. The impact of the goodwill impairment charge drove the year-over-year improvement in net loss from continuing operations.

The Company did not record any net loss from discontinued operations or non-controlling interest in fiscal 2013. For the 13-week period ended October 1, 2011, the Company recorded a total net loss of $11.5 million from discontinued operations, of which $5.3 million was recorded to non-controlling interest. Year-to-date last year, the Company recorded a total net loss of $23.8 million from discontinued operations, of which $11.4 million was recorded to non-controlling interest. Up to, and including, January 10, 2012, Indigo was the majority and controlling shareholder of Kobo and, as such, the results of Kobo were consolidated and non-controlling interest was recorded for the portion of Kobo losses attributable to minority shareholders. On January 11, 2012, the Company completed the sale of Kobo and, therefore, Kobo was no longer consolidated as at that date. As a result of the sale, the Company recorded Kobo's historical results in its consolidated financial statements as discontinued operations.

The net loss and comprehensive loss attributable to shareholders was $4.0 million for the 13-week period ended September 29, 2012 or $0.16 net loss per common share, compared to a net loss of $35.1 million or $1.39 net loss per common share last year. The improvement in the Company's performance was driven by reductions in cost of sales and cost of operations, the elimination of Kobo losses due to the sale of Kobo, and no goodwill impairment in fiscal 2013, as discussed above. Year-to-date, the net loss and comprehensive loss attributable to shareholders was $9.5 million or $0.38 net loss per common share, compared to a net loss of $53.2 million or $2.11 net loss per common share last year.

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.

	Fiscal quarters							
(thousands of Canadian dollars, except per share data)	**Q2 Fiscal 2013**	Q1 Fiscal 2013	Q4 Fiscal 2012	Q3 Fiscal 2012	Q2 Fiscal 2012	Q1 Fiscal 2012	Q4 Fiscal 2011	Q3 Fiscal 2011
Revenues	**185,589**	186,483	195,879	352,858	197,248	188,005	200,160	351,225
Net earnings (loss) attributable to shareholders of Indigo								
From continuing operations	**(4,013)**	(5,487)	(10,726)	23,711	(28,849)	(11,963)	(11,745)	26,950
From discontinued operations	**–**	–	142,253	(9,349)	(6,271)	(6,142)	(7,696)	(6,123)
Total net earnings (loss)	**(4,013)**	(5,487)	131,527	14,362	(35,120)	(18,105)	(19,441)	20,827
Basic earnings (loss) per share	**$ (0.16)**	$ (0.22)	$ 5.21	$ 0.57	$ (1.39)	$ (0.72)	$ (0.78)	$ 0.84
Diluted earnings (loss) per share	**$ (0.16)**	$ (0.22)	$ 5.16	$ 0.56	$ (1.39)	$ (0.72)	$ (0.78)	$ 0.82

Overview of Consolidated Balance Sheets

Total Assets

As at September 29, 2012, total assets increased by $74.4 million to $597.7 million compared to $523.3 million as at October 1, 2011. The sale of Kobo was completed in January 2012 and Kobo is no longer consolidated on the Company's balance sheet this year. Excluding fiscal 2012 Kobo assets of $68.5 million related

to discontinued operations, Indigo's total assets related to continuing operations increased $142.9 million compared to last year. The increase was primarily due to an increase in cash, partially offset by decreases in deferred tax assets and property, plant and equipment. The Company's cash balance increased by $174.1 million compared to last year as a result of the sale of Kobo. Deferred tax assets decreased by $14.3 million compared to last year due to the utilization of tax losses. The Company's property, plant and equipment decreased $12.3 million primarily due to impairment charges recorded during fiscal 2012.

On a fiscal year-to-date basis, total assets increased by $5.2 million to $597.7 million compared to $592.5 million as at March 31, 2012. The increase in total assets was primarily due to increased inventories, offset by a decrease in cash and cash equivalents. The increase of $17.9 million in inventories and decrease of $15.0 million in cash and cash equivalents are consistent with the seasonal nature of the business as the Company makes advance purchases in preparation for the holiday season.

Total Liabilities

As at September 29, 2012, total liabilities decreased $30.3 million to $256.3 million compared to $286.6 million as at October 1, 2011. Excluding fiscal 2012 Kobo liabilities of $48.1 million related to discontinued operations, Indigo's total liabilities related to continuing operations increased $17.8 million compared to last year. The increase was primarily the result of increases in current and long-term accounts payable and accrued liabilities, offset by a decrease in notes payable. The increase of $20.9 million in current and long-term accounts payable and accrued liabilities resulted from the timing of payments related to inventory purchases. The $5.2 million decrease in notes payable was a result of the Company's repayment of notes payable due in the fourth quarter of fiscal 2012.

On a fiscal year-to-date basis, total liabilities increased by $19.4 million to $256.3 million compared to $236.9 million as at March 31, 2012. The increase in total liabilities was driven by a $22.9 million increase in current and long-term accounts payable and accrued liabilities. The increase in current and long-term accounts payable and accrued liabilities is consistent with the increase in the Company's inventory position, as noted above. This increase was partially offset by a $4.8 million decrease in unredeemed gift card liability as customers continued to redeem gift cards purchased during the fiscal 2012 holiday season.

Non-Controlling Interest

As at September 29, 2012 and March 31, 2012, the Company had no non-controlling interest on its consolidated balance sheet compared to non-controlling interest of $22.0 million as at October 1, 2011. Non-controlling interest related solely to Kobo. As a result of the sale of Kobo during fiscal 2012, the Company no longer consolidated Kobo and therefore no longer recorded non-controlling interest on its consolidated balance sheet. Last year, 48.6% of Kobo was owned by minority shareholders, which resulted in the non-controlling interest balance of $22.0 million as at October 1, 2011. The Company has recorded the historical results of Kobo in its consolidated statements of loss and comprehensive loss as discontinued operations.

Total Equity

Total equity at September 29, 2012 increased $104.8 million to $341.4 million, compared to $236.6 million as at October 1, 2011. The increase in total equity was primarily due to the $164.5 million pre-tax gain on the sale of Kobo, offset by $11.1 million of dividend payments and the elimination of $22.0 million of non-controlling interest as discussed above. Share capital increased by $0.7 million mainly due to employees exercising their stock options and the redemption of Directors' deferred share units. Contributed surplus increased $0.7 million due to the expensing of employee stock options and Directors' deferred share units.

On a fiscal year-to-date basis, total equity decreased $14.2 million to $341.4 million, compared to $355.6 million as at March 31, 2012. The decrease was driven by the $9.5 million net loss from continuing operations and $5.6 million of dividend payments in the current fiscal year.

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 $208.7 million as at September 29, 2012, compared to $66.6 million as at October 1, 2011 and $224.1 million as at March 31, 2012. The increase in the Company's working capital from October 1, 2011 was primarily the result of cash proceeds received from the sale of Kobo.

The Company's leverage position (defined as Total Liabilities to Total Equity) was 0.8:1 at the end of the current quarter compared to 1.2:1 as at October 1, 2011 and 0.7:1 as at March 31, 2012. The decreased leverage position versus last year was driven by lower liabilities and higher equity. The increase in equity was primarily the result of the Company's gain on the sale of Kobo.

Overview of Consolidated Statements of Cash Flows

Cash and cash equivalents increased $4.0 million during the second quarter of fiscal 2013 compared to a decrease of $27.9 million last year. The increase in the current quarter was driven by cash flows generated from operating activities of $12.5 million, offset by cash flows used in investing activities of $5.5 million and financing activities of $2.4 million, and by the effect of foreign currency exchange rate changes on cash and cash equivalents of $0.5 million. Year-to-date, cash and cash equivalents decreased by $15.0 million compared to a decrease of $38.2 million last year.

Cash Flows Used in Operating Activities

The Company generated cash flows of $12.5 million in operating activities in the second quarter of fiscal 2013 compared to cash flows used by operating activities of $18.4 million last year. Excluding fiscal 2012 Kobo cash flows of $0.3 million used by discontinued operations, cash flows generated by operating activities for continuing operations was $12.5 million this year compared to cash flows used of $18.1 million last year, an increase of $30.6 million. The Company generated $10.7 million of cash from working capital this period compared to using $18.3 million of cash for working capital in the same period last year and had a lower net loss of $4.0 million in the current period compared to a net loss of $28.8 million last year. In fiscal 2012, net loss was higher as the result of a $25.4 million goodwill impairment charge.

On a year-to-date basis, cash flows used in operating activities decreased by $34.6 million to $2.2 million used this year compared to $36.8 million used last year. Excluding fiscal 2012 Kobo cash flows of $16.8 million used by discontinued operations, cash flows used by operating activities for continuing operations was $2.2 million this year compared to cash flows used of $20.0 million last year, a decrease of $17.8 million. The Company used $0.9 million of cash for working capital this period compared to using $11.5 million of cash for working capital in the same period last year and had a lower net loss of $9.5 million in the current period compared to a net loss of $40.8 million last year. In fiscal 2012, net loss was higher as the result of the goodwill impairment charge.

Cash Flows Used in Investing Activities

Total cash spent on capital projects for the current and comparative periods is outlined below:

(millions of Canadian dollars)	**13-week period ended September 29, 2012**	13-week period ended October 1, 2011	**26-week period ended September 29, 2012**	26-week period ended October 1, 2011
Store construction, renovations and equipment	**1.8**	3.2	**2.4**	4.9
Intangible assets (primarily application software and internal development costs)	**2.8**	2.3	**4.6**	3.9
Technology equipment	**0.9**	0.4	**1.1**	0.9
Capital expenditures of discontinued operations	–	2.4	–	4.6
	5.5	8.3	**8.1**	14.3

The Company used cash flows of $5.5 million in investing activities in the second quarter of fiscal 2013 compared to cash flows used by investing activities of $8.8 million last year. Last year, in addition to spending $8.3 million on capital projects, the Company paid $0.5 million to purchase non-capital tax losses from a related company. Excluding fiscal 2012 Kobo cash flows of $2.4 million used by discontinued operations, cash flows used in investing activities for continuing operations was $5.5 million this year compared to $6.4 million used last year, a decrease of $0.9 million. The decrease was driven by a reduction in property, plant and equipment purchases compared to last year, as outlined above.

On a year-to-date basis, cash flows used in investing activities decreased by $16.8 million to $8.1 million this year compared to $24.9 million last year. Excluding fiscal 2012 Kobo cash flows of $4.6 million used by discontinued operations, cash flows used in investing activities for continuing operations was $8.1 million this year compared to $20.3 million used last year, a decrease of $12.2 million. The Company paid $10.6 million to purchase non-capital tax losses from a related company last year. There was no such transaction this year, which drove the year-to-date decrease.

Cash Flows Used in Financing Activities

The Company used cash flows of $2.4 million for financing activities in the second quarter of fiscal 2013 compared to $2.9 million last year, a decrease of $0.5 million. The decrease was driven by higher interest revenue generated in the current year as a result of the Company's increased cash balance compared

to last year. The cash flows from financing activities generated by Kobo last year were immaterial on a quarter-over-quarter basis.

On a year-to-date basis, cash flows used in financing activities decreased by $26.1 million to $4.9 million used in the current year compared to cash flows generated from financing activities of $21.2 million last year. Excluding fiscal 2012 Kobo cash flows of $24.5 million generated by discontinued operations, cash flows used in financing activities for continuing operations was $4.9 million this year compared to $3.3 million last year, an increased use of $1.6 million. Last year, cash flows used in financing activities were offset by $5.3 million generated from a note payable related to the acquisition of non-capital tax losses last year; there was no such transaction in the current 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, cash and cash equivalents, and an operating line of credit.

Based on the Company's liquidity position and cash flow forecast, management expects its current cash position, 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 2013. 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 Judgments and Estimates

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. The preparation of these unaudited interim condensed consolidated financial statements in conformity with IFRS requires management to undertake a number of judgments and estimates about the recognition and measurement of assets, liabilities, revenues, and expenses. These judgments and estimates 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 judgments and estimates made by management, and actual results will seldom equal estimates.

Material judgments and estimates are made with respect to: revenue recognition from unredeemed gift cards and Plum points; fair value of Plum 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 and valuation of deferred tax assets.

The Company evaluates its judgments and estimates on an ongoing basis and methods used to calculate critical accounting estimates are consistent with prior periods. The significant accounting policies and significant judgments and estimates of the Company are described in notes 3 and 4 of the consolidated financial statements contained in the Company's fiscal 2012 Annual Report.

Accounting Standards Adopted in the Fiscal 2013

Adoption of these amendments in the first quarter of fiscal 2013 did not have an impact on the Company's results of operations, financial position or disclosures:

- Amendments to "Financial Instruments: Disclosures" ("IFRS 7") increased the disclosure requirements for transactions involving transfers of financial assets. These amendments are effective for annual periods beginning on or after July 1, 2011; and
- An amendment to "Income Taxes" ("IAS 12") introduced 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.

New Accounting Pronouncements

The IASB has not issued any new standards, amendments to standards, or interpretations that impact the Company during the 13 and 26-week periods ended September 29, 2012. Indigo's evaluation of previously issued new standards, amendments to standards, and interpretations is consistent with those disclosed in note 5 of the Company's fiscal 2012 Annual Report. Although early adoption is permitted, they have not been applied in preparing the Company's fiscal 2013 Second Quarter Report, except as discussed above.

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 2012 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 2012 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 1, 2012 and ended on September 29, 2012 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting. Management has determined that no material changes occurred during 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 IFRS. 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, amortization and impairment. 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 September 29, 2012**	13-week period ended October 1, 2011	**26-week period ended September 29, 2012**	26-week period ended October 1, 2011
EBITDA	**0.9**	2.3	**(1.8)**	(7.0)
Depreciation of property, plant and equipment	**4.3**	4.6	**9.0**	9.0
Amortization of intangible assets	**2.5**	2.1	**4.9**	4.2
Impairment of capital assets	**–**	–	**0.3**	–
Impairment of goodwill	**–**	25.4	**–**	25.4
Interest on long-term debt and financing charges	**0.0**	0.0	**0.1**	0.1
Interest expense (income) on cash and cash equivalents	**(0.6)**	0.1	**(1.2)**	0.0
Loss before income taxes	**(5.3)**	(29.9)	**(14.9)**	(45.7)

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NOTICE OF NO AUDITOR REVIEW OF INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

Heather Reisman
Chair & Chief Executive Officer

Kay Brekken
Chief Financial Officer

Dated as of the 6th day of November, 2012.

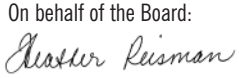
Consolidated Balance Sheets

(Unaudited)

(thousands of Canadian dollars)	**As at September 29, 2012**	As at October 1, 2011	As at March 31, 2012
ASSETS			
Current			
Cash and cash equivalents (note 5)	**192,598**	45,491	207,601
Accounts receivable	**14,092**	21,831	12,627
Inventories (note 6)	**247,604**	263,918	229,706
Prepaid expenses	**4,835**	15,285	3,695
Total current assets	**459,129**	346,525	453,629
Property, plant and equipment	**62,111**	76,031	67,464
Intangible assets	**22,467**	31,251	22,810
Goodwill	**–**	1,216	–
Deferred tax assets	**53,986**	68,250	48,633
Total assets	**597,693**	523,273	592,536
LIABILITIES AND EQUITY			
Current			
Accounts payable and accrued liabilities	**198,435**	224,159	174,201
Unredeemed gift card liability	**37,912**	36,292	42,711
Provisions	**175**	–	232
Deferred revenue	**12,882**	12,401	11,234
Income taxes payable	**111**	650	65
Notes payable (note 13)	**–**	5,168	–
Current portion of long-term debt	**900**	1,305	1,060
Total current liabilities	**250,415**	279,975	229,503
Long-term accrued liabilities	**4,448**	5,038	5,800
Long-term provisions	**391**	–	460
Long-term debt	**1,045**	1,623	1,141
Total liabilities	**256,299**	286,636	236,904
Equity			
Share capital (note 7)	**203,660**	202,962	203,373
Contributed surplus (note 8)	**7,570**	6,839	7,039
Retained earnings	**130,164**	4,882	145,220
Total equity attributable to shareholders of Indigo	**341,394**	214,683	355,632
Non-controlling interest (note 14)	**–**	21,954	–
Total equity	**341,394**	236,637	355,632
Total liabilities and equity	**597,693**	523,273	592,536

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 September 29, 2012**	13-week period ended October 1, 2011	**26-week period ended September 29, 2012**	26-week period ended October 1, 2011
Revenues	**185,589**	197,248	**372,072**	385,253
Cost of sales	**100,487**	111,497	**206,875**	222,579
Gross profit	**85,102**	85,751	**165,197**	162,674
Operating and administrative expenses (note 9)	**90,975**	115,579	**181,149**	208,270
Operating loss	**(5,873)**	(29,828)	**(15,952)**	(45,596)
Interest on long-term debt and financing charges	**29**	39	**60**	83
Interest expense (income) on cash and cash equivalents	**(578)**	56	**(1,159)**	(15)
Loss before income taxes	**(5,324)**	(29,923)	**(14,853)**	(45,664)
Income tax recovery	**(1,311)**	(1,074)	**(5,353)**	(4,852)
Loss and comprehensive loss for the period from continuing operations	**(4,013)**	(28,849)	**(9,500)**	(40,812)
Loss and comprehensive loss for the period from discontinued operations (net of tax) (note 14)	**–**	(11,542)	**–**	(23,773)
Net loss and comprehensive loss for the period	**(4,013)**	(40,391)	**(9,500)**	(64,585)
Net loss and comprehensive loss attributable to:				
Shareholders of Indigo	**(4,013)**	(35,120)	**(9,500)**	(53,225)
Non-controlling interest (note 14)	**–**	(5,271)	**–**	(11,360)
Net loss per common share from continuing operations				
Basic	**$ (0.16)**	$ (1.14)	**$ (0.38)**	$ (1.62)
Diluted	**$ (0.16)**	$ (1.14)	**$ (0.38)**	$ (1.62)
Net loss per common share from discontinued operations (note 14)				
Basic	**$ –**	$ (0.25)	**$ –**	$ (0.49)
Diluted	**$ –**	$ (0.25)	**$ –**	$ (0.49)
Net loss per common share (note 10)				
Basic	**$ (0.16)**	$ (1.39)	**$ (0.38)**	$ (2.11)
Diluted	**$ (0.16)**	$ (1.39)	**$ (0.38)**	$ (2.11)

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 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 (notes 7 and 8)	742	(164)	–	578	–	578
Directors' deferred stock units converted (note 7)	–	–	–	–	–	–
Stock-based compensation (note 8)	–	670	–	670	1,521	2,191
Directors' compensation (note 8)	–	267	–	267	–	267
Dividends paid	–	–	(5,539)	(5,539)	–	(5,539)
Acquisition of non-capital tax losses (note 13)	–	–	15,017	15,017	–	15,017
Issuance of equity securities by subsidiary to non-controlling interest (note 14)	–	–	–	–	21,345	21,345
Balance, October 1, 2011	202,962	6,839	4,882	214,683	21,954	236,637
Balance, March 31, 2012	**203,373**	**7,039**	**145,220**	**355,632**	**–**	**355,632**
Loss for the 26-week period ended September 29, 2012	**–**	**–**	**(9,500)**	**(9,500)**	**–**	**(9,500)**
Exercise of options (notes 7 and 8)	**272**	**(42)**	**–**	**230**	**–**	**230**
Directors' deferred stock units converted (note 7)	**15**	**(15)**	**–**	**–**	**–**	**–**
Stock-based compensation (note 8)	**–**	**359**	**–**	**359**	**–**	**359**
Directors' compensation (note 8)	**–**	**229**	**–**	**229**	**–**	**229**
Dividends paid	**–**	**–**	**(5,556)**	**(5,556)**	**–**	**(5,556)**
Balance, September 29, 2012	**203,660**	**7,570**	**130,164**	**341,394**	**–**	**341,394**

See accompanying notes

Consolidated Statements of Cash Flows

(Unaudited)

(thousands of Canadian dollars)	**13-week period ended September 29, 2012**	13-week period ended October 1, 2011	**26-week period ended September 29, 2012**	26-week period ended October 1, 2011
CASH FLOWS FROM OPERATING ACTIVITIES				
Net loss from continuing operations for the period	**(4,013)**	(28,849)	**(9,500)**	(40,812)
Add (deduct) items not affecting cash				
Depreciation of property, plant and equipment	**4,329**	4,557	**9,048**	9,016
Amortization of intangible assets	**2,515**	2,103	**4,937**	4,184
Impairment of capital assets (note 9)	**–**	–	**250**	–
Impairment of goodwill (note 9)	**–**	25,416	**–**	25,416
Loss on disposal of capital assets	**–**	11	**44**	15
Stock-based compensation (note 8)	**200**	75	**359**	670
Directors' compensation (note 8)	**96**	118	**229**	267
Deferred tax assets	**(1,311)**	(1,250)	**(5,353)**	(4,852)
Other	**510**	(2,125)	**(243)**	(2,411)
Net change in non-cash working capital balances related to continuing operations (note 11)	**10,667**	(18,306)	**(897)**	(11,501)
Interest on long-term debt and financing charges	**29**	39	**60**	83
Interest expense (income) on cash and cash equivalents	**(578)**	56	**(1,159)**	(15)
Income taxes received	**41**	–	**45**	–
Operating cash flows of discontinued operations (note 14)	**–**	(282)	**–**	(16,813)
Cash flows from (used in) operating activities	**12,485**	(18,437)	**(2,180)**	(36,753)
CASH FLOWS FROM INVESTING ACTIVITIES				
Acquisition of non-capital tax losses (note 13)	**–**	(450)	**–**	(10,559)
Purchase of property, plant and equipment	**(2,764)**	(3,651)	**(3,548)**	(5,848)
Addition of intangible assets	**(2,784)**	(2,259)	**(4,614)**	(3,888)
Investing cash flows of discontinued operations (note 14)	**–**	(2,488)	**–**	(4,646)
Cash flows used in investing activities	**(5,548)**	(8,848)	**(8,162)**	(24,941)
CASH FLOWS FROM FINANCING ACTIVITIES				
Notes payable (note 13)	**–**	225	**–**	5,280
Repayment of long-term debt	**(338)**	(393)	**(684)**	(712)
Interest received	**565**	10	**1,124**	94
Proceeds from share issuances (note 7)	**142**	–	**230**	578
Purchase of shares in subsidiary (note 14)	**–**	–	**–**	(3,009)
Dividends paid	**(2,780)**	(2,772)	**(5,556)**	(5,539)
Financing cash flows of discontinued operations (note 14)	**–**	36	**–**	24,478
Cash flows from (used in) financing activities	**(2,411)**	(2,894)	**(4,886)**	21,170
Effect of foreign currency exchange rate changes on cash and cash equivalents	**(523)**	2,285	**225**	2,354
Net increase (decrease) in cash and cash equivalents during the period	**4,003**	(27,894)	**(15,003)**	(38,170)
Cash and cash equivalents, beginning of period	**188,595**	73,385	**207,601**	83,661
Cash and cash equivalents, end of period	**192,598**	45,491	**192,598**	45,491
Cash and cash equivalents attributable to:				
Continuing operations	**192,598**	18,497	**192,598**	18,497
Discontinued operations	**–**	26,994	**–**	26,994
	192,598	45,491	**192,598**	45,491

See accompanying notes

Notes to the Interim Condensed Consolidated Financial Statements

September 29, 2012
(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. These unaudited interim condensed consolidated financial statements as at and for the 13 and 26 weeks ended September 29, 2012 and October 1, 2011 comprise the Company, its former subsidiary, Kobo Inc. ("Kobo"), and its joint venture interest in Calendar Club of Canada Limited Partnership ("Calendar Club"). Kobo was a subsidiary of the Company until January 10, 2012; and, subsequently, the Company closed on the sale of its full interest in Kobo on January 11, 2012. 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 using accounting policies consistent with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The unaudited interim condensed consolidated financial statements for the 13 and 26-week periods ended September 29, 2012 and October 1, 2011 were prepared in accordance with International Accounting Standard ("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 fiscal 2012 Annual Report. These unaudited interim condensed consolidated financial statements should be read in conjunction with the Company's fiscal 2012 Annual Report.

The unaudited interim condensed consolidated financial statements for the 13 and 26-week periods ended September 29, 2012 (including comparatives) were approved by the Board of Directors on November 6, 2012.

Significant judgments and estimates

The preparation of these unaudited interim condensed consolidated financial statements in conformity with IFRS requires management to undertake a number of judgments and estimates about the recognition and measurement of assets, liabilities, revenues, and expenses. These judgments and estimates 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 judgments and estimates made by management, and actual results will seldom equal estimates.

Material judgments and estimates are made with respect to: revenue recognition from unredeemed gift cards and plum rewards program ("Plum") points; fair value of Plum 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 and valuation of deferred tax assets.

3. CHANGES IN ACCOUNTING POLICIES

The Company adopted the following amendments in the first quarter of fiscal 2013. Adoption of these amendments did not have an impact on the Company's results of operations, financial position or disclosures:

- Amendments to "Financial Instruments: Disclosures" ("IFRS 7") increased the disclosure requirements for transactions involving transfers of financial assets. These amendments are effective for annual periods beginning on or after July 1, 2011; and
- An amendment to "Income Taxes" ("IAS 12") introduced 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.

New Accounting Pronouncements

The IASB has not issued any new standards, amendments to standards, or interpretations that impact the Company during the 13 and 26-week periods ended September 29, 2012. Indigo's evaluation of previously issued new standards, amendments to standards, and interpretations is consistent with those disclosed in note 5 of the Company's fiscal 2012 Annual Report. Although early adoption

is permitted, they have not been applied in preparing these unaudited interim condensed consolidated financial statements, except as discussed above.

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 September 29, 2012 and October 1, 2011 are not indicative of the results of other periods.

5. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

(thousands of Canadian dollars)	**September 29, 2012**	October 1, 2011	March 31, 2012
Cash	**69,076**	43,859	87,082
Cash equivalents	**120,869**	–	120,032
Restricted cash	**2,653**	1,632	487
Cash and cash equivalents	**192,598**	45,491	207,601

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 during the 13 and 26-week periods ended September 29, 2012 were $102.6 million and $208.7 million, respectively (2011: 13 weeks – $124.6 million; 26 weeks – $234.5 million). The amount of inventory write-downs as a result of net realizable value lower than cost during the 13 and 26-week periods ended September 29, 2012 were $1.1 million and $2.5 million, respectively (2011: 13 weeks – $1.2 million; 26 weeks – $3.2 million), and there was $2.1 million of reversals of inventory write-downs that were recognized in prior periods. The amount of inventory with net realizable value equal to cost was $1.4 million as at September 29, 2012 (2011 – $0.9 million).

7. SHARE CAPITAL

Share capital consists of the following:

	26-week period ended September 29, 2012		26-week period ended October 1, 2011		52-week period ended March 31, 2012	
	Number of shares	**Amount C$ (thousands)**	Number of shares	Amount C$ (thousands)	Number of shares	Amount C$ (thousands)
Balance, beginning of period	**25,238,414**	**203,373**	25,140,540	202,220	25,140,540	202,220
Issued during the period						
Directors' deferred share units converted	**1,075**	**15**	–	–	38,774	404
Options exercised	**37,400**	**272**	58,000	742	59,100	749
Balance, end of period	**25,276,889**	**203,660**	25,198,540	202,962	25,238,414	203,373

During the 13 and 26-week periods ended September 29, 2012, the Company distributed dividends per share of $0.11 and $0.22, respectively (2011: 13 weeks – $0.11; 26 weeks – $0.22).

8. SHARE-BASED COMPENSATION

As at September 29, 2012, 1,512,500 stock options were outstanding with exercise prices ranging from $4.45 to $16.75. Of these outstanding stock options, 594,500 were exercisable. As at October 1, 2011, there were 1,646,600 stock options outstanding of which 733,100 were exercisable.

The Company uses the fair value method of accounting for stock options, which estimates the fair value of the stock options granted on the date of grant, net of estimated forfeitures, and expenses this value over the vesting period. During the 13 and 26-week periods ended September 29, 2012, the pre-forfeiture rate fair value of options granted was $0.4 million and $0.4 million, respectively (2011: 13 weeks – nil; 26 weeks – $0.4 million).

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

	13-week period ended September 29, 2012
Black-Scholes assumptions	
Risk-free interest rate	**1.3%**
Expected volatility	**36.5%**
Expected time until exercise	**4.2 years**
Expected dividend yield	**5.2%**
Other assumptions	
Forfeiture rate	**25.0%**

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 350,000. During the 13 and 26-week periods ended September 29, 2012, the Company issued 10,945 DSUs with a value of $0.1 million and 25,769 DSUs with a value of $0.2 million, respectively (2011: 13 weeks – 15,867 DSUs with a value of $0.1 million; 26 weeks – 27,504 DSUs with a value of $0.2 million). The number of DSUs to be issued to each Director is based on a set fee schedule. The fair value of DSUs is equal to the traded price of the Company's common shares on grant date. The grant date fair value of the outstanding DSUs as at September 29, 2012 was $2.7 million (2011 – $2.7 million) and was recorded in contributed surplus.

Last year, the Company had outstanding agreements to allow one Indigo Director and one Kobo Director to purchase shares of Kobo. As at October 1, 2011, the agreements had a nil intrinsic value and allowed for the purchase of up to 470,000 Kobo shares. Exercise prices ranged from $1.00 to $3.86 per share. As a result of the sale of Kobo to Rakuten Inc. ("Rakuten"), the agreements were exercised in full in the fourth quarter of fiscal 2012 and the holders received a cash payout of $1.7 million.

9. OPERATING AND ADMINISTRATIVE EXPENSES

Supplemental operating and administrative expenses information:

Employee benefits

(thousands of Canadian dollars)	**13-week period ended September 29, 2012**	13-week period ended October 1, 2011	**26-week period ended September 29, 2012**	26-week period ended October 1, 2011
Wages, salaries and bonuses	**36,593**	34,991	**73,366**	72,575
Short-term benefits expense	**4,056**	4,043	**8,615**	8,472
Termination benefits expense	**408**	298	**627**	600
Retirement benefits expense	**311**	302	**621**	617
Stock-based compensation	**200**	75	**359**	670
Total employee benefits expense	**41,568**	39,709	**83,588**	82,934

Capital assets

During the 13 and 26-week periods ended September 29, 2012, the Company recognized capital asset impairments of nil and $0.3 million, respectively (2011: 13 weeks – nil; 26 weeks – nil) as the result of a store performing at lower-than-expected profitability.

Goodwill

During the 13-week period ended October 1, 2011, the Company performed a goodwill impairment test which resulted in a full write-down of the $25.4 million of goodwill allocated to the Indigo segment. Average growth rate and discount rate used for the impairment test were 2.0% and 14.0%, respectively.

10. 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 September 29, 2012 and October 1, 2011 diluted loss per share calculations.

11. CASH FLOW STATEMENT

Supplemental cash flow information:

(thousands of Canadian dollars)	**13-week period ended September 29, 2012**	13-week period ended October 1, 2011	**26-week period ended September 29, 2012**	26-week period ended October 1, 2011
Net change in non-cash working capital balances related to continuing operations:				
Accounts receivable	**(506)**	142	**(1,465)**	194
Inventories	**(27,640)**	(33,823)	**(17,898)**	(14,867)
Prepaid expenses	**(315)**	(8,965)	**(1,140)**	(9,162)
Income taxes payable (recoverable)	**1**	1	**1**	2
Accounts payable and accrued liabilities	**43,549**	28,777	**22,882**	16,585
Unredeemed gift card liability	**(5,262)**	(5,308)	**(4,799)**	(4,699)
Provisions	**(62)**	–	**(126)**	–
Deferred revenue	**902**	870	**1,648**	446
	10,667	(18,306)	**(897)**	(11,501)
Assets acquired under finance lease	**139**	133	**421**	133

12. 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, and investment in information technology and distribution capacity to support the online and retail networks. The Company's main sources of capital are its current cash position, cash flows generated from operations, a revolving line of credit, and long-term debt. The Company is able to draw $25.0 million from its revolving line of credit. As at September 29, 2012, the Company has no amounts drawn upon its revolving line of credit. Cash flow is used to fund working capital needs, capital expenditures, debt service requirements, and dividend distributions to shareholders. There were no changes to these objectives during the 13 and 26 weeks ended September 29, 2012.

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

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

(thousands of Canadian dollars)	**September 29, 2012**	October 1, 2011	March 31, 2012
Current portion of long-term debt	**900**	1,305	1,060
Long-term debt	**1,045**	1,623	1,141
Notes payable	**–**	5,168	–
Total debt	**1,945**	8,096	2,201
Total equity	**341,394**	236,637	355,632
Total debt : Total equity	**0.01:1**	0.03:1	0.01:1

13. RELATED PARTY TRANSACTIONS

The Company's related parties include its key management personnel, shareholders, defined contribution retirement plan, and joint venture. 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 September 29, 2012**	13-week period ended October 1, 2011	**26-week period ended September 29, 2012**	26-week period ended October 1, 2011
Wages, salaries, bonus and consulting	**1,024**	1,074	**2,096**	2,562
Short-term benefits expense	**50**	59	**103**	122
Retirement benefits expense	**17**	13	**33**	31
Stock-based compensation	**88**	(50)	**188**	413
Directors' compensation	**96**	118	**229**	267
Total remuneration	**1,275**	1,214	**2,649**	3,395

Transactions with shareholders

During the 13 and 26-week periods ended September 29, 2012, Indigo had no transactions with shareholders. In the same period last year, Indigo purchased two companies, the sole assets of which were certain tax losses, from a public company controlled by Mr. Gerald W. Schwartz, who is also the controlling shareholder of Indigo. Indigo acquired these companies with a total of $100.3 million of non-capital tax losses in exchange for total net cash consideration of $5.3 million and two notes payable totalling $5.3 million. The notes payable were non-interest bearing and were both due and repaid on March 31, 2012. The acquisitions included transaction costs shared between the two companies. As a result, the Company recorded a total deferred tax asset of $25.4 million and the difference of $15.0 million between the total net cash consideration and the total deferred tax asset was recorded directly to retained earnings.

Transactions with defined contribution retirement plan

The Company's transactions with the defined contribution retirement plan include contributions paid to the retirement plan as disclosed in note 9. 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 ended September 29, 2012 were $2.5 million and $3.5 million, respectively, paid by Indigo (2011: 13 weeks – $3.3 million; 26 weeks – $4.3 million).

14. DISCONTINUED OPERATIONS

On November 8, 2011, Indigo entered into an agreement allowing Rakuten to acquire all the outstanding shares of Kobo on a fully diluted basis. The Kobo sale closed on January 11, 2012 and Indigo received net cash proceeds of US$146.1 million, recognizing a net accounting gain of $148.2 million.

Below is a summary of Kobo's operating results which were included in the consolidated statements of loss and comprehensive loss for the 13 and 26-week periods ended October 1, 2011:

(thousands of Canadian dollars)	13-week period ended October 1, 2011	26-week period ended October 1, 2011
Revenues	21,224	35,312
Expenses	32,766	59,085
Net loss from discontinued operations (net of tax)	(11,542)	(23,773)
Net loss from discontinued operations attributable to:		
Shareholders of Indigo	(6,271)	(12,413)
Non-controlling interest	(5,271)	(11,360)
	(11,542)	(23,773)

For the 13 and 26-week periods ended October 1, 2011, the net amount of intercompany transactions were $18.1 million and $21.4 million, respectively, paid by Indigo to Kobo. The Company continued to eliminate all intercompany transactions until the sale was closed. During the 26-week period ended October 1, 2011, Indigo purchased $3.0 million of common shares in Kobo while a syndicate of investors purchased $23.0 million of common shares from Kobo. As a result of these share transactions, Indigo's ownership of Kobo was 51.4% as at October 1, 2011.

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