THIRD QUARTER REPORT

FOR THE 13 & 39-WEEK PERIODS ENDED DECEMBER 28, 2013

"You can't
use up creativity.
The more
you use, the more
you have."

— *Maya Angelou*

Indigo

Enrich your life™

Indigo Chapters indigo.ca

Table of Contents

Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") is prepared as at February 4, 2014 and is based primarily on the unaudited interim condensed consolidated financial statements of Indigo Books & Music Inc. (the "Company" or "Indigo") for the 13 and 39-week periods ended December 28, 2013 and December 29, 2012. 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 Accounting Standard ("IAS") 34, "Interim Financial Reporting." The same accounting policies and methods of computation as those used in the preparation of the fiscal 2013 Annual Report were followed in the preparation of these unaudited interim condensed consolidated financial statements.

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 30, 2013 and the MD&A included in the Company's fiscal 2013 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 *indigo.ca* website. As at December 28, 2013, the Company operated 96 superstores under the banners *Chapters*, *Indigo* and the *World's Biggest Bookstore* and 131 small format stores, under the banners *Coles*, *Indigo*, *Indigospirit*, *SmithBooks*, and *The Book Company*. During the third quarter of fiscal 2014, the Company did not open any new stores and closed one small format store. The Company also 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 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 shares outstanding for the third quarter of fiscal 2014 was 25,607,404 as compared to 25,543,433 last year. As at February 4, 2014, the number of outstanding common shares was 25,298,239 with a book value of $203.8 million. The number of common shares reserved for issuance under the employee stock option plan is 3,294,736 as at February 4, 2014. As at December 28, 2013, there were 1,486,150 stock options outstanding of which 189,950 were exercisable.

Results of Operations

The following table summarizes the Company's 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 December 28, 2013**	**% Revenues**	13-week period ended December 29, 2012	% Revenues	**39-week period ended December 28, 2013**	**% Revenues**	39-week period ended December 29, 2012	% Revenues
Revenues	**332.4**	**100.0**	322.6	100.0	**683.3**	**100.0**	694.8	100.0
Cost of sales	**(191.4)**	**57.6**	(185.5)	57.5	**(387.7)**	**56.7**	(392.2)	56.4
Cost of operations	**(80.8)**	**24.3**	(77.4)	24.0	**(211.6)**	**31.0**	(207.4)	29.9
Selling, administrative and other expenses	**(27.4)**	**8.2**	(25.8)	8.0	**(72.5)**	**10.6**	(62.0)	8.9
EBITDA[1]	**32.8**	**9.9**	33.9	10.5	**11.5**	**1.7**	33.2	4.8

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

Revenues Increased on Strong Holiday Sales

Total revenues for the 13-week period ended December 28, 2013 increased $9.8 million or 3.0% to $332.4 million from $322.6 million for the 13-week period ended December 29, 2012. The increase was primarily driven by strong December sales, despite challenges resulting from unusually poor weather conditions. Higher sales were driven by double-digit growth in lifestyle, paper, and toy sales and by new growth from the Company's launch of its Indigotech™ business in the current quarter. Compared to the third quarter of fiscal 2013, book sales were also higher in the current quarter as the result of stronger titles.

Comparable store sales for the third quarter of fiscal 2014 increased 2.6% in superstores and 0.5% in small format stores for the reasons discussed above. Comparable store sales are defined as sales generated by stores that have been open for more than 12 months on a 52-week basis. It is a key performance indicator for the Company as this measure excludes sales fluctuations due to store closings, permanent relocation, and chain expansion. As at December 28, 2013, the Company operated eight fewer small format stores and one less superstore compared to December 29, 2012.

Online sales for the 13-week period ended December 28, 2013 increased $6.7 million or 19.3% to $41.5 million from $34.8 million for the 13-week period ended December 29, 2012. Online book sales continue to increase as more customers purchase books online instead of in-store. Additionally, online sales of lifestyle, paper, and toy products continue to grow, benefiting from the Company's investments in growing its online customer base and IT enhancements, such as the website redesign launched at the end of the last fiscal year.

Revenues from other sources include revenues generated through irewards card sales, gift card breakage, plum points revenue, and revenue-sharing with Kobo Inc. Revenues from other sources decreased $0.9 million or 15.8% to $4.8 million for the 13-week period ended December 28, 2013 compared to $5.7 million last year primarily as a result of lower irewards membership income. irewards card sales have decreased as expected, as members continue moving to the free plum rewards program.

On a year-to-date basis, total consolidated revenues decreased by $11.5 million or 1.7% to $683.3 million compared to $694.8 million for the same period last year. Year-to-date comparable store sales decreased 1.5% for superstores and decreased 10.7% in small format stores as the result of strong sales of the *Fifty Shades* and *Hunger Games* trilogies in the first half of the last fiscal year.

Revenues by channel are highlighted below:

(millions of Canadian dollars)	**13-week period ended December 28, 2013**	13-week period ended December 29, 2012	%	Comparable store sales %
Superstores	**234.6**	229.7	2.1	2.6
Small format stores	**51.5**	52.4	(1.7)	0.5
Online (including store kiosks)	**41.5**	34.8	19.3	N/A
Other	**4.8**	5.7	(15.8)	N/A
	332.4	322.6	3.0	2.3

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

	Superstores		Small format stores	
(millions of Canadian dollars)	**13-week period ended December 28, 2013**	13-week period ended December 29, 2012	**13-week period ended December 28, 2013**	13-week period ended December 29, 2012
Total revenues	**234.6**	229.7	**51.5**	52.4
Adjustments for stores not in both fiscal periods	**(0.0)**	(1.2)	**(0.8)**	(1.9)
Comparable store sales	**234.6**	228.5	**50.7**	50.5

Cost of Sales (as a Percent of Revenues) Remained Flat

Cost of sales includes the landed cost of goods sold, online shipping costs, inventory shrink and damage reserve, less all vendor support programs. Cost of sales increased $5.9 million to $191.4 million, compared to $185.5 million for the same quarter last year. The increase was primarily driven by higher sales volumes. As a percent of total revenues, cost of sales increased by 0.1% to 57.6% compared to 57.5% in the same quarter last year.

On a year-to-date basis, cost of sales decreased $4.5 million to $387.7 million compared to $392.2 million in the same period last year. Cost of sales was lower in the first half of the year due to lower sales volumes and higher vendor support. This was partially offset by higher sales volumes in the third quarter of fiscal 2014. Year-to-date cost of sales as a percent of total revenues increased 0.3% to 56.7% compared to 56.4% in the same period last year mainly due to more aggressive discounting and summer clearance markdowns in the first quarter of the current fiscal year.

Cost of Operations Increased Over Last Year

Cost of operations includes all store, online, and distribution centre costs. Cost of operations increased $3.4 million to $80.8 million this year, compared to $77.4 million in the same quarter last year. The increase was primarily driven by higher online costs resulting from increased online marketing spend to drive sales and continued growth of the Company's customer base. Store occupancy costs were also higher compared to the same quarter last year as a result of contractual increases in leasing costs. As a percent of total revenues, cost of operations increased by 0.3% to 24.3% this year, compared to 24.0% in the same quarter last year.

On a year-to-date basis, cost of operations increased $4.2 million to $211.6 million compared to $207.4 million in the same period last year. Despite handling higher inventory volumes this year, retail distribution centre costs decreased $0.8 million, or 3.6%, compared to the same period last year as a result of efficiencies gained through continual implementation of various Galileo productivity initiatives. Other increases in cost of operations were driven by the same factors discussed above. Year-to-date cost of operations as a percent of total revenues increased 1.1% to 31.0% compared to 29.9% in the same period last year.

Selling, Administrative and Other Expenses Increased Compared to Last Year

Selling, administrative and other expenses include retail marketing, head office costs and operating expenses associated with the Company's transformation. These expenses increased $1.6 million to $27.4 million, compared to $25.8 million for the same quarter last year. The increase was primarily driven by investments made in relation to the Company's ongoing transformational strategy to become the premiere year-round gifting destination in Canada. Investments were made in the areas of store transformations, online enhancements, and improvements to internal system capabilities. As a percent of total revenues, selling, administrative and other expenses increased by 0.2% to 8.2%, compared to 8.0% last year.

On a year-to-date basis, selling, administrative and other expenses increased $10.5 million to $72.5 million compared to $62.0 million in the same period last year due to the same factors mentioned above. The Company incurred higher creative and retail marketing expenses to drive awareness of new products in its key growth categories and incurred higher employee and severance costs as a result of investments in talent to drive the Company's transformation. Additional factors contributing to increased expenses include the Company's offer of a one-time cash repurchase to certain option holders in the first quarter, which resulted in $0.4 million of incremental expense compared to the same period last year. Year-to-date selling, administrative and other expenses as a percent of total revenues increased 1.7% to 10.6% compared to 8.9% in the same period last year.

EBITDA Decreased Versus Last Year

EBITDA, defined as earnings before interest, taxes, depreciation, amortization, impairment, and equity investment decreased $1.1 million to $32.8 million for the 13-week period ended December 28, 2013, compared to $33.9 million for the 13-week period ended December 29, 2012. As discussed above, the increase of third quarter revenues over last year were partially offset by higher online marketing spend and investments related to the Company's ongoing transformational strategy. EBITDA as a percent of total revenues decreased by 0.6% to 9.9% this quarter compared 10.5% to the same quarter last year.

On a year-to-date basis, EBITDA decreased $21.7 million to $11.5 million compared to $33.2 million in the same period last year. The decrease was driven by lower book sales in the first half of the current fiscal year due to a lack of blockbuster titles compared to sales of the *Fifty Shades* and *Hunger Games* trilogies last year, along with higher current year expenses related to the Company's transformational strategy. Year-to-date EBITDA as a percent of total revenues decreased 3.1% to 1.7% compared to 4.8% in the same period last year.

Depreciation, Amortization and Asset Impairments Higher than Last Year

Depreciation and amortization for the 13-week period ended December 28, 2013 decreased by $0.1 million to $6.8 million compared to $6.9 million in the same quarter last year. Capital expenditures in the third quarter of fiscal 2014 totalled $11.6 million and included $7.8 million for store construction, renovations and equipment, $2.5 million for intangible assets (primarily application software and internal development costs), and $1.3 million for technology equipment. None of the $1.3 million expenditure in technology equipment was funded through finance leases. The Company had $0.5 million of capital asset impairments in the current quarter. These impairments were spread across a number of cash-generating units at the store level and arose due to stores performing at lower-than-expected profitability. There were no capital asset impairment reversals recorded in the current quarter.

On a year-to-date basis, depreciation and amortization decreased by $0.5 million to $20.4 million compared to $20.9 million in the same period last year. Year-to-date, the Company has spent $24.4 million on capital expenditures, including $13.3 million for store construction, renovations and equipment, $8.1 million for intangible assets (primarily application software and internal development costs), and $3.0 million for technology equipment. Of the $3.0 million expenditure in technology equipment, $0.1 million was funded through finance leases. As discussed above, the Company had $0.5 million of capital asset impairments in the current period compared to $0.3 million of impairment in the comparative period last year.

Net Interest Income Remained Flat

The Company recognized net interest income of $0.6 million for the 13-week period ended December 28, 2013 compared to $0.7 million in the same quarter last year. The Company nets interest income against interest expense.

On a year-to-date basis, the Company recognized net interest income of $1.7 million compared to $1.8 million in the same period last year.

Earnings from Equity Investment Decreased

The Company uses the equity method to account for its investment in Calendar Club and recognizes its share of Calendar Club's earnings and losses as part of consolidated net earnings and losses. Indigo recognized net earnings from Calendar Club of $1.6 million for the 13-week period ended December 28, 2013 compared to net earnings of $2.0 million in the same quarter last year. Total sales remained nearly flat to last year, but Calendar Club operated 16 additional kiosks in fiscal 2014, which increased operating costs. In addition, Calendar Club had less favourable locations in premiere malls this year, which impacted their earnings.

On a year-to-date basis, Indigo recognized net earnings from Calendar Club of $1.0 million compared to net earnings of $1.2 million in the same period last year. Earnings from Calendar Club decreased for the same reason discussed above.

Income Tax Expense Increased Due to Valuation Allowance

The Company recognized income tax expense of $19.2 million for the 13-week period ended December 28, 2013 compared to income tax expense of $7.7 million in the same period last year. The higher income tax expense was driven by a $12.4 million valuation allowance recorded against deferred tax assets during the quarter. Whilst management fully expects to utilize all deferred tax assets prior to their expiry, for the purposes of interpreting the Income Taxes standard ("IAS 12"), it is necessary to apply a probable threshold against management's best estimate of future taxable income. This interpretation has resulted in the recognition of a valuation allowance. The Company's effective tax rate increased to 69.4% in the third quarter of fiscal 2014 compared to 25.8% in the same period last year due to the valuation allowance discussed above.

On a year-to-date basis, the Company recognized an income tax expense of $9.9 million compared to an income tax expense of $2.3 million in the same period last year for the same reason discussed above.

Net Earnings Decreased from Last Year

The Company recognized net earnings of $8.5 million for the 13-week period ended December 28, 2013 ($0.33 net earnings per common share), compared to net earnings of $22.0 million ($0.86 net earnings per common share) in the same period last year. The decrease in earnings was partly the result of higher selling, administrative and other expenses compared to the same quarter last year. Earnings also decreased as a result of higher income tax expense, as discussed above.

On a year-to-date basis, the Company recognized a net loss of $16.6 million ($0.65 net loss per common share), compared to net earnings of $12.5 million ($0.49 net earnings per common share) in the same period last year.

Seasonality and Third Quarter Results

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

	Fiscal quarters							
(thousands of Canadian dollars, except per share data)	**Q3 Fiscal 2014**	Q2 Fiscal 2014	Q1 Fiscal 2014	Q4 Fiscal 2013	Q3 Fiscal 2013	Q2 Fiscal 2013	Q1 Fiscal 2013	Q4 Fiscal 2012
Revenues	**332,393**	179,417	171,525	183,976	322,620	185,563	186,626	194,853
Net earnings (loss) attributable to shareholders of Indigo								
From continuing operations	**8,497**	(10,070)	(15,048)	(8,247)	22,035	(4,013)	(5,487)	(10,726)
From discontinued operations	**–**	–	–	–	–	–	–	142,253
Total net earnings (loss)	**8,497**	(10,070)	(15,048)	(8,247)	22,035	(4,013)	(5,487)	131,527
Basic earnings (loss) per share	**$ 0.33**	$ (0.39)	$ (0.59)	$ (0.32)	$ 0.86	$ (0.16)	$ (0.22)	$ 5.21
Diluted earnings (loss) per share	**$ 0.33**	$ (0.39)	$ (0.59)	$ (0.32)	$ 0.86	$ (0.16)	$ (0.22)	$ 5.16

Overview of Consolidated Balance Sheets

Total Assets

As at December 28, 2013, total assets decreased $43.2 million to $668.9 million, compared to $712.1 million as at December 29, 2012. The decrease was primarily due to a $44.8 million decrease in cash and cash equivalents and a $7.5 million decrease in deferred tax assets, partially offset by a $7.9 million increase in inventories. The Company used its cash to make significant investments in capital assets and working capital as part of its transformation strategy. Capital asset purchases for the last four quarters totalled $29.6 million and the Company also used $15.0 million for working capital in the last four quarters. Most of the working capital was invested in inventories as the Company expanded its product assortment compared to the last year as part of the transformation. As previously discussed, deferred tax assets decreased because the Company recorded a $12.4 million valuation allowance during the quarter.

On a fiscal year-to-date basis, total assets increased $99.8 million to $668.9 million, compared to $569.1 million as at March 30, 2013. The increase was primarily due to increases in cash and cash equivalents, inventories and accounts receivable, partially offset by a decrease in deferred tax assets. The $54.7 million increase in cash and cash equivalents and $18.7 million increase in accounts receivable were driven by sales generated during the holiday period while the $31.2 million increase in inventories is also consistent with the seasonal nature of the business as the Company holds a significant amount of inventory during the holiday season.

Total Liabilities

As at December 28, 2013, total liabilities decreased $7.9 million to $343.2 million, compared to $351.1 million as at December 29, 2012. The decrease was driven by lower current and long-term accounts payable and accrued liabilities. The Company's changing product mix now includes more items with shorter payment terms, which drove the $8.2 million decrease in current and long-term accounts payable and accrued liabilities.

On a fiscal year-to-date basis, total liabilities increased $124.4 million to $343.2 million, compared to $218.8 million as at March 30, 2013. The increase was primarily due to a $108.9 million increase in current and long-term accounts payable and accrued liabilities and a $17.1 million increase in unredeemed gift card liability, which is consistent with the seasonal nature of a retail business for the holiday season.

Total Equity

Total equity at December 28, 2013 decreased $35.3 million to $325.7 million, compared to $361.0 million as at December 28, 2012. The decrease in total equity was primarily due to a net loss of $24.9 million and $11.1 million of dividend payments in the last four quarters. Share capital increased by $0.1 million due to the exercise of stock options. Contributed surplus increased $0.6 million as the expensing of employee stock options and Directors' deferred share units was partially offset by the Company's one-time options repurchase. In the first quarter of fiscal 2014, the Company offered a one-time cash repurchase to certain option holders. Unamortized expense related to repurchased options was immediately recognized and increased contributed surplus. This increase was offset by the cash payment made to the option holders.

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 and accounts payable to fund the business before generating a disproportionate amount of cash during the December holiday season. The Company reported working capital of $204.7 million as at December 28, 2013, compared to $235.2 million as at December 29, 2012 and $224.3 million as at March 30, 2013. The decrease in working capital from December 29, 2012 was mainly driven by lower cash and cash equivalents due to money spent in the Company's transformation.

The Company's leverage position (defined as Total Liabilities to Total Equity) was 1.1:1 at the end of the current quarter compared to 1.0:1 as at December 29, 2012 and 0.6:1 as at March 30, 2013. The increase in leverage position was driven by the decrease in total equity.

Overview of Consolidated Statements of Cash Flows

Cash and cash equivalents increased $99.0 million during the third quarter of fiscal 2014 compared to an increase of $117.8 million in the same quarter last year. The increase in the current quarter was driven by cash flows generated from operating activities of $112.6 million and the effect of foreign currency exchange rate changes on cash and cash equivalents of $0.4 million, partially offset by cash flows used in investing activities of $11.0 million and financing activities of $3.0 million. Year-to-date, cash and cash equivalents increased by $54.7 million compared to an increase of $103.4 million last year.

Cash Flows from Operating Activities

The Company generated $112.6 million from operating activities in the third quarter of fiscal 2014 compared to generating $125.5 million in the same period last year, a decrease of $12.9 million. The Company generated less cash from working capital and had lower net earnings this year compared to the same period last year. The Company generated $79.6 million of cash from working capital this quarter compared to generating $91.4 million of cash from working capital in the same quarter last year. The Company's net earnings was $8.5 million this quarter compared to $22.0 million last year. As previously discussed, the decrease in net earnings was driven by higher selling, administrative and other expenses and by higher income tax expense compared to the same quarter last year.

On a year-to-date basis, cash flows generated from operating activities decreased by $36.9 million to $86.8 million in the current period compared to $123.7 million used in the same period last year. The reduction in cash flows was mainly driven by the net loss of $16.6 million year-to-date compared to net earnings of $12.5 million in the same period last year.

Cash Flows from Investing Activities

In the current quarter, total cash spent on capital projects was $11.6 million compared to $5.7 million spent in the same period last year, as outlined below:

(millions of Canadian dollars)	**13-week period ended December 28, 2013**	13-week period ended December 29, 2012	**39-week period ended December 28, 2013**	39-week period ended December 29, 2012
Store construction, renovations and equipment	**7.8**	2.5	**13.3**	4.9
Intangible assets (primarily application software and internal development costs)	**2.5**	2.3	**8.1**	6.9
Technology equipment	**1.3**	0.9	**2.9**	2.0
	11.6	5.7	**24.3**	13.8

The Company received $0.6 million of interest in the current quarter compared to $0.7 million in the same period last year. In total, the Company used cash flows of $11.0 million for investing activities in the third quarter of fiscal 2014 compared to $5.0 million used for investing activities in the same quarter last year, an increase of $6.0 million. The increase was due to greater spending on capital projects in the current quarter as the Company continues to implement its transformation strategy.

On a year-to-date basis, cash flows used by investing activities increased by $10.6 million to $22.4 million in the current period compared to $11.8 million used in the same period last year for the same reasons discussed above.

Cash Flows from Financing Activities

The Company used $3.0 million for financing activities in the third quarter of fiscal 2014 compared to $2.9 million in the same period last year. The primary use of cash in both periods was $2.8 million of dividend payments.

On a year-to-date basis, cash flows used by financing activities increased by $1.0 million to $10.0 million in the current period compared to $9.0 million used in the same period last year. The increased use of cash in the current period was primarily due to the Company's repurchase of options, as previously discussed. The cash payment for the options repurchase was $1.0 million. The primary use of cash in both periods was $8.3 million of dividend payments.

Liquidity and Capital Resources

The Company has a highly seasonal business which generates the majority of its revenues and cash flows during the December holiday season. Indigo has minimal accounts receivable and a significant portion of book products are purchased on trade terms with the right to return. Indigo's main sources of capital are cash flows generated from operations, long-term debt, and cash and cash equivalents.

Based on the Company's liquidity position and cash flow forecast, management expects its current cash position and cash flow generated from operations to be sufficient to meet its working capital needs and debt service requirements for fiscal 2014. As a result, the Company cancelled its revolving line of credit on June 12, 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. In order to maintain sufficient capital resources to fund the Company's transformation, management and the Company's Board of Directors decided to suspend quarterly dividend payments beyond December 3, 2013. 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.

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 2013 Annual Report.

Accounting Standards Implemented in Fiscal 2014

Adoption of these amendments and standards in the first quarter of fiscal 2014 impacted the Company's results of operations, financial position, and disclosures as follows:

- 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. Previously, the Company accounted for its interest in Calendar Club under IAS 31 using proportionate consolidation. However, the Company has concluded that its interest in Calendar Club will not meet the definition of a joint arrangement under IFRS 11 and will need to be accounted for under "Investments in Associates and Joint Ventures" ("IAS 28") as a significant investment using the equity method. As part of the transition to IAS 28, the Company has retrospectively restated its comparative financial statements to reclassify proportionately consolidated Calendar Club operating results into a single equity investment line. These restatements have no impact to the Company's total net earnings (loss). The impact of reclassification on the Company's financial statements is as follows:

(thousands of Canadian dollars)	13-week period ended Dectember 29, 2012	39-week period ended December 29, 2012
Decrease in revenues	(13,345)	(13,822)
Decrease in expenses	(11,390)	(12,596)
Increase in equity investment	1,955	1,226

(thousands of Canadian dollars)	As at December 29, 2012	As at March 30, 2013
Decrease in assets	(7,663)	(2,074)
Increase in equity investment	2,080	968
Decrease in liabilities	(5,583)	(1,106)

- Amendments to Investments in Associates and Joint Ventures ("IAS 28") impact accounting for associates and joint ventures held for sale and changes in interests held in associates and joint ventures; and

- Disclosure of Interests in Other Entities ("IFRS 12") includes all of the disclosures that were previously in IAS 27, "Separate Financial Statements," IAS 31 and IAS 28, "Investments in Associates." These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates, and structured entities.

Adoption of the following amendments and standards in the first quarter of fiscal 2014 did not have an impact on the Company's results of operations, financial position, or disclosures:

- Amendments to Presentation of Financial Statements ("IAS 1") require companies to group together items within other comprehensive earnings which may be reclassified to net earnings. The amendments are effective for annual periods beginning on or after July 1, 2012 and must be applied retrospectively;
- Amendments to Financial Instruments: Disclosures ("IFRS 7") regarding the offsetting of financial instruments. These amendments must be applied retrospectively and are effective for annual periods beginning on or after January 1, 2013 and interim periods within those annual periods;
- 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 must be applied retrospectively and is effective for annual periods beginning on or after January 1, 2013;
- Amendments to Separate Financial Statements ("IAS 27") remove all requirements relating to consolidated financial statements. This standard must be applied retrospectively and is effective for annual periods beginning on or after January 1, 2013; and
- Consolidated Financial Statements ("IFRS 10") replaces portions of IAS 27, "Consolidated and Separate Financial Statements" and supersedes SIC-12, "Consolidation – Special Purpose Entities," and establishes standards for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. This standard must be applied retrospectively and is effective for annual periods beginning on or after January 1, 2013.

New Accounting Pronouncements

The IASB has not issued any new standards, amendments to standards, or interpretations that impact the Company during the 13 and 39-week periods ended December 28, 2013. Indigo's evaluations of previously issued new standards, amendments to standards, and interpretations are consistent with those disclosed in note 5 of the Company's fiscal 2013 Annual Report. New accounting pronouncements have not been applied in preparing the Company's fiscal 2014 Third 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 2013 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 2013 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.

As required by National Instrument 52-109, "Certification of Disclosure in Issuers' Annual and Interim Filings," the CEO and CFO have evaluated, or caused to be evaluated under their supervision, the effectiveness of such internal controls over financial reporting using the framework established in the Internal Control – Integrated Framework ("COSO Framework") published in 1992 by the Committee of Sponsoring Organizations of the Treadway Commission.

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 September 29, 2013 and ended on December 28, 2013 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 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, impairment, and equity investment. 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 December 28, 2013**	13-week period ended December 29, 2012	**39-week period ended December 28, 2013**	39-week period ended December 29, 2012
EBITDA	**32.8**	33.9	**11.5**	33.2
Depreciation of property, plant and equipment	**(4.1)**	(4.3)	**(12.2)**	(13.3)
Amortization of intangible assets	**(2.7)**	(2.6)	**(8.2)**	(7.6)
Net impairment of capital assets	**(0.5)**	–	**(0.5)**	(0.3)
Interest on long-term debt and financing charges	**0.0**	0.0	**(0.1)**	(0.1)
Interest income on cash and cash equivalents	**0.6**	0.7	**1.8**	1.8
Share of earnings from equity investment	**1.6**	2.0	**1.0**	1.2
Earnings (loss) before income taxes	**27.7**	29.7	**(6.7)**	14.9

Indigo Books & Music Inc.
468 King Street West, Suite 500
Toronto, ON M5V 1L8
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 4th day of February, 2014.

Consolidated Balance Sheets

(Unaudited)

(thousands of Canadian dollars)	**As at December 28, 2013**	As at December 29, 2012 restated (notes 3 and 15)	As at March 30, 2013 restated (notes 3 and 15)
ASSETS			
Current			
Cash and cash equivalents (note 5)	**265,292**	310,076	210,562
Accounts receivable	**25,846**	26,968	7,126
Inventories (note 6)	**247,780**	239,836	216,533
Prepaid expenses	**5,075**	4,144	4,153
Total current assets	**543,993**	581,024	438,374
Property, plant and equipment	**62,396**	60,619	58,903
Intangible assets	**22,039**	22,112	22,164
Equity investment	**1,609**	2,080	968
Deferred tax assets (note 10)	**38,821**	46,310	48,731
Total assets	**668,858**	712,145	569,140
LIABILITIES AND EQUITY			
Current			
Accounts payable and accrued liabilities	**259,559**	267,177	150,177
Unredeemed gift card liability	**64,256**	63,639	47,169
Provisions	**1,524**	221	2,168
Deferred revenue	**13,185**	13,882	13,733
Income taxes payable	**38**	111	11
Current portion of long-term debt (note 13)	**727**	811	773
Total current liabilities	**339,289**	345,841	214,031
Long-term accrued liabilities	**3,562**	4,153	4,004
Long-term provisions	**78**	285	78
Long-term debt (note 13)	**275**	856	705
Total liabilities	**343,204**	351,135	218,818
Equity			
Share capital (note 7)	**203,812**	203,733	203,805
Contributed surplus (note 8)	**8,422**	7,858	8,128
Retained earnings	**113,420**	149,419	138,389
Total equity	**325,654**	361,010	350,322
Total liabilities and equity	**668,858**	712,145	569,140

See accompanying notes

On behalf of the Board:

Heather Reisman, Director

Michael Kirby, Director

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

(Unaudited)

(thousands of Canadian dollars, except per share data)	**13-week period ended December 28, 2013**	13-week period ended December 29, 2012 restated (notes 3 and 15)	**39-week period ended December 28, 2013**	39-week period ended December 29, 2012 restated (notes 3 and 15)
Revenues	**332,393**	322,620	**683,335**	694,809
Cost of sales	**(191,433)**	(185,500)	**(387,657)**	(392,184)
Gross profit	**140,960**	137,120	**295,678**	302,625
Operating, selling and administrative expenses (note 9)	**(115,389)**	(110,032)	**(305,073)**	(290,768)
Operating profit (loss)	**25,571**	27,088	**(9,395)**	11,857
Interest on long-term debt and financing charges	**(25)**	(17)	**(82)**	(69)
Interest income on cash and cash equivalents	**582**	685	**1,766**	1,844
Share of earnings from equity investment	**1,609**	1,955	**1,000**	1,226
Earnings (loss) before income taxes	**27,737**	29,711	**(6,711)**	14,858
Income tax recovery (expense) (note 10)	**(19,240)**	(7,676)	**(9,910)**	(2,323)
Net earnings (loss) and comprehensive earnings (loss) for the period	**8,497**	22,035	**(16,621)**	12,535
Net earnings (loss) per common share (note 11)				
Basic	**$ 0.33**	$ 0.86	**$ (0.65)**	$ 0.49
Diluted	**$ 0.33**	$ 0.86	**$ (0.65)**	$ 0.49

See accompanying notes

Consolidated Statements of Changes in Equity

(Unaudited)

(thousands of Canadian dollars)	Share Capital	Contributed Surplus	Retained Earnings	Total Equity
Balance, March 31, 2012	203,373	7,039	145,220	355,632
Earnings for the 39-week period ended December 29, 2012	–	–	12,535	12,535
Exercise of options (notes 7 and 8)	345	(65)	–	280
Directors' deferred share units converted (note 7)	15	(15)	–	–
Stock-based compensation (note 8)	–	569	–	569
Directors' compensation (note 8)	–	330	–	330
Dividends paid (note 7)	–	–	(8,336)	(8,336)
Balance, December 29, 2012	203,733	7,858	149,419	361,010
Balance, March 30, 2013	**203,805**	**8,128**	**138,389**	**350,322**
Loss for the 39-week period ended December 28, 2013	**–**	**–**	**(16,621)**	**(16,621)**
Exercise of options (notes 7 and 8)	**7**	**–**	**–**	**7**
Directors' deferred share units converted (note 7)	**–**	**–**	**–**	**–**
Stock-based compensation (note 8)	**–**	**925**	**–**	**925**
Directors' compensation (note 8)	**–**	**344**	**–**	**344**
Dividends paid (note 7)	**–**	**–**	**(8,348)**	**(8,348)**
Repurchase of options (note 8)	**–**	**(975)**	**–**	**(975)**
Balance, December 28, 2013	**203,812**	**8,422**	**113,420**	**325,654**

See accompanying notes

Consolidated Statements of Cash Flows

(Unaudited)

(thousands of Canadian dollars)	**13-week period ended December 28, 2013**	13-week period ended December 29, 2012 restated (notes 3 and 15)	**39-week period ended December 28, 2013**	39-week period ended December 29, 2012 restated (notes 3 and 15)
CASH FLOWS FROM OPERATING ACTIVITIES				
Net earnings (loss) for the period	**8,497**	22,035	**(16,621)**	12,535
Add (deduct) items not affecting cash				
Depreciation of property, plant and equipment	**4,101**	4,277	**12,214**	13,325
Amortization of intangible assets	**2,724**	2,617	**8,198**	7,554
Net impairment of capital assets (note 9)	**505**	–	**505**	250
Loss on disposal of capital assets	**100**	–	**113**	44
Stock-based compensation (note 8)	**228**	210	**925**	569
Directors' compensation (note 8)	**100**	101	**344**	330
Deferred tax assets	**19,240**	7,676	**9,910**	2,323
Other	**(442)**	(195)	**(430)**	(440)
Net change in non-cash working capital balances (note 12)	**79,640**	91,363	**73,947**	90,068
Interest on long-term debt and financing charges	**25**	17	**82**	69
Interest income on cash and cash equivalents	**(582)**	(685)	**(1,766)**	(1,844)
Income taxes received (paid)	**27**	–	**26**	45
Distributions from equity investment	**–**	–	**359**	107
Share of earnings from equity investment	**(1,609)**	(1,955)	**(1,000)**	(1,226)
Cash flows from operating activities	**112,554**	125,461	**86,806**	123,709
CASH FLOWS FROM INVESTING ACTIVITIES				
Purchase of property, plant and equipment	**(9,030)**	(3,415)	**(16,188)**	(6,869)
Addition of intangible assets	**(2,508)**	(2,262)	**(8,073)**	(6,876)
Interest received	**582**	682	**1,823**	1,900
Cash flows used in investing activities	**(10,956)**	(4,995)	**(22,438)**	(11,845)
CASH FLOWS FROM FINANCING ACTIVITIES				
Notes payable (note 14)	**–**	190	**–**	190
Repayment of long-term debt	**(189)**	(280)	**(620)**	(964)
Interest paid	**–**	(41)	**(70)**	(127)
Proceeds from share issuances (note 7)	**–**	50	**7**	280
Dividends paid	**(2,783)**	(2,780)	**(8,348)**	(8,336)
Repurchase of options (note 8)	**–**	–	**(975)**	–
Cash flows used in financing activities	**(2,972)**	(2,861)	**(10,006)**	(8,957)
Effect of foreign currency exchange rate changes on cash and cash equivalents	**406**	224	**368**	451
Net increase in cash and cash equivalents during the period	**99,032**	117,829	**54,730**	103,358
Cash and cash equivalents, beginning of period	**166,260**	192,247	**210,562**	206,718
Cash and cash equivalents, end of period	**265,292**	310,076	**265,292**	310,076

See accompanying notes

Notes to the Interim Condensed Consolidated Financial Statements

December 28, 2013
(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 39-week periods ended December 28, 2013 and December 29, 2012 comprise the Company and its equity investment 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 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 39-week periods ended December 28, 2013 and December 29, 2012 were prepared in accordance with International Accounting Standard ("IAS") 34, "Interim Financial Reporting." The same accounting policies and methods of computation as those used in the preparation of the fiscal 2013 Annual Report were followed in the preparation of these unaudited interim condensed consolidated financial statements. These unaudited interim condensed consolidated financial statements should be read in conjunction with the Company's fiscal 2013 Annual Report.

The unaudited interim condensed consolidated financial statements for the 13 and 39-week periods ended December 28, 2013 (including comparatives) were approved by the Board of Directors on February 4, 2014.

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

Adoption of these amendments and standards in the first quarter of fiscal 2014 impacted the Company's results of operations, financial position, and disclosures as follows:

- 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. Previously, the Company accounted for its interest in Calendar Club under IAS 31 using proportionate consolidation. However, the Company has concluded that its interest in Calendar Club will not meet the definition of a joint arrangement under IFRS 11 and will need to be accounted for under "Investments in Associates and Joint Ventures" ("IAS 28") as a significant investment using the equity method. As part of the transition to IAS 28, the Company has retrospectively restated its comparative financial statements to reclassify proportionately consolidated Calendar Club operating results into a single equity investment line. These restatements have no impact to the Company's total net earnings (loss). The impact of reclassification on the Company's financial statements is as follows:

(thousands of Canadian dollars)	13-week period ended December 29, 2012	39-week period ended December 29, 2012
Decrease in revenues	(13,345)	(13,822)
Decrease in expenses	(11,390)	(12,596)
Increase in equity investment	1,955	1,226

(thousands of Canadian dollars)	As at December 29, 2012	As at March 30, 2013
Decrease in assets	(7,663)	(2,074)
Increase in equity investment	2,080	968
Decrease in liabilities	(5,583)	(1,106)

- Amendments to Investments in Associates and Joint Ventures ("IAS 28") impact accounting for associates and joint ventures held for sale and changes in interests held in associates and joint ventures; and
- Disclosure of Interests in Other Entities ("IFRS 12") includes all of the disclosures that were previously in IAS 27, "Separate Financial Statements," IAS 31 and IAS 28, "Investments in Associates." These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates, and structured entities.

Adoption of the following amendments and standards in the first quarter of fiscal 2014 did not have an impact on the Company's results of operations, financial position, or disclosures:

- Amendments to Presentation of Financial Statements ("IAS 1") require companies to group together items within other comprehensive earnings which may be reclassified to net earnings. The amendments are effective for annual periods beginning on or after July 1, 2012 and must be applied retrospectively;
- Amendments to Financial Instruments: Disclosures ("IFRS 7") regarding the offsetting of financial instruments. These amendments must be applied retrospectively and are effective for annual periods beginning on or after January 1, 2013 and interim periods within those annual periods;

- 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 must be applied retrospectively and is effective for annual periods beginning on or after January 1, 2013;
- Amendments to Separate Financial Statements ("IAS 27") remove all requirements relating to consolidated financial statements. This standard must be applied retrospectively and is effective for annual periods beginning on or after January 1, 2013; and
- Consolidated Financial Statements ("IFRS 10") replaces portions of IAS 27, "Consolidated and Separate Financial Statements" and supersedes SIC-12, "Consolidation – Special Purpose Entities," and establishes standards for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. This standard must be applied retrospectively and is effective for annual periods beginning on or after January 1, 2013.

New Accounting Pronouncements
The IASB has not issued any new standards, amendments to standards, or interpretations that impact the Company during the 13 and 39-week periods ended December 28, 2013. Indigo's evaluations of previously issued new standards, amendments to standards, and interpretations are consistent with those disclosed in note 5 of the Company's fiscal 2013 Annual Report. New accounting pronouncements 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 39-week periods ended December 28, 2013 and December 29, 2012 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)	**December 28, 2013**	December 29, 2012	March 30, 2013
Cash	**139,595**	188,294	88,268
Restricted cash	**3,238**	439	470
Cash equivalents	**122,459**	121,343	121,824
Cash and cash equivalents	**265,292**	310,076	210,562

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

6. INVENTORIES

Inventories consist of finished goods. The cost of inventories recognized as an expense during the 13 and 39-week periods ended December 28, 2013 were $192.7 million and $389.7 million, respectively (2012: 13 weeks – $187.1 million; 39 weeks – $395.6 million). The amount of inventory write-downs as a result of net realizable value lower than cost during the 13 and 39-week periods ended December 28, 2013 were $1.2 million and $5.6 million, respectively (2012: 13 weeks – $1.3 million; 39 weeks – $3.8 million), and there were no reversals of inventory write-downs that were recognized in prior periods (2012: 13 weeks – nil; 39 weeks – $2.1 million). The amount of inventory with net realizable value equal to cost was $1.0 million as at December 28, 2013 (2012 – $1.5 million).

7. SHARE CAPITAL

Share capital consists of the following:

	39-week period ended December 28, 2013		39-week period ended December 29, 2012		52-week period ended March 30, 2013	
	Number of shares	**Amount C$ (thousands)**	Number of shares	Amount C$ (thousands)	Number of shares	Amount C$ (thousands)
Balance, beginning of period	**25,297,389**	**203,805**	25,238,414	203,373	25,238,414	203,373
Issued during the period						
Directors' deferred share units converted	–	–	1,075	15	1,075	15
Options exercised	**850**	**7**	48,400	345	57,900	417
Balance, end of period	**25,298,239**	**203,812**	25,287,889	203,733	25,297,389	203,805

During the 13 and 39-week periods ended December 28, 2013, the Company distributed dividends per share of $0.11 and $0.33, respectively (2012: 13 weeks – $0.11; 39 weeks – $0.33).

8. SHARE-BASED COMPENSATION

As at December 28, 2013, 1,486,150 stock options were outstanding with exercise prices ranging from $7.20 to $15.21. Of these outstanding stock options, 189,950 were exercisable. As at December 29, 2012, there were 1,592,500 stock options outstanding of which 700,500 were exercisable.

During the first quarter of fiscal 2014, the Company offered a one-time cash repurchase to holders of stock options above a specified value. The repurchase was approved by the Board of Directors and by the Company's shareholders; repurchased options were subsequently cancelled by the Company. As part of this transaction, the Company immediately recorded the remaining unamortized expense for repurchased options. The Company repurchased and cancelled 870,500 options and made a cash payment to option holders of $1.0 million.

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 39-week periods ended December 28, 2013, the pre-forfeiture rate fair values of options granted were $0.1 million and $2.4 million, respectively (2012: 13 weeks – $0.2 million; 39 weeks – $0.6 million).

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

	13-week period ended December 28, 2013	13-week period ended December 29, 2012
Black-Scholes option pricing assumptions		
Risk-free interest rate	**1.3%**	1.2%
Expected volatility	**35.0%**	36.1%
Expected time until exercise	**3.0 years**	4.2 years
Expected dividend yield	**–**	5.0%
Other assumptions		
Forfeiture rate	**27.4%**	24.8%

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 500,000. During the 13 and 39-week periods ended December 28, 2013, the Company issued 12,181 DSUs with a value of $0.1 million and 35,071 DSUs with a value of $0.3 million, respectively (2012: 13 weeks – 10,088 DSUs with a value of $0.1 million; 39 weeks – 35,857 DSUs with a value of $0.3 million). The number of DSUs to be issued to each Director is based on a set fee schedule. The fair value of the outstanding DSUs as at December 28, 2013 was $3.3 million (2012 – $2.8 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.

9. OPERATING AND ADMINISTRATIVE EXPENSES

Supplemental operating and administrative expenses information:

(thousands of Canadian dollars)	**13-week period ended December 28, 2013**	13-week period ended December 29, 2012	**39-week period ended December 28, 2013**	39-week period ended December 29, 2012
Wages, salaries and bonuses	**45,942**	43,123	**121,209**	116,108
Short-term benefits expense	**4,556**	4,333	**13,328**	12,879
Termination benefits expense	**497**	1,100	**1,775**	1,727
Retirement benefits expense	**302**	288	**949**	909
Stock-based compensation	**228**	210	**925**	569
Total employee benefits expense	**51,525**	49,054	**138,186**	132,192

Termination benefits arise when the Company terminates certain employment agreements.

Capital assets

During the 13 and 39-week periods ended December 28, 2013, the Company recognized capital asset impairments of $0.5 million and $0.5 million, respectively (2012: 13 weeks – nil; 39 weeks – $0.3 million). During the 13 and 39-week periods ended December 28, 2013, the Company had no capital asset impairment reversals (2012: 13 weeks – nil; 39 weeks – nil).

Impairment losses were spread across a number of cash-generating units ("CGUs") and arose due to stores performing at lower-than-expected profitability. The key assumptions from the value in use calculation used for impairment testing are those regarding growth rates and discount rates. The cash flow projections are based on both past and forecasted performance and are extrapolated using long-term growth rates which are calculated separately for each CGU being tested. Average long-term growth rates for impairment testing ranged from 0.0% to 3.0% (2012 – 0.0% to 3.0%). Management's estimate of the discount rate reflects the current market assessment of the time value of money and the risks specific to the Company. The pre-tax discount rate used to calculate value in use was 21.8% (2012 – 22.0%).

10. INCOME TAXES

Deferred tax assets are recognized in accordance with the Income Taxes standard ("IAS 12") to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry-forward of unused tax credits and unused tax losses can be utilized. As at December 28, 2013, the Company has recorded $51.2 million in gross value of deferred tax assets with a valuation allowance of $12.4 million based on management's best estimate of future taxable income that the Company expects to achieve from reviewing its latest forecast. If the valuation allowance decreases as the result of subsequent events, the previously recognized valuation allowance will be reversed.

11. EARNINGS PER SHARE

Earnings per share is calculated based on the weighted average number of shares outstanding during the period. In calculating diluted earnings per share amounts under the treasury stock method, the numerator remains unchanged from the basic earnings per share calculations as the assumed exercise of the Company's stock options do not result in adjustment to net earnings. The reconciliation of the denominator in calculating diluted earnings per share amounts for the 13 and 39-week periods ended December 28, 2013 and December 29, 2012 is as follows:

	13-week period ended December 28, 2013	13-week period ended December 29, 2012	**39-week period ended December 28, 2013**	39-week period ended December 29, 2012
Weighted average number of common shares outstanding, basic	**25,607**	25,543	**25,596**	25,516
Effect of dilutive securities				
Stock options	**20**	51	**52**	30
Weighted average number of common shares outstanding, diluted	**25,627**	25,594	**25,648**	25,546

12. CASH FLOW STATEMENT

Supplemental cash flow information:

(thousands of Canadian dollars)	**13-week period ended December 28, 2013**	13-week period ended December 29, 2012	**39-week period ended December 28, 2013**	39-week period ended December 29, 2012
Net change in non-cash working capital balances:				
Accounts receivable	**(13,226)**	(12,884)	**(18,720)**	(14,348)
Inventories	**(5,841)**	2,860	**(31,247)**	(10,637)
Income taxes payable (recoverable)	**1**	–	**1**	1
Prepaid expenses	**1,566**	509	**(922)**	(452)
Accounts payable and accrued liabilities	**75,379**	74,211	**108,940**	92,114
Unredeemed gift card liability	**22,240**	25,727	**17,087**	20,928
Provisions	**(202)**	(60)	**(644)**	(186)
Deferred revenue	**(277)**	1,000	**(548)**	2,648
	79,640	91,363	**73,947**	90,068
Assets acquired under finance leases	**–**	–	**137**	421

13. CAPITAL MANAGEMENT

The Company's main objectives when managing capital are to safeguard its 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, and long-term debt. On June 12, 2013, the Company cancelled its revolving line of credit. Cash flow is used to fund working capital needs, capital expenditures and debt service requirements.

In order to maintain sufficient capital resources to fund the Company's transformation, management and the Company's Board of Directors decided to suspend quarterly dividend payments beyond December 3, 2013. The Company primarily manages its capital by monitoring its available cash balance to ensure that sufficient funds are available for long-term debt and interest payments over the next year.

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

(thousands of Canadian dollars)	**December 28, 2013**	December 29, 2012	March 30, 2013
Current portion of long-term debt	**727**	811	773
Long-term debt	**275**	856	705
Total debt	**1,002**	1,667	1,478
Total equity	**325,654**	361,010	350,322
Total capital under management	**326,656**	362,677	351,800

14. RELATED PARTY TRANSACTIONS

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

Transactions with key management personnel

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

(thousands of Canadian dollars)	**13-week period ended December 28, 2013**	13-week period ended December 29, 2012	**39-week period ended December 28, 2013**	39-week period ended December 29, 2012
Wages, salaries, bonus and consulting	**1,236**	996	**3,746**	3,092
Short-term benefits expense	**51**	55	**166**	158
Termination benefits expense	**–**	450	**457**	450
Retirement benefits expense	**13**	16	**47**	49
Stock-based compensation	**155**	126	**590**	314
Directors' compensation	**100**	101	**344**	330
Total remuneration	**1,555**	1,744	**5,350**	4,393

Transactions with shareholders

During the 13 and 39-week periods ended December 28, 2013, Indigo purchased goods and services from companies in which Mr. Gerald W. Schwartz, who is the controlling shareholder of Indigo, holds a controlling or significant interest. During the 13 and 39-week periods ended December 28, 2013, Indigo paid \$3.2 million and \$4.6 million, respectively, for these transactions (2012: 13 weeks – \$0.2 million; 39 weeks – \$0.2 million). As at December 28, 2013, Indigo had less than \$0.1 million payable to these companies under standard payment terms and \$2.8 million of restricted cash pledged as collateral for letter of credit obligations issued to support the Company's purchases of merchandise from these companies. All transactions were in the normal course of business for both Indigo and the related companies.

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 associate

The Company's associate, Calendar Club, is a seasonal operation which is dependent on the December holiday sales season to generate revenues. During the year, the Company loans cash to Calendar Club for working capital requirements and Calendar Club repays the loans once profits are generated in the third quarter. The net amount of these transactions for the 13 and 39-week periods ended December 28, 2013 was \$4.5 million and nil, respectively, received by Indigo (2012: 13 weeks – \$3.5 million received by Indigo; 39 weeks – nil).

15. COMPARATIVE UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The comparative unaudited interim condensed consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the current year unaudited interim condensed consolidated financial statements.

Investor Information

Support Office

468 King Street West, Suite 500
Toronto, Ontario Canada M5V 1L8
Telephone (416) 364-4499
Fax (416) 364-0355
www.chapters.indigo.ca/investor-relations/

Investor Contact

Kay Brekken
Chief Financial Officer
Telephone (416) 646-8945

Media Contact

Janet Eger
Vice President, Public Affairs
Telephone (416) 342-8561

Stock Listing

Toronto Stock Exchange

Trading Symbol

IDG

Transfer Agent and Registrar

CST Trust Company
P.O. Box 700, Station B
Montreal, Quebec Canada H3B 3K3
Telephone (Toll Free) 1-800-387-0825
(Toronto)   (416) 682-3860

Auditors

Ernst & Young LLP
Ernst & Young Tower
Toronto-Dominion Centre
Toronto, Ontario Canada M5K 1J7