"A WORD AFTER A WORD AFTER A WORD IS POWER."

Margaret Atwood

THIRD QUARTER REPORT
FOR THE 13 AND
39-WEEK PERIODS
ENDED DECEMBER 31, 2016

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Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") is prepared as at February 7, 2017 and is based primarily on the unaudited interim condensed consolidated financial statements of Indigo Books & Music Inc. (the "Company" or "Indigo") for the 13 and 39-week periods ended December 31, 2016 and December 26, 2015. The Company's unaudited interim condensed consolidated financial statements and 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 2016 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 International Financial Reporting Standards ("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 53-week period ended April 2, 2016, and the MD&A included in the Company's fiscal 2016 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 ten provinces and one territory in Canada and offering online sales through the *indigo.ca* website and the Company's mobile applications. As at February 7, 2017, the Company operated 89 superstores under the banners *Chapters* and *Indigo* and 124 small format stores under the banners *Coles*, *Indigospirit*, *SmithBooks*, and *The Book Company*. 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.

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

The weighted average number of common shares outstanding for the third quarter of fiscal 2017 was 26,393,667 compared to 25,953,545 for the same period last year. As at February 7, 2017, the number of outstanding common shares was 26,313,509 with a book value of $215.5 million. The number of common shares reserved for issuance under the employee stock option plan was 3,447,026 as at February 7, 2017. As at December 31, 2016, there were 1,909,150 stock options outstanding of which 678,725 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 31, 2016**	**% Revenue**	13-week period ended December 26, 2015	% Revenue	**39-week period ended December 31, 2016**	**% Revenue**	39-week period ended December 26, 2015	% Revenue
Revenue	**400.3**	**100.0**	383.2	100.0	**810.3**	**100.0**	773.8	100.0
Cost of sales	**(223.2)**	**55.8**	(214.1)	55.9	**(449.6)**	**55.5**	(429.7)	55.5
Cost of operations	**(89.5)**	**22.4**	(85.3)	22.3	**(227.6)**	**28.1**	(218.5)	28.3
Selling, administrative, and other expenses	**(31.1)**	**7.7**	(31.3)	8.1	**(78.3)**	**9.6**	(71.5)	9.2
Adjusted EBITDA[1]	**56.5**	**14.1**	52.5	13.7	**54.8**	**6.8**	54.1	7.0

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

Revenue

Total consolidated revenue for the 13-week period ended December 31, 2016 increased $17.1 million or 4.5% to $400.3 million from $383.2 million for the 13-week period ended December 26, 2015. Higher revenue was driven by double-digit growth in general merchandise, particularly in the lifestyle and toy categories, which was partly offset by the declining trend for adult colouring books. As at December 31, 2016, the Company operated one less superstore and two fewer small format stores compared to December 26, 2015.

Online revenue increased by $6.4 million or 11.8% to $60.5 million for the 13-week period ended December 31, 2016 compared to $54.1 million in the same period last year. Online sales continued to grow across all categories, in both print and general merchandise, with exceptional growth in lifestyle and toys.

Total comparable sales, which includes online sales, increased by 3.8% in the third quarter. Comparable retail store sales for the third quarter increased 3.1% in superstores and decreased 0.8% in small format stores. Increases in comparable sales were primarily driven by continued general merchandise growth and strong online sales growth. The decline in the trend for adult colouring books had a greater impact on small format stores, where the product mix is more focused towards print categories. Total comparable sales is based on comparable retail store sales and includes online sales for the same period. Comparable retail store sales are defined as sales generated by stores that have been open for more than 12 months on a 52-week basis. These measures exclude sales fluctuations due to store openings and closings, permanent relocation, and material changes in square footage, and they are key performance indicators for the Company.

Revenue from other sources includes revenue generated through cafés, irewards card sales, revenue from unredeemed gift cards ("gift card breakage"), revenue from unredeemed plum points ("plum breakage"), corporate sales, and revenue-sharing with Rakuten Kobo Inc. ("Kobo"). Revenue from other sources increased by $1.6 million or 24.2% to $8.2 million for the 13-week period ended December 31, 2016 compared to $6.6 million in the same period last year, primarily driven by higher gift card breakage. Subtle changes in consumer behaviour relating to gift card redemption patterns led to an increase of $1.9 million in revenue from breakage compared to the same period last year.

On a fiscal year-to-date basis, total consolidated revenue increased by $36.5 million or 4.7% to $810.3 million compared to $773.8 million for the same period last year. The increase was driven by continued strong sales growth across channels and general merchandise product categories, notably in lifestyle and toys. Year-to-date total comparable sales, which includes online sales, increased 4.9%, while year-to-date comparable retail store sales increased 4.4% for superstores and increased 2.6% in small format stores.

Revenue by channel is highlighted below:

(millions of Canadian dollars)	**13-week period ended December 31, 2016**	13-week period ended December 26, 2015	% increase	Comparable sales % increase
Superstores	**275.1**	266.1	3.4	3.1
Small format stores	**56.5**	56.4	0.2	(0.8)
Online (including store kiosks)	**60.5**	54.1	11.8	11.8
Other	**8.2**	6.6	24.2	N/A
Total	**400.3**	383.2	4.5	3.8

Revenue by product line is as follows:

	13-week period ended December 31, 2016	13-week period ended December 26, 2015	**39-week period ended December 31, 2016**	39-week period ended December 26, 2015
Print[1]	**53.8%**	57.8%	**58.4%**	61.6%
General merchandise[2]	**43.2%**	39.5%	**38.2%**	34.9%
eReading[3]	**1.2%**	1.2%	**1.2%**	1.5%
Other[4]	**1.8%**	1.5%	**2.2%**	2.0%
Total	**100.0%**	100.0%	**100.0%**	100.0%

1 Includes books, calendars, magazines, newspapers, and shipping revenue.
2 Includes lifestyle, paper, toys, music, DVDs, electronics, and shipping revenue.
3 Includes eReaders, eReader accessories, Kobo revenue share, and shipping revenue.
4 Includes cafés, irewards, gift card breakage, Plum breakage, and corporate sales.

Reconciliations between total revenue and comparable sales are provided below:

(millions of Canadian dollars)	**13-week period ended December 31, 2016**	13-week period ended December 26, 2015
Total retail store revenue	**331.6**	322.5
Total online revenue	**60.5**	54.1
Adjustments for stores not in both fiscal periods	**(13.4)**	(11.9)
Total comparable sales	**378.7**	364.7

	Superstores		Small format stores	
(millions of Canadian dollars)	**13-week period ended December 31, 2016**	13-week period ended December 26, 2015	**13-week period ended December 31, 2016**	13-week period ended December 26, 2015
Total revenue	**275.1**	266.1	**56.5**	56.4
Adjustments for stores not in both fiscal periods	**(11.3)**	(10.3)	**(2.1)**	(1.6)
Comparable retail store sales	**263.8**	255.8	**54.4**	54.8

Cost of Sales

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 $9.1 million to $223.2 million or 4.3% for the 13-week period ended December 31, 2016, compared to $214.1 million for the same period last year. The increase was driven by higher sales volume, as discussed above. As a percent of total revenue, cost of sales decreased by 0.1% to 55.8%, compared to 55.9%

for the same period last year. The slight improvement in margin rate was driven by higher sell-through of full-priced goods in the current period, compared to the same period last year.

On a fiscal year-to-date basis, cost of sales increased by $19.9 million or 4.6% to $449.6 million compared to $429.7 million for the same period last year for the same reasons discussed above. Year-to-date cost of sales as a percent of total revenue remained flat at 55.5%, compared to the same period last year. Higher discounts in the first half of fiscal 2017, which were driven by promotional discounting and increased markdowns on slow-moving general merchandise, were offset by greater sell-through of full-priced goods in the third quarter of fiscal 2017.

Cost of Operations

Cost of operations includes all store, store support, online, and distribution centre costs. Cost of operations increased $4.2 million to $89.5 million for the 13-week period ended December 31, 2016, compared to $85.3 million for the same period last year. Improved efficiencies in retail store operations resulted in a $1.3 million reduction in operating costs at store level, or 2.0% compared to the same period last year. This was offset by a $4.9 million increase in total distribution centre costs, which includes both retail and online, due to both higher sales volume and increased labour costs. In September 2016, the Company went live with new systems and processes intended to improve the productivity of its online distribution centre. The launch resulted in some stabilization challenges which impacted the Company's fulfilment capabilities during the holiday season. Additionally, increased labour rates were required to attract seasonal labour in an increasingly competitive labour market. As a percent of total revenue, cost of operations increased by 0.1% to 22.4%, compared to 22.3% for the same period last year.

On a fiscal year-to-date basis, cost of operations increased by $9.1 million or 4.2% to $227.6 million compared to $218.5 million for the same period last year. As discussed above, the increase was driven by higher sales volume and distribution centre costs. An increase in retail store wage rates also resulted in comparatively higher store labour costs in the first two quarters of fiscal 2017. Year-to-date cost of operations as a percent of total revenue decreased by 0.2% to 28.1%, compared to 28.3% for the same period last year.

Selling, Administrative, and Other Expenses

Selling, administrative, and other expenses include marketing, head office costs, and operating expenses associated with the Company's strategic initiatives. These expenses decreased by $0.2 million to $31.1 million for the 13-week period ended December 31, 2016, compared to $31.3 million for the same period last year. The decrease was driven by lower bonus accruals this year compared to the exceptional performance of the prior period, partially offset by increased marketing costs. In the current period, the Company also had a foreign exchange loss of $0.1 million compared to a $0.1 million foreign exchange gain in the same period last year. As a percent of total revenue, selling, administrative, and other expenses decreased by 0.4% to 7.7%, compared to 8.1% for the same period last year.

On a fiscal year-to-date basis, selling, administrative, and other expenses increased $6.8 million to $78.3 million compared to $71.5 million in the same period last year. In the comparative period, the Company received one-time net proceeds of $4.5 million related to exiting a lease, without which current year expenses would only have increased by $2.3 million. Higher expenses were driven by a $1.5 million increase in marketing costs and by a lower foreign exchange gain. Increased marketing costs are consistent with the Company's revenue growth and have remained flat year-over-year as a percentage of revenue. In the current year, there was a foreign exchange gain of $0.1 million, compared to a gain of $2.5 million in the same period last year. The lower gain in the current year was driven by lower U.S. dollar cash holdings and a steady USD/CAD exchange rate compared to the same period last year, when the U.S. dollar strengthened significantly against the Canadian dollar. Lower U.S. dollar cash holdings in the current year resulted from implementation of a hedging program during the first quarter of fiscal 2017. Year-to-date selling, administrative, and other expenses as a percent of total revenue increased 0.4% to 9.6% compared to 9.2% in the same period last year.

Adjusted EBITDA

Adjusted EBITDA, defined as earnings before interest, taxes, depreciation, amortization, impairment, asset disposals, and equity investment improved by $4.0 million to $56.5 million for the 13-week period ended December 31, 2016, compared to $52.5 million for the same period last year. Adjusted EBITDA as a percent of revenue improved to 14.1% this period compared to 13.7% for the same period last year. Higher adjusted EBITDA in the current period was driven by continued growth in revenue and margin, partially off-set by higher operating costs at the retail and online distribution centres.

On a fiscal year-to-date basis, adjusted EBITDA increased $0.7 million to $54.8 million compared to $54.1 million in the same period last year. Year-to-date adjusted EBITDA as a percent of total revenue was 6.8% compared to 7.0% in the same period last year. As indicated above, the Company had a one-time impact of receiving $4.5 million from exiting a lease in the same period last year. Excluding this impact, adjusted EBITDA increased $5.2 million compared to the same period last year, for the same reasons discussed above.

Capital Assets

Depreciation and amortization increased $0.6 million to $6.5 million for the 13-week period ended December 31, 2016 compared to $5.9 million for the same period last year. Capital expenditures in the third quarter of fiscal 2017 totalled $10.5 million compared to $9.8 million last year as the Company continued to implement changes across its retail outlets and invest in its digital business with back-end productivity initiatives, including increased distribution centre automation and a new product information management system. Capital expenditures in the third quarter of fiscal 2017 included $5.2 million for construction, renovations and equipment, $1.7 million for technology equipment, and $3.6 million primarily for application software and internal development costs, which are classified as intangible assets. None of the capital expenditures were financed through leases. The Company also had $1.0 million of capital asset impairment reversals in the current period compared to net capital asset reversals of $1.6 million in the comparative period last year. Impairment reversals were spread across a number of cash-generating units at the store level and were driven by improved store performance and the likelihood of lease term renewals.

On a fiscal year-to-date basis, depreciation and amortization increased by $0.9 million to $18.6 million compared to $17.7 million in the same period last year. Year-to-date, the Company has spent $24.6 million on capital expenditures compared to $19.4 million last year for the same reasons discussed above and also due to the opening of a new superstore in the first quarter of fiscal 2017. Capital expenditures for the current year included $13.2 million for retail store renovations and equipment, $2.7 million for technology equipment, and $8.7 million primarily for application software and internal development costs, which are classified as intangible assets. None of the capital expenditures were financed through leases. As discussed above, the Company had $1.0 million of capital asset impairment reversals in the current period compared to net capital asset reversals of $1.6 million in the comparative period last year.

Net Interest Income

The Company recognized net interest income of $0.6 million for the 13-week period ended December 31, 2016 compared to $0.3 million for the same period last year. Compared to the same period last year, the Company maintained a higher average cash balance in short-term investments at higher interest rates. The Company nets interest expense against interest income.

On a fiscal year-to-date basis, the Company recognized net interest income of $1.5 million compared to $1.0 million in the same period last year for the same reasons discussed above.

Earnings from Equity Investment

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. Calendar Club is a seasonal operation that is dependent on the December holiday sales season to generate revenue. The Company recognized net earnings from Calendar Club of $2.9 million in the 13-week period ended December 31, 2016 compared to net earnings of $2.4 million for the same period last year.

On a fiscal year-to-date basis, Indigo recognized net earnings from Calendar Club of $2.0 million compared to net earnings of $1.7 million in the same period last year.

Income Tax Expense

The Company recognized a non-cash income tax expense of $14.5 million for the 13-week period ended December 31, 2016 compared to recognizing a net income tax recovery of $2.1 million for the 13-week period ended December 26, 2015. The Company used a tax rate of 26.8% to calculate income tax expense for the third quarter of fiscal 2017. Current income tax expense relates to a decrease in deferred tax assets. In the same period last year, the Company fully reversed a previously-recorded valuation allowance against deferred tax assets based on management's best estimate of future taxable income the Company expected to achieve, which resulted in an income tax recovery. Excluding the impact of the valuation allowance, income tax expense in the comparative prior year period was $13.4 million.

On a fiscal year-to-date basis, Indigo recognized a non-cash income tax expense of $11.2 million compared to recognizing a net income tax recovery of $2.1 million in the same period last year for the same reasons discussed above. Excluding the impact of the previously-recorded valuation allowance, income tax expense in the comparative prior year period was $10.3 million. On the basis of a full 52-week period, the Company does not expect to pay cash income taxes, as deferred tax assets, which includes non-capital loss carryforwards, can be utilized to offset taxable income.

Net Earnings Before Taxes

The Company recognized net earnings before taxes of $54.4 million for the 13-week period ended December 31, 2016 compared to pre-tax net earnings of $50.7 million in the same period last year. Higher pre-tax earnings in the current period were driven by improved revenue and margin, partially offset by higher operating costs in the online distribution centre. As indicated above, the Company recognized income tax expense in the current period compared to a net income tax recovery in the comparative prior year period due to reversal of a previously-recorded valuation allowance.

On a fiscal year-to-date basis, the Company recognized net earnings before taxes of $40.9 million, compared to pre-tax net earnings of $39.9 million in the same period last year. Excluding the Company's one-time proceeds from disposal of a lease in the prior year period, the Company recognized adjusted pre-tax net earnings of $35.4 million last year. Higher adjusted earnings were driven by the same reasons discussed above.

Net Earnings

The Company recognized net earnings of $40.0 million for the 13-week period ended December 31, 2016 ($1.51 net earnings per common share), compared to net earnings of $52.8 million ($2.03 net earnings per common share) for the same period last year. The decrease in net earnings was driven by the recognition of income tax expense in the current period compared to a net income tax recovery in the comparative prior year period due to reversal of a previously-recorded valuation allowance.

On a fiscal year-to-date basis, the Company recognized net earnings of $29.8 million ($1.13 net earnings per common share), compared to net earnings of $42.0 million ($1.62 net earnings per common share) in the same period last year. Lower net earnings were driven by the same reasons discussed above.

Other Comprehensive Income

During the first quarter of fiscal 2017, the Company implemented a formal hedging policy to mitigate foreign exchange risk, entering into contracts to manage the currency fluctuation risk associated with forecasted U.S. dollar expenses. All contracts entered in fiscal 2017 have been designated as cash flow hedges for accounting purposes.

Accordingly, the effective portion of the change in the fair value of the foreign exchange forward contracts that are designated and qualify as cash flow hedges is recognized in other comprehensive income until related payments have been made in future accounting periods. Associated gains and losses recognized in other comprehensive income will be reclassified to earnings in the periods when the hedged item is recognized in earnings.

During the 13 and 39-week periods ended December 31, 2016, the Company entered into forward contracts with total notional amounts of C$49.0 million and C$135.5 million, respectively, to buy U.S. dollars and sell Canadian dollars. These contracts were entered into in order to manage the currency fluctuation risk associated with forecasted U.S. dollar payments, primarily for inventory purchases.

As at December 31, 2016, the Company had remaining forward contracts in place representing a total notional amount of C$56.6 million. These contracts extend over a period not exceeding 12 months. The total fair value of these contracts as at December 31, 2016 was an unrealized net gain of $1.1 million. During the 13 and 39-week periods ended December 31, 2016, net gains of $0.8 million and $1.1 million, respectively, were reclassified from other comprehensive income to inventory and expenses. Reclassified amounts resulting from hedge ineffectiveness were immaterial for the 13 and 39-week periods ended December 31, 2016.

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 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 revenue, net earnings (loss) attributable to shareholders of the Company, basic and diluted earnings (loss) per share for the preceding eight fiscal quarters. Under an accounting convention common in the retail industry, the Company follows a 52-week reporting cycle which periodically necessitates a fiscal year of 53 weeks. Fiscal years 2017 and 2015 are 52 weeks, while fiscal year 2016 was 53 weeks.

	Fiscal quarters							
(millions of Canadian dollars, except per share data)	**Q3[1] Fiscal 2017**	Q2[1] Fiscal 2017	Q1[1] Fiscal 2017	Q4[2] Fiscal 2016	Q3[1] Fiscal 2016	Q2[1] Fiscal 2016	Q1[1] Fiscal 2016	Q4[1] Fiscal 2015
Revenue	400.3	216.9	193.1	220.4	383.2	205.7	184.9	186.2
Total net earnings (loss)	40.0	(1.2)	(9.0)	(13.4)	52.8	(1.8)	(9.0)	(13.9)
Basic earnings (loss) per share	$1.51	($0.04)	($0.34)	($0.51)	$2.03	($0.07)	($0.35)	($0.54)
Diluted earnings (loss) per share	$1.48	($0.04)	($0.34)	($0.51)	$2.02	($0.07)	($0.35)	($0.54)

1 13-week period
2 14-week period

Overview of Consolidated Balance Sheets

Assets

As at December 31, 2016, total assets increased $28.2 million to $710.6 million, compared to $682.4 million as at December 26, 2015. The increase was driven by higher inventory levels and capital assets, partially offset by a reduction in deferred tax assets. The inventories increase of $22.9 million was primarily driven by higher trade book inventory, as sales of key titles were lower than anticipated during the holiday season. As previously discussed, the Company also continues to implement changes across its retail outlets and invest in its digital business, driving the $10.5 million increase in capital assets. Deferred tax assets were applied to offset the Company's estimated tax expense, resulting in a $6.0 million decrease in assets.

On a fiscal year-to-date basis, total assets increased by $126.6 million to $710.6 million compared to $584.0 million as at April 2, 2016. The increase was primarily driven by higher cash and cash equivalents, inventories, and accounts receivable, partly offset by lower deferred tax assets. The $99.8 million increase in cash and cash equivalents and $10.6 million increase in accounts receivable were primarily driven by sales generated during the fiscal 2017 holiday season. Consistent with the seasonal nature of the business, inventory increased by $25.7 million, as the Company holds a higher amount of inventory during the holiday season. Deferred tax assets were applied to offset the Company's estimated tax expense, resulting in an $11.5 million decrease in assets.

Liabilities

As at December 31, 2016, total liabilities increased $3.5 million to $330.0 million, compared to $326.5 million as at December 26, 2015. Current and long-term accounts payable and accrued liabilities increased by $6.8 million due to the timing of invoice processing. Higher accounts payable and accrued liabilities were partially offset by a $2.7 million decrease in unredeemed gift card liabilities, primarily due to increased breakage compared to the same period last year.

On a fiscal year-to-date basis, total liabilities increased $90.0 million to $330.0 million compared to $240.0 million as at April 2, 2016. The increase was driven by a $75.3 million increase in current and long-term accounts payable and accrued liabilities and a $15.0 million increase in unredeemed gift card liabilities, which are consistent with the seasonal nature of a retail business during the holiday season.

Equity

Total equity at December 31, 2016 increased $24.7 million to $380.6 million, compared to $355.9 million as at December 26, 2015. Over the last four quarters, the Company generated net earnings of $16.4 million and had a $7.6 million increase in share capital. Share capital increased due to the exercise of stock options and deferred share units. Correspondingly, contributed surplus decreased due to exercise of stock options, but the decrease was offset by the issuance of new stock options.

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 $255.3 million as at December 31, 2016, compared to $235.9 million as at December 26, 2015 and $217.9 million as at April 2, 2016. Increased working capital compared to the same period last year was driven by higher current assets. As previously discussed, inventories increased by $22.9 million and capital assets increased by $10.5 million.

The Company's leverage position (defined as Total Liabilities to Total Equity) remained flat as at December 31, 2016 at 0.9:1 compared to the same period last year. The Company's leverage position as at December 31, 2016 increased slightly compared to 0.7:1 as at April 2, 2016 due to the seasonal nature of the business.

Overview of Consolidated Statements of Cash Flows

Cash and cash equivalents increased $132.4 million for the 13-week period ended December 31, 2016 compared to an increase of $136.1 million in the same period last year. The increase in the current period was driven by cash flows generated from operating activities of $139.2 million, financing activities of $3.0 million, and the effect of foreign currency exchange rate changes on cash and cash equivalents of $0.2 million. These increases were partially offset by cash used for investing activities of $10.1 million. On a fiscal year-to-date basis, cash and cash equivalents increased by $99.8 million due to the seasonal nature of the business, as the Company generates the majority of its revenue during the holiday season.

Cash Flows from Operating Activities

The Company generated cash flows of $139.2 million from operating activities in the 13-week period ended December 31, 2016 compared to generating $143.7 million in the same period last year, a decrease of $4.5 million. The decrease was driven by a reduction in cash generated from working capital. The Company generated $82.2 million of cash from working capital this period compared to generating $91.4 million of cash from working capital in the same period last year, primarily driven by higher print inventories.

On a fiscal year-to-date basis, cash flows generated from operating activities decreased by $5.3 million to $117.5 million in the current period compared to $122.8 million generated in the same period last year for the same reasons discussed above. The Company generated $61.3 million of cash from working capital this year compared to generating $70.7 million of cash from working capital in the same period last year.

Cash Flows Used for Investing Activities

The Company used cash flows of $10.1 million for investing activities in the 13-week period ended December 31, 2016 compared to using $9.5 million in the same period last year, an increase of $0.6 million. Capital asset expenditures were $10.5 million compared to $9.8 million in the same period last year. The Company continues to transform its retail outlets and invest in its digital business with back-end productivity initiatives such as improved distribution centre automation and a new product information management system.

On a fiscal year-to-date basis, the Company used cash flows of $23.2 million for investing activities compared to using $18.7 million in the same period last year, an increase of $4.5 million. The Company spent $24.6 million on capital projects compared to spending $19.4 million in the same period last year. As discussed above, the Company is investing in a number of initiatives to improve productivity and enhance the customer experience. Cash was also used for the construction of a new superstore which opened during the first quarter of fiscal 2017.

Cash was used for capital projects as follows:

(millions of Canadian dollars)	**13-week period ended December 31, 2016**	13-week period ended December 26, 2015	**39-week period ended December 31, 2016**	39-week period ended December 26, 2015
Construction, renovations, and equipment	**5.2**	6.5	**13.2**	11.5
Intangible assets (primarily application software and internal development costs)	**3.6**	2.1	**8.7**	5.9
Technology equipment	**1.7**	1.2	**2.7**	2.0
Total	**10.5**	9.8	**24.6**	19.4

Cash Flows from Financing Activities

The Company generated cash flows of $3.0 million from financing activities in the 13-week period ended December 31, 2016 compared to $1.2 million in the same period last year, an increase of $1.8 million. The increase was driven by a greater number of option exercises in the current period. Proceeds from share issuances increased by $1.8 million in the current period compared to the same period last year.

On a fiscal year-to-date basis, cash flows generated from financing activities increased to $4.5 million in the current period compared to $1.3 million in the same period last year. As discussed above, increased cash flow was driven by a greater number of option exercises. In the current period, proceeds from share issuances increased by $3.1 million compared to the same period last year.

Liquidity and Capital Resources

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

Based on the Company's liquidity position and cash flow forecast, management expects its current cash position and cash flows generated from operations to be sufficient to meet its working capital needs for fiscal 2017. In addition, the Company has the ability to reduce capital spending requirements if necessary;

however, a long-term decline in capital expenditures may negatively impact revenue and profit growth.

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 requirements and service requirements for finance lease agreements. In addition, other factors not presently known to management could materially and adversely affect the Company'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 2016 Annual Report.

Accounting Standards Implemented in Fiscal 2017

There were no new standards implemented in the third quarter of fiscal 2017.

Presentation of Financial Statements ("IAS 1")

In December 2014, the IASB issued amendments to IAS 1 as part of the IASB's Disclosure Initiative. These amendments encourage entities to apply professional judgment regarding disclosure and presentation in their financial statements and are effective for annual periods beginning on or after January 1, 2016. The implementation of these amendments in the first quarter of fiscal 2017 did not have a significant impact on the Company's interim financial statements and the Company is currently assessing the impact to its annual disclosures.

New Accounting Pronouncements

Statement of Cash Flows ("IAS 7")

In January 2016, the IASB issued amendments to IAS 7 as part of the IASB's Disclosure Initiative. These amendments require entities to provide additional disclosures that will enable financial statement users to evaluate changes in liabilities arising from financing activities, including changes arising from cash flows and non-cash changes. These amendments are effective for annual periods beginning on or after January 1, 2017 with early application permitted. The Company is assessing the impact of adopting these amendments on its results of operations, financial position, and disclosures. The Company plans to apply this standard for annual reporting periods beginning on or after January 1, 2017.

Revenue from Contracts with Customers ("IFRS 15")

In May 2014, the IASB issued IFRS 15, a new standard that specifies how and when to recognize revenue as well as requiring entities to provide users of financial statements with more informative, relevant disclosures. IFRS 15 supersedes IAS 18, "Revenue," IAS 11, "Construction Contracts," and a number of revenue-related interpretations. Application of IFRS 15 is mandatory for all IFRS reporters and it applies to nearly all contracts with customers: the main exceptions are leases, financial instruments, and insurance contracts. IFRS 15 must be applied for annual reporting periods beginning on or after January 1, 2018 and early adoption is permitted. The Company is assessing the impact of adopting this standard on its results of operations, financial position, and disclosures. The Company plans to apply this standard for annual reporting periods beginning on or after January 1, 2018.

Financial Instruments ("IFRS 9")
In July 2014, the IASB issued the final version of IFRS 9, which reflects all phases of the financial instruments project and replaces IAS 39, "Financial Instruments: Recognition and Measurement," and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after January 1, 2018, with early application permitted. The Company is assessing the impact of the new standard on its results of operations, financial position, and disclosures. The Company plans to apply this standard for annual reporting periods beginning on or after January 1, 2018.

Leases ("IFRS 16")
In January 2016, the IASB issued IFRS 16, which supersedes existing standards and interpretations under IAS 17, "Leases." IFRS 16 requires all leases to be reported on a company's balance sheet and will provide greater transparency on companies' leased assets and liabilities. The new standard will apply for annual periods beginning on or after January 1, 2019. Earlier application is permitted provided the Company has also adopted IFRS 15. The Company is assessing the impact of adopting this standard on its results of operations, financial position, and disclosures. The Company plans to apply this standard for annual reporting periods beginning on or after January 1, 2019.

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 2013 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 October 2, 2016 and ended on December 31, 2016 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting. The Company has determined that no material changes in internal controls over financial reporting have occurred in this period.

Cautionary Statement Regarding Forward-Looking Statements

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

Non-IFRS Financial Measures

The Company prepares its 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 sales and adjusted 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.

Total comparable sales (including online), comparable retail store sales, and adjusted EBITDA are key indicators used by the Company to measure performance against internal targets and prior period results. These measures are commonly used by financial analysts and investors to compare the Company to other retailers.

Total comparable sales is based on comparable retail store sales and includes online sales for the same period. Comparable retail store sales are defined as sales generated by stores that have been open for more than 12 months on a 52-week basis. These measures exclude sales fluctuations due to store openings and closings, permanent relocation, and material changes in square footage, and they are key performance indicators for the Company. Adjusted EBITDA is defined as earnings before interest, taxes, depreciation, amortization, impairment, asset disposals, and equity investment. The method of calculating adjusted EBITDA is consistent with that used in prior periods.

Reconciliations between total comparable sales, comparable retail store sales, and revenue (the most comparable IFRS measure) were included earlier in this report. A reconciliation between adjusted EBITDA and earnings (loss) before income taxes (the most comparable IFRS measure) is provided below:

(millions of Canadian dollars)	**13-week period ended December 31, 2016**	13-week period ended December 26, 2015	**39-week period ended December 31, 2016**	39-week period ended December 26, 2015
Adjusted EBITDA	**56.5**	52.5	**54.8**	54.1
Depreciation of property, plant, and equipment	**(4.3)**	(3.7)	**(12.0)**	(10.8)
Amortization of intangible assets	**(2.3)**	(2.2)	**(6.5)**	(6.9)
Net reversal of capital asset impairments	**1.0**	1.6	**1.0**	1.6
Loss on disposal of capital assets	–	(0.2)	**0.0**	(0.9)
Net interest income	**0.6**	0.3	**1.6**	1.1
Share of earnings from joint venture	**2.9**	2.4	**2.0**	1.7
Earnings before income taxes	**54.4**	50.7	**40.9**	39.9

Indigo Books & Music Inc.
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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 and Chief Executive Officer

Laura Carr
Chief Financial Officer

Dated as of the 7th day of February, 2017.

Consolidated Balance Sheets

(Unaudited)

(thousands of Canadian dollars)	**As at December 31, 2016**	As at December 26, 2015	As at April 2, 2016
ASSETS			
Current			
Cash and cash equivalents (note 5)	**316,255**	312,254	216,488
Accounts receivable	**18,250**	22,354	7,663
Inventories (note 6)	**243,439**	220,507	217,788
Income taxes recoverable	**–**	–	25
Prepaid expenses	**3,825**	4,576	11,290
Derivative financial instruments (note 7)	**1,060**	–	–
Total current assets	**582,829**	559,691	453,254
Property, plant, and equipment	**65,779**	58,340	60,973
Intangible assets	**18,646**	15,593	16,506
Equity investment	**2,948**	2,426	1,421
Deferred tax assets	**40,381**	46,332	51,836
Total assets	**710,583**	682,382	583,990
LIABILITIES AND EQUITY			
Current			
Accounts payable and accrued liabilities	**248,547**	241,539	171,112
Unredeemed gift card liability	**66,002**	68,735	50,969
Provisions	**26**	43	34
Deferred revenue	**12,948**	13,414	13,232
Income taxes payable	**26**	25	–
Current portion of long-term debt	**9**	84	53
Total current liabilities	**327,558**	323,840	235,400
Long-term accrued liabilities	**2,353**	2,596	4,483
Long-term provisions	**89**	83	109
Long-term debt	**–**	9	–
Total liabilities	**330,000**	326,528	239,992
Equity			
Share capital (note 8)	**215,463**	207,897	209,318
Contributed surplus (note 9)	**10,481**	10,455	10,591
Retained earnings	**153,863**	137,502	124,089
Accumulated other comprehensive income (note 7)	**776**	–	–
Total equity	**380,583**	355,854	343,998
Total liabilities and equity	**710,583**	682,382	583,990

See accompanying notes

On behalf of the Board:

Heather Reisman

Heather Reisman, Director

Michael Kirby, Director

Consolidated Statements of Earnings and Comprehensive Earnings

(Unaudited)

(thousands of Canadian dollars, except per share data)	**13-week period ended December 31, 2016**	13-week period ended December 26, 2015	**39-week period ended December 31, 2016**	39-week period ended December 26, 2015
Revenue (note 10)	**400,296**	383,171	**810,340**	773,787
Cost of sales	**(223,175)**	(214,057)	**(449,608)**	(429,669)
Gross profit	**177,121**	169,114	**360,732**	344,118
Operating, selling, and administrative expenses (note 10)	**(126,230)**	(121,162)	**(323,275)**	(306,963)
Operating profit	**50,891**	47,952	**37,457**	37,155
Net interest income	**639**	326	**1,527**	1,048
Share of earnings from equity investment	**2,886**	2,426	**1,964**	1,700
Earnings before income taxes	**54,416**	50,704	**40,948**	39,903
Income tax recovery (expense)	**(14,462)**	2,091	**(11,174)**	2,091
Net earnings	**39,954**	52,795	**29,774**	41,994
Other comprehensive income (note 7)				
Items that are or may be reclassified subsequently to net earnings:				
Net change in fair value of cash flow hedges (net of tax of $467 and $686; 2015 – $0 and $0)	**1,278**	–	**1,876**	–
Reclassification of net realized gain (net of tax of $288 and $402; 2015 – $0 and $0)	**(789)**	–	**(1,100)**	–
Other comprehensive income	**489**	–	**776**	–
Total comprehensive earnings	**40,443**	52,795	**30,550**	41,994
Net earnings per common share (note 11)				
Basic	**$1.51**	$2.03	**$1.13**	$1.62
Diluted	**$1.48**	$2.02	**$1.11**	$1.61

See accompanying notes

Consolidated Statements of Changes in Equity

(Unaudited)

(thousands of Canadian dollars)	Share Capital	Contributed Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Total Equity
Balance, March 28, 2015	205,871	9,770	95,508	–	311,149
Net earnings	–	–	41,994	–	41,994
Exercise of options (note 8)	1,735	(269)	–	–	1,466
Directors' deferred stock units converted (note 8)	291	(291)	–	–	–
Share-based compensation (note 9)	–	951	–	–	951
Directors' compensation (note 9)	–	294	–	–	294
Other comprehensive income (note 7)	–	–	–	–	–
Balance, December 26, 2015	207,897	10,455	137,502	–	355,854
Balance, April 2, 2016	**209,318**	**10,591**	**124,089**	**–**	**343,998**
Net earnings	**–**	**–**	**29,774**	**–**	**29,774**
Exercise of options (note 8)	**5,475**	**(930)**	**–**	**–**	**4,545**
Directors' deferred stock units converted (note 8)	**670**	**(670)**	**–**	**–**	**–**
Share-based compensation (note 9)	**–**	**1,210**	**–**	**–**	**1,210**
Directors' compensation (note 9)	**–**	**280**	**–**	**–**	**280**
Other comprehensive income (note 7)	**–**	**–**	**–**	**776**	**776**
Balance, December 31, 2016	**215,463**	**10,481**	**153,863**	**776**	**380,583**

See accompanying notes

Consolidated Statements of Cash Flows

(Unaudited)

(thousands of Canadian dollars)	**13-week period ended December 31, 2016**	13-week period ended December 26, 2015	**39-week period ended December 31, 2016**	39-week period ended December 26, 2015
CASH FLOWS FROM OPERATING ACTIVITIES				
Net earnings	**39,954**	52,795	**29,774**	41,994
Add (deduct) items not affecting cash				
Depreciation of property, plant, and equipment	**4,281**	3,666	**12,040**	10,830
Amortization of intangible assets	**2,254**	2,210	**6,530**	6,870
Net reversal of capital asset impairments (note 10)	**(963)**	(1,619)	**(963)**	(1,619)
Loss on disposal of capital assets	**–**	236	**1**	896
Share-based compensation (note 9)	**454**	341	**1,210**	951
Directors' compensation (note 9)	**83**	98	**280**	294
Deferred tax assets	**14,462**	(2,091)	**11,171**	(2,091)
Other	**40**	(665)	**(335)**	(3,316)
Net change in non-cash working capital balances (note 12)	**82,154**	91,397	**61,253**	70,723
Interest expense	**3**	4	**33**	9
Interest income	**(642)**	(330)	**(1,560)**	(1,057)
Income taxes received	**51**	50	**51**	50
Share of earnings from equity investment	**(2,886)**	(2,426)	**(1,964)**	(1,700)
Cash flows from operating activities	**139,245**	143,666	**117,521**	122,834
CASH FLOWS FROM INVESTING ACTIVITIES				
Purchase of property, plant, and equipment	**(6,860)**	(7,665)	**(15,884)**	(13,562)
Addition of intangible assets	**(3,620)**	(2,106)	**(8,670)**	(5,880)
Proceeds from disposal of capital assets	**–**	–	**–**	5
Distributions from equity investment	**–**	–	**437**	–
Interest received	**422**	284	**963**	770
Cash flows used for investing activities	**(10,058)**	(9,487)	**(23,154)**	(18,667)
CASH FLOWS FROM FINANCING ACTIVITIES				
Repayment of long-term debt	**(12)**	(40)	**(44)**	(135)
Interest paid	**(1)**	(17)	**(27)**	(51)
Proceeds from share issuances (note 8)	**3,008**	1,209	**4,545**	1,466
Cash flows from financing activities	**2,995**	1,152	**4,474**	1,280
Effect of foreign currency exchange rate changes on cash and cash equivalents	**178**	724	**926**	3,645
Net increase in cash and cash equivalents during the period	**132,360**	136,055	**99,767**	109,092
Cash and cash equivalents, beginning of period	**183,895**	176,199	**216,488**	203,162
Cash and cash equivalents, end of period	**316,255**	312,254	**316,255**	312,254

See accompanying notes

Notes to the Interim Condensed Consolidated Financial Statements

December 31, 2016
(Unaudited)

1. CORPORATE INFORMATION

Indigo Books & Music Inc. (the "Company" or "Indigo") is a corporation domiciled and incorporated under the laws of the Province of Ontario in Canada. The Company's registered office is located at 468 King Street West, Toronto, Ontario, M5V 1L8, Canada. The unaudited interim condensed consolidated financial statements of the Company comprise the Company, its equity investment in Calendar Club of Canada Limited Partnership ("Calendar Club"), and its wholly-owned subsidiary, Indigo Design Studios, Inc. 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") and 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 2016 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 2016 Annual Report.

The unaudited interim condensed consolidated financial statements for the 13 and 39-week periods ended December 31, 2016 (including comparatives) were approved by the Board of Directors on February 7, 2017.

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

Presentation of Financial Statements ("IAS 1")

In December 2014, the IASB issued amendments to IAS 1 as part of the IASB's Disclosure Initiative. These amendments encourage entities to apply professional judgment regarding disclosure and presentation in their financial statements and are effective for annual periods beginning on or after January 1, 2016. The implementation of these amendments in the first quarter of fiscal 2017 did not have a significant impact on the Company's interim financial statements and the Company is currently assessing the impact to its annual disclosures.

New Accounting Pronouncements

Statement of Cash Flows ("IAS 7")

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Revenue from Contracts with Customers ("IFRS 15")

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Financial Instruments ("IFRS 9")

In July 2014, the IASB issued the final version of IFRS 9, which reflects all phases of the financial instruments project and replaces IAS 39, "Financial Instruments: Recognition and Measurement," and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after January 1, 2018, with early application permitted. The Company is assessing the impact of the new standard on its results of operations, financial position, and disclosures. The Company plans to apply this standard for annual reporting periods beginning on or after January 1, 2018.

Leases ("IFRS 16")

In January 2016, the IASB issued IFRS 16, which supersedes existing standards and interpretations under IAS 17, "Leases." IFRS 16 requires all leases to be reported on a company's balance sheet and will provide greater transparency on companies' leased assets and liabilities. The new standard will apply for annual periods beginning on or after January 1, 2019. Earlier application is permitted provided the Company has also adopted IFRS 15. The Company is assessing the impact of adopting this standard on its results of operations, financial position, and disclosures. The Company plans to apply this standard for annual reporting periods beginning on or after January 1, 2019.

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 revenue is typically earned in the third fiscal quarter. Therefore, the results of operations for the 13 and 39-week periods ended December 31, 2016 and December 26, 2015 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 31, 2016**	December 26, 2015	April 2, 2016
Cash	**147,809**	228,206	102,862
Restricted cash	**3,217**	3,550	3,460
Cash equivalents	**165,229**	80,498	110,166
Cash and cash equivalents	**316,255**	312,254	216,488

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

6. INVENTORIES

The cost of inventories recognized as an expense during the 13 and 39-week periods ended December 31, 2016 were \$223.8 million and \$455.6 million, respectively (2015: 13 weeks – \$217.2 million; 39 weeks – \$436.8 million). Inventories consist of the landed cost of goods sold and exclude online shipping costs, inventory shrink and damage reserve, and all vendor support programs. 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 31, 2016 were \$3.2 million and \$5.8 million, respectively (2015: 13 weeks – \$2.6 million; 39 weeks – \$6.4 million), and there were no reversals of inventory write-downs that were recognized in prior periods (2015: 13 and 39 weeks – nil). The amount of inventory with net realizable value equal to cost was \$3.7 million as at December 31, 2016 (December 26, 2015 – \$3.1 million).

7. DERIVATIVE FINANCIAL INSTRUMENTS

The Company's derivative financial instruments consist of foreign exchange forward contracts. These contracts were entered into in order to manage the currency fluctuation risk associated with forecasted U.S. dollar payments, primarily for inventory purchases, and have been designated as cash flow hedges for accounting purposes.

At the inception of a hedge relationship, the Company documents the relationship between the hedging instrument and the hedged item along with the Company's risk management objectives and strategy for undertaking various hedge transactions. Furthermore, at inception and on an ongoing basis, the Company documents whether the hedging instrument is highly effective in offsetting changes in cash flows of the hedged item attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

Accordingly, the effective portion of the change in the fair value of the foreign exchange forward contracts that are designated and qualify as cash flow hedges is recognized in other comprehensive income (loss) until related payments have been made in future accounting periods. Associated gains and losses recognized in other comprehensive income (loss) are reclassified to earnings in the periods when the hedged item is recognized in earnings. These earnings are included within the same line of the consolidated statement of earnings (loss) as the recognized item. However, when the hedged forecast transaction results in the recognition of a non-financial asset, the gains and losses previously recognized in other comprehensive income (loss) are transferred from equity and included in the initial measurement of the cost of the non-financial asset. The fair value of the foreign exchange forward contracts is determined using the forward exchange rates at the measurement date, with the resulting value discounted back to present value. The gain or loss relating to the ineffective portion is recognized immediately in the consolidated statements of earnings (loss).

During the 13 and 39-week periods ended December 31, 2016, the Company entered into forward contracts with total notional amounts of C$49.0 million and C$135.5 million, respectively, to buy U.S. dollars and sell Canadian dollars. As at December 31, 2016, the Company had remaining forward contracts in place representing a total notional amount of C$56.6 million (December 26, 2015 – no forward contracts). These contracts extend over a period not exceeding 12 months.

The total fair value of the forward contracts as at December 31, 2016 was an unrealized net gain of $1.1 million (December 26, 2015 – no forward contracts) and the carrying value of the derivative financial instruments is equivalent to the pre-tax unrealized gain at period end. During the 13 and 39-week periods ended December 31, 2016, net gains of $0.8 million and $1.1 million, respectively, (2015: 13 and 39 weeks – nil) were reclassified from other comprehensive income to inventory and expenses. Reclassified amounts resulting from hedge ineffectiveness were immaterial for the 13 and 39-week periods ended December 31, 2016 (2015: 13 and 39 weeks – nil).

8. SHARE CAPITAL

Share capital consists of the following:

	39-week period ended December 31, 2016		39-week period ended December 26, 2015		53-week period ended April 2, 2016	
	Number of shares	**Amount C$ (thousands)**	Number of shares	Amount C$ (thousands)	Number of shares	Amount C$ (thousands)
Balance, beginning of period	**25,797,351**	**209,318**	25,495,289	205,871	25,495,289	205,871
Issued during the period						
Directors' deferred share units converted	**67,108**	**670**	29,142	291	29,142	291
Options exercised	**449,050**	**5,475**	151,645	1,735	272,920	3,156
Balance, end of period	**26,313,509**	**215,463**	25,676,076	207,897	25,797,351	209,318

9. SHARE-BASED COMPENSATION

As at December 31, 2016, 1,909,150 stock options were outstanding with exercise prices ranging from $8.00 to $18.00. Of these outstanding stock options, 678,725 were exercisable at a weighted average exercise price of $9.83. As at December 26, 2015, there were 1,926,205 stock options outstanding of which 664,825 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 39-week periods ended December 31, 2016, the pre-forfeiture fair value of options granted were less than $0.1 million and $2.8 million, respectively (2015: 13 weeks – less than $0.1 million; 39 weeks – $1.3 million).

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

	13-week period ended December 31, 2016	13-week period ended December 26, 2015
Black-Scholes option pricing assumptions		
Risk-free interest rate	**0.6%**	0.5%
Expected volatility	**33.0%**	33.0%
Expected time until exercise	**3.0 years**	3.0 years
Expected dividend yield	**–**	–
Other assumptions		
Forfeiture rate	**26.9%**	28.4%

Directors' Compensation

The Company has established a Directors' Deferred Share Unit Plan ("DSU Plan"). Under the DSU Plan, Directors annually elect whether to receive their annual retainer fees and other Board-related compensation in the form of deferred share units ("DSUs") or receive up to 50% of this compensation in cash. All compensation during the 13 and 39-week periods ended December 31, 2016 was in the form of DSUs.

The number of shares reserved for issuance under this plan is 500,000. During the 13 and 39-week periods ended December 31, 2016, the Company issued 4,627 DSUs with a value of $0.1 million and 16,266 DSUs with a value of $0.3 million, respectively (2015: 13 weeks – 7,197 DSUs with a value of $0.1 million; 39 weeks – 26,211 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 grant date fair value of the outstanding DSUs as at December 31, 2016 was $3.4 million (December 26, 2015 – $3.7 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 the grant date.

10. SUPPLEMENTARY OPERATING INFORMATION

Supplemental product line revenue information:

(thousands of Canadian dollars)	**13-week period ended December 31, 2016**	13-week period ended December 26, 2015	**39-week period ended December 31, 2016**	39-week period ended December 26, 2015
Print[1]	**215,316**	221,532	**473,210**	476,992
General merchandise[2]	**173,080**	151,327	**309,693**	270,273
eReading[3]	**4,593**	4,762	**9,747**	11,441
Other[4]	**7,307**	5,550	**17,690**	15,081
Total	**400,296**	383,171	**810,340**	773,787

1 Includes books, calendars, magazines, newspapers, and shipping revenue.
2 Includes lifestyle, paper, toys, music, DVDs, electronics, and shipping revenue.
3 Includes eReaders, eReader accessories, Kobo revenue share, and shipping revenue.
4 Includes cafés, irewards, gift card breakage, Plum breakage, and corporate sales.

Supplemental operating and administrative expenses information:

(thousands of Canadian dollars)	**13-week period ended December 31, 2016**	13-week period ended December 26, 2015	**39-week period ended December 31, 2016**	39-week period ended December 26, 2015
Wages, salaries, and bonuses	**53,712**	52,283	**136,916**	132,782
Short-term benefits expense	**4,650**	4,758	**14,115**	13,987
Termination benefits expense	**518**	1,305	**1,444**	2,189
Retirement benefits expense	**397**	380	**1,172**	1,070
Share-based compensation	**454**	341	**1,210**	951
Total employee benefits expense	**59,731**	59,067	**154,857**	150,979

Termination benefits arise when the Company terminates certain employment agreements.

Capital assets

During the 13 and 39-week periods ended December 31, 2016, the Company recognized capital asset impairment reversals of $1.0 million and $1.0 million, respectively (2015: 13 weeks – $2.3 million; 39 weeks – $2.3 million). The Company did not recognize any capital asset impairments during the 13 and 39-week periods ended December 31, 2016 (2015: 13 weeks – $0.6 million; 39 weeks – $0.6 million). All impairments and reversals are recorded as part of operating, selling, and administrative expenses in the Consolidated Statements of Earnings and Comprehensive Earnings.

Impairment reversals were spread across a number of cash-generating units at the store level and were driven by improved store performance and its impact on the likelihood of lease term renewals. 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 growth rates which are calculated separately for each CGU being tested. Average long-term growth rates used to extrapolate cash flow projections beyond the period covered by the most recent forecasts ranged from 0.0% to 3.0% (2015 – 0.0% to 3.0%). Cash flows for stores expected to operate beyond the current lease term and renewal options were projected using a terminal value calculation. 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 16.9% (2015 – 19.7%).

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 and DSUs do not result in adjustment to net earnings. The reconciliation of the denominator in calculating diluted earnings per share amounts for the 13 and 39-week periods ended December 31, 2016 and December 26, 2015 is as follows:

(thousands of shares)	**13-week period ended December 31, 2016**	13-week period ended December 26, 2015	**39-week period ended December 31, 2016**	39-week period ended December 26, 2015
Weighted average number of common shares outstanding, basic	**26,394**	25,954	**26,300**	25,902
Effect of dilutive securities – stock options	**552**	168	**589**	142
Weighted average number of common shares outstanding, diluted	**26,946**	26,122	**26,889**	26,044

For the 13 and 39-week periods ended December 31, 2016, 652,000 and 652,000 anti-dilutive stock options, respectively (2015: 13 weeks – 712,500 options; 39 weeks – 1,057,900 options) were excluded from the computation of diluted net earnings per common share.

12. STATEMENTS OF CASH FLOWS

Supplemental year-to-date cash flow information:

(thousands of Canadian dollars)	**13-week period ended December 31, 2016**	13-week period ended December 26, 2015	**39-week period ended December 31, 2016**	39-week period ended December 26, 2015
Accounts receivable	**48**	(3,738)	**(10,587)**	(17,458)
Inventories	**20,828**	36,445	**(25,651)**	(12,112)
Prepaid expenses	**1,219**	267	**7,465**	901
Accounts payable and accrued liabilities (current and long-term)	**39,667**	32,712	**75,305**	79,649
Unredeemed gift card liability	**21,028**	26,486	**15,033**	20,524
Provisions (current and long-term)	**(9)**	(17)	**(28)**	(897)
Deferred revenue	**(627)**	(758)	**(284)**	116
Net change in non-cash working capital balances	**82,154**	91,397	**61,253**	70,723

13. 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. 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 Executive Officers of the Company. Key management personnel remuneration includes the following expenses:

(thousands of Canadian dollars)	**13-week period ended December 31, 2016**	13-week period ended December 26, 2015	**39-week period ended December 31, 2016**	39-week period ended December 26, 2015
Wages, salaries, and bonus	**1,737**	1,168	**4,808**	3,648
Short-term benefits expense	**51**	53	**142**	153
Termination benefits expense	**–**	454	**–**	454
Retirement benefits expense	**14**	19	**42**	54
Share-based compensation	**315**	185	**774**	540
Directors' compensation	**83**	98	**280**	294
Total remuneration	**2,200**	1,977	**6,046**	5,143

Transactions with Shareholders

During the third quarter of fiscal 2017, the Company 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. For the 13 and 39-week periods ended December 31, 2016, the Company paid $2.9 million and $4.7 million, respectively, for these transactions (2015: 13 weeks – $1.8 million; 39 weeks – $3.0 million). As at December 31, 2016, Indigo had $0.3 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 (December 26, 2015 – less than $0.1 million payable and $2.8 million restricted cash). All transactions were measured at fair market value and 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 10. 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 that is dependent on the December holiday sales season to generate revenue. 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. In the 13 and 39-week periods ended December 31, 2016, Indigo loaned $4.3 million and $11.6 million, respectively to Calendar Club (2015 loans: 13 weeks – $1.3 million; 39 weeks – $11.1 million). All loans were repaid in full as at December 31, 2016.

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