

The background features large, light blue, stylized letters 'B', 'R', and 'O' stacked vertically on the left side of the page. The rest of the background is a solid teal color.

*“A truly great book
should be read in youth,
again in maturity and
once more in old age,
as a fine building should
be seen by morning light,
at noon and by moonlight.”*

– ROBERTSON DAVIES

SECOND QUARTER REPORT
FOR THE 13 AND 26-WEEK
PERIODS ENDED
SEPTEMBER 30, 2017

Table of Contents

- 3. Management's Discussion and Analysis
- 23. Consolidated Financial Statements and Notes
- 37. Investor Information

Management’s Discussion and Analysis

The following Management’s Discussion and Analysis (“MD&A”) is prepared as at November 1, 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 26-week periods ended September 30, 2017 and October 1, 2016. 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.” Except as noted, the same accounting policies and methods of computation as those used in the preparation of the fiscal 2017 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 52-week period ended April 1, 2017 and the MD&A included in the Company’s fiscal 2017 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 September 30, 2017, the Company operated 89 superstores under the banners *Chapters* and *Indigo* and 122 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. In the first quarter fiscal 2018, the Company invested in Unplug Meditation LLC (“Unplug”), a U.S. meditation studio, resulting in a 20% voting interest and representation on the board of managers.

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, its suppliers, and its employees.

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 September 30,		13-week period ended October 1,		26-week period ended September 30,		26-week period ended October 1,	
	2017	% Revenue	2016	% Revenue	2017	% Revenue	2016	% Revenue
Revenue	224.5	100.0	216.9	100.0	430.8	100.0	410.0	100.0
Cost of sales	(124.8)	55.6	(119.2)	55.0	(237.2)	55.1	(226.4)	55.2
Cost of operations	(72.8)	32.4	(70.6)	32.5	(140.8)	32.7	(138.2)	33.7
Selling, administrative, and other expenses	(26.8)	12.0	(22.5)	10.4	(52.8)	12.2	(46.8)	11.4
Adjusted EBITDA¹	0.1	0.0	4.6	2.1	0.0	0.0	(1.4)	0.3

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

Adjusted EBITDA is a key indicator used by the Company to measure performance against internal targets and prior period results and is commonly used by financial analysts and investors to assess performance. This measure is specific to Indigo and has no standardized meaning prescribed by IFRS. Therefore, adjusted EBITDA may not be comparable to similar measures presented by other companies.

Revenue

Total consolidated revenue for the 13-week period ended September 30, 2017 increased \$7.6 million or 3.5% to \$224.5 million from \$216.9 million for the 13-week period ended October 1, 2016. Higher revenue was driven by continued double-digit growth in general merchandise, particularly in the lifestyle and toy categories. Book sales saw modest growth, after adjusting for the blockbuster release of *Harry Potter and the Cursed Child* in the second quarter of fiscal 2017.

Online revenue increased by \$4.1 million or 15.1% to \$31.3 million for the 13-week period ended September 30, 2017 compared to \$27.2 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 2.8% for the second quarter. Comparable retail superstore sales for the quarter increased 2.0%, while small format stores declined 4.0%. The release of *Harry Potter and the Cursed Child* in the second quarter of fiscal 2017 held greater significance to total comparable sales in small format stores, therefore causing a decline this quarter. Total comparable sales is based on comparable retail store sales and

includes online sales for the same period. Comparable retail store sales are based on a 52-week fiscal year and defined as sales generated by stores that have been open for more than 52 weeks. These measures exclude sales fluctuations due to store openings and closings, permanent relocation, and material changes in square footage. Both measures are key performance indicators for the Company but have no standardized meaning prescribed by IFRS and may not be comparable to similar measures presented by other companies. During the 13-week period ended September 30, 2017, the Company renovated three small format stores and two superstores which were rebranded from Chapters to Indigo.

Revenue from other sources includes café revenue, 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 \$1.8 million or 23.7% to \$9.4 million for the 13-week period ended September 30, 2017 compared to \$7.6 million in the same period last year as higher gift card breakage was partially offset by lower café revenue.

Subtle changes in historic gift card redemption patterns drove a \$4.0 million increase in gift card breakage revenue compared to last year. Management reviewed its accounting estimates related to the calculation of gift card breakage and adjusted accordingly to reflect these subtle changes in redemption patterns. The impact of this change in estimate for the 13-week period ended September 30, 2017 was \$3.8 million, which represents the remainder of the change in estimate. This change will be accounted for prospectively as a change in accounting estimate. Management will continue to monitor redemption patterns and will adjust for changes as observed. This increase was partially offset by a \$2.4 million decrease in café revenue due to the termination of the Company’s license to operate Starbucks-branded cafés within certain retail locations. The Company now subleases space to Starbucks in each of the previously licensed locations for Starbucks to operate corporate-run cafés in the Company’s retail locations.

On a fiscal year-to-date basis, total consolidated revenue increased by \$20.8 million or 5.1% to \$430.8 million compared to \$410.0 million for the same period last year. As discussed above, the increase was driven by continued strong sales growth across channels and many product categories. Key areas of growth include lifestyle and toys. Year-to-date total comparable sales, which includes online sales, increased 4.4%, while year-to-date comparable retail store sales increased 2.6% for superstores and increased 0.7% in small format stores.

Revenue by channel is highlighted below:

(millions of Canadian dollars)	13-week period ended September 30, 2017	13-week period ended October 1, 2016	% increase	Comparable sales % increase
Superstores	154.4	151.6	1.8 %	2.0 %
Small format stores	29.4	30.5	(3.6)%	(4.0)%
Online (including store kiosks)	31.3	27.2	15.1 %	15.1 %
Other	9.4	7.6	23.7 %	N/A
Total	224.5	216.9	3.5 %	2.8 %

Revenue by product line is as follows:

	13-week period ended September 30, 2017	13-week period ended October 1, 2016	26-week period ended September 30, 2017	26-week period ended October 1, 2016
Print ¹	58.4%	63.1%	58.7%	62.9%
General merchandise ²	36.7%	32.6%	36.6%	33.3%
eReading ³	1.1%	1.2%	1.2%	1.3%
Other ⁴	3.8%	3.1%	3.5%	2.5%
Total	100.0%	100.0%	100.0%	100.0%

¹ Includes books, magazines, newspapers, and shipping revenue.

² Includes lifestyle, paper, toys, calendars, 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 September 30, 2017	13-week period ended October 1, 2016
Total retail store revenue	183.8	182.1
Total online revenue	31.3	27.2
Adjustments for stores not in both fiscal periods	(2.6)	(2.7)
Total comparable sales	212.5	206.6

(millions of Canadian dollars)	Superstores		Small format stores	
	13-week period ended September 30, 2017	13-week period ended October 1, 2016	13-week period ended September 30, 2017	13-week period ended October 1, 2016
Total revenue by format	154.4	151.6	29.4	30.5
Adjustments for stores not in both fiscal periods	(1.1)	(1.2)	(1.5)	(1.5)
Comparable retail store sales	153.3	150.4	27.9	29.0

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 \$5.6 million to \$124.8 million for the 13-week period ended September 30, 2017, compared to \$119.2 million for the same period last year. The increase was driven by higher sales volumes, as discussed above. As a percent of total revenue, cost of sales increased 0.6% to 55.6% compared to 55.0% for the same period last year. Margin rate declined due to timing differences associated with shrink and vendor support.

On a fiscal year-to-date basis, cost of sales increased by \$10.8 million or 4.8% to \$237.2 million compared to \$226.4 million for the same period last year as a result of higher sales volumes. Year-to-date cost of sales as a percent of total revenue decreased 0.1% to 55.1% compared to 55.2% in the same period last year.

Cost of Operations

Cost of operations includes all store, store support, online, and distribution centre costs. Cost of operations increased \$2.2 million to \$72.8 million for the 13-week period ended September 30, 2017, compared to \$70.6 million for the same period last year. As a percent of total revenue, cost of operations decreased by 0.1% to 32.4% this year, compared to 32.5% for the same period last year. Operating costs increased primarily due to higher distribution costs as a result

of increased sales volumes, partially offset by improved selling and administration efficiencies within retail store operations.

On a fiscal year-to-date basis, cost of operations increased by \$2.6 million to \$140.8 million compared to \$138.2 million for the same period last year. The increase was driven by higher retail and online operations costs as a result of higher sales volumes. Year-to-date cost of operations as a percent of total revenue decreased by 1.0% to 32.7%, compared to 33.7% for the same period last year, as discussed above.

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 increased \$4.3 million to \$26.8 million for the 13-week period ended September 30, 2017, compared to \$22.5 million for the same period last year. As a percent of total revenue, selling, administrative, and other expenses increased by 1.6% to 12.0%, compared to 10.4% for the same period last year. Higher expenses in the current year were driven primarily by increased investment in creative, marketing and other head office areas to support sales growth and the transformation of retail and digital platforms. In addition, expenses were lower in the prior year as the Company received a non-recurring payment from a reconciliation of café charges.

On a fiscal year-to-date basis, selling, administrative, and other expenses increased \$6.0 million to \$52.8 million compared to \$46.8 million in the same period last year, for the same reasons discussed above. Year-to-date selling, administrative, and other expenses as a percent of total revenue increased 0.8% to 12.2% compared to 11.4% in the same period last year.

Adjusted EBITDA

Adjusted EBITDA, defined as earnings before interest, taxes, depreciation, amortization, impairment, asset disposals, and equity investment decreased \$4.5 million to \$0.1 million for the 13-week period ended September 30, 2017, compared to \$4.6 million for the same period last year. Adjusted EBITDA as a percent of revenue decreased by 2.1% to 0.0% this year from 2.1% for the same period last year. Lower adjusted EBITDA was driven by higher operating costs, as a result of higher sales volumes and investments in selling, administrative and other expenses to support strategic projects. This impact was partially offset by higher revenue and margin as discussed above.

On a fiscal year-to-date basis, adjusted EBITDA increased \$1.4 million to \$0.0 million compared to a \$1.4 million loss in the same period last year.

Year-to-date adjusted EBITDA as a percent of total revenue was 0.0% compared to a 0.3% loss in the same period last year. A reconciliation of adjusted EBITDA to net earnings before taxes has been included in the “Non-IFRS Financial Measures” section of Management’s Discussion and Analysis.

Capital Assets

Depreciation and amortization for the 13-week period ended September 30, 2017 increased by \$0.3 million to \$6.3 million compared to \$6.0 million for the same period last year. Capital expenditures in the second quarter of fiscal 2018 totaled \$11.1 million compared to \$6.7 million for the same period last year. Capital expenditure increases in the current period were driven by continued implementation of changes across Indigo’s retail outlets, including full renovations and rebranding of stores, investments in digital, and investments in back-end productivity initiatives. Capital expenditures for the second quarter of fiscal 2018 included \$6.1 million for retail store renovations and equipment, \$2.0 million for technology equipment, and \$3.0 million primarily for application software and internal development costs. None of the capital expenditures were financed through leases.

On a fiscal year-to-date basis, depreciation and amortization increased by \$0.6 million to \$12.6 million compared to \$12.0 million in the same period last year. Year-to-date, the Company has spent \$18.7 million on capital expenditures compared to \$14.1 million last year due to the ramp up of the Company’s store renovation activities. Capital expenditures for the current year included \$10.5 million for retail store renovations and equipment, \$3.5 million for technology equipment, and \$4.7 million primarily for application software and internal development costs, which are classified as intangible assets. None of the capital expenditures were financed through leases.

Net Interest Income

The Company recognized net interest income of \$0.7 million for the 13-week period ended September 30, 2017, compared to \$0.4 million for the same period last year. The Company nets interest income against interest expense. Compared to the same period last year, the Company generated more interest income by maintaining a higher average cash balance in short-term investments at higher interest rates.

On a fiscal year-to-date basis, the Company recognized net interest income of \$1.3 million compared to \$0.9 million in the same period last year for the same reasons discussed above.

Loss from Equity Investments

The Company uses the equity method to account for its investments in Calendar Club and Unplug. The Company recognizes its share of equity investment earnings and losses as part of consolidated net earnings and losses. Calendar Club is primarily a seasonal operation that is dependent on the November/December holiday sales season to generate revenue while Unplug generates year-round revenue. The Company recognized a net loss from Calendar Club of \$0.5 million for the 13-week period ended September 30, 2017, compared to a net loss of \$0.4 million for the same period last year. Earnings from Unplug were immaterial for the 13-week period ended September 30, 2017.

On a fiscal year-to-date basis, Indigo recognized net loss from Calendar Club of \$1.0 million compared to net loss of \$0.9 million in the same period last year. Earnings from Unplug were immaterial on a fiscal year-to-date basis.

Income Taxes

The Company recognized a non-cash income tax recovery of \$1.3 million for the 13-week period ended September 30, 2017, compared to recognizing a non-cash income tax recovery of \$0.2 million for the same period last year. The increase in income tax recovery is due to the increase in net loss before income taxes during the second quarter fiscal 2018. Income tax recoveries are related to an increase in deferred tax assets. The Company used a tax rate of 26.8% to calculate income tax recovery for the second quarter of fiscal 2018. Based on a full 52-week period, the Company does not expect to pay cash income taxes as deferred tax assets, which include non-capital loss carryforwards, can be utilized to offset taxable income.

On a fiscal year-to-date basis, Indigo recognized a non-cash income tax recovery of \$3.0 million compared to recognizing a net income tax recovery of \$3.3 million in the same period last year. Income tax recovery decreased as a result of lower net loss before income for the 26-week period ended September 30, 2017.

Net Loss

The Company recognized a net loss of \$4.7 million for the 13-week period ended September 30, 2017 (\$0.18 net loss per common share), compared to a net loss of \$1.2 million (\$0.04 net loss per common share) for the same period last year. The increase in net loss was primarily driven by higher distribution costs due to increased volumes, as well as higher selling, administrative, and other expenses to support strategic projects. This impact was partially offset by revenue and margin growth.

On a fiscal year-to-date basis, the Company recognized a net loss of \$10.0 million (\$0.37 net loss per common share), compared to a net loss of \$10.2 million (\$0.39 net loss per common share) in the same period last year.

Other Comprehensive Income

Other comprehensive income consists primarily of gains and losses related to hedge accounting. The Company has 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, primarily for general merchandise inventory purchases. Financial instruments used to mitigate risk include foreign exchange forward contracts. All contracts entered during the quarter have been designated as cash flow hedges for accounting purposes and extend over a period not exceeding 12 months.

During the 13-week period ended September 30, 2017, the Company entered contracts with total notional amounts of C\$10.1 million to buy U.S. dollars and sell Canadian dollars. In the same period last year, the Company entered contracts with total notional amounts of C\$43.4 million. On a fiscal year-to-date basis, the Company entered contracts with total notional amounts of C\$67.8 million to buy U.S. dollars and sell Canadian dollars, compared to entering contracts with total notional amounts of C\$86.5 million in the same period last year.

As at September 30, 2017, the Company had remaining contracts in place representing a total notional amount of C\$77.6 million and an unrealized net loss of \$3.8 million, compared to a total notional amount of C\$45.9 million and an unrealized net gain of \$0.4 million as at October 1, 2016. During the 13 and 26-week periods ended September 30, 2017, net losses of \$2.2 million and \$2.1 million, respectively, from settled contracts were reclassified from other comprehensive income to inventory and expenses compared to reclassified net gains of \$0.4 million and \$0.3 million for the same periods last year.

Seasonality and Second Quarter Results

Indigo's business is highly seasonal and follows quarterly sales and profit (loss) fluctuation patterns, which are similar to those of other retailers that are highly dependent on the November/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 revenue, net earnings (loss), 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 2018 and 2017 are 52 weeks, while fiscal year 2016 was 53 weeks.

(millions of Canadian dollars, except per share data)	Fiscal quarters							
	Q2 ¹	Q1 ¹	Q4 ¹	Q3 ¹	Q2 ¹	Q1 ¹	Q4 ²	Q3 ¹
	Fiscal 2018	Fiscal 2018	Fiscal 2017	Fiscal 2017	Fiscal 2017	Fiscal 2017	Fiscal 2016	Fiscal 2016
Revenue	224.5	206.3	209.5	400.3	216.9	193.1	220.4	383.2
Total net earnings (loss)	(4.7)	(5.3)	(8.9)	40.0	(1.2)	(9.0)	(13.4)	52.8
Basic earnings (loss)								
per share	(\$0.18)	(\$0.20)	(\$0.33)	\$1.51	(\$0.04)	(\$0.34)	(\$0.51)	\$2.03
Diluted earnings (loss)								
per share	(\$0.18)	(\$0.20)	(\$0.33)	\$1.48	(\$0.04)	(\$0.34)	(\$0.51)	\$2.02

¹ 13 week period

² 14 week period

Overview of Consolidated Balance Sheets

Assets

As at September 30, 2017, total assets increased \$21.7 million to \$628.2 million, compared to \$606.5 million as at October 1, 2016. The increase was driven by higher inventory and property plant and equipment, partly offset by lower cash, cash equivalents and short term investments and deferred tax assets. The inventories increase of \$28.1 million was primarily driven by higher trade book, lifestyle, and paper inventory to support the upcoming holiday season. The increase in property, plant and equipment of \$8.0 million was driven by investment in retail store renovations. Cash, cash equivalents and short term investments decreased \$13.4 million as a result of increased inventory to support the holiday season. Deferred tax assets were applied during the prior year to offset the Company's estimated tax expense, resulting in a \$6.8 million decrease in assets.

As at September 30, 2017, total assets increased by \$19.6 million to \$628.2 million compared to \$608.6 million as at April 1, 2017. The increase was driven by higher inventory, cash and cash equivalents, accounts receivable and property plant and equipment, offset by a decrease in short term investments. Inventories increased by \$60.8 million and were offset by a net decrease in cash, cash equivalents and short term investments of \$59.9 million, which is consistent with the seasonal nature of the business as noted above. Accounts receivable increased by \$10.7 million, due to a \$12.2 million loan to Calendar Club.

The increase of \$5.1 million in property, plant and equipment was due to store investment as noted above.

Assets held for sale as at April 1, 2017 related to the termination of the Company's license to operate Starbucks-branded cafés within certain retail locations and the subsequent subleasing arrangement for Starbucks to operate corporate-run cafés in these locations. All assets were transferred to Starbucks as at May 1, 2017.

Liabilities

As at September 30, 2017, total liabilities decreased \$3.3 million to \$266.6 million, compared to \$269.9 million as at October 1, 2016. The decrease was primarily due to the \$8.6 million reduction in unredeemed gift card liability, which was driven by a change in accounting estimate as noted above. This decrease was partially offset by a negative mark-to-market on the Company's derivative portfolio as a result of the Canadian dollar appreciating against the US dollar, resulting in a \$3.8 million derivative liability in the current quarter.

On a fiscal year-to-date basis, total liabilities increased \$29.8 million to \$266.6 million compared to \$236.8 million as at April 1, 2017. The increase was primarily driven by higher current and long-term accounts payable and accrued liabilities, partly offset by a reduction in unredeemed gift card liability. The \$39.7 million increase in current and long-term accounts payable and accrued liabilities is consistent with the seasonal growth in inventories leading up to the holiday season. This increase was partially offset by a reduction of \$14.0 million in unredeemed gift card liability as customers continued to redeem gift cards purchased during the 2016 holiday season, combined with the previously discussed change in accounting estimate.

Equity

Total equity at September 30, 2017 increased \$25.0 million to \$361.6 million, compared to \$336.6 million as at October 1, 2016. Over the last four quarters, the Company generated net earnings of \$21.1 million and had a \$6.9 million increase in share capital. Share capital increased due to the exercise of stock options and Directors' deferred share units ("DSUs").

On a fiscal year-to-date basis, total equity at September 30, 2017 decreased \$10.2 million to \$361.6 million, compared to \$371.8 million as at April 1, 2017 primarily due to the year to date net loss of \$10.0 million .

The weighted average number of common shares outstanding for the second quarter of fiscal 2018 was 26,707,263 compared to 26,284,648 for the same

period last year. As at November 1, 2017, the number of outstanding common shares was 26,541,734 with a book value of \$218.1 million.

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 \$225.7 million as at September 30, 2017, compared to \$204.9 million as at October 1, 2016 and \$245.7 million as at April 1, 2017. Increased working capital compared to the same period last year was driven by higher current assets. As previously discussed, an increase in inventories of \$28.1 million was offset by a reduction in cash, cash equivalents and short-term investments of \$13.4 million.

The Company's leverage position (defined as Total Liabilities to Total Equity) declined slightly to 0.7:1 as at September 30, 2017 compared to 0.8:1 as at October 1, 2016 as a result of total equity growing faster than total liabilities. The Company's leverage position as at September 30, 2017 increased slightly compared to 0.6:1 as at April 1, 2017 due to seasonal nature of the business.

Overview of Consolidated Statements of Cash Flows

Cash and cash equivalents increased \$63.9 million for the 13-week period ended September 30, 2017 compared to an increase of \$7.1 million in the same period last year. The increase in the current period was a result of cash flows from investing activities of \$79.6 million, primarily from maturities of short term investments, partially offset by cash flows used in operating activities of \$17.4 million.

On a fiscal year to basis, cash and cash equivalents increased \$30.1 million due to the previously discussed settlement of short term investments, offset by cash flows used in operating activities of \$41.5 million. This is consistent with the noted impact of seasonality on the Company's operations.

Cash Flows Used for Operating Activities

The Company used cash flows of \$17.4 million from operating activities in the 13-week period ended September 30, 2017 compared to the \$12.2 million generated in the same period last year, a decrease of \$29.6 million. The decrease was driven by a reduction in cash used for working capital. The Company used \$15.6 million of cash for working capital this year compared to generating \$7.8 million of cash for working capital in the same period last year, primarily

driven by timing differences associated with the payment of accounts payable and accrued liabilities in the current period.

On a fiscal year-to-date basis, cash flows used for operating activities increased by \$19.8 million to \$41.5 million in the current period compared to \$21.7 million used in the same period last year. This was a result of an increase in cash used for working capital purposes to sustain higher inventories in support of the upcoming holiday season.

Cash Flows Used for Investing Activities

The Company received cash flows of \$79.6 million from investing activities in the 13-week period ended September 30, 2017 compared to using \$6.3 million in the same period last year, an increase of \$85.9 million. The increase was primarily driven by the change in short term investments of \$90.0 million due to the settlement of securities in the period. The Company spent \$11.1 million on capital projects this year compared to spending \$6.7 million in the same period last year. The Company continues to transform its retail outlets and is investing in its digital business with back-end productivity initiatives, such as improved distribution centre automation.

On a fiscal year-to-date basis, the Company generated cash flows of \$70.2 million for investing activities compared to using \$13.1 million in the same period last year, an increase of \$83.3 million. The increase was primarily driven by the change in short term investments of \$90.0 million as noted above. The Company spent \$18.7 million on capital projects compared to spending \$14.1 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 used for capital projects as follows:

(millions of Canadian dollars)	13-week period ended September 30, 2017	13-week period ended October 1, 2016	26-week period ended September 30, 2017	26-week period ended October 1, 2016
Construction, renovations, and equipment	6.1	3.1	10.5	8.0
Intangible assets (primarily application software and internal development costs)	3.0	3.1	4.7	5.1
Technology equipment	2.0	0.5	3.5	1.0
Total	11.1	6.7	18.7	14.1

Cash Flows from Financing Activities

The Company generated cash flows of \$1.4 million from financing activities in the 13-week period ended September 30, 2017 compared to generating \$0.5 million in the same period last year, an increase of \$0.9 million. The variance was driven by an increase in option exercises in the current period.

On a fiscal year-to-date basis, cash flows generated from financing activities increased to \$1.8 million in the current period compared to \$1.5 million in the same period last year. This increase of \$0.3 million was driven by the same reasons discussed above.

Liquidity and Capital Resources

The Company has a highly seasonal business that generates a significant portion of its revenue and cash flows during the November/December holiday season. The Company has minimal accounts receivable and a majority 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, cash and cash equivalents, and short-term investments.

Based on the Company's liquidity position and cash flow forecast, management expects its current cash position and future cash flows generated from operations to be sufficient to meet its working capital needs for fiscal 2018. In addition, the Company has the ability to reduce capital spending if necessary; however, a long-term decline in capital expenditures may negatively impact revenue and profit growth.

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 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 2017 Annual Report, except as noted.

Accounting Standards Implemented in the Second Quarter of Fiscal 2018

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. The Company applied this standard beginning April 2, 2017. Adopting these amendments did not have a significant impact on the Company’s results of operations, financial position, or disclosures.

New Accounting Pronouncements

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 retrospectively using either the retrospective or cumulative effect method for annual reporting periods beginning on or after January 1, 2018. The Company plans to apply this standard beginning April 1, 2018 but is still assessing which transition method it will apply.

Implementation of IFRS 15 is expected to impact the allocation of deferred plum program revenue. Revenue is currently allocated to plum points using the residual fair value method. Under IFRS 15, revenue will be allocated based on relative standalone selling prices between plum points and the goods on which points were earned. The Company is currently assessing the impact of this change and other impacts of adopting this standard on its results of operations, financial position, and disclosures.

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. The Company plans to apply this standard beginning on April 1, 2018.

IFRS 9 more closely aligns hedge accounting with risk management activities and applies a more qualitative and forward-looking approach to assessing hedge effectiveness. The Company is currently assessing the impact of this change and other impacts of adopting this standard on its results of operations, financial position, and disclosures.

Leases (“IFRS 16”)

In January 2016, the IASB issued IFRS 16, which supersedes existing standards and interpretations under IAS 17, “Leases.” IFRS 16 introduces a single lessee accounting model, eliminating the distinction between operating and finance leases. The new lessee accounting model requires substantially all leases to be reported on a company’s balance sheet and will provide greater transparency on companies’ leased assets and liabilities. IFRS 16 substantially carries forward the lessor accounting in IAS 17 with the distinction between operating leases and finance leases being retained. The Company is assessing the impact of adopting this standard on its results of operations, financial position, and disclosures.

The new standard will apply for annual periods beginning on or after January 1, 2019. The Company plans to apply this standard beginning March 31, 2019. For leases where the Company is the lessee, it has the option of adopting a full retrospective approach or a modified retrospective approach on transition to IFRS 16. The Company has not yet determined which transition method it will apply or whether it will use the optional exemptions or practical expedients available under the standard.

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.

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 disclosure controls and procedures.

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 International Financial Reporting Standards.

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 July 2, 2017 and ended on September 30, 2017 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 International Financial Reporting Standards (“IFRS”). 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 based on a 52-week fiscal year and defined as sales generated by stores that have been open for more than 52 weeks. These measures exclude sales fluctuations due to store openings and closings, permanent relocation, and material changes in square footage. Both measures are key performance indicators for the Company.

Adjusted EBITDA is defined as earnings before interest, taxes, depreciation, amortization, impairment, asset disposals, and equity investments. 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 October 1, 2016	13-week period ended September 26, 2015	26-week period ended October 1, 2016	26-week period ended September 26, 2015
Adjusted EBITDA	0.1	4.6	0.0	(1.4)
Depreciation of property, plant, and equipment	(4.5)	(3.9)	(8.9)	(7.8)
Amortization of intangible assets	(1.8)	(2.1)	(3.7)	(4.3)
Loss on disposal of capital assets	–	0.0	(0.7)	0.0
Net interest income	0.7	0.4	1.3	0.9
Share of losses from equity investments	(0.5)	(0.4)	(1.0)	(0.9)
Loss before income taxes	(6.0)	(1.4)	(13.0)	(13.5)

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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



Hugues Simard
Chief Financial Officer

Dated as of the 1st day of November, 2017.

Consolidated Balance Sheets

(Unaudited)

(thousands of Canadian dollars)	As at September 30, 2017	As at October 1, 2016	As at April 1, 2017
ASSETS			
Current			
Cash and cash equivalents (note 5)	160,540	183,895	130,438
Short-term investments (note 5)	10,000	—	100,000
Accounts receivable	18,139	18,298	7,448
Inventories (note 6)	292,377	264,267	231,576
Income taxes recoverable	—	25	—
Prepaid expenses	7,473	5,044	11,706
Derivative assets (note 7)	77	392	266
Other assets (note 7)	1,910	—	—
Assets held for sale (note 8)	—	—	1,037
Total current assets	490,516	471,921	482,471
Property, plant, and equipment	70,208	62,237	65,078
Intangible assets	16,296	17,280	15,272
Equity investments	2,993	62	1,800
Deferred tax assets	48,212	55,022	43,981
Total assets	628,225	606,522	608,602
LIABILITIES AND EQUITY			
Current			
Accounts payable and accrued liabilities	211,019	208,424	170,611
Unredeemed gift card liability	36,374	44,974	50,396
Provisions	178	28	110
Deferred revenue	13,405	13,575	12,852
Income taxes payable	22	—	360
Current portion of long-term debt	—	21	—
Derivative liabilities (note 7)	3,835	—	—
Total current liabilities	264,833	267,022	234,329
Long-term accrued liabilities	1,708	2,809	2,378
Long-term provisions	45	96	51
Total liabilities	266,586	269,927	236,758
Equity			
Share capital (note 9)	218,080	211,185	215,971
Contributed surplus (note 10)	11,295	11,214	10,671
Retained earnings	135,016	113,909	145,007
Accumulated other comprehensive income (note 7)	(2,752)	287	195
Total equity	361,639	336,595	371,844
Total liabilities and equity	628,225	606,522	608,602

See accompanying notes

On behalf of the Board:


Heather Reisman, Director


Michael Kirby, Director

Consolidated Statements of Loss and Comprehensive Loss

(Unaudited)

(thousands of Canadian dollars, except per share data)	13-week period ended September 30, 2017	13-week period ended October 1, 2016	26-week period ended September 30, 2017	26-week period ended October 1, 2016
Revenue <small>(note 11)</small>	224,510	216,945	430,828	410,044
Cost of sales	(124,776)	(119,207)	(237,225)	(226,433)
Gross profit	99,734	97,738	193,603	183,611
Operating, selling, and administrative expenses <small>(note 11)</small>	(105,886)	(99,147)	(206,787)	(197,045)
Operating loss	(6,152)	(1,409)	(13,184)	(13,434)
Net interest income	661	408	1,258	888
Share of loss from equity investments	(466)	(411)	(1,039)	(922)
Loss before income taxes	(5,957)	(1,412)	(12,965)	(13,468)
Income tax recovery (expense)				
Current	(180)	–	(180)	–
Deferred	1,447	232	3,154	3,288
Net loss	(4,690)	(1,180)	(9,991)	(10,180)
Other comprehensive income <small>(note 7)</small>				
Items that are or may be reclassified subsequently to net earnings (loss):				
Net change in fair value of cash flow hedges [net of taxes of 902 and 1,569; 2016 – (184) and (219)]	(2,467)	503	(4,293)	598
Reclassification of net realized (gain) loss [net of taxes of (581) and (563); 2016 – 145 and 114]	1,589	(395)	1,541	(311)
Other comprehensive income (loss)	(878)	108	(2,752)	287
Total comprehensive loss	(5,568)	(1,072)	(12,743)	(9,893)
Net loss per common share <small>(note 12)</small>				
Basic	\$ (0.18)	\$ (0.04)	\$ (0.37)	\$ (0.39)
Diluted	\$ (0.18)	\$ (0.04)	\$ (0.37)	\$ (0.39)

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, April 2, 2016	209,318	10,591	124,089	–	343,998
Net loss	–	–	(10,180)	–	(10,180)
Exercise of options (note 9)	1,867	(330)	–	–	1,537
Share-based compensation (note 10)	–	756	–	–	756
Directors' compensation (note 10)	–	197	–	–	197
Other comprehensive income (note 7)	–	–	–	287	287
Balance, October 1, 2016	211,185	11,214	113,909	287	336,595
Balance, April 1, 2017	215,971	10,671	145,007	195	371,844
Net loss	–	–	(9,991)	–	(9,991)
Exercise of options (note 9)	2,109	(339)	–	–	1,770
Share-based compensation (note 10)	–	782	–	–	782
Directors' compensation (note 10)	–	181	–	–	181
Other comprehensive income (note 7)	–	–	–	(2,947)	(2,947)
Balance, September 30, 2017	218,080	11,295	135,016	(2,752)	361,639

See accompanying notes

Consolidated Statements of Cash Flows

(Unaudited)

(thousands of Canadian dollars)	13-week period ended September 30, 2017	13-week period ended October 1, 2016	26-week period ended September 30, 2017	26-week period ended October 1, 2016
CASH FLOWS FROM OPERATING ACTIVITIES				
Net loss	(4,690)	(1,180)	(9,991)	(10,180)
Adjustments to reconcile net loss to cash flows from operating activities				
Depreciation of property, plant, and equipment	4,530	3,896	8,898	7,759
Amortization of intangible assets	1,790	2,145	3,697	4,276
Loss on disposal of capital assets	(39)	—	(39)	1
Share-based compensation (note 10)	348	354	782	756
Directors' compensation (note 10)	82	89	181	197
Deferred tax assets	(1,447)	(232)	(3,154)	(3,291)
Disposal of assets held for sale (note 8)	—	—	1,037	—
Collateral from derivative transactions (note 7)	(1,910)	—	(1,910)	—
Other	(237)	(670)	437	(375)
Net change in non-cash working capital balances (note 13)	(15,613)	7,785	(41,266)	(20,901)
Interest expense	3	13	5	30
Interest income	(664)	(421)	(1,263)	(918)
Share of loss from equity investments	466	411	1,039	922
Cash flows from (used for) operating activities	(17,381)	12,190	(41,547)	(21,724)
CASH FLOWS FROM INVESTING ACTIVITIES				
Purchase of property, plant, and equipment	(8,107)	(3,607)	(13,989)	(9,024)
Addition of intangible assets	(2,976)	(3,081)	(4,721)	(5,050)
Change in short-term investments	90,000	—	90,000	—
Distribution from equity investments	—	—	434	437
Interest received	663	414	1,106	541
Investment in associate (note 1)	—	—	(2,666)	—
Cash flows from (used for) investing activities	79,580	(6,274)	70,164	(13,096)
CASH FLOWS FROM FINANCING ACTIVITIES				
Repayment of long-term debt	—	(12)	—	(32)
Interest paid	—	(11)	—	(26)
Proceeds from share issuances (note 9)	1,445	537	1,770	1,537
Cash flows from financing activities	1,445	514	1,770	1,479
Effect of foreign currency exchange rate changes on cash and cash equivalents	235	675	(285)	748
Net increase (decrease) in cash and cash equivalents during the period	63,879	7,105	30,102	(32,593)
Cash and cash equivalents, beginning of period	96,661	176,790	130,438	216,488
Cash and cash equivalents, end of period	160,540	183,895	160,540	183,895

See accompanying notes

Notes to Consolidated Financial Statements

September 30, 2017

(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 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 subsidiaries, Indigo Design Studio, Inc. and YYZ Holdings Inc. (“YYZ”), along with YYZ’s equity investment in Unplug Meditation LLC. (“Unplug”). In the first quarter of fiscal 2018, the Company invested \$2.7 million in Unplug, a U.S. meditation studio, resulting in a 20.0% voting interest and representation on the board of managers. 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 2017 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 2017 Annual Report.

The unaudited interim condensed consolidated financial statements for the 13 and 26-week periods ended September 30, 2017 (including comparatives) were approved by the Board of Directors on November 1, 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.

Management reviewed its accounting estimates related to revenue recognition from unredeemed gift cards and adjusted accordingly to reflect subtle changes in historic gift card redemption patterns. The impact of this change in estimate in the 13 and 26-week periods ended September 30, 2017 was \$3.8 million and \$7.6 million, respectively. This change will be accounted for prospectively as a change in accounting estimate.

3. CHANGES IN ACCOUNTING POLICIES

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. The Company applied this standard beginning April 2, 2017. Adopting these amendments did not have a significant impact on the Company's results of operations, financial position, or disclosures.

New Accounting Pronouncements

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IFRS 15 must be applied retrospectively using either the retrospective or cumulative effect method for annual reporting periods beginning on or after January 1, 2018. The Company plans to apply this standard beginning April 1, 2018 but is still assessing which transition method it will apply.

Implementation of IFRS 15 is expected to impact the allocation of deferred plum program revenue. Revenue is currently allocated to plum points using the residual fair value method. Under IFRS 15, revenue will be allocated based on relative standalone selling prices between plum points and the goods on which points were earned. The Company is currently assessing the impact of this change and other impacts of adopting this standard on its results of operations, financial position, and disclosures.

Financial Instruments (“IFRS 9”)

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IFRS 9 more closely aligns hedge accounting with risk management activities and applies a more qualitative and forward-looking approach to assessing hedge effectiveness. The Company is currently assessing the impact of this change and other impacts of adopting this standard on its results of operations, financial position, and disclosures.

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The new standard will apply for annual periods beginning on or after January 1, 2019. The Company plans to apply this standard beginning March 31, 2019. For leases where the Company is the lessee, it has the option of adopting a full retrospective approach or a modified retrospective approach on transition to IFRS 16. The Company has not yet determined which transition method it will apply or whether it will use the optional exemptions or practical expedients available under the standard.

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 26-week periods ended September 30, 2017 and October 1, 2016 are not indicative of the results of other periods.

5. CASH, CASH EQUIVALENTS, AND SHORT-TERM INVESTMENTS

Cash and cash equivalents consist of the following:

(thousands of Canadian dollars)	September 30, 2017	October 1, 2016	April 1, 2017
Cash	59,197	88,407	63,872
Restricted cash	1,343	5,259	1,343
Cash equivalents	100,000	90,229	65,223
Cash and cash equivalents	160,540	183,895	130,438

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

As at September 30, 2017 the Company held short-term investments of \$10.0 million (October 1, 2016 – no such investments; April 1, 2017 – \$100.0 million). Short-term investments consist of guaranteed investment securities with an original maturity date greater than 90 days and remaining term to maturity of less than 365 days from the date of acquisition. These investments are non-redeemable until the maturity date, and therefore they are classified separately from cash and cash equivalents.

6. INVENTORIES

The cost of inventories recognized as an expense during the 13 and 26-week periods ended September 30, 2017 were \$124.2 million and \$237.0 million, respectively (2016: 13 weeks – \$122.6 million; 26 weeks – \$231.8 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 26-week periods ended September 30, 2017 were \$1.5 million and \$3.5 million, respectively (2016: 13 weeks – \$1.0 million; 26 weeks – \$2.6 million), and there were no reversals of inventory write-downs that were recognized in prior periods (2016: 13 and 26 weeks – nil). The amount of inventory with net realizable value equal to cost was \$2.6 million as at September 30, 2017 (October 1, 2016 – \$2.8 million).

7. DERIVATIVE FINANCIAL INSTRUMENTS

The Company uses derivative financial instruments, such as foreign exchange forward contracts, to manage the currency fluctuation risk associated with forecasted U.S. dollar payments, primarily for general merchandise inventory purchases. These contracts have been designated as cash flow hedges for accounting purposes. The fair values of derivative financial instruments are determined based on observable market information as well as valuations determined by external valuers with experience in financial markets.

During the 13 and 26-week periods ended September 30, 2017, the Company entered into forward contracts with total notional amounts of C\$10.1 million and C\$67.8 million, respectively, to buy U.S. dollars and sell Canadian dollars (2016: 13-week – C\$43.4 million; 26-week – C\$86.5 million). As at September 30, 2017, the Company had remaining contracts in place representing a total notional amount of C\$77.6 million (October 1, 2016 – C\$45.9 million). These contracts extend over a period not exceeding 12 months.

The total fair value of the contracts as at September 30, 2017 resulted in the recognition of a derivative asset of less than \$0.1 million (October 1, 2016 – \$1.1 million; April 1, 2017 – \$0.3 million), and a derivative liability of \$3.8 million (October 1, 2016 – no derivative liability; April 1, 2017 – no derivative liability). As a result, the Company had an unrealized net loss of \$3.8 million (October 1, 2016 – \$0.4 million net gain; April 1, 2017 – \$0.3 million net gain) recognized as other comprehensive income.

During the 13 and 26-week periods ended September 30, 2017, a net loss of \$2.2 million and \$2.1 million, respectively from settled contracts (2016: 13-week – net gain of \$0.4 million; 26-week – net gain of \$0.3 million) was reclassified from other comprehensive income to inventory and expenses.

In the current quarter, there was a foreign exchange realized loss of less than \$0.1 million, compared to a realized gain of \$0.3 million in the same period last year.

The Company has in certain instances entered into an ISDA master agreement with its counterparties. These agreements require that, in the event the fair value change in the net derivatives position between the two parties exceeds certain dollar thresholds, the party in the net liability position posts collateral. The Company has posted \$1.9 million in cash collateral for its derivative transactions as at September 30, 2017 (October 1, 2016 – no collateral posted).

8. ASSETS HELD FOR SALE

On February 17, 2017, the Company formalized a Letter of Intent with Starbucks Coffee Canada Inc. (“Starbucks”) whereby, among other things, the Company and Starbucks mutually agreed to terminate the Company’s license to operate Starbucks-branded cafés within 11 retail locations.

Based on the terms of the Letter of Intent, the Company agreed to transfer to Starbucks the café inventories and capital assets from the terminated licensed locations, and the Company classified these inventories and capital assets as assets held for sale. Subsequent to the transfer, the Company has subleased space in each of the previously licensed locations for Starbucks to operate corporate-run cafés, similar to the 72 other Starbucks-branded cafés Starbucks operates in the Company’s retail locations. The transfer and subsequent subleasing were completed on May 1, 2017.

9. SHARE CAPITAL

Share capital consists of the following:

	26-week period ended September 30, 2017		26-week period ended October 1, 2016		52-week period ended April 1, 2017	
	Number of shares	Amount C\$ (thousands)	Number of shares	Amount C\$ (thousands)	Number of shares	Amount C\$ (thousands)
Balance, beginning of period	26,351,484	215,971	25,797,351	209,318	25,797,351	209,318
Issued during the period						
Directors’ deferred share units converted	–	–	–	–	67,108	670
Options exercised	187,750	2,109	148,300	1,867	487,025	5,983
Balance, end of period	26,539,234	218,080	25,945,651	211,185	26,351,484	215,971

10. SHARE-BASED COMPENSATION

As at September 30, 2017, 1,998,000 stock options were outstanding with exercise prices ranging from \$8.12 to \$18.00. Of these outstanding stock options, 929,155 were exercisable at a weighted average exercise price of \$11.43. As at October 1, 2016, there were 2,211,500 stock options outstanding of which 934,525 were exercisable.

The Company uses the fair value method of accounting for stock options, which estimates the fair value of the stock options granted on the date of grant, net of estimated forfeitures, and expenses this value over the vesting period. During the 13 and 26-week periods ended September 30, 2017, the pre-forfeiture value of the options was \$2.1 million and \$2.1 million, respectively (2016: 13-weeks – \$2.6 million; 26 weeks – \$2.7 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 in the comparative prior year period:

	13-week period ended September 30, 2017	13-week period ended October 1, 2016
Black-Scholes option pricing assumptions		
Risk-free interest rate	1.3%	0.6%
Expected volatility	31.6%	33.8%
Expected time until exercise	3.0 years	3.0 years
Expected dividend yield	–	–
Other assumptions		
Forfeiture rate	27.2%	27.3%

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 Directors' compensation during the 13 and 26-week periods ended September 30, 2017 was in the form of DSUs (2016 – all DSUs).

The number of shares reserved for issuance under this plan is 500,000. During the 13 and 26-week periods ended September 30, 2017, the Company issued 5,141 DSUs with a value of \$0.1 million and 11,541 DSUs with a value of \$0.2 million, respectively (2016: 13 weeks – 5,258 DSUs with a value of \$0.1 million; 26 weeks – 11,639 DSUs with a value of \$0.2 million). The number of DSUs to be issued to each Director is based on a set fee schedule.

The grant date fair value of the outstanding DSUs as at September 30, 2017 was \$3.7 million (October 1, 2016 – \$4.0 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.

11. SUPPLEMENTARY OPERATING INFORMATION

Supplemental product line revenue information:

(thousands of Canadian dollars)	13-week period ended September 30, 2017	13-week period ended October 1, 2016	26-week period ended September 30, 2017	26-week period ended October 1, 2016
Print ¹	131,007	136,258	252,971	257,382
General merchandise ²	82,396	71,325	157,529	137,125
eReading ³	2,542	2,690	5,005	5,154
Other ⁴	8,565	6,672	15,323	10,383
Total	224,510	216,945	430,828	410,044

¹ Includes books, magazines, newspapers, and shipping revenue.

² Includes lifestyle, paper, toys, calendars, 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 September 30, 2017	13-week period ended October 1, 2016	26-week period ended September 30, 2017	26-week period ended October 1, 2016
Wages, salaries, and bonuses	44,828	42,324	88,293	83,204
Short-term benefits expense	4,958	4,358	10,402	9,465
Termination benefits expense	508	427	1,979	926
Retirement benefits expense	429	389	849	775
Share-based compensation	348	354	782	756
Total employee benefits expense	51,071	47,852	102,305	95,126

Termination benefits arise when the Company terminates certain employment agreements.

12. LOSS PER SHARE

Loss per share is calculated based on the weighted average number of common shares outstanding during the period. The Company's stock options were anti-dilutive as the Company reported a loss and, therefore, were not included in the September 30, 2017 and October 1, 2016 diluted loss per share calculations.

13. STATEMENTS OF CASH FLOWS

Supplemental cash flow information:

(thousands of Canadian dollars)	13-week period ended September 30, 2017	13-week period ended October 1, 2016	26-week period ended September 30, 2017	26-week period ended October 1, 2016
Accounts receivable	(8,494)	(6,498)	(10,691)	(10,635)
Inventories	(50,090)	(47,035)	(60,801)	(46,479)
Prepaid expenses	6,213	7,385	4,233	6,246
Accounts payable and accrued liabilities (current and long-term)	47,033	60,611	39,738	35,638
Unredeemed gift card liability	(10,210)	(6,571)	(14,022)	(5,995)
Provisions (current and long-term)	69	(8)	62	(19)
Income tax payable	(338)	—	(338)	—
Deferred revenue	204	(99)	553	343
Net change in non-cash working capital balances	(15,613)	7,785	(41,266)	(20,901)

14. RELATED PARTY TRANSACTIONS

The Company's related parties include its key management personnel, shareholders, defined contribution retirement plan, equity investments in associates, and subsidiaries. Unless otherwise stated, none of the transactions incorporate special terms and conditions and no guarantees were given or received.

Outstanding balances are usually settled in cash

Transactions with Key Management Personnel

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

(thousands of Canadian dollars)	13-week period ended September 30, 2017	13-week period ended October 1, 2016	26-week period ended September 30, 2017	26-week period ended October 1, 2016
Wages, salaries, and bonus	1,582	1,715	3,275	3,071
Short-term benefits expense	46	51	106	91
Retirement benefits expense	9	14	20	28
Share-based compensation	262	277	534	459
Directors' compensation	82	89	181	197
Total remuneration	1,981	2,146	4,116	3,846

Transactions with Shareholders

During the second quarter of fiscal 2018, 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. During the 13 and 26-week periods ended September 30, 2017, the Company paid \$1.3 million and \$2.5 million, respectively for these transactions (2016: 13 weeks – \$0.9 million; 26 weeks – \$1.9 million). As at September 30, 2017, Indigo had \$0.3 million payable to these companies under standard payment terms and \$1.0 million of restricted cash pledged as collateral for letter of credit obligations issued to support the Company's purchases of merchandise from these companies (October 1, 2016 – \$0.3 million payable and \$2.8 million restricted cash). All transactions were measured at fair market value and were in the normal course of business, under normal commercial terms, 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 11. The Company has not entered other transactions with the retirement plan.

Transactions with Associates

Calendar Club is a seasonal operation that is dependent on the November/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 26-week periods ended September 30, 2017, Indigo loaned \$9.7 million and \$12.2 million, respectively to Calendar Club (2016: 13 weeks – \$4.9 million; 26 weeks – \$7.4 million).

The Company had immaterial transactions with Unplug during the period.

15. SUBSEQUENT EVENTS

In October 2017, the Company's bid for the acquisition of a Sears Canada Distribution Centre, as part of the retail group's proceedings under the *Companies' Creditors Arrangement Act (CCAA)*, was approved.

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Toronto Stock Exchange

Trading Symbol

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