indigo

"THE FUTURE BELONGS TO THOSE WHO BELIEVE IN THE BEAUTY OF THEIR DREAMS."

– ELEANOR ROOSEVELT

SECOND QUARTER REPORT
FOR THE 13 AND 26-WEEK
PERIODS ENDED
SEPTEMBER 29, 2018

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Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") is prepared as at November 6, 2018 and is based primarily on the unaudited interim condensed consolidated financial statements of Indigo Books & Music Inc. (the "Company" or "Indigo") for the 13 and 26-week periods ended September 29, 2018 and September 30, 2017. 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 2018 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 March 31, 2018 and the MD&A included in the Company's fiscal 2018 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 and offering online sales through the *indigo.ca* website and the Company's mobile applications. As at September 29, 2018, the Company operated 84 superstores under the banners *Chapters* and *Indigo* and 120 small format stores under the banners *Coles*, *Indigospirit* and *The Book Company*.

The Company has a 50% interest in Calendar Club of Canada Limited Partnership ("Calendar Club"), which operates seasonal kiosks and year-round stores in shopping malls across Canada. The Company is also comprised of its wholly-owned subsidiaries, Indigo Design Studio, Inc., Indigo Cultural Department Store Inc. ("Indigo U.S."), and YYZ Holdings Inc. ("YYZ"), along with its equity investments in Unplug Meditation, LLC ("Unplug").

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 29, 2018**	**% Revenue**	13-week period ended September 30, 2017[2]	% Revenue	**26-week period ended September 29, 2018**	**% Revenue**	26-week period ended September 30, 2017[2]	% Revenue
Revenue	**216.3**	**100.0**	224.6	100.0	**421.7**	**100**	430.9	100.0
Cost of sales	**(128.9)**	**59.6**	(124.8)	55.6	**(246.3)**	**58.4**	(237.2)	55.0
Cost of operations	**(78.4)**	**36.2**	(72.8)	32.4	**(152.5)**	**36.2**	(140.8)	32.7
Selling, administrative, and other expenses	**(27.6)**	**12.8**	(26.9)	12.0	**(54.7)**	**13.0**	(52.8)	12.3
Adjusted EBITDA[1]	**(18.6)**	**8.6**	0.1	0.0	**(31.8)**	**7.5**	0.1	0.0
Amortization and other related capital charges	**(7.5)**	**3.5**	(6.2)	2.8	**(15.2)**	**3.6**	(13.3)	3.1
Net interest income	**0.8**	**0.4**	0.7	0.3	**1.6**	**0.4**	1.3	0.3
Share of loss from equity investments	**(0.5)**	**0.2**	(0.5)	0.2	**(1.1)**	**0.3**	(1.0)	0.2
Loss before income taxes	**(25.8)**	**11.9**	(5.9)	2.6	**(46.5)**	**11.0**	(12.9)	3.0

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

2 Certain balances were restated as a result of IFRS 15 adjustments. Refer to Note 3 of the unaudited condensed interim consolidated financial statements for additional information.

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. Earnings (loss) before income taxes, the most directly comparable measure determined under IFRS, is presented above for informational purposes.

Revenue

Total consolidated revenue for the 13-week period ended September 29, 2018 decreased $8.3 million or 3.7% to $216.3 million from $224.6 million for the 13-week period ended September 30, 2017. The decline in sales was driven by the closure of a few low performing stores, and ongoing renovations in 12 stores as the Company transforms its retail operations.

Online revenue increased by $2.3 million or 7.3% to $33.6 million for the 13-week period ended September 29, 2018 compared to $31.3 million in the same period last year. Online sales continued to grow, in books and general merchandise, due to an increase in online traffic as a result of the success of the Company's "every book ships for free" promotion.

Total comparable sales, which includes online sales, increased by 0.7% for the second quarter. Comparable retail superstore sales for the quarter decreased 1.4% driven by softer year-over-year store traffic, while small format store sales increased 3.1%. 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 52 weeks. These measures exclude sales fluctuations due to store openings and closings, significant renovations, permanent relocations, material changes in square footage, and the impact of a 53-week fiscal year. 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 29, 2018, the Company closed two low performing stores, one of which will be relocated.

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 decreased $3.9 million or 41.1% to $5.6 million for the 13-week period ended September 29, 2018 compared to $9.5 million in the same period last year primarily driven by gift card breakage. In fiscal 2018, management recognized revenue of $3.8 million related to gift card breakage due to a change in accounting estimates to reflect changes in customer redemption patterns. Management will continue to monitor redemption activity and will adjust for changes as observed.

On a fiscal year-to-date basis, total consolidated revenue decreased by $9.2 million or 2.1% to $421.7 million compared to $430.9 million for the same period last year. Lower revenue was driven by strategic store closures and disruptions due to renovations as part of the Company's retail transformation. In addition, there was a revenue adjustment for gift card breakage which totaled $7.5 million during the first and second quarters of prior period. These decreases were partially offset by growth in the online channel.

Revenue by channel is highlighted below:

(millions of Canadian dollars)	**13-week period ended September 29, 2018**	13-week period ended September 30, 2017[1]	% increase	Comparable sales % increase
Superstores	**146.4**	154.4	(5.2)%	(1.4)%
Small format stores	**30.7**	29.4	4.4 %	3.1 %
Online (including store kiosks)	**33.6**	31.3	7.3 %	7.3 %
Other[2]	**5.6**	9.5	(41.1)%	N/A
Total	**216.3**	224.6	(3.7)%	0.7 %

1 Certain balances were restated as a result of IFRS 15 adjustments. Refer to Note 3 of the unaudited condensed interim consolidated financial statements for additional information.

2 Includes cafés, irewards, gift card breakage, plum breakage, corporate sales, and Kobo revenue share.

Revenue by product line is as follows:

	13-week period ended September 29, 2018	13-week period ended September 30, 2017[4]	**26-week period ended September 29, 2018**	26-week period ended September 30, 2017[4]
Print[1]	**58.8%**	58.4%	**58.2%**	58.7%
General merchandise[2]	**38.7%**	37.4%	**39.2%**	37.3%
Other[3]	**2.5%**	4.2%	**2.6%**	4.0%
Total	**100.0%**	100.0%	**100.0%**	100.0%

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

2 Includes lifestyle, paper, toys, electronics, eReaders, eReader accessories, and shipping revenue.

3 Includes cafés, irewards, gift card breakage, plum breakage, corporate sales, and Kobo revenue share.

4 Certain balances were restated as a result of IFRS 15 adjustments. Refer to Note 3 of the unaudited condensed interim consolidated financial statements for additional information.

Reconciliations between total revenue and comparable sales are provided below:

(millions of Canadian dollars)	**13-week period ended September 29, 2018**	13-week period ended September 30, 2017
Total retail store revenue	**177.1**	183.8
Total online revenue	**33.6**	31.3
Adjustments for stores not in both fiscal periods	**(15.7)**	(21.5)
Total comparable sales	**195.0**	193.6

(millions of Canadian dollars)	Superstores **13-week period ended September 29, 2018**	 13-week period ended September 30, 2017	Small format stores **13-week period ended September 29, 2018**	 13-week period ended September 30, 2017
Total revenue by format	**146.4**	154.4	**30.7**	29.4
Adjustments for stores not in both fiscal periods	**(14.8)**	(20.9)	**(1.0)**	(0.6)
Comparable retail store sales	**131.6**	133.5	**29.7**	28.8

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 $4.1 million to $128.9 million for the 13-week period ended September 29, 2018, compared to $124.8 million for the same period last year. As a percent of total revenue, cost of sales increased 4.0% to 59.6% compared to 55.6% for the same period last year. This increase was driven both by a higher proportion of lower margin online sales and the associated online shipping costs, and deeper discounting compared to the same period last year to move through unproductive inventory.

On a fiscal year-to-date basis, cost of sales increased by $9.1 million or 3.8% to $246.3 million compared to $237.2 million for the same period last year. Year-to-date cost of sales as a percent of total revenue increased 3.4% to 58.4% compared to 55.0% in the same period last year for the same reasons discussed above.

Cost of Operations

Cost of operations includes all store, store support, online, and distribution centre costs. Cost of operations increased $5.6 million to $78.4 million for the 13-week period ended September 29, 2018, compared to $72.8 million for the same period last year. As a percent of total revenue, cost of operations increased by 3.8% to 36.2% this year, compared to 32.4% for the same period last year. Operating costs increased primarily due to a rise in minimum wage across the country, particularly in Ontario. Additionally, the Company's expansion of its distribution facilities in Alberta and Ontario contributed to operating cost increases. The Company will continue to incur disproportionate costs in these distribution centres until both facilities are fully utilized and optimized for efficiencies.

On a fiscal year-to-date basis, cost of operations increased by $11.7 million to $152.5 million compared to $140.8 million for the same period last year. Year-to-date cost of operations as a percent of total revenue increased by 3.5% to 36.2%, compared to 32.7% for the same period last year. These increases were driven by the same reasons 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 $0.7 million to $27.6 million for the 13-week period ended September 29, 2018, compared to $26.9 million for the same period last year. As a percent of total revenue, selling, administrative, and other expenses increased by 0.8% to 12.8%, compared to 12.0% for the same period last year. Higher expenses in the current year were driven by accelerated investments in strategic initiatives to transform the Company's retail and digital platforms.

On a fiscal year-to-date basis, selling, administrative, and other expenses increased $1.9 million to $54.7 million compared to $52.8 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 0.7% to 13.0% compared to 12.3% 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 $18.7 million to a loss of $18.6 million for the 13-week period ended September 29, 2018, compared to $0.1 million for the same period last year. Adjusted EBITDA as a percent of revenue decreased by 8.6% to a loss of 8.6% this year from 0.0% for the same period last year. Lower adjusted EBITDA was primarily driven by a top-line decline due to the closure of a few low performing stores and renovations in 12 stores, higher discounting and increased operating costs as discussed above. Also contributing to this decline is an adjustment of $3.8 million to gift card breakage, in the prior period, as a result of a change in accounting estimates.

On a fiscal year-to-date basis, adjusted EBITDA decreased $31.9 million to a loss of $31.8 million compared to $0.1 million in the same period last year. Year-to-date adjusted EBITDA as a percent of total revenue decreased by 7.5% to a loss of 7.5% this year from 0.0% in the same period last year, for the same reasons as discussed above, including the impact of the prior period gift card breakage adjustment on a fiscal year-to-date basis of $7.5 million. 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 29, 2018 increased by $1.2 million to $7.4 million compared to $6.2 million for the same period last year. Capital expenditures in the second quarter of fiscal 2019 totaled $25.6 million compared to $11.1 million for the same period last year. Increased capital expenditures in the current period were driven by continued implementation of changes across Indigo's retail outlets, including full renovations, net new locations and rebranding of stores, as well as investments in digital and supply chain. Capital expenditures for the second quarter of fiscal 2019 included $19.3 million for retail store renovations and equipment, $1.2 million for technology equipment, and $5.1 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 $2.1 million to $14.7 million compared to $12.6 million in the same period last year. Year-to-date, the Company has spent $48.5 million on capital expenditures compared to $18.7 million last year primarily due to the acceleration of the Company's store renovation activities. Capital expenditures for the current year included $36.0 million for retail store renovations and equipment, $2.3 million for technology equipment, and $10.2 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 $0.8 million for the 13-week period ended September 29, 2018, compared to $0.7 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 that earn higher interest rates.

On a fiscal year-to-date basis, the Company recognized net interest income of $1.6 million compared to $1.3 million in the same period last year for the same reasons discussed above.

Share of 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 29, 2018, consistent with the net loss of $0.5 million recognized for the same period last year. Earnings from Unplug were immaterial for the 13-week period ended September 29, 2018.

On a fiscal year-to-date basis, Indigo recognized a net loss from Calendar Club of $1.1 million compared to a net loss of $1.0 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 $6.6 million for the 13-week period ended September 29, 2018, compared to recognizing a non-cash income tax recovery of $1.3 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 of fiscal 2019. The Company used a tax rate of 26.86% to calculate income tax expense in the current period. Based on a full 52-week period, the Company does not expect to pay cash income taxes as it has sufficient non-capital loss carry forwards to offset taxable income.

On a fiscal year-to-date basis, Indigo recognized a non-cash income tax recovery of $11.9 million compared to recognizing a non-cash income tax recovery of $3.0 million in the same period last year. The income tax recovery increased as a result of the same reasons discussed above.

Net Loss

The Company recognized a net loss of $19.1 million for the 13-week period ended September 29, 2018 ($0.70 net earnings per common share), compared to a net loss of $4.6 million ($0.17 net earnings per common share) for the same period last year. The increase in net loss was primarily driven by the impact of the Company's investment in strategic initiatives, including store renovations and the expansion of its distribution facilities, coupled with the increase in minimum wage across the country.

On a fiscal year-to-date basis, the Company recognized a net loss of $34.5 million ($1.28 net earnings per common share), compared to a net loss of $9.9 million ($0.37 net earnings per common share) in the same period last year. This decline in profitability was driven by the same reasons discussed above.

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 29, 2018, the Company entered contracts with total notional amounts of C$50.1 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$10.1 million. On a fiscal year-to-date basis, the Company entered contracts with total notional amounts of C$102.0 million to buy U.S. dollars and sell Canadian dollars, compared to entering contracts with total notional amounts of C$67.8 million in the same period last year.

As at September 29, 2018, the Company had remaining contracts in place representing a total notional amount of C$104.4 million and an unrealized net gain of $0.5 million, compared to a total notional amount of C$77.6 million and an unrealized net loss of $3.8 million as at September 30, 2017. During the 13 and 26-week periods ended September 29, 2018, net gain (net of taxes) of $0.4 million and $0.5 million, respectively, from settled contracts were reclassified from other comprehensive income to inventory and expenses compared to reclassified net losses (net of taxes) of $1.6 million and $1.5 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.

	Fiscal quarters[1]							
(millions of Canadian dollars, except per share data)	**Q2 Fiscal 2019**	Q1 Fiscal 2019	Q4 Fiscal 2018	Q3 Fiscal 2018	Q2 Fiscal 2018	Q1 Fiscal 2018	Q4 Fiscal 2017	Q3 Fiscal 2017
Revenue	**216.3**	205.4	215.4	433.3	224.6	206.4	209.6	400.4
Total net earning (loss)	**(19.1)**	(15.4)	(10.7)	42.6	(4.6)	(5.3)	(8.9)	40.0
Basic earnings (loss) per share	**($0.70)**	($0.57)	($0.40)	$1.58	($0.17)	($0.20)	($0.33)	$1.51
Diluted earnings (loss) per share	**($0.70)**	($0.57)	($0.40)	$1.56	($0.17)	($0.20)	($0.33)	$1.48

1 Certain balances were restated as a result of IFRS 15 adjustments. Refer to Note 3 of the unaudited condensed interim consolidated financial statements for additional information.

Overview of Consolidated Balance Sheets

Assets

As at September 29, 2018, total assets increased $17.5 million to $646.6 million, compared to $629.0 million as at September 30, 2017. The increase was primarily driven by higher property, plant and equipment, intangible assets and inventory, partly offset by a decrease in cash, cash equivalents and short-term investments. The increase in property, plant and equipment of $39.9 million and in intangible assets of $13.6 million was driven by investment in retail store renovations, digital projects and software to support various strategic initiatives. Inventory increased by $11.4 million to support the anticipated demand during the upcoming holiday season. Cash, cash equivalents and short-term investments decreased $50.7 million in line with expectations, as cash was used to fund the noted capital investments and operating activities.

On a fiscal year-to-date basis, total assets increased by $12.2 million to $646.6 million compared to $634.4 million as at March 31, 2018. The increase was driven by higher inventory, property, plant and equipment, accounts receivable and deferred tax assets. This movement was primarily offset by a decrease in cash and cash equivalents. Inventory increased by $39.2 million, which is consistent with the seasonal nature of the business. Property, plant and equipment increased by $27.8 million as further capital investments were made during the period for store renovations and other strategic initiatives. The decrease in cash and cash equivalents of $90.6 million is consistent with the seasonal nature of the business, and amplified by the noted capital investments made during the period. Accounts receivable increased by $15.5 million, which was primarily due to a $12.3 million loan to Calendar Club. The increase in deferred tax assets of $12.3 million related to the net loss recognized during the period.

Liabilities

As at September 29, 2018, total liabilities increased $9.0 million to $274.7 million, compared to $265.7 million as at September 30, 2017. This increase was driven by a $16.9 million increase in current accounts payable and accrued liabilities due to timing differences, and was partially offset by a $4.3 million reduction in deferred revenue. The deferred revenue variance was driven by the outstanding plum liability, which was impacted by a change in accounting estimates in fiscal 2018. Derivative liabilities also decreased by $3.7 million as a result of the positive mark-to-market on the Company's derivative portfolio caused by currency fluctuations in the market.

On a fiscal year-to-date basis, total liabilities increased $43.1 million to $274.7 million compared to $231.6 million as at March 31, 2018. The increase was primarily driven by a $51.3 million increase in current accounts payable and accrued liabilities which is consistent with the seasonal growth in inventories leading up to the holiday season. This increase was partially offset by a reduction of $9.0 million in unredeemed gift card liabilities, as customers continued to redeem gift cards purchased during the 2018 holiday season.

Equity

Total equity at September 29, 2018 increased $8.5 million to $371.8 million, compared to $363.3 million as at September 30, 2017. Over the last four quarters, the Company generated net loss of $2.6 million and had a $7.3 million increase in share capital, due to the exercise of stock options and deferred share units. Accumulated other comprehensive income also increased by $3.1 million from the unrealized gains on the Company's foreign currency hedge portfolio.

On a fiscal year-to-date basis, total equity at September 29, 2018 decreased $31.1 million to $371.8 million, compared to $402.9 million as at March 31, 2018 primarily due to the year-to-date net loss of $34.5 million.

The weighted average number of common shares outstanding for the second quarter of fiscal 2019 was 27,050,938 compared to 26,707,263 for the same period last year. As at November 6, 2018, the number of outstanding common shares was 27,122,486 with a book value of $225.4 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 $184.2 million as at September 29, 2018, compared to $227.4 million as at September 30, 2017 and $258.8 million as at March 31, 2018. The decrease in working capital compared to the same period last year was a result of lower current assets and higher current liabilities. This was primarily driven by the discussed decrease in cash, cash equivalents and short-term investments used to fund property, plant and equipment and intangible assets during the year.

The Company's leverage position (defined as Total Liabilities to Total Equity) remained consistent at 0.7:1 as at September 29, 2018 compared to 0.7:1 as at September 30, 2017. The Company's leverage position as at September 29, 2018 increased slightly from 0.6:1 as at March 31, 2018, due to the seasonal nature of the business.

Overview of Consolidated Statements of Cash Flows

Cash and cash equivalents decreased $35.3 million for the 13-week period ended September 29, 2018 compared to an increase of $63.9 million in the same period last year. The decrease in the current period was a result of cash flows used in investing activities of $25.1 million during the period, compared to cash flows generated from investing activities of $79.6 million in the same period last year, which was a result of short-term investment maturities.

On a fiscal year-to-date basis, cash and cash equivalents decreased $90.6 million due to the seasonal nature of the business, as the Company generates the majority of its revenue during the holiday season. In the current year, the cash and cash equivalents balance was further impacted by strategic capital investments.

Cash Flows Used for Operating Activities

The Company used cash flows of $12.7 million from operating activities in the 13-week period ended September 29, 2018 compared to the $17.4 million used in the same period last year, a decrease of $4.7 million. This decrease was primarily driven by an increase in cash generated from working capital, partially offset by the increase of $14.5 million in the net loss realized during the current period. The Company generated $5.8 million of cash for working capital this year compared to using $15.7 million of cash in the same period last year, primarily driven by higher accounts payable and accrued liabilities.

On a fiscal year-to-date basis, cash flows used for operating activities increased by $5.7 million to $47.2 million in the current period compared to $41.5 million used in the same period last year. This was primarily a result of the increased net loss and associated change in deferred tax expense, a combined impact of $33.6 million, partially offset by a decrease in cash used for working capital of $25.5 million.

Cash Flows From (Used for) Investing Activities

The Company used cash flows of $25.1 million in investing activities in the 13-week period ended September 29, 2018 compared to generating $79.6 million in the same period last year, a change of $104.7 million. This was primarily driven by $90.0 million of short-term investments that were settled in the prior year, as well as an incremental $12.4 million of property, plant and equipment and $2.1 million of intangible investments in the current period.

On a fiscal year-to-date basis, the Company used cash flows of $46.7 million for investing activities compared to generating $70.2 million in the same period last year, a change of $116.9 million. This was primarily driven by the short-term investments discussed above. The Company also invested $48.5 million on capital projects compared to $18.7 million in the same period last year.

Cash was used for capital projects as follows:

(millions of Canadian dollars)	**13-week period ended September 29, 2018**	13-week period ended September 30, 2017	**26-week period ended September 29, 2018**	26-week period ended September 30, 2017
Construction, renovations, and equipment	**19.3**	6.1	**36.0**	10.5
Intangible assets (primarily application software and internal development costs)	**5.1**	3.0	**10.2**	4.7
Technology equipment	**1.2**	2.0	**2.3**	3.5
Total	**25.6**	11.1	**48.5**	18.7

Cash Flows from Financing Activities

The Company generated cash flows of $2.1 million from financing activities in the 13-week period ended September 29, 2018 compared to generating $1.4 million in the same period last year, an increase of $0.7 million. The variance was driven by higher cash proceeds received from option exercises in the current period.

On a fiscal year-to-date basis, cash flows generated from financing activities increased to $2.8 million in the current period compared to $1.8 million in the same period last year. This increase of $1.0 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 2019. 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; unprocessed online returns; 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, except as noted. 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 2018 Annual Report.

Accounting Standards Implemented in the First Quarter of Fiscal 2019

Revenue from Contracts with Customers ("IFRS 15")

Effective in the first quarter of fiscal 2019, the Company adopted IFRS 15, which provides a comprehensive framework for the recognition, measurement and disclosure of revenue from contracts with customers, excluding contracts within the scope of the accounting standards on leases, insurance contracts and financial instruments. IFRS 15 is effective for annual reporting periods beginning on or after January 1, 2018 and supersedes IAS 18, "Revenue," IAS 11, "Construction Contracts," and a number of revenue-related interpretations.

The Company adopted the standard on April 1, 2018, applying the requirements using the full retrospective transition method. The adoption of IFRS 15 did not have a material impact on the Company's consolidated financial statements other than on the Company's recognition of deferred loyalty program revenue and its sales return allowance.

Under IAS 18, loyalty revenue was allocated to plum points using the residual fair value method. Under this method, a portion of the consideration equaling the fair value of the points was deferred until the points were actually redeemed while the residual consideration was allocated to the goods sold and recognized as revenue. IFRS 15 stipulates that revenue will be allocated based on relative standalone selling prices between loyalty points and the goods on which points were earned. Using this relative fair value approach, the amount allocated to the loyalty points and recorded as deferred revenue will be lower than the amounts allocated under the residual value method.

Under IAS 18, sales return allowance on the consolidated balance sheets was recognized on a net basis with no adjustment to current assets. Upon adoption of IFRS 15, the sales return allowance is recognized on a gross basis, resulting in an adjustment of the balance sheet line items noted below.

The impacts on the Company's balance sheets as at September 30, 2017 and March 31, 2018 are as follows:

(thousands of Canadian dollars)	Balance at September 30, 2017	IFRS 15 Adjustment	**Adjusted September 30, 2017**	Balance at March 31, 2018	IFRS 15 Adjustment	**Adjusted March 31, 2018**
Assets						
Other assets	1,910	794	**2,704**	–	865	**865**
Liabilities						
Accounts payable and accrued liabilities	211,019	794	**211,813**	176,479	865	**177,344**
Deferred revenue	13,405	(1,684)	**11,721**	8,807	(1,778)	**7,029**
Equity						
Retained earnings	135,016	1,684	**136,700**	166,807	1,778	**168,585**

The impacts on the Company's opening balance sheet as at April 2, 2017 are as follows:

(thousands of Canadian dollars)	Opening balance at April 2, 2017	IFRS 15 Adjustment	**Adjusted April 2, 2017**
Assets			
Other assets	–	794	**794**
Liabilities			
Accounts payable and accrued liabilities	170,611	794	**171,405**
Deferred revenue	12,852	(1,585)	**11,267**
Equity			
Retained earnings	145,007	1,585	**146,592**

The impacts on the Company's statements of loss for the 13 and 26-week periods ended September 30, 2017 are as follows:

(thousands of Canadian dollars)	13-week period ended September 30, 2017	IFRS 15 Adjustment	**Adjusted 13-week period ended September 30, 2017**	26-week period ended September 30, 2017	IFRS 15 Adjustment	**Adjusted 26-week period ended September 30, 2017**
Revenue	224,510	60	**224,570**	430,828	99	**430,927**
Cost of sales	124,776	–	**124,776**	237,225	–	**237,225**
Gross profit	99,734	60	**99,794**	193,603	99	**193,702**

The impact of these adjustments were also realized in both adjusted EBITDA and the net loss balances in the above noted periods. This resulted in a decrease to the basic and diluted loss per share of $0.01 for the 13-week period ended September 30, 2017. On a fiscal year-to-date basis, this resulted in no change to the basic loss per share and a decrease of $0.01 in the diluted loss per share for the 26-week period ended September 30, 2017.

Financial Instruments ("IFRS 9")

The Company adopted IFRS 9 during the first quarter of fiscal 2019, which replaces IAS 39 "Financial Instruments: Recognition and Measurement." The standard introduces new requirements for classification and measurement of financial assets and liabilities, impairment of financial assets, and hedge accounting.

The classification and measurement approach for financial assets and liabilities under IFRS 9 reflects the business model in which assets are managed and their cash flow characteristics. While the new approach results in changes to classification categories, there were no consequential measurement changes to the Company's financial instruments on adoption.

IFRS 9 replaces the incurred loss model of IAS 39 with a model based on expected credit losses. Under the new standard, the loss allowance for a financial instrument will be calculated at an amount equal to 12-month expected credit losses, or life time expected credit losses if there has been a significant increase in the credit risk on the instrument. The Company has determined that the adoption of IFRS 9 has not resulted in any additional impairment allowance for the 13 and 26-week periods ended September 29, 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's risk management strategy and hedging activities are disclosed in the Company's 2018 Annual Report, Note 21 "Financial Risk

Management" and in this Quarterly Report, Note 7 "Derivative Financial Instruments". The Company's hedging relationships in place as at March 31, 2018 qualified for hedge accounting in accordance with IFRS 9 and were therefore regarded as continuing hedging relationships. As the critical terms of the hedging instruments match those of their corresponding hedged items, all hedging relationships continue to be effective under IFRS 9's effectiveness assessment requirements.

The Company has applied IFRS 9 retrospectively, with the initial application date of April 1, 2018. As permitted by the transitional provisions of the standard, the Company elected not to restate comparative figures or note disclosures. Apart from the aforementioned hedge accounting considerations, there was no material impact to the Company's consolidated financial statements.

New Accounting Pronouncements

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. While the Company is still assessing the impact of adopting this standard on its consolidated financial statements, the recognition of certain leases is expected to have a material impact on the Company's Consolidated Balance Sheets.

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 formed a project team and has begun the process of determining which transition method it will apply or whether it will use the optional exemptions or practical expedients available under the standard.

The project team has also selected a lease accounting software to quantify the required components of IFRS 16, and is currently in the process of implementing this software throughout its locations. The Company expects to disclose additional information, including the estimated quantitative financial effects, before the adoption of IFRS 16.

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 1, 2018 and ended on September 29, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting. The Company has determined that no material changes in internal controls over financial reporting have occurred in this period.

Cautionary Statement Regarding Forward-Looking Statements

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

Non-IFRS Financial Measures

The Company prepares its unaudited interim condensed consolidated financial statements in accordance with International Financial Reporting Standards ("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, significant renovations, 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 September 29, 2018**	13-week period ended September 30, 2017[1]	**26-week period ended September 29, 2018**	26-week period ended September 30, 2017[1]
Adjusted EBITDA	**(18.6)**	0.1	**(31.8)**	0.1
Depreciation of property, plant, and equipment	**(5.0)**	(4.5)	**(10.2)**	(8.9)
Amortization of intangible assets	**(2.4)**	(1.7)	**(4.6)**	(3.7)
Loss on disposal of capital assets	**(0.1)**	–	**(0.4)**	(0.7)
Net interest income	**0.8**	0.7	**1.6**	1.3
Share of loss from equity investments	**(0.5)**	(0.5)	**(1.1)**	(1.0)
Earnings before income taxes	**(25.8)**	(5.9)	**(46.5)**	(12.9)

1 Certain balances were restated as a result of IFRS 15 adjustments. Refer to Note 3 of the unaudited condensed interim consolidated financial statements for additional information.

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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 6th day of November, 2018.

Consolidated Balance Sheets

(Unaudited)

(thousands of Canadian dollars)	**As at September 29, 2018**	As at September 30, 2017[1]	As at March 31, 2018[1]
ASSETS			
Current			
Cash and cash equivalents (note 5)	**59,623**	160,540	150,256
Short-term investments (note 5)	**60,222**	10,000	60,000
Accounts receivable	**22,294**	18,139	6,747
Inventories (note 6)	**303,782**	292,377	264,586
Prepaid expenses	**8,518**	7,473	4,124
Derivative assets (note 7)	**588**	77	1,439
Other assets (notes 3 and 7)	**983**	2,704	865
Total current assets	**456,010**	491,310	488,017
Property, plant, and equipment	**110,122**	70,208	82,314
Intangible assets	**29,882**	16,296	24,215
Equity investments	**2,684**	2,993	4,330
Deferred tax assets	**47,857**	48,212	35,563
Total assets	**646,555**	629,019	634,439
LIABILITIES AND EQUITY			
Current			
Accounts payable and accrued liabilities (note 3)	**228,676**	211,813	177,344
Unredeemed gift card liability	**35,236**	36,374	44,218
Provisions	**160**	178	166
Deferred revenue (note 3)	**7,452**	11,721	7,029
Income taxes payable	**152**	22	152
Derivative liabilities (note 7)	**109**	3,835	327
Total current liabilities	**271,785**	263,943	229,236
Long-term accrued liabilities	**2,904**	1,708	2,283
Long-term provisions	**45**	45	45
Total liabilities	**274,734**	265,696	231,564
Equity			
Share capital (note 9)	**225,360**	218,080	221,854
Contributed surplus (note 10)	**12,040**	11,295	11,621
Retained earnings (note 3)	**134,071**	136,700	168,585
Accumulated other comprehensive income (loss) (note 7)	**350**	(2,752)	815
Total equity	**371,821**	363,323	402,875
Total liabilities and equity	**646,555**	629,019	634,439

See accompanying notes

1 Certain prior period figures have been restated due to the adoption of IFRS 15 (refer to Note 3).

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 29, 2018**	13-week period ended September 30, 2017[1]	**26-week period ended September 29, 2018**	26-week period ended September 30, 2017[1]
Revenue (note 11)	**216,313**	224,570	**421,689**	430,927
Cost of sales	**(128,871)**	(124,776)	**(246,334)**	(237,225)
Gross profit	**87,442**	99,794	**175,355**	193,702
Operating, selling, and administrative expenses (note 11)	**(113,466)**	(105,886)	**(222,254)**	(206,787)
Operating loss	**(26,024)**	(6,092)	**(46,899)**	(13,085)
Net interest income	**750**	661	**1,560**	1,258
Share of loss from equity investments	**(479)**	(466)	**(1,118)**	(1,039)
Loss before income taxes	**(25,753)**	(5,897)	**(46,457)**	(12,866)
Income tax recovery	**6,628**	1,267	**11,943**	2,974
Net loss	**(19,125)**	(4,630)	**(34,514)**	(9,892)
Other comprehensive income (loss) (note 7)				
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 551 and (3); 2017 – 902 and 1,569]	**(1,499)**	(2,467)	**6**	(4,293)
Reclassification of net realized (gain) loss [net of taxes of 156 and 173; 2017 – (581) and (563)]	**(426)**	1,589	**(471)**	1,541
Other comprehensive loss	**(1,925)**	(878)	**(465)**	(2,752)
Total comprehensive loss	**(21,050)**	(5,508)	**(34,979)**	(12,644)
Net loss per common share (note 12)				
Basic	**($0.70)**	($0.17)	**($1.28)**	($0.37)
Diluted	**($0.70)**	($0.17)	**($1.28)**	($0.36)

See accompanying notes

[1] Certain prior period figures have been restated due to the adoption of IFRS 15 (refer to Note 3).

Consolidated Statements of Changes in Equity

(Unaudited)

(thousands of Canadian dollars)	Share Capital	Contributed Surplus	Retained Earnings[1]	Accumulated Other Comprehensive Income (Loss)	Total Equity[1]
Balance, April 1, 2017	215,971	10,671	146,592	195	373,429
Net loss	–	–	(9,892)	–	(9,892)
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 loss (note 7)	–	–	–	(2,947)	(2,947)
Balance, September 30, 2017	218,080	11,295	136,700	(2,752)	363,323
Balance, March 31, 2018	**221,854**	**11,621**	**168,585**	**815**	**402,875**
Net loss	**–**	**–**	**(34,514)**	**–**	**(34,514)**
Exercise of options (note 9)	**3,446**	**(682)**	**–**	**–**	**2,764**
Directors' deferred share units converted (note 9)	**60**	**(60)**	**–**	**–**	**–**
Share-based compensation (note 10)	**–**	**976**	**–**	**–**	**976**
Directors' compensation (note 10)	**–**	**185**	**–**	**–**	**185**
Other comprehensive loss (note 7)	**–**	**–**	**–**	**(465)**	**(465)**
Balance, September 29, 2018	**225,360**	**12,040**	**134,071**	**350**	**371,821**

See accompanying notes

1 Certain prior period figures have been restated due to the adoption of IFRS 15 (refer to Note 3).

Consolidated Statements of Cash Flows

(Unaudited)

(thousands of Canadian dollars)	**13-week period ended September 29, 2018**	13-week period ended September 30, 2017[1]	**26-week period ended September 29, 2018**	26-week period ended September 30, 2017[1]
CASH FLOWS USED FOR OPERATING ACTIVITIES				
Net loss	**(19,125)**	(4,630)	**(34,514)**	(9,892)
Adjustments to reconcile net loss to cash flows from operating activities				
Depreciation of property, plant, and equipment	**5,038**	4,530	**10,165**	8,898
Amortization of intangible assets	**2,362**	1,790	**4,554**	3,697
Loss on disposal of capital assets	**90**	(39)	**330**	(39)
Share-based compensation (note 10)	**487**	348	**976**	782
Directors' compensation (note 10)	**96**	82	**185**	181
Deferred tax assets	**(6,719)**	(1,447)	**(12,125)**	(3,154)
Disposal of assets held for sale (note 8)	**–**	–		1,037
Collateral from derivative transactions (note 7)	**–**	(1,910)	**–**	(1,910)
Other	**(395)**	(237)	**(475)**	437
Net change in non-cash working capital balances (note 13)	**5,756**	(15,673)	**(15,867)**	(41,365)
Interest expense	**–**	3	**3**	5
Interest income	**(749)**	(664)	**(1,563)**	(1,263)
Share of loss from equity investments	**479**	466	**1,118**	1,039
Cash flows used for operating activities	**(12,680)**	(17,381)	**(47,213)**	(41,547)
CASH FLOWS FROM (USED FOR) INVESTING ACTIVITIES				
Purchase of property, plant, and equipment	**(20,541)**	(8,107)	**(38,298)**	(13,989)
Addition of intangible assets	**(5,060)**	(2,976)	**(10,225)**	(4,721)
Change in short-term investments	**(222)**	90,000	**(222)**	90,000
Distribution from equity investments	**–**	–	**528**	434
Interest received	**749**	663	**1,562**	1,106
Investment in associate (note 1)	**–**	–	**–**	(2,666)
Cash flows from (used for) investing activities	**(25,074)**	79,580	**(46,655)**	70,164
CASH FLOWS FROM FINANCING ACTIVITIES				
Proceeds from share issuances (note 9)	**2,076**	1,445	**2,764**	1,770
Cash flows from financing activities	**2,076**	1,445	**2,764**	1,770
Effect of foreign currency exchange rate changes on cash and cash equivalents	**394**	235	**471**	(285)
Net increase (decrease) in cash and cash equivalents during the period	**(35,284)**	63,879	**(90,633)**	30,102
Cash and cash equivalents, beginning of period	**94,907**	96,661	**150,256**	130,438
Cash and cash equivalents, end of period	**59,623**	160,540	**59,623**	160,540

See accompanying notes

[1] Certain prior period figures have been restated due to the adoption of IFRS 15 (refer to Note 3).

Notes to Consolidated Financial Statements

September 29, 2018
(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 and its wholly-owned subsidiaries, Indigo Design Studio, Inc., Indigo Cultural Department Store Inc. ("Indigo U.S."), and YYZ Holdings Inc. ("YYZ"), along with equity investments in Calendar Club of Canada Limited Partnership ("Calendar Club"), and Unplug Meditation, LLC ("Unplug"). 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 2018 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 2018 Annual Report.

The unaudited interim condensed consolidated financial statements for the 13 and 26-week periods ended September 29, 2018 (including comparatives) were approved by the Board of Directors on November 6, 2018.

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; unprocessed online returns; 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

These interim unaudited condensed consolidated financial statements have been prepared using the accounting policies as outlined in note 4 of the fiscal 2018 Annual Report, with the exception of the accounting standards adopted in the year ending March 31, 2019. The Company has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

Changes to significant accounting policies are described below.

Revenue from Contracts with Customers ("IFRS 15")

Effective in the first quarter of fiscal 2019, the Company adopted IFRS 15, which provides a comprehensive framework for the recognition, measurement and disclosure of revenue from contracts with customers, excluding contracts within the scope of the accounting standards on leases, insurance contracts and financial instruments. IFRS 15 is effective for annual reporting periods beginning on or after January 1, 2018 and supersedes IAS 18, "Revenue," IAS 11, "Construction Contracts," and a number of revenue-related interpretations.

The Company adopted the standard on April 1, 2018, applying the requirements using the full retrospective transition method. The adoption of IFRS 15 did not have a material impact on the Company's consolidated financial statements other than on the Company's recognition of deferred loyalty program revenue and its sales return allowance.

Under IAS 18, loyalty revenue was allocated to plum points using the residual fair value method. Under this method, a portion of the consideration equaling the fair value of the points was deferred until the points were actually redeemed while the residual consideration was allocated to the goods sold and recognized as revenue. IFRS 15 stipulates that revenue will be allocated based on relative standalone selling prices between loyalty points and the goods on which points were earned. Using this relative fair value approach, the amount allocated to the loyalty points and recorded as deferred revenue will be lower than the amounts allocated under the residual value method.

Under IAS 18, sales return allowance on the consolidated balance sheets was recognized on a net basis with no adjustment to current assets. Upon adoption of IFRS 15, the sales return allowance is recognized on a gross basis, resulting in an adjustment of the balance sheet line items noted below.

The impacts on the Company's balance sheets as at September 30, 2017 and March 31, 2018 are as follows:

(thousands of Canadian dollars)	Balance at September 30, 2017	IFRS 15 Adjustment	**Adjusted September 30, 2017**	Balance at March 31, 2018	IFRS 15 Adjustment	**Adjusted March 31, 2018**
Assets						
Other assets	1,910	794	**2,704**	–	865	**865**
Liabilities						
Accounts payable and accrued liabilities	211,019	794	**211,813**	176,479	865	**177,344**
Deferred revenue	13,405	(1,684)	**11,721**	8,807	(1,778)	**7,029**
Equity						
Retained earnings	135,016	1,684	**136,700**	166,807	1,778	**168,585**

The impacts on the Company's opening balance sheet as at April 2, 2017 are as follows:

(thousands of Canadian dollars)	Opening balance at April 2, 2017	IFRS 15 Adjustment	**Adjusted April 2, 2017**
Assets			
Other assets	–	794	**794**
Liabilities			
Accounts payable and accrued liabilities	170,611	794	**171,405**
Deferred revenue	12,852	(1,585)	**11,267**
Equity			
Retained earnings	145,007	1,585	**146,592**

The impacts on the Company's statements of loss for the 13 and 26-week periods ended September 30, 2017 are as follows:

(thousands of Canadian dollars)	13-week period ended September 30, 2017	IFRS 15 Adjustment	**Adjusted 13-week period ended September 30, 2017**	26-week period ended September 30, 2017	IFRS 15 Adjustment	**Adjusted 26-week period ended September 30, 2017**
Revenue	224,510	60	**224,570**	430,828	99	**430,927**
Cost of sales	124,776	–	**124,776**	237,225	–	**237,225**
Gross profit	99,734	60	**99,794**	193,603	99	**193,702**

The impact of these adjustments were also realized in both adjusted EBITDA and the net loss balances in the above noted periods. This resulted in a decrease to the basic and diluted loss per share of $0.01 for the 13-week period ended September 30, 2017. On a fiscal year-to-date basis, this resulted in no change to the basic loss per share and a decrease of $0.01 in the diluted loss per share for the 26-week period ended September 30, 2017.

Financial Instruments ("IFRS 9")

The Company adopted IFRS 9 during the first quarter of fiscal 2019, which replaces IAS 39 "Financial Instruments: Recognition and Measurement." The standard introduces new requirements for classification and measurement of financial assets and liabilities, impairment of financial assets, and hedge accounting.

The classification and measurement approach for financial assets and liabilities under IFRS 9 reflects the business model in which assets are managed and their cash flow characteristics. While the new approach results in changes to classification categories, there were no consequential measurement changes to the Company's financial instruments on adoption.

IFRS 9 replaces the incurred loss model of IAS 39 with a model based on expected credit losses. Under the new standard, the loss allowance for a financial instrument will be calculated at an amount equal to 12-month expected credit losses, or life time expected credit losses if there has been a significant increase in the credit risk on the instrument. The Company has determined that the adoption of IFRS 9 has not resulted in any additional impairment allowance for the 13 and 26-week periods ended September 29, 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's risk management strategy and hedging activities are disclosed in the Company's 2018 Annual Report, Note 21 "Financial Risk Management" and in this Quarterly Report, Note 7 "Derivative Financial Instruments". The Company's hedging relationships in place as at March 31, 2018 qualified for hedge accounting in accordance with IFRS 9 and were therefore regarded as continuing hedging relationships. As the critical terms of the hedging instruments match those of their corresponding hedged items, all hedging relationships continue to be effective under IFRS 9's effectiveness assessment requirements.

The Company has applied IFRS 9 retrospectively, with the initial application date of April 1, 2018. As permitted by the transitional provisions of the standard, the Company elected not to restate comparative figures or note disclosures. Apart from the aforementioned hedge accounting considerations, there was no material impact to the Company's consolidated financial statements.

NEW ACCOUNTING PRONOUNCEMENTS

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. While the Company is still assessing the impact of adopting this standard on its consolidated financial statements, the recognition of certain leases is expected to have a material impact on the Company's Consolidated Balance Sheets.

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 formed a project team and has begun the process of determining which transition method it will apply or whether it will use the optional exemptions or practical expedients available under the standard.

The project team has also selected a lease accounting software to quantify the required components of IFRS 16, and is currently in the process of implementing this software throughout its locations. The Company expects to disclose additional information, including the estimated quantitative financial effects, before the adoption of IFRS 16.

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 29, 2018 and September 30, 2017 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 29, 2018**	September 30, 2017	March 31, 2018
Cash	**27,801**	59,197	67,709
Restricted cash	**1,593**	1,343	2,093
Cash equivalents	**30,229**	100,000	80,454
Cash and cash equivalents	**59,623**	160,540	150,256

Restricted cash represents cash pledged as collateral for letter of credit obligations issued to support the Company's purchases of offshore merchandise and cash placed in escrow for asset acquisitions that occurred in the prior fiscal year.

As at September 29, 2018, the Company held short-term investments of $60.2 million (September 30, 2017 – $10.0 million; March 31, 2018 – $60.0 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 or equal to 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 29, 2018 were $125.2 million and $241.9 million, respectively (2017: 13 weeks – $124.2 million; 26 weeks – $237.0 million). Inventories consist of the landed cost of goods sold and exclude 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 29, 2018 were $4.1 million and $6.3 million, respectively (2017: 13 weeks – $1.5 million; 26 weeks – $3.5 million). The amount of inventory with net realizable value equal to cost was $3.2 million as at September 29, 2018 (September 30, 2017 – $2.6 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 valuators with experience in financial markets.

During the 13 and 26-week periods ended September 29, 2018, the Company entered into forward contracts with total notional amounts of C$50.1 million and C$102.0 million, respectively, to buy U.S. dollars and sell Canadian dollars (2017: 13 weeks – C$10.1 million; 26 weeks – C$67.8 million). As at September 29, 2018, the Company had remaining contracts in place representing a total notional amount of C$104.4 million (September 30, 2017 – C$77.6 million). These contracts extend over a period not exceeding 12 months.

The total fair value of the contracts as at September 29, 2018 resulted in the recognition of a derivative asset of $0.6 million (September 30, 2017 – less than $0.1 million; March 31, 2018 – $1.4 million), and a derivative liability of $0.1 million (September 30, 2017 – $3.8 million; March 31, 2018 – $0.3 million).

For the 13 and 26-week periods ended September 29, 2018, the Company had a net loss (net of taxes) from the change in fair value of outstanding cash flow hedges of $1.5 million and a net gain of $0.0 million (2017: 13 weeks – net loss of $2.5 million; 26 weeks – net loss of $4.3 million). During the same periods, the Company reclassified a net gain (net of taxes) from settled contracts of $0.4 million and $0.5 million, respectively, from other comprehensive income to inventory and expenses (2017: 13 weeks – net loss of $1.6 million; 26 weeks – net loss of $1.5 million). The result was an other comprehensive loss of $1.9 million and $0.5 million for the 13 and 26-week periods ended September 29, 2018, respectively (2017: 13 weeks – loss of $0.9 million; 26 weeks – loss of $2.8 million).

In the current quarter, there was a foreign exchange realized gain of $0.1 million, compared to a realized loss of less than $0.1 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 $0.0 million in cash collateral for its derivative transactions as at September 29, 2018 (September 30, 2017 – $1.9 million).

8. ASSETS HELD FOR SALE

On April 28, 2017, the Company entered into an agreement 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 agreement, 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 71 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 29, 2018		26-week period ended September 30, 2017		52-week period ended March 31, 2018	
	Number of shares	**Amount C$ (thousands)**	Number of shares	Amount C$ (thousands)	Number of shares	Amount C$ (thousands)
Balance, beginning of period	**26,800,609**	**221,854**	26,351,484	215,971	26,351,484	215,971
Issued during the period						
Directors' deferred share units converted	**4,021**	**60**	–	–	–	–
Adjustment for share exchange per 2001 merger agreement	**519**	**–**	–	–	–	–
Options exercised	**317,337**	**3,446**	187,750	2,109	449,125	5,883
Balance, end of period	**27,122,486**	**225,360**	26,539,234	218,080	26,800,609	221,854

10. SHARE-BASED COMPENSATION

As at September 29, 2018, 1,990,013 stock options were outstanding with exercise prices ranging from $10.09 to $18.40. Of these outstanding stock options, 788,553 were exercisable at a weighted average exercise price of $14.39. As at September 30, 2017, there were 1,998,000 stock options outstanding of which 929,155 were exercisable.

The Company uses the fair value method of accounting for stock options, which estimates the fair value of the stock options granted on the date of grant, net of estimated forfeitures, and expenses this value over the vesting period. During the 13 and 26-week periods ended September 29, 2018, the pre-forfeiture value of the options were $1.8 million (2017: 13 weeks, 26 weeks – $2.1 million).

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

	13-week period ended September 29, 2018	13-week period ended September 30, 2017
Black-Scholes option pricing assumptions		
Risk-free interest rate	**1.3%**	1.3%
Expected volatility	**31.4%**	31.6%
Expected time until exercise	**3.0 years**	3.0 years
Expected dividend yield	**–**	–
Other assumptions		
Forfeiture rate	**27.1%**	27.2%

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 29, 2018 was in the form of DSUs (2017 – all DSUs).

The number of shares reserved for issuance under this plan is 500,000. During the 13 and 26-week periods ended September 29, 2018, the Company issued 6,839 DSUs with a value of $0.1 million and 12,089 DSUs with a value of $0.2 million, respectively (2017: 13 weeks – 5,141 DSUs with a value of $0.1 million; 26 weeks – 11,541 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 29, 2018 was $3.9 million (September 30, 2017 – $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.

11. SUPPLEMENTARY OPERATING INFORMATION

Set out below is the disaggregation of the Company's revenue from contracts with customers.

The following table summarizes net revenue by product line:

(thousands of Canadian dollars)	**13-week period ended September 29, 2018**	13-week period ended September 30, 2017[4]	**26-week period ended September 29, 2018**	26-week period ended September 30, 2017[4]
Print[1]	**127,273**	131,007	**245,625**	252,971
General merchandise[2]	**83,490**	84,052	**165,155**	160,884
Other[3]	**5,551**	9,511	**10,909**	17,072
Total	**216,313**	224,570	**421,689**	430,927

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

2 Includes lifestyle, paper, toys, electronics, eReaders, eReader accessories, and shipping revenue.

3 Includes cafés, irewards, gift card breakage, plum breakage, corporate sales, and Kobo revenue share.

4 Certain balances were restated as a result of IFRS 15 adjustments. Refer to Note 3 of the unaudited condensed interim consolidated financial statements for additional information.

The following table summarizes net revenue by channel:

(thousands of Canadian dollars)	**13-week period ended September 29, 2018**	13-week period ended September 30, 2017[1]	**26-week period ended September 29, 2018**	26-week period ended September 30, 2017[1]
Superstores	**146,366**	154,423	**284,785**	296,118
Small format stores	**30,747**	29,377	**58,570**	56,443
Online (including store kiosks)	**33,649**	31,259	**67,425**	61,294
Other	**5,551**	9,511	**10,909**	17,072
Total	**216,313**	224,570	**421,689**	430,927

1 Certain balances were restated as a result of IFRS 15 adjustments. Refer to Note 3 of the unaudited condensed interim consolidated financial statements for additional information.

Supplemental operating and administrative expenses information:

(thousands of Canadian dollars)	**13-week period ended September 29, 2018**	13-week period ended September 30, 2017	**26-week period ended September 29, 2018**	26-week period ended September 30, 2017
Wages, salaries, and bonuses	**48,022**	44,828	**93,451**	88,293
Short-term benefits expense	**4,879**	4,958	**10,614**	10,402
Termination benefits expense	**664**	508	**1,191**	1,979
Retirement benefits expense	**459**	429	**930**	849
Share-based compensation	**487**	348	**976**	782
Total employee benefits expense	**54,511**	51,071	**107,162**	102,305

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 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 29, 2018 and September 30, 2017 diluted loss per share calculations.

13. STATEMENTS OF CASH FLOWS

Supplemental cash flow information:

(thousands of Canadian dollars)	**13-week period ended September 29, 2018**	13-week period ended September 30, 2017[1]	**26-week period ended September 29, 2018**	26-week period ended September 30, 2017[1]
Accounts receivable	**(9,924)**	(8,494)	**(15,547)**	(10,691)
Other assets	**(61)**	–	**(118)**	–
Inventories	**(46,064)**	(50,090)	**(39,196)**	(60,801)
Prepaid expenses	**(1,673)**	6,213	**(4,394)**	4,233
Accounts payable and accrued liabilities (current and long-term)	**69,997**	47,033	**51,953**	39,738
Unredeemed gift card liability	**(6,791)**	(10,210)	**(8,982)**	(14,022)
Provisions (current and long-term)	–	69	**(6)**	62
Income tax payable	–	(338)	–	(338)
Deferred revenue	**272**	144	**423**	454
Net change in non-cash working capital balances	**5,756**	(15,673)	**(15,867)**	(41,365)

1 Certain balances were restated as a result of IFRS 15 adjustments. Refer to Note 3 of the unaudited condensed interim consolidated financial statements for additional information.

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 29, 2018**	13-week period ended September 30, 2017	**26-week period ended September 29, 2018**	26-week period ended September 30, 2017
Wages, salaries, and bonus	**1,946**	1,582	**3,965**	3,275
Short-term benefits expense	**43**	46	**82**	106
Retirement benefits expense	**20**	9	**39**	20
Share-based compensation	**303**	262	**641**	534
Directors' compensation	**96**	82	**185**	181
Total remuneration	**2,408**	1,981	**4,912**	4,116

Transactions with Shareholders

During the second quarter of fiscal 2019, 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 29, 2018, the Company paid \$1.3 million and \$2.1 million, respectively for these transactions (2017: 13 weeks – \$1.3 million; 26 weeks – \$2.5 million). As at September 29, 2018, Indigo did not have an outstanding payable to these companies, but holds \$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 (September 30, 2017 – \$0.3 million payable and \$1.0 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 into 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 29, 2018, Indigo loaned $8.0 million and $12.3 million, respectively to Calendar Club (2017: 13 weeks – $9.7 million; 26 weeks – $12.2 million).

The Company had immaterial transactions with Unplug during the period.

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