Indigo

FIRST QUARTER REPORT FOR THE
13-WEEK PERIOD ENDED
JUNE 27, 2020

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Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") is prepared as at August 6, 2020 and is based primarily on the unaudited interim condensed consolidated financial statements of Indigo Books & Music Inc. (the "Company" or "Indigo") for the 13-week periods ended June 27, 2020 and June 29, 2019. 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 otherwise noted, the same accounting policies and methods of computation as those used in the preparation of the fiscal 2020 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 28, 2020 and the MD&A included in the Company's fiscal 2020 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. The Company also has retail operations in the United States through a wholly-owned subsidiary, operating one retail store in Short Hills, New Jersey. As at June 27, 2020, the Company operated 88 superstores under the banners *Chapters* and *Indigo* and 94 small format stores under the banners *Coles*, *Indigospirit* and *The Book Company*.

The Company is inclusive 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 20% equity investment in Unplug Meditation, LLC ("Unplug").

The Company supports a separate registered charity called the 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.

Statement on COVID-19

As previously discussed in the fiscal 2020 Annual Report, the Company has taken proactive measures in response to the COVID-19 pandemic to protect the health and safety of its customers, employees and communities and to ensure the continuity of the Company's business operations with a focus on preserving cash to manage liquidity.

In the first quarter of fiscal 2021, the Company undertook the following actions:

- Recognized $2.4 million in rent concessions as a direct response to the economic impact of the COVID-19 pandemic and in accordance with IFRS 16 *Leases* ("IFRS 16"). The Company continues to negotiate with landlords regarding rent concessions to share the financial burden of COVID-19.
- Reduced forward inventory purchases and processed returns on unproductive book purchases to suppliers at full credit, while maintaining an optimized assortment.
- Accelerated its digital road map and launched curbside pick-up to alleviate demand on the Company's distribution centres and to protect the health and safety of the Company's customers, employees and communities.
- Commenced the phased reopening of its retail stores on May 19, 2020, in accordance with the directives of local government and public health authorities, with all but one of its 182 stores reopened by the end of the quarter.
- Recalled 3,030 of its retail leadership and hourly employees from temporary layoff.
- Applied for the Canada Emergency Wage Subsidy ("CEWS") program and recognized payroll subsidies of $16.8 million in the period. These subsidies were recorded as a reduction in the associated eligible salaries and wage expenses recognized in cost of operations and selling, general and administrative expenses.

The Company anticipates challenging conditions for the remainder of fiscal 2021; however, investment made in the Company's digital infrastructure and distribution networks in recent years provides the agility to serve customers in many ways.

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. The selected financial information is derived from the unaudited interim condensed consolidated financial statements for the 13-week periods ended June 27, 2020 and June 29, 2019.

(millions of Canadian dollars)	**13-week period ended June 27, 2020**	**% Revenue**	13-week period ended June 29, 2019	% Revenue
Revenue	**135.1**	**100.0**	192.6	100.0
Cost of sales	**(96.9)**	**71.7**	(108.7)	56.4
Cost of operations	**(32.1)**	**23.8**	(58.7)	30.5
Selling, general and administrative expenses	**(12.6)**	**9.3**	(25.4)	13.2
Depreciation of right-of-use assets	**(10.7)**	**7.9**	(9.8)	5.1
Finance charges related to leases	**(6.5)**	**4.8**	(6.1)	3.2
Adjusted EBITDA[1]	**(23.7)**	**17.5**	(16.1)	8.4
Depreciation of property, plant and equipment	**(4.6)**	**3.4**	(5.9)	3.1
Amortization of intangible assets	**(3.2)**	**2.4**	(3.3)	1.7
Loss on disposal of capital assets	**(0.2)**	**0.1**	(0.5)	0.3
Net interest income	**0.2**	**0.1**	0.7	0.4
Share of loss from equity investments	**–**	**–**	(0.8)	0.4
Loss before income taxes	**(31.6)**	**23.4**	(25.9)	13.4

1 Earnings before interest, taxes, depreciation, amortization, asset disposals, and share of loss from equity investments, and includes IFRS 16 right-of-use asset depreciation and associated finance charges. For further information on the key metric and its computation, 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.

Adjusted EBITDA includes certain impacts of IFRS 16, which represents a change in calculation methodology from the prior period. All prior period numbers have been consistently stated. For further information regarding this metric refer to "Non-IFRS Financial Measures".

A reconciliation of adjusted EBITDA to 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 June 27, 2020 decreased $57.5 million or 29.8% to $135.1 million from $192.6 million for the 13-week period ended June 29, 2019. This reflects a decline in the retail channel of 74.0% due to temporary store closures as a result of the ongoing COVID-19 pandemic, partially offset by exceptional growth of 214.1% in the online channel. The Company experienced demand growth in core categories that supported reading, wellness and at-home learning and entertainment, partially offset by a decline in impulse-led categories more sought-after by customers shopping in physical retail. This highlights the agility and competitive strength of the Company's assortment breadth. Additionally, the launch of curbside pickup generated further sales during temporary store closures and alleviated pressure from the Company's online fulfillment centres.

Historically, the Company has reported on comparable sales, which in the past has been a key performance indicator for the Company. Due to the temporary store closures from COVID-19 and strict social distancing requirements limiting capacity in stores upon reopening, the Company believes comparable sales is not currently representative of the underlying trends of its business. The metric has therefore not been discussed in this MD&A.

Retail revenue decreased by $118.6 million or 73.8% to $42.1 million for the 13-week period ended June 27, 2020 compared to $160.6 million in the same period last year. The decline in revenue was a result of temporary store closures in the first half of the quarter due to COVID-19. On May 19, 2020, where permitted by local authorities, the Company began the phased reopening of its retail stores, with 120 stores reopened in the ninth week, and all but one store reopened by the end of the quarter. On average, reopened stores tracked at approximately 72% of last year's sales. Although traffic has not made a full recovery, conversion and average transaction values increased year-over-year as more customers visited stores with the intention of making a purchase.

Online revenue increased by $61.5 million or 214.1% to $90.3 million for the 13-week period ended June 27, 2020 compared to $28.8 million in the same period last year. The exceptional growth in online revenue was driven by an increase in both traffic and conversion, up 99% and 96% respectively during retail store closures. This was driven by a lift in demand for core categories, loyal customers further embracing the Company's online channel during mandated stay-at-home orders, and a significant influx of customers new to *indigo.ca*. The growth was further supported by the Company's ability to successfully manage peak online volumes which proved to be a competitive advantage during this period. Growth of the online channel moderated with the reopening of stores and as customers shifted back to the retail channel, but remained significantly stronger than historical trends.

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"), *plum PLUS* membership fees ("*plum PLUS* revenue"), corporate sales, and revenue-sharing with Rakuten Kobo Inc. ("Kobo"). Revenue from other sources decreased $0.5 million or

14.5% to $2.7 million for the 13-week period ended June 27, 2020 compared to $3.2 million in the same period last year, primarily driven by lower gift card breakage, partially offset by an increase in *plum PLUS* revenue.

Revenue by channel is highlighted below:

(millions of Canadian dollars)	**13-week period ended June 27, 2020**	13-week period ended June 29, 2019	% increase
Superstores	**37.6**	135.5	(72.2)
Small format stores	**4.4**	25.1	(82.4)
Online (including store kiosks)	**90.3**	28.8	214.1
Other[1]	**2.7**	3.2	(14.5)
Total	**135.1**	192.6	(29.8)

1 Includes cafés, irewards, gift card breakage, *plum* breakage, *plum PLUS* revenue, corporate sales, and Kobo revenue share.

Revenue by product line is as follows:

	13-week period ended June 27, 2020	13-week period ended June 29, 2019
Print[1]	**62.3%**	59.6%
General merchandise[2]	**35.7%**	38.7%
Other[3]	**2.0%**	1.7%
Total	**100.0%**	100.0%

1 Includes books, magazines, newspapers, and related shipping revenue.
2 Includes lifestyle, paper, toys, electronics, eReaders, eReader accessories, and related shipping revenue.
3 Includes cafés, irewards, gift card breakage, *plum* breakage, *plum PLUS* revenue, corporate sales, and Kobo revenue share.

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 decreased $11.8 million to $96.9 million for the 13-week period ended June 27, 2020, compared to $108.7 million for the same period last year. As a percent of total revenue, cost of sales increased 15.3% to 71.7% compared to 56.4% for the same period last year, primarily a function of increased shipping costs. In addition to the higher penetration of online sales, the Company temporarily changed its fulfillment strategy to maximize through-put across its three distribution centres and service all customers to meet the surge in online demand while maintaining safe social distancing.. While this allowed the Company to prioritize the health and safety of its employees and fulfill orders in a timely manner, it caused a temporary increase in shipping costs.

Cost of Operations

Cost of operations includes all store, store support, online, and distribution centre costs. Cost of operations decreased by $26.6 million to $32.1 million for the 13-week period ended June 27, 2020, compared to $58.7 million for the same period last year. As a percent of total revenue, cost of operations decreased by 6.7% to 23.8% this year, compared to 30.5% for the same period last year. The Company realized $13.2 million in labour cost reductions as a result of store closures, the associated temporary lay-off of retail employees, and curtailed staffing needs upon reopening. Additionally, operating costs were reduced by $9.4 million from the CEWS (partial benefit attributed to operating costs), which offset retail and distribution centre labour costs incurred, and negotiated rent concessions of $2.4 million, which was recognized in the quarter in accordance with the IFRS 16 COVID-19 practical expedient for rent concessions. Further savings were also achieved in the retail network as a result of temporary store closures and the overall sales decline, partially offset by increased variable costs in the Company's online distribution network and the incremental costs of maintaining social distancing.

Selling, General and Administrative Expenses

Selling, general and administrative expenses include marketing, head office costs, and operating expenses associated with the Company's strategic initiatives. These expenses decreased $12.8 million to $12.6 million for the 13-week period ended June 27, 2020, compared to $25.4 million for the same period last year. As a percent of total revenue, selling, general and administrative expenses decreased 3.9% to 9.3%, compared to 13.2% for the same period last year. Lower expenses in the quarter were driven by $7.4 million of CEWS (partial benefit attributed to selling, general and administrative expenses), which offset head office labour charges. This was furthered by the impact of cost-cutting measures, including the temporary reduction of marketing spending, the rationalization of the Company's head office workforce, and other reductions in discretionary spending.

Lease Charges

Lease charges associated with IFRS 16 include the depreciation of the right-of-use assets, and finance charges associated with the lease liabilities. Lease charges increased by $1.2 million to $17.2 million for the 13-week period ended June 27, 2020, compared to $15.9 million for the same period last year as a result of lease renewals recognized over the past four quarters.

Adjusted EBITDA

Adjusted EBITDA is defined as earnings before interest, taxes, depreciation, amortization, impairment, asset disposals, and share of loss from equity investments, and includes IFRS 16 right-of-use asset depreciation and associated finance charges. Adjusted EBITDA decreased $7.6 million to a loss of $23.7 million for the 13-week period ended June 27, 2020, compared to a loss of $16.1 million for the same period last year. Adjusted EBITDA, as a percent of revenue, decreased by 9.1% to a loss of 17.5% this year, compared to a loss of 8.4% for the same period last year. Lower adjusted EBITDA was driven by the overall decline in revenue, impacted by the temporary retail store closures from the ongoing COVID-19 pandemic. This was partially offset by a reduction in labour expenses of $16.8 million from the CEWS, as well as a marked reduction in discretionary spending and a restructuring of the Company's workforce to better align to the current retail climate.

A reconciliation of adjusted EBITDA to losses before taxes has been included in the "Results of Operations" section of this MD&A.

Capital Assets

Depreciation and amortization of capital assets, excluding right-of-use assets, for the 13-week period ended June 27, 2020 decreased $1.4 million to $7.8 million compared to $9.2 million for the same period last year. The decrease in depreciation and amortization was driven by the impairment charge taken on capital assets in the prior year, which reduced the Company's capital asset base. Capital expenditures in the first quarter of fiscal 2021 totaled $2.2 million compared to $5.3 million for the same period last year. Capital investment was deferred due to the uncertainty surrounding COVID-19, as the Company prioritized the preservation of cash and undertook additional cost-cutting measures. Capital expenditures for the first quarter of fiscal 2021 included $1.7 million primarily for digital application software and internal development costs, $0.2 million for furniture, fixtures and equipment and $0.2 million for technology equipment. None of the capital expenditures were financed through leases.

Net Interest Income

Net interest income, excluding finance charges related to leases, decreased $0.5 million to $0.2 million for the 13-week period ended June 27, 2020, compared to $0.7 million of net interest income for the same period last year. The Company nets interest income against interest expense. Compared to the prior year, the Company earned lower interest income as a result of a decrease in interest rates in the quarter.

Equity Investments

The Company uses the equity method to account for its investment in Unplug, and its previous investment in Calendar Club of Canada Limited Partnership ("Calendar Club"). The Company recognizes its share of equity investment earnings and losses as part of consolidated net earnings and losses. In the third quarter of fiscal 2020, the Company sold its equity investments in Calendar Club to Paris Southern Lights Inc. (a minority partner in the partnership). Prior to the fiscal 2020 transaction, the Company recognized a net loss from Calendar Club of $0.8 million for 13-week period ended June 29, 2019.

Earnings from Unplug were immaterial for the 13-week period ended June 27, 2020 and June 29, 2019.

Income Taxes

The Company recognized no income taxes for the 13-week period ended June 27, 2020, compared to recognizing a non-cash income tax recovery of $6.8 million for the same period last year. This was a result of deferred tax assets that were not recognized in the current period, which was influenced by the Company's current operating loss, and uncertainty surrounding future profitability introduced by the COVID-19 pandemic, among other factors. As such, uncertainty exists surrounding the probability of sufficient taxable income being available to utilize all deferred tax assets within the timeline of management's forecasts. The time period of future projected taxable profits used to assess the recognition of deferred tax assets was shorter than the expiration period of the non-capital tax loss carryforward, and other deferred tax assets which do not expire.

The Company used a statutory income tax rate of 26.8% for the quarter, and 26.7% in the prior year. The Company does not expect to pay cash income taxes for the current year.

Net Loss

The Company recognized a net loss of $31.6 million for the 13-week period ended June 27, 2020 ($1.15 net loss per common share), compared to a net loss of $19.1 million ($0.69 net loss per common share) for the same period last year. As discussed, the Company experienced a decline in top-line retail revenue as a result of temporary store closures due to COVID-19. While the CEWS, along with a decreased workforce and reduced discretionary spending generated cost savings, these measures did not completely offset the above noted loss in revenue.

Other Comprehensive Loss

Other comprehensive income (loss) consists primarily of gains and losses related to hedge accounting and the Company's foreign currency translation adjustments. 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 into 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 June 27, 2020, the Company entered into contracts with total notional amounts of C$6.8 million to buy U.S. dollars and sell Canadian dollars, compared to entering contracts with total notional amounts of C$32.8 million in the prior year. As at June 27, 2020, the Company had remaining contracts in place representing a total notional amount of C$52.1 million and an unrealized net gain of $1.6 million, compared to a total notional amount of C$78.6 million and an unrealized net loss of $0.9 million as at June 29, 2019.

During the period ended June 27, 2020, the Company had a net loss (net of taxes) from the change in fair value of outstanding cash flow hedges of $0.9 million, compared to a net loss (net of taxes) of $1.0 million in the prior year. During the same respective periods, the Company reclassified net gains (net of taxes) from settled contracts of $1.3 million and $0.5 million from other comprehensive loss to inventory and expenses. This resulted in an overall impact to other comprehensive loss of $2.2 million for the period ended June 27, 2020, and $1.5 million in the prior year.

Amounts recognized in other comprehensive loss relating to foreign currency translation adjustments were immaterial for both periods ended June 27, 2020 and June 29, 2019.

Seasonality and First Quarter Results

Indigo's business is highly seasonal and follows quarterly sales and profit (loss) fluctuation patterns, which are similar to those of other retailers that are highly dependent on the holiday sales season. A disproportionate amount of revenues and profits are earned in the third quarter. As a result, quarterly performance is not necessarily indicative of the Company's performance for the rest of the year. For fiscal 2021, revenue and net earnings may not follow historic patterns of seasonality due to the impact of the COVID-19 pandemic.

The following table sets out revenue, net earnings (loss), basic and diluted earnings (loss) per share for the preceding eight fiscal quarters.

(millions of Canadian dollars, except per share data)	**Q1 Fiscal 2021[1]**	Q4 Fiscal 2020[1]	Q3 Fiscal 2020[1]	Q2 Fiscal 2020[1]	Q1 Fiscal 2020[1]	Q4 Fiscal 2019	Q3 Fiscal 2019	Q2 Fiscal 2019
	Fiscal quarters							
Revenue	**135.1**	178.1	383.7	203.4	192.6	199.2	426.0	216.3
Total net earnings (loss)	**(31.6)**	(171.3)	25.8	(20.5)	(19.1)	(23.8)	21.5	(19.1)
Basic earnings (loss) per common share	**($1.15)**	($6.22)	$0.94	($0.74)	($0.69)	($0.86)	$0.80	($0.70)
Diluted earnings (loss) per common share	**($1.15)**	($6.22)	$0.94	($0.74)	($0.69)	($0.86)	$0.79	($0.70)

1 The Company implemented IFRS 16 on March 31, 2019 using the modified retrospective approach. As a result, the Company's fiscal 2021 and 2020 results reflect lease accounting under IFRS 16, while the prior quarters have not been restated. Refer to Note 4 of the consolidated financial statements in the Company's fiscal 2020 Annual Report for additional information.

Overview of Consolidated Balance Sheets

Assets

As at June 27, 2020, total assets decreased $147.3 million to $849.6 million, compared to $996.9 million as at June 29, 2019. The decrease was primarily driven by decreases in deferred tax assets, capital assets, and inventories, partially offset by an increase in net cash and cash equivalents and short term investments, and accounts receivables. The balance of deferred tax assets were not recognized in the fourth quarter of fiscal 2020, due to the Company's operating loss recognized, and uncertainty surrounding future profitability as a result of the COVID-19 pandemic, among other factors. This resulted in a decrease of $92.8 million in deferred tax assets compared to the first quarter last year. Capital assets decreased by $64.4 million, which primarily related to impairment charges recognized in the prior year. This was furthered by amortization incurred over the past four quarters associated with the significant fiscal 2019 capital investment program. Inventories also decreased by $23.7 million, driven by deliberate actions taken to reduce unproductive inventory while maintaining an optimized assortment, prioritizing the Company's liquidity during the ongoing COVID-19 pandemic. Net cash, cash equivalents and short term investments increased $20.2 million compared to the same period in the prior year as a result of the Company's treasury response to COVID-19 and measures taken to preserve its cash. Accounts receivables increased $12.5 million, primarily as a result of the CEWS not yet collected by the end of the quarter.

On a fiscal year-to-date basis, total assets decreased by $33.4 million to $849.6 million compared to $883.0 million as at March 28, 2020. The decrease was driven by decreases in inventories, capital assets, and cash and cash equivalents, partially offset by an increase in accounts receivable. Inventories decreased by $23.7 million for the same reasons discussed above. Capital assets decreased by $15.5 million due to lease renewals and capital investments being outpaced by the impact of amortization in the current quarter. Cash and cash equivalents decreased by $9.9 million, which is consistent with the seasonal nature of the business. These variances were partially offset by the increase of $17.2 million to accounts receivables, primarily for the same reasons discussed above.

Liabilities

As at June 27, 2020, total liabilities increased $46.9 million to $799.0 million, compared to $752.1 million as at June 29, 2019. The increase was driven by increases in accounts payable and accrued liabilities and long-term lease liabilities. Accounts payable and accrued liabilities increased by $20.2 million in response to the Company's efforts to extend payment terms with many of its vendors and the cessation of normal rent payments during rent concession negotiations to share the financial burden of COVID-19. Long-term lease liabilities increased $21.2 million driven by interest and repayment of principal on lease liabilities recognized.

On a fiscal year-to-date basis, total liabilities was $799.0 million as at both June 27, 2020 and March 28, 2020. Although total liabilities did not experience a material change, accounts payable and accrued liabilities increased $10.8 million, for the reasons discussed above, fully offset by decreases of $3.1 million and $7.5 million in short- and long-term lease liabilities, respectively.

Equity

Total equity at June 27, 2020 decreased $194.2 million to $50.6 million, compared to $244.8 million as at June 29, 2019. The decrease in total equity was driven by a decrease in retained earnings, partially offset by increases in accumulated comprehensive income and share capital. Retained earnings decreased $197.5 million over the last four quarters due to the net loss recognized. This was partially offset by a $1.7 million increase in accumulated other comprehensive income, primarily due to the change in the fair value of outstanding cash flow hedges. Additionally, share capital increased by $1.5 million year-over-year due to the redemption of deferred stock units in fiscal 2020.

The weighted average number of common shares outstanding for the first quarter of fiscal 2021 was 27,573,730 compared to 27,496,588 for the same period last year. As at August 6, 2020, the number of outstanding common shares was 27,273,961 with a book value of $227.0 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 holiday season.

The Company reported working capital of $59.7 million as at June 27, 2020, compared to $75.0 million as at June 29, 2019 and $85.2 million as at March 28, 2020. The decrease in working capital compared to the same period last year was primarily driven by the decrease in inventories and increases in accounts payable and accrued liabilities, as previously discussed.

Overview of Consolidated Statements of Cash Flows

Cash and cash equivalents decreased $9.9 million for the 13-week period ended June 27, 2020 compared to an increase of $11.1 million in the same period last year. The decrease in the current period was driven by cash flows used for financing activities of $15.7 million and for investing activities of $2.0 million, partially offset by cash generated from operating activities of $8.1 million.

Cash Flows from (Used for) Operating Activities

The Company generated cash flows of $8.1 million from operating activities in the 13-week period ended June 27, 2020 compared to using $17.1 million in the same period last year, an increase of $25.1 million. This was primarily driven by $16.5 million of cash generated from working capital, compared to using $17.5 million of cash for working capital in the same period last year, partially offset by the decrease in adjusted EBITDA recognized in the quarter.

Cash Flows from (Used for) Investing Activities

The Company used cash flows of $2.0 million for investing activities in the 13-week period ended June 27, 2020 compared to generating $44.5 million in the same period last year, a change of $46.5 million. This was driven by the maturity of $49.2 million of short-term investments in the prior year and the Company's fiscal 2021 treasury response to the global COVID-19 pandemic, which resulted in the temporary discontinuation of its use of short-term investments. The Company has also executed a smaller capital investment program in the first quarter of fiscal 2021, investing $0.5 million in property, plant and equipment and $1.7 million in intangible assets, compared to $2.8 million and $2.5 million in the same period in the prior year, respectively.

Cash was used for capital projects as follows:

(millions of Canadian dollars)	**13-week period ended June 27, 2020**	13-week period ended June 29, 2019
Construction, renovations, and equipment, net	**0.2**	2.5
Intangible assets (primarily application software and internal development costs)	**1.7**	2.5
Technology equipment	**0.2**	0.3
Total	**2.2**	5.3

Cash Flows Used for Financing Activities

The Company used cash flows of $15.7 million for financing activities in the 13-week period ended June 27, 2020 compared to $16.1 million in the same period last year, a change of $0.4 million. This was driven by increased interest and principal repayments associated with the IFRS 16 lease liabilities.

Liquidity and Capital Resources

The Company has a highly seasonal business that generates a significant portion of its revenue and cash flows during the holiday season. The Company has minimal accounts receivable and the majority of book products are purchased on trade terms with the right to return to suppliers at full credit. The Company's main sources of capital are cash flows generated from operations, cash and cash equivalents, and short-term investments. Cash flows from operating activities could be negatively impacted by decreased demand for the Company's product offerings, which could result from factors such as, but not limited to, adverse economic conditions resulting from the COVID-19 pandemic and associated changes in consumer preferences, by the impact of social distancing policies and general public health sentiment on retail store traffic, and the Company's ability to safely fulfill orders through its online distribution network.

Based on the Company's current business plan, liquidity position, cash flow forecast, and factors known to date, including the currently known impacts of COVID-19, it is expected that the Company's current cash position and future cash flows generated from operations will be sufficient to meet its working capital requirements for fiscal 2021. However, the Company's ability to fund future operations will depend on its operating performance, which could be affected by risks associated by the COVID-19 pandemic, as discussed.

Subsequent to June 27, 2020, the Company entered into a $25 million related party revolving line of credit to enhance its liquidity. The Company can seek to raise additional funding should a significant risk to liquidity arise, as it currently has no outstanding debt financing, and can reduce capital spending if necessary. However, the COVID-19 pandemic creates a number of additional risks to obtaining such funding, such as the ability to access capital at a reasonable cost. Also, a long-term decline in capital expenditures may negatively impact the Company's revenue and profit growth.

For additional discussion surrounding risks and uncertainties related to COVID-19, refer to the "Risks and Uncertainties" section in the Company's fiscal 2020 Annual Report.

Accounting Policies

Amendment to IFRS 16 *Leases* – COVID-19-Related Rent Concessions

On May 28, 2020, the IASB issued an amendment to IFRS 16 that provides an optional practical expedient for lessees from assessing whether a rent concession that is being offered as a direct response to the economic impacts of COVID-19 is a lease modification, which would have capitalized the benefit received. The Company is applying the practical expedient in the current period and will account for any eligible change in lease payments resulting from a COVID-19-related rent concession in profit or loss in the period the deal is executed.

Accounting Standards Implemented in Fiscal 2020

IFRS 16 *Leases*

Effective in the first quarter of fiscal 2020, the Company adopted IFRS 16, which introduces a single lessee accounting model, eliminating the distinction between operating and finance leases. IFRS 16 was effective for annual reporting periods beginning on or after January 1, 2019 and superseded IAS 17.

The Company adopted the standard on March 31, 2019, applying the requirements using the modified retrospective transition method, with the cumulative effect recognized in retained earnings. The adoption of IFRS 16 has resulted in the recognition of right-of-use assets and lease liabilities for substantially all operating leases where the Company is a lessee.

During the course of the Company's financial statement close process for the year ended March 28, 2020, accounting errors were identified in the assessment of the modified retrospective application of the day one right-of-use assets ("ROU assets") performed in connection with the adoption of IFRS 16 as at March 31, 2019. The net effect of these errors result in the following impacts on the June 29, 2019 consolidated balance sheet: an overstatement of the ROU asset of $19.0 million, overstatement of $24.4 million to long-term lease liabilities, an overstatement of $1.4 million of deferred tax assets and an understatement of $4.0 million to retained earnings.

Additionally, there was an error with the classification between short-term and long-term lease liabilities of $22.1 million as a result of implementing an amortization approach rather than the present value of lease payments due within twelve months of the reporting date.

Correction of these errors has a non-cash impact on the ROU asset, deferred tax asset balance, short and long-term lease liabilities and opening retained earnings (deficit) balance, and will result in lower depreciation of the ROU assets going forward.

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, acknowledging that the extent to which the impacts of the COVID-19 pandemic affect the judgments and estimates described herein depend on future developments, which are highly uncertain and cannot be predicted. Management will continue to monitor and assess the impact of the pandemic on its judgments, estimates, accounting policies and amounts recognized in these consolidated financial statements, including but not limited to impairment of assets. 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 ("gift card breakage"); revenue from unredeemed *plum* points ("*plum* breakage"), *plum PLUS* membership fees ("*plum PLUS* revenue"); 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"), indicators of impairment and expected future cash flows from CGUs; depreciation and amortization periods; lease recognition and measurement; 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 2020 Annual Report.

Disclosure Controls and Procedures

Management is responsible for establishing and maintaining a system of disclosure controls and procedures to provide reasonable assurance that all material information relating to the Company is gathered and reported on a timely basis to senior management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), so that appropriate decisions can be made by them regarding public disclosure.

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 IFRS.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to consolidated financial statement preparation and presentation. Additionally, management is necessarily required to use judgment in evaluating controls and procedures.

As required by National Instrument 52-109, "Certification of Disclosure in Issuers' Annual and Interim Filings," the CEO and CFO have evaluated, or caused to be evaluated under their supervision, the effectiveness of such internal controls over financial reporting using the framework established in the Internal Control – Integrated Framework ("COSO Framework") published in 2013 by the Committee of Sponsoring Organizations of the Treadway Commission.

Changes in Internal Controls over Financial Reporting

Management has also evaluated whether there were changes in the Company's internal controls over financial reporting that occurred during the period beginning on March 29, 2020 and ended on June 27, 2020 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 analyses 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, acknowledging that the extent to which the impacts of the COVID-19 pandemic affect the factors described herein depend on future developments, which are highly uncertain and cannot be predicted. However, whether actual results and developments will conform to the expectations and predictions of the Company is subject to a number of risks and uncertainties, including the general economic, market, or business conditions; competitive actions by other companies; changes in laws or regulations; and other factors, many of which are beyond the control of the Company. Consequently, all of the forward-looking statements made in this discussion are qualified by these cautionary statements and there can be no assurance that results or developments anticipated by the Company will be realized or, even if substantially realized, that they will have the expected consequences to, or effects on, the Company.

Non-IFRS Financial Measures

The Company prepares its unaudited interim condensed consolidated financial statements in accordance with IFRS. To provide additional insight into the business, the Company has also provided non-IFRS data, including adjusted EBITDA, in the discussion and analysis section above. Such measures are specific to Indigo and have no standardized meaning prescribed by IFRS. Therefore, such measures may not be comparable to similar measures presented by other companies.

The Company believes Adjusted EBITDA is a useful measure of operating performance as it provides a relevant picture of operating results in that it excludes certain effects of financing and investing activities by removing the effects of interest (excluding those related to lease liabilities), depreciation and amortization expenses (excluding those related to the Company's right-of-use assets), impairment, asset disposals, and share of earnings (loss) from equity investments. As retail occupancy leases represent a material component of the Company's cost structure and are managed with its operating costs, an adjustment was made for lease-related expenses in the calculation of Adjusted EBITDA. As a result, IFRS 16 right-of-use asset depreciation and associated lease finance costs are reflected in the key metric. This represents a change in calculation methodology from the prior period, and all prior period numbers have been consistently stated.

The Company typically believes that investors would find comparable store sales and total comparable sales useful in assessing the performance of the business. However, as the temporary store closures from COVID-19 have resulted in a significant number of stores being removed from its comparable store base, the Company believes total comparable sales and comparable store sales are not currently representative of the underlying trends of the business, and as a result, these metrics have not been reflected in this MD&A.

Reconciliations between adjusted EBITDA and loss before income taxes (the most comparable IFRS measure) were included earlier in this report.

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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

Craig Loudon
Chief Financial Officer and
Executive Vice President, Supply Chain

Dated as of the 6th day of August, 2020.

Consolidated Balance Sheets

(Unaudited)

(thousands of Canadian dollars)	**As at June 27, 2020**	As at June 29, 2019	As at March 28, 2020
ASSETS			
Current			
Cash and cash equivalents (note 5)	**110,563**	52,344	120,473
Short-term investments (note 5)	**–**	38,000	–
Accounts receivable	**24,872**	12,325	7,640
Inventories (note 6)	**218,124**	241,868	241,812
Prepaid expenses	**6,747**	7,652	6,062
Income taxes receivable	**138**	573	138
Derivative assets (note 7)	**1,622**	–	3,794
Other assets	**2,271**	871	2,320
Total current assets	**364,337**	353,633	382,239
Loan receivable	**446**	–	446
Property, plant, and equipment, net	**87,008**	122,362	91,215
Right-of-use assets, net	**372,360**	392,748	382,146
Intangible assets, net	**23,055**	31,743	24,571
Equity investment, net	**2,353**	3,588	2,353
Deferred tax assets	**–**	92,797	–
Total assets	**849,559**	996,871	882,970
LIABILITIES AND EQUITY			
Current			
Accounts payable and accrued liabilities	**175,130**	154,886	164,294
Unredeemed gift card liability	**51,320**	48,794	51,673
Provisions	**2,203**	200	2,034
Deferred revenue	**10,718**	7,897	10,682
Short-term lease liabilities (note 8)	**65,260**	65,914	68,402
Derivative liabilities (note 7)	**–**	924	–
Total current liabilities	**304,631**	278,615	297,085
Long-term accrued liabilities	**950**	1,877	1,196
Long-term provisions	**672**	45	469
Long-term lease liabilities (note 8)	**492,701**	471,529	500,215
Total liabilities	**798,954**	752,066	798,965
Equity			
Share capital (note 9)	**226,986**	225,531	226,986
Contributed surplus (note 10)	**13,197**	13,048	12,822
Retained earnings (deficit)	**(190,404)**	7,127	(158,801)
Accumulated other comprehensive income (loss) (note 7)	**826**	(901)	2,998
Total equity	**50,605**	244,805	84,005
Total liabilities and equity	**849,559**	996,871	882,970

See accompanying notes

On behalf of the Board:

Heather Reisman, Director

Anne Marie O'Donovan, Director

Consolidated Statements of Loss and Comprehensive Loss

(Unaudited)

(thousands of Canadian dollars, except per share data)	**13-week period ended June 27, 2020**	13-week period ended June 29, 2019
Revenue (note 11)	**135,081**	192,556
Cost of sales	**(96,944)**	(108,682)
Gross profit	**38,137**	83,874
Operating, selling, and other expenses (note 11)	**(63,456)**	(103,571)
Operating loss	**(25,319)**	(19,697)
Net interest expense (note 8)	**(6,284)**	(5,424)
Share of loss from equity investments	**–**	(773)
Loss before income taxes	**(31,603)**	(25,894)
Income tax recovery	**–**	6,824
Net loss	**(31,603)**	(19,070)
Other comprehensive loss (note 7)		
Items that are or may be reclassified subsequently to net loss:		
Net change in fair value of cash flow hedges (net of taxes of 0; 2019 – 368)	**(909)**	(1,004)
Reclassification of net realized gain (net of taxes of 0; 2019 – 167)	**(1,263)**	(455)
Other comprehensive loss	**(2,172)**	(1,459)
Total comprehensive loss	**(33,775)**	(20,529)
Net loss per common share (note 12)		
Basic	**($1.15)**	($0.69)
Diluted	**($1.15)**	($0.69)

See accompanying notes

Consolidated Statements of Changes in Equity

(Unaudited)

(thousands of Canadian dollars)	Share Capital	Contributed Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Equity
Balance, March 30, 2019	225,531	12,716	131,311	558	370,116
Adjustment on adoption of IFRS 16 *Leases*	–	–	(105,114)	–	(105,114)
Balance, March 31, 2019	225,531	12,716	26,197	558	265,002
Net loss for the period	–	–	(19,070)	–	(19,070)
Share-based compensation (note 10)	–	248	–	–	248
Directors' compensation (note 10)	–	84	–	–	84
Other comprehensive loss (note 7)	–	–	–	(1,459)	(1,459)
Balance, June 29, 2019	225,531	13,048	7,127	(901)	244,805
Balance, March 28, 2020	**226,986**	**12,822**	**(158,801)**	**2,998**	**84,005**
Net loss for the period	**–**	**–**	**(31,603)**	**–**	**(31,603)**
Share-based compensation (note 10)	**–**	**300**	**–**	**–**	**300**
Directors' compensation (note 10)	**–**	**75**	**–**	**–**	**75**
Other comprehensive loss (note 7)	**–**	**–**	**–**	**(2,172)**	**(2,172)**
Balance, June 27, 2020	**226,986**	**13,197**	**(190,404)**	**826**	**50,605**

See accompanying notes

Consolidated Statements of Cash Flows

(Unaudited)

(thousands of Canadian dollars)	**13-week period ended June 27, 2020**	13-week period ended June 29, 2019
OPERATING ACTIVITIES		
Net loss	**(31,603)**	(19,070)
Adjustments to reconcile net loss to cash flows from (used for) operating activities		
Depreciation of property, plant, and equipment	**4,591**	5,932
Depreciation of right-of-use assets	**10,652**	9,833
Amortization of intangible assets	**3,208**	3,266
Loss on disposal of capital assets	**247**	461
Share-based compensation (note 10)	**300**	248
Directors' compensation (note 10)	**75**	84
Deferred income tax recovery	**–**	(6,824)
Rent concessions	**(2,411)**	–
Other	**259**	256
Net change in non-cash working capital balances related to operations (note 13)	**16,466**	(17,453)
Interest expense (note 8)	**6,498**	6,077
Interest income	**(214)**	(653)
Share of loss from equity investments	**–**	773
Cash flows from (used for) operating activities	**8,068**	(17,070)
INVESTING ACTIVITIES		
Net purchases of property, plant, and equipment	**(498)**	(2,849)
Addition of intangible assets	**(1,705)**	(2,482)
Change in short-term investments	**–**	49,150
Interest received	**214**	653
Cash flows from (used for) investing activities	**(1,989)**	44,472
FINANCING ACTIVITIES		
Repayment of principal on lease liabilities (note 8)	**(9,232)**	(10,013)
Interest paid (note 8)	**(6,498)**	(6,078)
Cash flows used for financing activities	**(15,730)**	(16,091)
Effect of foreign currency exchange rate changes on cash and cash equivalents	**(259)**	(257)
Net increase (decrease) in cash and cash equivalents during the period	**(9,910)**	11,054
Cash and cash equivalents, beginning of period	**120,473**	41,290
Cash and cash equivalents, end of period	**110,563**	52,344

See accompanying notes

Notes to Consolidated Financial Statements

June 27, 2020
(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 620 King Street West, Suite 400, Toronto, Ontario, M5V 1M6, Canada. The unaudited interim condensed 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 investment in 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 2020 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 2020 Annual Report.

The unaudited interim condensed consolidated financial statements for the 13-week period ended June 27, 2020 (including comparatives) were approved by the Board of Directors on August 6, 2020.

COVID-19 Pandemic

Commencing from the declaration of COVID-19 as a pandemic, to the release of these statements, the Company has been responding to the repercussions of the global crisis on its business, operations and performance. The impact of the outbreak on the financial results of the Company will depend on future developments, including the duration and spread of the outbreak and its impact on the overall economy and related advisories and restrictions.

In response to the COVID-19 pandemic, the Company announced the temporary closure of its retail locations on March 17, 2020 and made the difficult decision to temporarily lay-off 5,200 of its retail employees. Commencing May 19, 2020, as permitted by federal and provincial regulations, the Company began the phased reopening of its retail stores. As of August 6, 2020, the Company had reopened 181 of its previously closed retail stores, representing all but one of its full complement, and recalled 3,030 of its retail leadership and hourly employees.

The Company has also leveraged applicable government business support programs for COVID-19, including the Canada Emergency Wage Subsidy ("CEWS"), and will continue to do so subject to eligibility.

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, acknowledging that the extent to which the impacts of the COVID-19 pandemic affect the judgments and estimates described herein depend on future developments, which are highly uncertain and cannot be predicted. Management will continue to monitor and assess the impact of the pandemic on its judgments, estimates, accounting policies and amounts recognized in these consolidated financial statements, including but not limited to impairment of assets. 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 ("gift card breakage"); revenue from unredeemed *plum* points ("*plum* breakage"), *plum PLUS* membership fees ("*plum PLUS* revenue"); 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"), indicators of impairment and expected future cash flows from CGUs; depreciation and amortization periods; lease recognition and measurement; and recognition and valuation of deferred tax assets.

The temporary retail closures as a result of COVID-19 and the associated revenue decrease during the 13-week periods ended June 27, 2020 are considered to be an indicator of impairment. The Company performed a recoverability assessment for its capital assets and determined that that there was no impairment.

3. CHANGES IN ACCOUNTING POLICIES

These unaudited interim condensed consolidated financial statements have been prepared using the accounting policies as outlined in note 4 of the fiscal 2020 Annual Report. 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.

New Accounting Pronouncements

Amendment to IFRS 16 Leases ("IFRS 16") – COVID-19-Related Rent Concessions

On May 28, 2020, the IASB issued an amendment to IFRS 16 that provides an optional practical expedient for lessees from assessing whether a rent concession that is being offered as a direct response to the economic impacts of COVID-19 is a lease modification, which would have capitalized the benefit received. The Company is applying the practical expedient in the current period and will account for any eligible change in lease payments resulting from a COVID-19-related rent concession in profit or loss in the period the deal is executed.

Classification of Liabilities as Current or Non-Current (Amendments to IAS 1)

In January 2020, IASB issued Classification of Liabilities as Current or Non-Current, which amends IAS 1 – Presentation of Financial Statements. The narrow scope amendments affect only the presentation of liabilities in the statement of financial position and not the amount or timing of its recognition. It clarifies that the classification of liabilities as current or non-current is based on rights that are in existence at the end of the reporting period and specifies that classification is unaffected by expectations about whether an entity will exercise its right to defer settlement of a liability. It also introduces a definition of 'settlement' to make clear that settlement refers to the transfer to the counterparty of cash, equity instruments, other assets or services. The amendments are effective for annual reporting periods beginning on or after January 1, 2022. Earlier application is permitted. The Company is assessing the potential impact of these amendments.

Accounting Standards Implemented in Fiscal 2020

IFRS 16 *Leases*

Effective in the first quarter of fiscal 2020, the Company adopted IFRS 16, which introduces a single lessee accounting model, eliminating the distinction between operating and finance leases. IFRS 16 was effective for annual reporting periods beginning on or after January 1, 2019 and superseded IAS 17.

The Company adopted the standard on March 31, 2019, applying the requirements using the modified retrospective transition method, with the cumulative effect recognized in retained earnings. The adoption of IFRS 16 has resulted in the recognition of right-of-use assets and lease liabilities for substantially all operating leases where the Company is a lessee.

During the course of the Company's financial statement close process for the year ended March 28, 2020, accounting errors were identified in the assessment of the modified retrospective application of the day one right-of-use assets ("ROU assets") performed in connection with the adoption of IFRS 16 as at March 31, 2019. The net effect of these errors result in the following impacts on the June 29, 2019 consolidated balance sheet: an overstatement of the ROU asset of $19.0 million, overstatement of $24.4 million to long-term lease liabilities, an overstatement of $1.4 million of deferred tax assets and an understatement of $4.0 million to retained earnings.

Additionally, there was an error with the classification between short-term and long-term lease liabilities of $22.1 million as a result of implementing an amortization approach rather than the present value of lease payments due within twelve months of the reporting date.

Correction of these errors has a non-cash impact on the ROU asset, deferred tax asset balance, short and long-term lease liabilities and opening retained earnings (deficit) balance, and will result in lower depreciation of the ROU assets going forward.

4. SEASONALITY OF OPERATIONS

The business of Indigo historically 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-week periods ended June 27, 2020 and June 29, 2019 are not indicative of the results of other periods.

For fiscal 2021, revenue and net earnings (losses) may not follow historic patterns of seasonality presented above, due to the impact of the COVID-19 pandemic.

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

Cash and cash equivalents consist of the following:

(thousands of Canadian dollars)	**June 27, 2020**	June 29, 2019	March 28, 2020
Cash	**110,295**	50,519	48,955
Restricted cash	**241**	1,593	1,212
Cash equivalents	**27**	232	70,306
Cash and cash equivalents	**110,563**	52,344	120,473

Restricted cash represents cash pledged as collateral for letter of credit obligations issued to support the Company's purchases of offshore merchandise as well as certain deposits related to its utilities contracts.

As at June 27, 2020, the Company held no short-term investments (June 29, 2019 – $38.0 million; March 28, 2020 – no short-term investments). 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-week period ended June 27, 2020 was $82.3 million (June 29, 2019 – $108.6 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-week period ended June 27, 2020 was $0.9 million (June 29, 2019 – $1.6 million). The amount of inventory with net realizable value equal to cost was $0.9 million as at June 27, 2020 (June 29, 2019 – $5.7 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. There is an economic relationship between the hedged items and the hedging instruments as the terms of the foreign exchange forward contracts match the terms of the expected highly probable forecast transactions (i.e., notional amount and expected payment date). Furthermore, the Company has established a hedge ratio of 1:1 for the hedging relationships as the underlying risk of the foreign exchange forward contracts are identical to the hedged risk components.

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-week period ended June 27, 2020, the Company entered into contracts with total notional amounts of C$6.8 million to purchase U.S. dollar / Canadian dollar currency pair forwards (June 29, 2019 – C$32.8 million). As at June 27, 2020, the Company had remaining contracts in place representing a total notional amount of C$52.1 million (June 29, 2019 – C$78.6 million) at an average forward rate of 1.32 (June 29, 2019 – 1.32). These contracts extend over a period not exceeding 12 months. There were no forecast transactions for which hedge accounting had been used in the previous period, but which were no longer expected to occur, or hedging relationships discontinued and restarted during the 13-week period ended June 27, 2020, as well as in the prior year.

The total fair value of the contracts as at June 27, 2020 resulted in the recognition of a derivative asset of $1.6 million (June 29, 2019 – $0.0 million; March 28, 2020 – $3.8 million), and no derivative liability (June 29, 2019 – $0.9 million; March 28, 2020 – $0.0 million).

During the period ended June 27, 2020, the Company had a net loss (net of taxes) from the change in fair value of outstanding cash flow hedges of $0.9 million (June 29, 2019 – net loss (net of taxes) of $1.0 million). During the same period, the Company reclassified a net gain (net of taxes) from settled contracts of $1.3 million from other comprehensive income to inventory and expenses (June 29, 2019 – net gain (net of taxes) of $0.5 million). This resulted in an other comprehensive loss for the period ended June 27, 2020 of $2.2 million (June 29, 2019 – other comprehensive loss of $1.5 million).

Potential causes of mismatch between the hedging instrument and hedged item which would generate ineffectiveness include changes in credit risk, a timing mismatch between the maturity of the instrument and the future transaction date, and/or the hedged transaction does not occur.

Reclassified amounts resulting from hedge ineffectiveness and realized foreign exchange amounts as a result of derivative financial instruments totaled $0.3 million and $0.4 million in the current year, respectively. Both amounts were immaterial in the quarter ended June 29, 2019.

8. LEASE LIABILITY

The following table reconciles the change in lease liabilities for the 13-week period ended June 27, 2020:

(thousands of Canadian dollars)	Lease Liabilities
Balance as at March 28, 2020	568,617
Lease renewals included in the scope of IFRS 16	987
Accretion of lease liabilities	6,498
Repayment of interest and principle on lease liabilities	(15,730)
Rent concession	(2,411)
Balance as at June 27, 2020	**557,961**

For the 13-week period ended June 27, 2020, the Company has applied the practical expedient offered under the amendment to IFRS 16 for COVID-19 to all rent concessions that meet the criteria. The Company recognized $2.4 million benefit in its Consolidated Statements of Loss and Comprehensive Loss to reflect changes in lease payments that arise from COVID-19-related rent concessions.

9. SHARE CAPITAL

Share capital consists of the following:

	13-week period ended June 27, 2020		13-week period ended June 29, 2019		52-week period ended March 28, 2020	
	Number of shares	**Amount C$ (thousands)**	Number of shares	Amount C$ (thousands)	Number of shares	Amount C$ (thousands)
Balance, beginning of period	**27,273,961**	**226,986**	27,136,386	225,531	27,136,386	225,531
Issued during the period						
Directors' deferred stock units converted	**–**	**–**	–	–	137,575	1,455
Options exercised	**–**	**–**	–	–	–	–
Balance, end of period	**27,273,961**	**226,986**	27,136,386	225,531	27,273,961	226,986

10. SHARE-BASED COMPENSATION

As at June 27, 2020, 2,784,613 stock options were outstanding with exercise prices ranging from $1.00 to $18.40. Of these outstanding stock options, 883,738 were exercisable, at a weighted average exercise price of $15.45.
As at June 29, 2019, there were 1,689,038 stock options outstanding of which 704,863 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-week period ended June 27, 2020, the pre-forfeiture value of the options granted was $0.3 million (June 29, 2019 – $0.3 million).

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

	13-week period ended June 27, 2020	13-week period ended June 29, 2019
Black-Scholes option pricing assumptions		
Risk-free interest rate	**0.3%**	1.4%
Expected volatility	**62.4%**	31.5%
Expected time until exercise	**2.5 years**	3.0 years
Expected dividend yield	**–**	–
Other assumptions		
Forfeiture rate	**26.0%**	26.9%

Directors' Compensation

The Company has established a Directors' Deferred Stock 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 stock units ("DSUs") or receive up to 50% of this compensation in cash. All Directors' compensation during the 13-week period ended June 27, 2020 was in the form of DSUs (June 29, 2019 – all DSUs).

The number of shares reserved for issuance under this plan is 500,000. During the 13-week period ended June 27, 2020, the Company issued 89,286 DSUs with a value of $0.1 million (June 29, 2019 – 10,704 DSUs with a value of $0.1 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 June 27, 2020 was $3.0 million (June 29, 2019 – $4.2 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 June 27, 2020**	13-week period ended June 29, 2019
Print[1]	**84,105**	114,825
General merchandise[2]	**48,276**	74,574
Other[3]	**2,700**	3,157
Total	**135,081**	192,556

1 Includes books, magazines, newspapers, and related shipping revenue.
2 Includes lifestyle, paper, toys, electronics, eReaders, eReader accessories, and related shipping revenue.
3 Includes cafés, irewards, gift card breakage, *plum* breakage, *plum PLUS* revenue, corporate sales, and Rakuten Kobo Inc. ("Kobo") revenue share.

The following table summarizes net revenue by channel:

(thousands of Canadian dollars)	**13-week period ended June 27, 2020**	13-week period ended June 29, 2019
Superstores	**37,638**	135,509
Small format stores	**4,429**	25,134
Online (including store kiosks)	**90,314**	28,756
Other[1]	**2,700**	3,157
Total	**135,081**	192,556

1 Includes cafés, irewards, gift card breakage, *plum* breakage, *plum PLUS* revenue, corporate sales, and Kobo revenue share.

Supplemental operating and administrative expenses information:

(thousands of Canadian dollars)	**13-week period ended June 27, 2020**	13-week period ended June 29, 2019
Wages, salaries, and bonuses	**16,550**	45,014
Short-term benefits expense	**4,070**	5,635
Termination benefits expense	**1,572**	1,890
Retirement benefits expense	**417**	445
Share-based compensation	**300**	248
Total employee benefits expense	**22,909**	53,232

The Company has recognized payroll subsidies of $16.8 million in the period from the CEWS program. These subsidies were recorded as a reduction in the associated eligible salaries and wage expenses recognized in operating, selling, and other expenses. Of the amount recognized, $12.5 million remains outstanding in accounts receivable as at June 27, 2020.

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 June 27, 2020 and June 29, 2019 diluted loss per share calculations.

13. STATEMENTS OF CASH FLOWS

Supplemental cash flow information:

(thousands of Canadian dollars)	**13-week period ended June 27, 2020**	13-week period ended June 29, 2019
Accounts receivable	**(17,232)**	(1,782)
Inventories	**23,688**	10,673
Prepaid expenses	**(685)**	(1,850)
Income taxes recoverable	**–**	(90)
Other assets	**49**	(18)
Accounts payable and accrued liabilities (current and long-term) and other	**10,591**	(24,852)
Unredeemed gift card liability	**(353)**	65
Provisions (current and long-term)	**372**	140
Deferred revenue	**36**	261
Net change in non-cash working capital balances related to operations	**16,466**	(17,453)

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 June 27, 2020**	13-week period ended June 29, 2019
Wages, salaries, and bonus	**1,125**	1,576
Short-term benefits expense	**24**	35
Termination benefits expense	**–**	793
Retirement benefits expense	**16**	20
Share-based compensation	**249**	95
Directors' compensation	**75**	84
Total remuneration	**1,489**	2,603

Transactions with Shareholders

During the first quarter of fiscal 2021, 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-week period ended June 27, 2020, the Company paid $0.1 million for these transactions (June 29, 2019 – $0.3 million). As at June 27, 2020, Indigo had a nominal amount payable to these companies under standard payment terms and $0.1 million of restricted cash pledged as collateral for letter of credit obligations issued to support the Company's purchases of merchandise from these companies (June 29, 2019 – nominal amount 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 "Supplementary Operating Information". The Company has not entered into other transactions with the retirement plan.

Transactions with Associates

The Company had immaterial transactions with Unplug during the period.

15. SUBSEQUENT EVENTS

On August 6, 2020, the Company entered into a secured revolving credit facility for $25 million from a company controlled by Mr. Gerald W. Schwartz, who is the controlling shareholder of Indigo. The non-interest bearing facility has a maturity date of February 1, 2021, and was issued on favourable commercial terms. The purpose of this credit facility is to allow the Company to manage its operations in the most effective manner.

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