ANNUAL REPORT

FOR THE 52-WEEK PERIOD ENDED APRIL 2, 2005

"Books are an uniquely portable magic."

STEPHEN KING

Indigo

Books & Music Inc.

www.indigo.ca

The Indigo Mission

The book-lover's r*etailer of choice

To provide book-lovers, culture makers, information and entertainment seekers with the most inspiring, richly stocked and inviting r*etail environments in the world; and to provide shareholders and employees with a meaningful return on their investment in this enterprise.

Indigo operates under the following banners: *Indigo Books, Music & More*; *Chapters*; *The World's Biggest Bookstore; Coles*; *SmithBooks*; *The Book Company* and *chapters.indigo.ca*. The Company employs approximately 6,000 people across the country.

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Report of the CEO

Dear Shareholder,

Once again, it is a pleasure for me to be writing this annual letter to our Indigo shareholders.

The Year in Summary

Fiscal 05 was an important year for us. We transformed the infrastructure of the Company with the implementation of our SAP enterprise systems. As part of this major change process, we effected several organizational changes to ensure our ability to leverage the opportunities created by the new IT platform.

We saw tremendous growth in our online operation and, while absorbing the operational impact of adjusting to an entirely new inventory management system, Chapters and Indigo managed to earn the Number 1 and 2 spots as the most valued retail brand of Canadian consumers.

Net profits improved meaningfully from $5.1 million in Fiscal 04 to $11.7 million in Fiscal 05, an improvement of 129%. We were less satisfied that EBITDA remained essentially flat, primarily the result of inventory and margin issues during the 6 months of stabilization under our new inventory systems, and a much weaker than expected new release line-up in the fourth quarter. Looking at current trends however, and based on the overall number of advances we can make with our new systems, we expect to see positive EBITDA gains in the future.

We began the year with 87 superstores and ended with 86. With our moratorium on store openings now over, we are in a position to respond to market opportunities for expansion. In fact, as of the writing of this note we have made commitments to open three new stores which will mark the first period of expansion for Indigo since our merger. Two new Indigo superstores will open in the fall of 2005 and the third will open in the spring of 2006.

In addition, we have finally reached agreement to sublet two poorly performing Indigo and Chapters superstores which had been on our disposition list for some time. These store closings will not only eliminate losses for the stores in question, but are also expected to improve top line and contribution results at neighbouring stores.

Same store sales in our Indigo and Chapters superstores were essentially flat at (0.5%). Same store sales in our small format Coles division were down 2.3%. This was indeed disappointing. The system changes noted above and a relatively weak fourth quarter product line-up combined to have an affect on this key metric. However, we are clearly beginning to see the positive impact of initiatives implemented over the last 18 months. I would also

note that sales of loyalty cards and gift cards have also been experiencing healthy growth – both indicators of positive momentum.

Indigo and Chapters – on Becoming the World's First Cultural Department Stores

At last year's Annual Meeting I commented that, in our superstores, we will move toward our vision of becoming the world's first true cultural department store for booklovers. I talked about our Indigo and Chapters superstores being the place to find cultural products – books, music, movies, news and magazines. But also, increasingly a place where meaningful information can easily be found to edit, distill, and help customers make informed, satisfying decisions – a place to easily purchase cherishable gifts or "take a journey" down a track of interest – i.e., photography, Pilates, geo-politics or Indian cooking.

Some newspaper reporters jumped on this to mean that we will lessen our focus on books, have fewer titles in our stores, or give too much space to "gift items". Nothing could be further from the truth. So, for the benefit of all our shareholders, I would like to set the record straight.

First – a Word About Books

We will carry not fewer but, in fact, a greater selection of titles. With the implementation of our new systems, we are now in the best position ever to expand and tailor the selection in each store to meet the idiosyncratic needs of the customers in our 80 trade areas. Our much improved inventory information, combined with several new programs initiated by our print category managers, will drive this improvement in selection, quality and breadth. And the expanded role of our distribution centre is already driving quicker restocking. In the past it often took two to four weeks to replenish titles. This impacted the number of any specific title which we needed to carry and impacted our breadth of titles. In many cases, this replenishment time has been cut to five days, freeing up inventory dollars to enrich our selection.

One great example of our new approach to editing and wrapping information around our offering can be found in our Trusted Advisor Health Program. Initiated this past year, the purpose of this program was to expand both the quality and breadth of titles being offered in each area of disease. To improve our ability to help our customers make truly informed decisions, leading physicians in each clinical area have been engaged to review available consumer literature related to their specific area of expertise. This program allows us to highlight the very best material. Often we are bringing into the foreground books which have been less widely known but provide information deemed highly meaningful by our medical experts. Since implementing this program last June, sales in this category have increased by over 8%. As important, customer and employee feedback has been excellent.

We are now taking the concept of Trusted Advisor to several other non-fiction categories including Business, Geo-Politics, Environment, and Home, and a major Trusted Advisor initiative is in the works for our entire Kids business.

The impetus for our Trusted Advisor Initiative is a simple reality. Today, so much information and so many products bombard us daily. While continuing to provide a broad selection, we feel that the best thing we can do for our customers is help edit and bring intelligent decision support to the in-store or online book buying experience.

Another key initiative launched late in the year and designed to bring benefit to both our consumers and our shareholders is our Co-Publishing Program. In partnership with selected publishers in Europe and Canada, Indigo will develop material in selected non-fiction areas to support our offering. Our strategy in this area is to offer extremely high quality books in areas such as cooking, gardening, children's reading, and skills development, at price points which are advantageous to our customers.

On to Music and Movies

Under the umbrella of Cultural Department Store, our music and DVD business is also undergoing major changes.

Again, we see our role as helping our customers to sort through the broad array of what can be purchased to find the specific additions to their music or movie library that will delight in every way. Whether it is reconnecting with old favourites, discovering new music that totally resonates, or being exposed to under-the-radar music or movies that are outstanding but might well have been missed, what we hear from our customers daily is – "Give me suggestions. Help me build my library." Shortly we will be rolling out a Trusted Advisor Program specifically geared to this area of our offering – providing recommendations in a manner which we feel will be particularly meaningful to our customers.

In addition, this past year we introduced a small range of digital entertainment products – beginning with the iPod. This program has been very well received and we intend, on a selective basis, to introduce other products which we believe are "best in class" and are of unique interest to our customers. Of course, we will continue to understand the impact of the digital revolution on our business so we can effectively adapt and leverage opportunities.

Our Papery

Our stores have always been a great destination for gift shopping. Perhaps nothing says as much about what is in your heart as a book that can be cherished forever or a piece of music that clearly will touch the heart of the recipient. To support this, during the latter part of

the year, we expanded our Papery – broadening our selection of beautiful papers, cards, journals, scrapbooks, keepsake boxes and writing instruments.

Booklovers are People too… So to Lifestyle

Most often our customers visit us to find something that will provide a delicious few hours of escape – a great novel, an irresistible movie, or soul touching music. But, just as often customers come for information and if possible, solutions to every day challenges.

With this in mind, this past year we have expanded some of our offering to customers shopping in our Home and Lifestyles area. For example, equipment for Pilates can now be purchased along with books and DVDs on this subject. Beautifully designed and affordable storage boxes and desk accessories can now be purchased along with books which deal with Home and Home Office Organization. Similarly, boxes designed for protecting and storing photographs, as well as a beautiful range of picture frames, can now be purchased, together with excellent books on photography. Moving forward we intend to thoughtfully seek opportunities in our various categories to expand our offering to provide customers with "solutions" – always staying true to our mission to be the ultimate environment for booklovers.

A "picture" of course is worth a thousand words…

As with everything, new ideas are hard to describe and are best experienced. Our stores are just beginning to reflect a number of the plans we have to evolve our concept and more richly serve both our customers and our shareholders. We look forward to having you visit our stores and experience the changes over the course of the next 18 months. In addition, in November of this year, we will open two entirely new stores – both under the Indigo banner which will be our first fully realized cultural department stores.

Coles

As noted above, our small format Coles stores continued to struggle with declining sales growth last year although profitability remains meaningful in this business. The good news is that work implemented last year on inventory systems, employee knowledge and development, and inventory assortment are now beginning to show results. While it is still early, we are targeting to improve sales, loyalty enrollment, and gift card sales each and every quarter of Fiscal 06. Furthermore, we believe that several opportunities remain to grow both the footprint and the profitability of this business. This year, we will open three new Coles stores as well as our first Indigospirit – a small format book and gift store conceived to serve specific captive markets. This first Indigospirit opened at Mount Sinai Hospital in Toronto in June 2005. Keep posted for further news…

Chapters.Indigo.ca

The very positive news about this channel is that our business continues to grow at a very healthy rate. Online sales of books, music and DVD grew 24% over the past year and we expect this trend to continue. We feel confident in reporting that this growth reflects our position as a highly valued Canadian e-tailer. The business continues to be extremely competitive, especially on pricing and free shipping. However, a number of initiatives are currently underway to lower costs, and further improve margins. We remain fully committed to this channel, and to the integral role it can and will play in leveraging opportunity in the world of digital entertainment, information sharing and communication.

The I-Reward Loyalty Program

I am pleased to report that Indigo, under each of our banners, continues to develop and grow our I-Reward Loyalty Program. This year almost one million customers joined this program. Sales to these customers grew year-over-year as did average basket size. We launched the first phase of a special newsletter – called INDULGE – to further strengthen our relationship with these very important customers and we intend to continue to find ways to build on these very valuable relationships. We regularly communicate with and survey our loyalty base, and feel extremely fortunate with the relationships that have been created. Within the Company our motto is that "each and every time we interact with a customer, it is our job to add a little joy to their shopping experience". We care about every single person we serve and feel that our loyalty members in particular keep us fully tuned in to emerging needs, concerns and opportunities.

Gift Cards

I think it is worth making a brief comment on our gift card program which is now in its second full year and really coming into its own. This past year over 1.8 million gift cards were sold for a total value of $51 million. This represented a meaningful growth over the previous year and we expect this growth trend to continue.

We intend to further build this program in-store, online, and in our corporate market. Our gift card program provides a wonderful opportunity for those who want to give a cherishable gift but are not sure exactly what the right thing might be. In addition, through purchase of our gift card "pillow box", customers are joining us in making a contribution to the Indigo Love of Reading Fund which I will comment on more fully below.

The Canadian Publishing Community

Much has been written about the challenging relationship between the publishing community and Indigo. I believe it is fair to say that daily, weekly and monthly, the partnership between Indigo and the publishers in this country is strengthening. Ours is an idiosyncratic industry to say the least. Thousands of new titles get published each year and in most cases the chances of success are small. Books get written, edited, published, distributed, positioned at retail, and often in quantities far above the demand. Many get returned or recycled in some way through a "remainder" process. Each participant in the chain works hard – the writer, the publisher/distributor, the retailer. In order for each participant to earn the best return on their efforts, a great deal of collaboration is required, as is a great deal of sharing of information. Over the past year a good deal of progress was made in the area of information sharing and supply chain streamlining. But much is still to be done. We appreciate the effort that many publishers have demonstrated and want to go on record as saying we will continue to do everything we can to make our relationships strong and mutually beneficial.

Indigo Love of Reading Fund

This past year Indigo formally launched our Love of Reading Fund. Conceived after a three-year pilot in an inner city Toronto public school, The Indigo Love of Reading Fund has been established to ensure that children in resource challenged schools get the books and technology they need so that when they complete public school they are on a "level playing field" with students from more richly resourced schools and environments. We believe strongly that setting kids up to be second class citizens, right from the get go, is simply wrong.

Through an outreach program, public school principals from across the country are invited to apply for grants from the Indigo Love of Reading Fund. A selection committee including representatives from Indigo and from the public school education community participates in making the selection decisions. Key criteria for selection include: (i) a demonstrated commitment on the part of the school principal to instill a love of reading, exploration and learning in the student body, notwithstanding resource limitations; and (ii) a clear indication of need.

This past year the combined contributions of the Company and our customers resulted in our being able to provide 11 schools with a grant of $150,000 each to be given in equal installments over three years. The funds are to be used for books, computer equipment, and special projects.

Participating principals are involved in discussions with their peers during which time best practises are shared, and we at Indigo play a key role in facilitating these discussions.

As we move forward with this program, we intend to test literacy improvement in the students and use the results to engage in dialogue with government on the need to improve funding for literacy in all under-resourced schools.

Each year additional schools will be added to the program and, in each case, it will be a multi-year commitment as experience suggests that it takes time to build the resources to the level that is ideal.

It is worth noting that in many cases these grants double or even triple the funds available to these schools to meet the needs of their students. Please feel free to visit our web site at www.chapters.indigo.ca to learn more about this program. I do however want to use this report to thank our customers, our shareholders and our employees who in combination make this program possible.

A Word on Our Employees

Each year in this report, I comment in one way or another on the incredible loyalty, spirit and commitment of the people who work at Indigo. I would have to say, as Indigo CEO, that I don't believe there is a retail company in this country with a more dedicated staff. In each area of our business – in stores, in our distribution centre, at home office, we benefit from the talent and dedication of an incredible group of people. Average tenure at Indigo is high – 5, 10 and 15 year employees are the norm, not the exception. I want to take this opportunity to thank everyone in the organization for all the hard work, not just of the past year, but of the past several years. A huge amount of work has gone into preparing us to achieve our potential. Customers are already the beneficiaries of this work, and I believe shareholders will continually see more benefits as we move forward.

I note with sadness the passing of Ralph Peter who spent many years with the Coles organization and was a member of the Indigo start up team. Ralph was an extraordinarily fine man who had a real impact on this company. He will surely be missed.

Looking Forward

Without doubt, ours is an industry in transition. Digitization, the Internet, and new home entertainment technology all impact our business. At one level each provides challenges. It is also true that each presents opportunities for us as we advance our ability to serve our customers. We intend to keep our eye firmly on our heritage as the leading Canadian booksellers but, just as clearly, on the changing dynamics of our time. As always, I look forward to the year ahead and to meeting the expectations of each of our key constituents – our customers, our employees, our suppliers and our shareholders.

Management's Responsibility for Financial Reporting

Management of Indigo Books & Music Inc. ("Indigo") is responsible for the preparation and integrity of the financial statements as well as the information contained in this report. The following consolidated financial statements of Indigo have been prepared in accordance with Canadian generally accepted accounting principles, which involve management's best estimates and judgments based on available information.

Indigo's accounting procedures and related systems of internal control are designed to provide reasonable assurance that its assets are safeguarded and its financial records are reliable. In recognizing that the Company is responsible for both the integrity and objectivity of the consolidated financial statements, management is satisfied that the consolidated financial statements have been prepared according to and within reasonable limits of materiality and that the financial information throughout this report is consistent with these consolidated financial statements.

Ernst & Young LLP, Chartered Accountants, serve as Indigo's auditors. Ernst & Young's report on the accompanying consolidated financial statements follows. Their report outlines the extent of their examination as well as an opinion on the consolidated financial statements. The Board of Directors of Indigo, along with the management team, have reviewed and approved the consolidated financial statements and information contained within this report.

Heather Reisman
Chair and Chief Executive Officer

Jim McGill
Chief Financial Officer and Secretary

Management's Discussion and Analysis

The following discussion and analysis is prepared as at June 17, 2005 and is based primarily on the consolidated financial statements of Indigo Books & Music Inc. (the "Company" or "Indigo") for the 52-week period ended April 2, 2005 and the 53-week period ended April 3, 2004. It should be read in conjunction with the consolidated financial statements and notes contained in the attached Annual Report. Additional information about the Company, including the Annual Information Form, can be found on SEDAR at www.sedar.com.

Certain financial measures discussed in the following discussion and analysis are not necessarily defined by Canadian generally accepted accounting principles and may not be comparable to similar measures presented by other companies.

Overview

Indigo is the nation's largest book retailer, operating stores in all ten provinces in Canada and offering online sales through its *www.chapters.indigo.ca* web site. As at April 2, 2005, the Company operated 86 superstores under the banners *Chapters*, *Indigo* and the *World's Biggest Bookstore*, and 166 small format stores, under the banners *Coles*, *Indigo*, *SmithBooks* and *The Book Company*. The Company also has a 50% interest in Calendar Club of Canada Limited Partnership, which operates seasonal kiosks in shopping malls across Canada.

During the year, the Company closed one superstore and four small format stores as part of an ongoing initiative to streamline its real estate portfolio. The Company also opened three small format stores during fiscal 2005. In addition, the Company, along with its joint venture partner, transferred the management contracts to operate the five college bookstores of its Chapters Campus Bookstores Company ("CCBC") to a third party. The third party also purchased the inventory and fixed assets of CCBC. As a result of this transaction, the operations of CCBC were deemed discontinued at the closing date of this transaction on August 19, 2004.

On May 2, 2004, the Company replaced its procurement, inventory management and financial reporting systems with an integrated SAP Supply Chain system ("SAP"). The Company experienced normal transition issues associated with a system conversion of this magnitude, including sporadic shortages of some titles in some locations. The Company believes these issues have largely been resolved as at year end.

Following the recent SEC clarification on lease accounting, the Company reviewed its lease accounting practice and concluded that adjustments were necessary to present its financial position and results of operations in accordance with Canadian generally accepted accounting principles. As a result, previously issued consolidated financial statements of the Company for the fiscal year ended April 3, 2004 have been restated in the Annual Report along with the five year Summary of Financial Information. Historically, the Company had recognized rent expense for its operating leases using a lease term that commenced when actual rent payments began, which generally coincided with the month the store opened. This practice had the effect of excluding the construction period of the stores. Also, the Company had recognized rent expense based on actual rent payments throughout the lease term. Following the recent clarification, the Company has determined that it should have recognized rent expense on a straight-line basis over the lease term including the construction period.

For the year ended April 2, 2005, the correction has resulted in an increase in net earnings of $1.9 million, and an increase in basic and diluted earnings per share of $0.08. For the year ended April 3, 2004, the retroactive adjustment has resulted in an increase in net earnings of $0.7 million, and an increase in basic and diluted earnings per share of $0.03. The opening deficit for fiscal 2004 and fiscal 2005 were increased by $18.1 million and $17.4 million, respectively, to reflect more rent should have been expensed earlier in the lease term under the straight-line method. The correction had no impact on current or future cash flow.

The weighted average number of common shares outstanding for the year was approximately 24.1 million as compared to 24.0 million last year. This increase was mainly due to the issuance of 107,600 shares from treasury, which were purchased by a former officer of the Company on April 20, 2004. As at June 17, 2005, the number of outstanding common shares was 24,087,852 with a book value of $194.0 million. The number of common shares reserved for issuance under the employee stock option plan is 2,157,232. As at April 2, 2005, 1,398,492 stock options were outstanding with 381,831 of them exercisable.

Results of Operations

Revenues

Total consolidated revenues for the 52-week period ended April 2, 2005 decreased 2.3% to $787.5 million from $805.7 million for the 53-week period ended April 3, 2004. On a normalized 52-week basis, total revenues were down 0.7% compared to the previous year. Comparable store sales (for stores that were open for more than 12 months) were down 0.5% in superstores and down 2.3% in small format stores. Revenues by channel are highlighted below:

(millions of dollars)	FY05	FY04	% increase	% increase normalized for 52 weeks	Comparable store sales % increase
Superstores	**532.5**	548.2	(2.9)	(1.3)	(0.5)
Small format stores	**154.9**	169.4	(8.6)	(7.3)	(2.3)
Online (including store kiosks)	**64.8**	52.1	24.4	26.6	N/A
Campus	**0.4**	5.5	(93.4)	(93.2)	N/A
Other	**34.9**	30.5	14.6	15.8	N/A
	787.5	805.7	(2.3)	(0.7)	(0.9)

The overall decrease in revenues was primarily due to:

- The strong sales of the Harry Potter book released in the first quarter of fiscal 2004. The Company did not have a blockbuster title of this magnitude in fiscal 2005.
- The discontinuance of the Campus Bookstores operation, which operated five campus bookstores, in August 2004, resulted in a $5.1 million decrease in net revenue.
- The conversion to SAP in May 2004, which resulted in sporadic shortages of some titles in some locations.
- Net closure of one small format store and one superstore during fiscal 2005.

These decreases were partially offset by:

- Strong growth in the Online channel, which was driven by growing consumer acceptance of ordering from in-store kiosks and online shopping in general, along with aggressive pricing, broader product selection, and improved shipping options.
- Increases in other revenues, which include corporate sales, the Company's loyalty card program, and its proportionate share of a joint venture in seasonal kiosks.

Cost of Product, Purchasing, Selling and Administration

Operating costs, including cost of goods sold and selling and administration expenses, decreased $17.2 million which corresponds to the decrease in revenues. As a percentage of sales, operating costs were consistent with last year at 94.4% of sales.

Cost of goods sold as a percentage of sales decreased slightly by 0.1%. Selling and administration expenses as a percentage of sales increased by 0.1%.

Operating Earnings

Operating earnings, defined as revenues less cost of product, purchasing, selling and administration, decreased 2.1% to $44.2 million from $45.2 million last year driven by lower sales as described above. On a normalized 52-week basis, operating earnings were down 0.6%.

Recovery of Restructuring Costs

At the end of fiscal 2005, the Company completed its annual assessment on restructuring costs and concluded that only $6.5 million of the restructuring provision was required. As a result, the Company reduced its remaining $7.4 million of restructuring provision to $6.5 million and recognized the difference of $0.9 million into income in this fiscal year (See Note 11 to the consolidated financial statements for details).

Amortization

Amortization increased $2.7 million to $27.0 million compared to $24.3 million last year. The increase was primarily due to the amortization of the SAP development costs which started on the implementation date of May 2, 2004. Capital expenditures in the current year totalled $14.9 million and included $5.1 million in store renovations and equipment and $9.8 million in technology-related projects.

Interest Expense

Interest expense decreased 61.0% to $5.8 million from $14.9 million last year. Interest expense in fiscal 2004 included a debt settlement expense of $3.5 million relating to the repayment of the Company's convertible subordinated notes. Excluding this one-time charge, interest expense decreased 48.8% compared to last year due to the refinancing of the Company's debt that was completed at the end of fiscal 2004. The refinancing resulted in a reduction in both the average interest rate and total debt outstanding, as well as lower amortization of financing fees.

Income Tax Expense

Income tax expense decreased $0.3 million to $0.6 million from $0.9 million. The decrease in the income tax expense was due to increases in the deductions that are allowed for the calculation of the large corporations tax and a decrease in valuation allowance, and was partially offset by an increase in the combined federal and provincial tax rates.

Net Earnings

Net earnings for the period increased $6.6 million ($0.28 per common share) to $11.7 million ($0.49 per common share) from $5.1 million ($0.21 per common share) last year. The increase was mainly due to a decrease in interest and income tax expenses and the reduction in the provision for restructuring costs, partially offset by a decrease in operating earnings and an increase in amortization as noted above.

Selected financial information of the Company for the last three fiscal years are shown in the following table:

(thousands of dollars, except per share data)	**52-week period ended April 2, 2005**	53-week period ended April 3, 2004 (Restated – Note 3)	52-week period ended March 29, 2003 (Restated – Note 3)
Revenues			
Superstores	**532,526**	548,222	528,122
Small format stores	**154,906**	169,450	173,967
Other	**35,329**	35,982	38,062
Online (including store kiosks)	**64,766**	52,062	39,093
	787,527	805,716	779,244
Net income	**11,702**	5,092	1,594
Total assets	**393,085**	400,734	394,777
Long-term debt (including current portion)	**39,994**	52,446	85,602
Basic earnings per share	**$0.49**	$0.21	$0.07
Diluted earnings per share	**$0.48**	$0.21	$0.07

Selected operating information of the Company for the last three fiscal years are shown in the following table:

	52-week period ended April 2, 2005	53-week period ended April 3, 2004	52-week period ended March 29, 2003
Comparable Store Sales			
Superstores	**(0.5%)**	2.7%	5.3%
Small format stores	**(2.3%)**	(0.1%)	(0.2%)
Stores Opened			
Superstores	**–**	–	–
Small format stores	**3**	1	–
	3	1	–
Stores Closed			
Superstores	**1**	1	2
Small format stores	**4**	13	8
Campus bookstores	**5**	1	–
	10	15	10
Number of Stores Open at Year-End			
Superstores	**86**	87	88
Small format stores	**166**	167	179
Campus bookstores	**–**	5	6
	252	259	273
Selling Square Footage at Year-End (in thousands)			
Superstores	**2,086**	2,105	2,123
Small format stores	**448**	451	476
Campus bookstores	**–**	10	38
	2,534	2,566	2,637

Seasonality and Fourth Quarter Results

Indigo's business is highly seasonal and follows quarterly sales and profit (loss) fluctuation patterns, which are similar to those of other retailers that are highly dependent on the December holiday sales season. A disproportionate amount of revenues and profits are earned in the third quarter. As a result, quarterly performance is not necessarily indicative of the Company's performance for the rest of the year. The following table sets out revenues, net earnings (loss), basic and diluted earnings (loss) per share for the preceding eight fiscal quarters. As a result of changes in lease accounting, comparative figures for the previous seven fiscal quarters in the following table have been restated (see Note 3 to the consolidated financial statements for details).

	Fiscal quarters ended on or about:			
(thousands of dollars, except per share data)	June 30	September 30	December 31	March 31
Fiscal 2005 Revenues	**155,947**	**168,462**	**286,585**	**176,533**
Net earnings (loss)	**(10,972)**	**(7,793)**	**34,332**	**(3,865)**
Basic earnings (loss) per share	**$ (0.49)**	**$ (0.36)**	**$ 1.38**	**$ (0.05)**
Diluted earnings (loss) per share	**$ (0.49)**	**$ (0.36)**	**$ 1.38**	**$ (0.05)**
Fiscal 2004 Revenues	164,248	170,080	279,431	191,957
Net earnings (loss)	(11,420)	(7,428)	28,965	(5,025)
Basic earnings (loss) per share	$ (0.48)	$ (0.31)	$ 1.21	$ (0.21)
Diluted earnings (loss) per share	$ (0.48)	$ (0.31)	$ 1.13	$ (0.21)

Consolidated revenues for the fourth quarter in fiscal 2005 were down $15.4 million (8.0%) to $176.5 million due largely to there being one extra week in the fourth quarter of fiscal 2004. On a normalized 13-week basis, revenues were down 1.6%. Net earnings were up 23.1% on an absolute basis, and 24.4% on a normalized 13-week basis. Net earnings in the fourth quarter increased relative to the same period last year due to reduced shrink, improved labour productivity and lower interest expense. Interest expense in the fourth quarter of fiscal 2004 included a debt settlement expense of $3.5 million relating to the repayment of the Company's convertible subordinated notes.

Overview of Consolidated Balance Sheets

Total assets decreased by $7.6 million as compared to the fiscal year ended April 3, 2004. This is primarily due to lower net capital assets, prepaid expenses and a reduction in goodwill which were partially offset by an increase in future tax assets, accounts receivable and inventories. Net capital assets decreased $11.9 million due to the net closure of two stores, the conversion of 11 company-run cafés to Starbucks locations, and the discontinuance of the Campus Bookstores operation during the fiscal year. Prepaid expenses decreased $8.1 million compared to fiscal 2004 due to the higher than normal prepaid expenses at the end of fiscal 2004 as the Company prepaid some occupancy expenses for April 2004. A $4.3 million reduction in goodwill was offset by the increase in future tax assets. During the business combination in fiscal 2002, the Company did not recognize the acquired tax loss carryforwards as future tax assets. As the Company used a portion of the acquired unused tax losses this year, the benefit of the use of these losses was applied to reduce unamortized goodwill. Inventories increased $8.2 million compared to fiscal 2004. Inventories at the end of fiscal 2004 were lower than usual as the Company rationalized its inventory levels in preparation for the SAP conversion.

Total liabilities decreased by $20.2 million as compared to the fiscal year ended April 3, 2004. Total net debt (including cash, bank indebtedness and long-term debt) decreased by $24.3 million compared to fiscal 2004 primarily due to the $12.0 million principal repayment the Company made on its existing long-term debt in December 2004. This reduction in net debt was partially offset by an accounts payable increase of $5.0 million resulting from higher inventories, as first mentioned above.

Shareholders' equity increased by $12.6 million compared to last year primarily due to net earnings of $11.7 million. Share capital increased $0.5 million as a result of the issuance of shares from treasury and the exercise of employees' stock options. Additionally, the expensing of stock options and the issuance of Directors' Deferred Stock Units were recorded as contributed surplus. In fiscal 2005, $0.2 million was recorded for stock option expenses and $0.2 million was recorded for Directors' Deferred Stock Units.

Overview of Consolidated Statements of Cash Flows

Cash and cash equivalents increased $1.4 million during fiscal 2005 compared to an increase of $8.7 million in fiscal 2004.

Net cash flows generated from operating activities were $38.5 million compared to $31.2 million in fiscal 2004. This increase was mainly due to net earnings of $11.7 million and non-cash amortization of $27.0 million in fiscal 2005, compared to net earnings of $5.1 million and non-cash amortization of $24.3 million in fiscal 2004. Non-cash working capital related to operations was $0.9 million higher than fiscal 2004. This is primarily due to higher inventories of $8.2 million as explained above, higher accounts receivable of $2.9 million, higher income taxes recoverable of $1.8 million, and lower deferred revenue of $1.1 million. These increases are partially offset by lower prepaid expenses of $8.1 million as discussed earlier, and higher accounts payable and accrued liabilities of $5.0 million as the Company reduced its accounts payable in preparation for the SAP conversion at the end of fiscal 2004.

The Company spent $14.9 million in capital projects in fiscal 2005, $4.2 million less than fiscal 2004 as outlined below:

(millions of dollars)	**FY05**	FY04
Store renovations	**5.1**	5.9
Technology-related projects	**9.8**	13.2
	14.9	19.1

Store renovations are typically done upon lease renewal and at selected points throughout a lease term. The amounts spent in fiscal 2005 and fiscal 2004 are reflective of the average term of leases in the Company's portfolio. The investment in technology-related projects was higher in fiscal 2004 due to the investment in SAP and the installation of in-store order kiosks in all small format stores in fiscal 2004.

In addition, the Company received cash proceeds of $0.8 million in fiscal 2005 when it converted 11 Company-operated cafes to Starbucks locations in the first quarter and $0.4 million from the sale of the Campus Bookstore assets in the second quarter. As a result, net cash flows used in investing activities in fiscal 2005 were $13.8 million compared to $19.1 million in fiscal 2004.

Net cash flows used in financing activities in fiscal 2005 were $23.3 million. In fiscal 2005, the Company repaid $12.0 million of its existing long-term debt and $1.4 million of its capital leases. In addition, the Company decreased the use of its operating line by $10.4 million at year end as a result of improved net earnings and reduced capital expenditures relative to fiscal 2004.

Liquidity and Capital Resources

The Company has a highly seasonal business which generates the majority of its revenues and cash flows during the December holiday season. Indigo has minimal accounts receivable, as its customers pay largely by cash or credit card and it purchases products on trade terms with the right to return a significant portion of its products. As a result, the Company is usually in a working capital deficit position at the end of the fiscal year. Indigo historically has been a net borrower in the first, second and fourth quarters, and has repaid all of its outstanding debt owing on its credit line during the third quarter.

Indigo's main sources of capital are cash flow generated from operations, a revolving line of credit and long-term debt. Under an existing agreement with its bank, the Company can borrow up to $90.0 million on its line of credit. As at April 2, 2005, $47.9 million was drawn against this facility. The Company's contractual obligations due over the next five years are summarized below:

(millions of dollars)	Less than 1 year	1-3 years	4-5 years	After 5 years	Total
Long-term debt	12.0	25.0	–	–	37.0
Capital lease obligations	1.5	1.5	–	–	3.0
Operating leases	54.4	134.6	23.6	46.6	259.2
Total obligations	67.9	161.1	23.6	46.6	299.2

Based on current operating levels, management expects cash flow generated from operations along with the available borrowing capacity under the Company's credit facility to be sufficient to meet its working capital needs and debt service requirements for the next fiscal year. Indigo also has the ability to reduce capital spending to fund debt requirements if necessary, however, a long-term decline in capital expenditures may negatively impact revenue and profit growth.

There can be no assurance that operating levels will not deteriorate over the ensuing fiscal year, which could result in the Company being unable to meet its current working capital and debt service requirements. In addition, other factors, not presently known to management, could materially and adversely affect Indigo's future cash flow. In such events, the Company would be required to obtain additional capital as is necessary to satisfy its working capital and debt service requirements from other sources. Alternative sources of capital could result in increased dilution to shareholders and may be on terms that are not favourable to the Company.

Accounting Policies

Critical Accounting Estimates

The discussion and analysis of Indigo's operations and financial condition are based upon the consolidated financial statements, which have been prepared in accordance with Canadian generally accepted accounting principles. The preparation of these consolidated financial statements requires the Company to estimate the effect of several variables that are inherently uncertain. These estimates and assumptions can affect the reported amounts of assets, liabilities, revenues and expenses. Indigo bases its estimates on historical experience and other assumptions which the Company believes to be reasonable under the circumstances. The Company also evaluates its estimates on an ongoing basis. The significant accounting policies of the Company are described in Note 2 to the consolidated financial statements.

The following items in the consolidated financial statements involve significant estimation or judgment:

Inventory Valuation

Indigo uses the cost method to account for inventory and cost of sales. Under this method, inventory is recorded at the article level. The average cost of an article is continually updated based on the cost of each purchase recorded into inventory. When the Company permanently reduces the retail price of an item, there is a corresponding reduction in inventory recognized in the period if the markdown incurred brings the retail price below the cost of the item. The Company also reduces inventory for estimated shrinkage that has occurred between annual physical inventory counts. The net result is that inventory is valued at the lower of costs, determined on a moving average cost basis, or market, being net realizable value.

Prior to fiscal 2005, the retail inventory method was used. Under this method, inventory was separated into similar merchandise categories. All receipts were added into an inventory pool using actual costs, and all sales were removed from the inventory pool using an average margin for the pool. The average margin was continually updated

based on the flow of goods into and out of the pool. When the Company permanently reduced the retail price of an item, there was a corresponding reduction in inventory recognized in the period the markdown was incurred rather than at the time of sale. The Company reduced inventory for estimated shrinkage that had occurred between annual physical inventory counts. The net result was that inventory was valued at the lower of costs or net realizable value, less a normal profit margin.

Indigo records an obsolescence provision based on assumptions about future sales demand, inventory levels and product quality. Management reviews the provision regularly and assesses whether it is appropriate based on actual experience. In addition, the Company records a vendor settlement provision to cover any disputes between the Company and its vendors. Management estimates this provision based on historical experience of settlement.

Given that inventory and cost of sales are significant components of the consolidated balance sheets and consolidated statements of earnings, any changes in assumptions and estimates could have a material impact on the Company's financial position.

Pension Plan

The plan obligations and related assets of the pension plan are presented in Note 8 to the consolidated financial statements. The plan obligation is calculated based upon actuarial assumptions on variables such as the discount rate, rate of compensation increase, and the expected long-term rates of return on pension plan assets. The variability of the estimates is discussed in more detail in the "Risks and Uncertainties" section of this MD&A. Given the Company has effected a windup of the pension plan effective June 30, 2004, the variability of the estimates will not have a material effect on the plan obligations given that the Company expects to settle the plan in the first quarter of fiscal 2006.

Income Taxes

The Company follows the liability method of tax allocation for accounting for income taxes. Under the liability method of tax allocation, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the substantively enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse.

Indigo currently has future tax assets associated with its non-capital loss carryforwards, which are available to reduce taxable income in the future. The Company evaluates the likelihood of using all or a portion of the loss carryforwards based on expected future earnings which are derived from internal forecasts, earnings or losses in recent years, and the expiry date of these losses. Based on this information, Indigo determines the amount of income tax valuation allowance that is required to reduce the value of its total loss carryforwards to which it estimates it can utilize. Any changes in estimates would affect the income tax expense on the consolidated statements of earnings and future tax assets on the consolidated balance sheets. If actual experience differs from the current estimates, the future value of these loss carryforwards may change significantly and the Company may incur a non-cash tax expense.

As part of the purchase price allocation for the acquisition of Indigo Books & Music, Inc. ("Old Indigo"), no future income tax asset was recognized for the unused tax losses of Old Indigo that existed at the date of acquisition. When unused tax losses acquired in a business combination that are not recognized as a future tax asset by the acquirer at the date of the acquisition are subsequently recognized by the acquirer, the benefit is applied to reduce any unamortized goodwill related to the acquisition and the Company incurs a non-cash tax expense in the same amount. As a result, the Company may incur non-cash tax expense in future years when utilizing the acquired unused non-capital loss carryforwards.

Restructuring Provision

Indigo has a provision for restructuring costs which was established at the time of the merger in fiscal 2002. The provision includes estimates for rent subsidies, legal fees, commissions and disposal costs for stores that were identified

for closure at the time of merger but still remain open. These are based on management's best estimates of the costs at which the Company would be willing to sublease these properties. Indigo has each of these sites listed with an outside realtor who is actively looking for new tenants to lease these properties. The Company evaluates any proposals at the time of receipt to determine if the offer is fair based on existing market conditions. Any changes in assumptions, such as prevailing market rent or intention to close a store, could result in the recognition of income or expense on the Company's consolidated statements of earnings in future years.

Accounting Changes

The following accounting standards have been adopted by the Company in the current fiscal year:

Hedging Relationships

The Canadian Institute of Chartered Accountants ("CICA") has issued a new accounting guideline on hedging relationships. This guideline requires companies to identify, designate, document and assess the effectiveness of its hedging relationships in order to apply hedge accounting. A derivative instrument that does not meet the new criteria for hedge accounting must be marked-to-market on the balance sheet, with the corresponding gain or loss recorded in the period in which the change occurs. The Company has evaluated all hedges currently in place and concluded that they met the hedging criteria. As a result, the implementation of this guideline did not have a material financial impact on the Company's net earnings.

Cash Consideration Received from a Vendor

The Emerging Issues Committee of the CICA has issued a new abstract on accounting for certain consideration received from a vendor. The new abstract will affect the accounting for and the classification of amounts received from a vendor, such as cooperative advertising. Under the new abstract, cash consideration received from a vendor is presumed to be a reduction of the prices of the vendor's products rather than revenue and should be classified as a reduction in cost of sales, unless certain specific conditions are met. The guidance will apply to all financial statements for annual and interim periods ending on or after August 15, 2004 and is to be applied retroactively. The implementation of this guideline did not have a material impact on cost of sales and net earnings.

Inventory

With the conversion of its supply chain system to SAP on May 2, 2004, Indigo changed its accounting policy with respect to inventory valuation. Previously, the Company used the retail inventory method. Under the new method, inventory is valued at the lower of cost and net realizable value. The new accounting policy was adopted on a prospective basis, since the necessary financial data for retroactive adoption could not be reasonably determined. The change in accounting policy did not have a material impact on the Company's net earnings.

Lease Accounting

Following the recent SEC clarification on lease accounting, the Company reviewed its lease accounting practice and concluded that adjustments were necessary. As a result, previously issued consolidated financial statements of the Company for the fiscal year ended April 3, 2004 have been restated. Historically, the Company had recognized rent expense for its operating leases using a lease term that commenced when actual rent payments began, which generally coincided with the month the store opened. This practice had the effect of excluding the construction period of the stores. Also, the Company had recognized rent expense based on actual rent payments throughout the lease term. Following the recent clarification, the Company has determined that it should have recognized rent expense on a straight-line basis over the lease term including the construction period.

For the year ended April 2, 2005, the correction has resulted in an increase in net earnings of $1.9 million, and an increase in basic and diluted earnings per share of $0.08. For the year ended April 3, 2004, the retroactive adjustment has resulted in an increase in net earnings of $0.7 million, and an increase in basic and diluted earnings per share of $0.03. The opening deficit for fiscal 2004 and fiscal 2005 were adjusted by $18.1 million and $17.4 million, respectively, with the offset recorded in accrued liabilities. The correction has no impact on current or future cash flow.

Financial Instruments

Indigo uses derivative financial instruments to manage the risks of its foreign currency and interest rate exposures. The Company enters into foreign forward exchange contracts to hedge future purchases of U.S. denominated goods and services. The Company also uses interest rate swap agreements to manage the fixed and floating interest rate mix of Indigo's total debt portfolio. The risks associated with the use of derivative financial instruments are discussed further under the "Risks and Uncertainties" section.

The fair value of financial instruments is the estimated amount the Company would receive or pay to terminate the contracts at the reporting date. The following methods and assumptions were used to estimate the fair value of each type of financial instrument by reference to various market value data and other valuation techniques, as appropriate.

The fair values of cash and cash equivalents, accounts receivable, income taxes recoverable, income taxes payable, bank indebtedness and accounts payable and accrued liabilities approximate their carrying values, given their short-term maturities.

The fair values of long-term debt is estimated based on the discounted cash payments of the debt at Indigo's estimated incremental borrowing rates for debt of the same remaining maturities. The fair value of the long-term debt approximates its carrying value.

The fair values of interest rate derivatives are estimated by discounting cash payments of the derivatives at market rates for derivatives of the same remaining maturities. The Company entered into an interest rate swap agreement on April 2, 2004 and the mark-to-market value of the interest rate swap was $0.1 million in favour of the Company as at April 2, 2005. At this time, the Company does not intend to terminate the interest rate swap agreement, and therefore does not anticipate any impact on earnings arising from the differences between book value and fair value.

The fair values of foreign forward exchange contracts represent an approximation of the amounts that the Company would have paid to or received from counterparties to unwind its position prior to maturity. The fair value of the foreign forward exchange contracts was $0.6 million in favour of the counterparties as at April 2, 2005.

New Accounting Pronouncement

The following accounting standard will be adopted by the Company in the future:

Financial Instruments

The CICA recently issued three new accounting standards: "Comprehensive Income", "Financial Instruments – Recognition and Measurement" and "Hedges". These new standards regarding recognition and measurement of financial instruments, hedging and comprehensive income have been created to harmonize with the generally accepted accounting principles already in use in the United States. These new standards have to be adopted by the Company at the latest for the period beginning October 1, 2006, but early adoption is acceptable. The Company is presently evaluating the impact of these new standards on the consolidated financial statements.

Risks and Uncertainties

Competition

The retail book selling business is highly competitive. Specialty bookstores, independents, other book superstores, regional multi-store operators, supermarkets, drug stores, warehouse clubs, mail order clubs, Internet booksellers,

mass merchandisers and other retailers offering books are all sources of competition for the Company. Aggressive merchandising or discounting by competitors in either the retail or online sectors could reduce the Company's market share and its operating margins.

Economic Environment

Traditionally, retail businesses are highly susceptible to market conditions in the economy. A decline in consumer spending, especially over the December holiday season, could have an adverse effect on the Company's financial condition. Other variables, such as unanticipated increases in merchandise costs, increases in labour costs, increases in shipping rates or interruptions in shipping service, higher interest rates or unemployment rates, could also unfavourably impact the Company's financial performance.

External Events

Weather conditions, as well as events such as political or social unrest, natural disasters, disease outbreaks, or acts of terrorism, could have a material adverse effect on the Company's financial performance. Moreover, if such events were to occur at peak times in the Company's annual business cycle, the impact of these events on operating performance could be significantly greater than it would otherwise have been.

Regulatory Environment

The distribution and sale of books is a regulated industry in which foreign ownership is generally not permitted under the Investment Canada Act. As well, the sourcing and importation of books is governed by the Book Importation Regulations to the Copyright Act (Canada). There is no assurance that the existing regulatory framework will not change in the future or that it will be effective in preventing foreign-owned retailers from competing in Canada.

Foreign Exchange, Interest Rate and Credit Risk

It is the Company's policy to identify and manage foreign exchange risk and interest rate risk through the use of derivative financial instruments. Counter-party credit risk is considered to be negligible as the Company only deals with highly rated financial institutions.

Indigo is currently using foreign forward exchange contracts to hedge its foreign exchange risks. Foreign exchange risk is largely limited to currency fluctuations between the Canadian and U.S. Dollar. The Company has minimal requirements for Euros, British Pounds, Hong Kong Dollars or other currencies. Indigo is currently using forward contracts to fix the exchange rate on a portion of its expected requirement for U.S. Dollars. The Company's interest rate risk is limited to the fluctuation of the floating rates on its outstanding debt.

Leases

The average unexpired lease term of Indigo's small format stores is approximately 3.0 years. The Company attempts to renew these leases as they come due on favourable terms and conditions, but is susceptible to volatility in the market for shopping mall space. Unanticipated increases in occupancy costs, and the incursion of store closing costs or relocation expenses could unfavourably impact the Company's performance. With an average unexpired lease term of 4.4 years, Indigo's superstores' rental expense is expected to remain stable.

Pension Plan

The Company is in the process of winding up its defined benefit plan and disbursing all assets to plan members. The timing of the disbursement is expected to be in the first quarter of fiscal 2006. There is no assurance that the Company's benefit plan assets will be able to earn the assumed rate of return between now and the estimated final

settlement of the plan. If actual returns and/or the final settlement date of the plan are different than the current estimates, Indigo may incur a larger settlement expense than anticipated.

Dependence on Key Personnel

Indigo's continued success will depend to a significant extent upon its management group. The loss of the services of key personnel, particularly Ms. Reisman, could have a material adverse effect on Indigo.

Legal Proceedings

In the normal course of business, Indigo becomes involved in various claims and litigation. While the final outcome of such claims and litigation pending as at April 2, 2005 cannot be predicted with certainty, management believes that any such amount would not have a material impact on the Company's financial position.

Disclosure Controls and Procedures

The Company's management is responsible for establishing and maintaining the Company's disclosure controls and procedures to ensure that information used internally and disclosed externally is complete and reliable. The Chief Executive Officer and the Chief Financial Officer of the Company have evaluated the effectiveness of the Company's disclosure controls and procedures and have concluded that they are adequate and effective as of the end of the fiscal year ended April 2, 2005, based on such evaluation.

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 with 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 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.

Auditors' Report

To the Shareholders of Indigo Books & Music Inc.

We have audited the consolidated balance sheets of Indigo Books & Music Inc. as at April 2, 2005 and April 3, 2004 and the consolidated statements of earnings, deficit and cash flows for the 52-week and 53-week periods then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at April 2, 2005 and April 3, 2004 and the results of its operations and its cash flows for the 52-week and 53-week periods then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Chartered Accountants
Toronto, Canada,
May 30, 2005

Consolidated Balance Sheets

(thousands of dollars)	As at April 2, 2005	As at April 3, 2004 (Restated – Note 3)
ASSETS		
Current		
Cash and cash equivalents	**10,100**	8,698
Accounts receivable	**9,879**	6,951
Inventories	**207,643**	199,421
Income taxes recoverable	**455**	–
Prepaid expenses	**4,296**	12,431
Future tax assets (note 5)	**10,723**	10,108
Total current assets	**243,096**	237,609
Capital assets, net (note 4)	**91,277**	103,146
Future tax assets (note 5)	**9,807**	6,471
Goodwill (note 6)	**48,233**	52,496
Deferred financing fees, net of accumulated amortization of $340 (April 3, 2004 – nil)	**672**	1,012
	393,085	400,734
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Bank indebtedness (note 7)	**52,968**	63,369
Accounts payable and accrued liabilities (note 11)	**203,248**	198,199
Income taxes payable	**–**	1,376
Deferred revenue	**7,631**	8,732
Current portion of long-term debt (note 7)	**13,488**	13,183
Total current liabilities	**277,335**	284,859
Accrued benefit obligations (note 8)	**376**	328
Long-term debt (note 7)	**26,506**	39,263
Total liabilities	**304,217**	324,450
Commitments and contingencies (note 14)		
Shareholders' equity		
Share capital (note 9)	**193,974**	193,426
Contributed surplus (note 9)	**772**	438
Deficit	**(105,878)**	(117,580)
Total shareholders' equity	**88,868**	76,284
	393,085	400,734

See accompanying notes

On behalf of the Board:

Heather M. Reisman
Director

Senator Michael Kirby
Director

Consolidated Statements of Earnings

(thousands of dollars, except per share data)	**52-week period ended April 2, 2005**	53-week period ended April 3, 2004 (Restated – Note 3)
Revenues	**787,527**	805,716
Cost of product, purchasing, selling and administration	**743,327**	760,554
	44,200	45,162
Amortization of capital assets	**27,000**	24,313
Recovery of restructuring costs (note 11)	**(923)**	–
Interest on long-term debt and financing charges (notes 7 and 10)	**1,598**	9,241
Interest on bank indebtedness (note 7)	**4,211**	5,640
Earnings before income taxes	**12,314**	5,968
Income tax expense (note 5)	**612**	876
Net earnings for the period	**11,702**	5,092
Net earnings per common share (note 9)		
Basic	**$0.49**	$0.21
Diluted	**$0.48**	$0.21

See accompanying notes

Consolidated Statements of Deficit

(thousands of dollars)	**52-week period ended April 2, 2005**	53-week period ended April 3, 2004 (Restated – Note 3)
Deficit, beginning of period, as reported	**(100,194)**	(104,965)
Lease accounting adjustments (note 3)	**(17,386)**	(18,132)
Deficit, beginning of period, as restated	**(117,580)**	(123,097)
Early redemption of convertible notes (note 10)	**–**	425
Net earnings for the period	**11,702**	5,092
Deficit, end of period	**(105,878)**	(117,580)

See accompanying notes

Consolidated Statements of Cash Flows

(thousands of dollars)	52-week period ended April 2, 2005	53-week period ended April 3, 2004 (Restated – Note 3)
CASH FLOWS FROM OPERATING ACTIVITIES		
Net earnings for the period	**11,702**	5,092
Add (deduct) items not affecting cash		
Amortization	**27,000**	24,313
Stock-based compensation (note 9)	**166**	113
Directors' compensation (note 9)	**168**	325
Future income taxes	**312**	66
Loss (gain) on disposal of capital assets	**(385)**	716
Benefit plan credits	**48**	(558)
Accrued interest on convertible notes	**–**	3,259
Amortization of deferred financing fees	**340**	1,784
Early extinguishment of convertible notes (note 10)	**–**	3,546
Net change in non-cash working capital balances related to operations		
Accounts receivable	**(2,928)**	2,432
Inventories	**(8,222)**	3,034
Prepaid expenses	**8,135**	(6,768)
Income taxes recoverable/payable	**(1,831)**	1,557
Deferred revenue	**(1,101)**	1,897
Accounts payable and accrued liabilities	**5,049**	(9,635)
Cash flows provided by operating activities	**38,453**	31,173
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of capital assets	**(14,918)**	(19,115)
Proceeds from sale of capital assets	**1,160**	–
Cash flows used in investing activities	**(13,758)**	(19,115)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase (decrease) in bank indebtedness	**(10,401)**	41,981
Proceeds from share issuances	**548**	–
Repayment of long-term debt (note 7)	**(13,440)**	(31,954)
Proceeds from long-term debt issuance (note 7)	**–**	27,000
Repayment of convertible notes (note 10)	**–**	(39,375)
Deferred financing fees	**–**	(1,012)
Cash flows used in financing activities	**(23,293)**	(3,360)
Net increase in cash and cash equivalents during the period	**1,402**	8,698
Cash and cash equivalents, beginning of period	**8,698**	–
Cash and cash equivalents, end of period	**10,100**	8,698

See accompanying notes

Notes to Consolidated Financial Statements

April 2, 2005

1. NATURE OF OPERATIONS

Indigo Books & Music Inc. (the "Company" or "Indigo"), the nation's largest book retailer, was formed as a result of an amalgamation of Chapters Inc. and Indigo Books & Music, Inc. under the laws of the Province of Ontario, pursuant to a Certificate of Amalgamation dated August 16, 2001. The Company operates a chain of retail bookstores across all ten provinces in Canada, including 86 (April 3, 2004 – 87) superstores under the *Chapters*, *Indigo*, and *World's Biggest Bookstore* names, as well as 166 (April 3, 2004 – 167) small format stores under the banners *Coles*, *Indigo*, *SmithBooks*, and *The Book Company*. The Company operates *www.chapters.indigo.ca*, an e-commerce retail destination, which sells books, videos, DVDs, music and gifts. The Company also operates seasonal kiosks in shopping malls across Canada through its Calendar Club of Canada Limited Partnership.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include the accounts of the Company and its subsidiary companies. All significant intercompany balances and transactions have been eliminated on consolidation.

Inventories

Inventories are valued at the lower of cost, determined on a moving average cost basis, and market, being net realizable value. Vendor rebates are recorded as a reduction in the price of the vendor's products and corresponding inventory is recorded net of vendor rebates.

Prepaid expenses

Prepaid expenses include pre-opening store costs, license fees and maintenance contracts. All costs associated with the opening of new stores are deferred and amortized over the respective store's first twelve months of operations. Other costs are amortized over the term of the contract.

Capital assets

Capital assets are recorded at cost and amortized over their estimated useful lives on a straight-line basis over the following periods:

Furniture, fixtures and equipment	5 – 10 years
Computer equipment and development costs	3 – 5 years
Leasehold improvements	over the term of the lease to a maximum of ten years
Equipment under capital lease	3 – 5 years

Employee future benefits

The cost of pensions and other retirement benefits earned by employees is determined using the projected benefits method prorated on service and management's best estimate of expected plan investment performance, salary escalation, expected cost trends and retirement ages of employees. The discount rate used to determine the accrued benefit obligation is determined by reference to market interest rates at the measurement date on high-quality debt

instruments with cash flows that match the timing and amount of expected benefit payments. For purposes of calculating the expected return on plan assets, those assets are valued at fair market value. The excess of the cumulative unamortized net actuarial gain (loss) over 10% of the greater of the accrued benefit obligation and the fair market value of plan assets at the beginning of the year is amortized over the average remaining service life of active employees.

Deferred financing fees

Financing fees are deferred on a straight-line basis, which approximates the effective yield method, and are amortized over the term of the respective indebtedness.

Deferred revenue

For an annual fee, the Company offers customers loyalty cards that entitle the cardholder to receive discounts on purchases. Each card is issued with a twelve-month expiry period. The fee revenue related to the issuance of a card is deferred and is amortized to earnings over the expiry period, based upon historical sales volumes.

Income taxes

The Company follows the liability method of tax allocation for accounting for income taxes. Under the liability method of tax allocation, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the substantively enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse.

Goodwill

Goodwill represents the excess of the cost over the value assigned to the net identifiable assets acquired at the date of acquisition. Goodwill is not amortized and is subject to annual review for impairment at the reporting unit level. Fair value is determined using the discounted cash flow method.

Joint ventures

The accounts of the Company reflect its proportionate interest in retail activities conducted through joint ventures.

Stock-based compensation

The fair value of each stock option granted is estimated on the date of the grant using the Black-Scholes option pricing model and expensed over the option's vesting period. Any consideration paid by employees on exercise of stock options is credited to share capital, with a corresponding reduction to contributed surplus.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances with banks and highly liquid investments that are readily convertible to cash with less than three months to maturity at the date of acquisition.

Foreign currency translation

Transactions in foreign currencies are translated at rates of exchange at the time of the transaction. Monetary assets and liabilities denominated in a foreign currency are translated at current foreign exchange rates with the resultant gains or losses included in net earnings (loss) for the period.

Financial instruments

The Company uses derivative financial instruments to manage risks of its foreign currency and interest rate exposures. The Company enters into foreign forward exchange contracts to hedge future purchases of U.S. denominated goods

and services. The Company also uses interest rate swap agreements to manage the fixed and floating interest rate mix of the Company's total debt portfolio. Counterparty credit risk is considered to be negligible as the Company only deals with highly rated financial institutions.

Derivative financial instruments that do not meet the new criteria for hedge accounting are marked-to-market on the balance sheet, with the corresponding gain or loss recorded in the period in which the change occurs. The fair value of financial instruments is disclosed in Note 15 to the consolidated financial statements.

Use of estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from those estimates.

Revenue recognition

The Company recognizes revenue when title passes to the customer. Revenue for retail customers is recognized at the point of sale and revenue for online customers is recognized when the product is shipped. The Company reports its revenue net of sales discounts and returns and is inclusive of amounts invoiced for shipping. Revenue from the gift card program is recognized as gift cards are redeemed. The Company accrues the amount received from the sale of gift cards, net of an estimate for breakage.

Earnings per share

Basic earnings per share is determined by dividing the net earnings attributable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated in accordance with the treasury stock method and is based on the weighted average number of common shares and dilutive common share equivalents outstanding during the period. The weighted average number of shares used in the computation of both basic and fully diluted earnings per share may be the same due to the anti-dilutive effect of options and convertible notes.

3. ACCOUNTING CHANGES

Hedging Relationships

Effective April 4, 2004, the Company adopted the new accounting guideline issued by the Canadian Institute of Chartered Accountants ("CICA") on hedging relationships. This guideline requires companies to identify, designate, document and assess the effectiveness of its hedging relationships in order to apply hedge accounting. A derivative instrument that does not meet the new criteria for hedge accounting must be marked-to-market on the balance sheet, with the corresponding gain or loss recorded in the period in which the change occurs. The Company has evaluated all hedges currently in place and concluded that they met the hedging criteria. As a result, the implementation of this guideline did not have a material financial impact on the Company's net earnings.

Cash Consideration Received from a Vendor

Effective August 15, 2004, the Company adopted the new abstract issued by the Emerging Issues Committee of the CICA on accounting for certain consideration received from a vendor. The new abstract will affect the accounting for and the classification of amounts received from a vendor, such as cooperative advertising. Under the new abstract, cash consideration received from a vendor is presumed to be a reduction of the prices of the vendor's products rather

than revenue and should be classified as a reduction in cost of sales, unless certain specific conditions are met. The guidance applies to all financial statements for annual and interim periods ending on or after August 15, 2004 and is to be applied retroactively. The implementation of this guideline did not have a material impact on cost of sales and net earnings.

Inventory

Effective May 2, 2004, with the conversion of its supply chain system to SAP, Indigo changed its accounting policy with respect to inventory valuation. Previously, the Company used the retail inventory method. Under the new method, inventory is valued at the lower of cost or net realizable value. The new accounting policy was adopted on a prospective basis, since the necessary financial data for retroactive adoption could not be reasonably determined. The change in accounting policy did not have a material impact on the Company's net earnings.

Lease accounting

Following the recent SEC clarification on lease accounting, the Company reviewed its lease accounting practice and concluded that adjustments were necessary. As a result, previously issued consolidated financial statements of the Company for the fiscal year ended April 3, 2004 have been restated. Historically, the Company had recognized rent expense for its operating leases using a lease term that commenced when actual rent payments began, which generally coincided with the month the store opened. This practice had the effect of excluding the construction period of the stores. Also, the Company had recognized rent expense based on actual rent payments throughout the lease term. Following the recent clarification, the Company has determined that it should have recognized rent expense on a straight-line basis over the lease term including the construction period.

For the year ended April 2, 2005, the correction has resulted in an increase in net earnings of $1.9 million, and an increase in basic and diluted earnings per share of $0.08. For the year ended April 3, 2004, the retroactive adjustment has resulted in an increase in net earnings of $0.7 million, and an increase in basic and diluted earnings per share of $0.03. The opening deficit for fiscal 2004 and fiscal 2005 were increased by $18.1 million and $17.4 million, respectively, with the offset recorded in accrued liabilities.

4. CAPITAL ASSETS

Capital assets consist of the following:

	April 2, 2005		April 3, 2004	
(thousands of dollars)	Cost	Accumulated amortization	Cost	Accumulated amortization
Furniture, fixtures and equipment	**103,003**	**64,906**	102,242	55,388
Computer equipment and development costs	**71,514**	**48,733**	61,673	42,301
Leasehold improvements	**76,068**	**49,010**	73,607	40,743
Equipment under capital lease	**5,407**	**2,066**	4,419	363
	255,992	**164,715**	241,941	138,795
Less accumulated amortization	**164,715**		138,795	
Net book value	**91,277**		103,146	

5. INCOME TAXES

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's future tax assets and liabilities are as follows:

(thousands of dollars)	April 2, 2005	April 3, 2004
Current future tax assets		
Deferred contract fee	31	45
Reserves and allowances	10,692	10,063
Net current future tax assets	10,723	10,108

(thousands of dollars)	April 2, 2005	April 3, 2004
Non-current future tax assets		
Tax loss carryforwards	63,709	76,488
Share issue costs	1,054	1,264
Book amortization in excess of cumulative eligible capital deduction	513	383
Accrued benefit obligations	134	116
Book amortization in excess of capital cost allowance	21,491	14,008
Non-current future tax assets before valuation allowance	86,901	92,259
Valuation allowance	(77,094)	(85,788)
Net non-current future tax assets	9,807	6,471

Significant components of the income tax expense attributable to continuing operations are as follows:

(thousands of dollars)	52-week period ended April 2, 2005	53-week period ended April 3, 2004
Current income tax expense	300	810
Future income tax benefit relating to origination and reversal of temporary differences	(833)	(1,790)
Increase (decrease) in valuation allowance	(8,694)	1,905
Future income tax expense relating to utilization of loss carryforwards	5,347	3,824
Future income tax expense relating to utilization of tax losses acquired	4,263	5,962
Adjustment to future income tax assets resulting from reduction (increase) in substantively enacted tax rates	65	(9,835)
Other, net	164	–
Total income tax expense	612	876

The reconciliation of income taxes attributable to continuing operations computed at the statutory income tax rates to income tax expense is as follows:

(thousands of dollars)	52-week period ended April 2, 2005	53-week period ended April 3, 2004
Tax at combined federal and provincial tax rates	**4,379**	2,176
Tax effect of expenses not deductible for income tax purposes	**306**	315
Increase (decrease) in valuation allowance	**(8,694)**	1,905
Tax effect of utilization of tax losses acquired	**4,263**	5,962
Large Corporations Tax	**300**	600
Adjustment to future income tax assets resulting from reduction (increase) in substantively enacted tax rates	**65**	(9,835)
Other, net	**(7)**	(247)
	612	876

As at April 2, 2005, the Company has combined non-capital loss carryforwards of approximately $179.2 million for income tax purposes that expire as follows if not utilized:

(thousands of dollars)	
2006	39,615
2007	101,573
2008	11,239
2009	18,213
2010	2,582
2011	4,686
2012	1,248
	179,156

Included in the total non-capital loss carryforwards are unused tax losses acquired of approximately $61.8 million, the benefit of which will be applied to reduce goodwill when they are utilized.

6. GOODWILL

The Company performed its annual impairment test on April 3, 2004 and April 2, 2005 using the discounted cash flow method. The results of this test indicated no goodwill impairment.

As part of the purchase price allocation for the acquisition of Indigo Books & Music, Inc. ("Old Indigo"), no future income tax asset was recognized for the unused tax losses of Old Indigo that existed at the date of acquisition. When unused tax losses acquired in a business combination that are not recognized as a future tax asset by the acquirer at the date of the acquisition are subsequently recognized by the acquirer, the benefit is applied to reduce any unamortized goodwill related to the acquisition. For the period ended April 2, 2005, the Company utilized a portion of the acquired unused tax losses which were not recognized and, accordingly, reduced goodwill by $4.3 million (April 3, 2004 – $6.0 million).

7. BANK INDEBTEDNESS AND LONG-TERM DEBT

In the fourth quarter of fiscal 2004, the Company repaid $31.0 million of long-term debt pursuant to its credit agreement. On April 2, 2004, the Company renegotiated its credit agreement with its bank. The new credit agreement provides for the following:

(i) A revolving line of credit of up to $90.0 million, based on defined levels of inventory and accounts receivable, bearing interest, at the Company's option, at either the bank's prime rate or the bankers' acceptance rate plus 0.5% to 2.5% depending on certain financial ratios. At April 2, 2005, the Company's interest rate was the bankers' acceptance rate plus 1.75% which resulted in an effective interest rate of 4.32%. The Company has an annual clean down provision on this revolving line of credit. The Company is required to reduce the amount outstanding under this facility to $25.0 million or less for a period of 30 consecutive days in fiscal 2005, and to nil in subsequent years. The revolving line of credit is to be repaid in full and expired on July 31, 2007. As at April 2, 2005, $47.9 million was drawn against this facility.

(ii) The long-term debt facility of $49.0 million bears interest at the same rates as the revolving line of credit. The facility is to be repaid as follows: $12.0 million on December 31, 2004; $12.0 million on December 31, 2005; $12.0 million on December 31, 2006; and $13.0 million on July 31, 2007. The first payment of $12.0 million was repaid on December 31, 2004.

The revolving line of credit and long-term debt are collateralized by a first-ranking security over all the property and assets of the Company, and are dependent upon the continued compliance with certain financial covenants.

On April 2, 2004, the Company entered into an interest rate derivative agreement to fix the interest rate on its long-term debt. The agreement involves the exchange of 30-day bankers' acceptance floating interest rates for fixed interest rates on a notional amount of $49.0 million. There are reductions in the notional amounts of the derivative agreement that coincide with the principal repayments of the underlying long-term debt. The fixed interest rate on the notional amount is 3.06%. The agreement expires on July 31, 2007.

The Company has entered into capital lease agreements for certain equipment. The obligations under these capital leases is $3.0 million, of which $1.5 million is included in the current portion of long-term debt. These capital leases have an average interest rate of 8% and an average term of 39 months.

As at April 2, 2005, the Company had outstanding letters of credit totalling $0.8 million (April 3, 2004 – $0.9 million).

8. ACCRUED BENEFIT OBLIGATIONS

The Company uses actuarial reports prepared by independent actuaries for funding and accounting purposes. The significant actuarial assumptions adopted in measuring the Company's accrued benefit obligations are detailed below. In March 2004, the Company amended the terms of its pension plan to effect a wind up with an effective date of June 30, 2004. The final actuarial valuation for the plan was completed as of June 30, 2004. The plan was in a deficit position of $772 thousand and $328 thousand as of April 2, 2005 and April 3, 2004 respectively. The Company will fund this deficit prior to final settlement of the plan which is expected to occur during fiscal 2006. The Company replaced the pension plan with a Company-sponsored RRSP/DPSP in October 2004.

(thousands of dollars)	April 2, 2005	April 3, 2004
Accrued benefit obligations, beginning of period	**12,000**	12,319
Current service cost	**404**	1,323
Interest on accrued benefits	**642**	862
Benefits paid	**(582)**	(762)
Experience loss	**536**	979
Curtailment gain	**–**	(2,721)
Balance, end of period	**13,000**	12,000
Fair value of plan assets, beginning of period	**11,672**	9,527
Remeasurement	**–**	(156)
Employees' and employers' contributions	**591**	1,226
Return on plan assets	**408**	672
Benefits paid	**(582)**	(762)
Experience gain	**139**	1,165
Fair value of plan assets, end of period	**12,228**	11,672
Funded status – plan deficit	**772**	328
Unamortized loss	**(396)**	–
Accrued benefit obligations	**376**	328

The following is a summary of the significant weighted average actuarial assumptions used in measuring the Company's accrued benefit obligations:

	April 2, 2005	April 3, 2004
Weighted average assumptions		
Discount rate	**5.30%**	5.30%
Expected long-term rate of return on plan assets	**3.50%**	7.00%
Rate of compensation increase	**N/A**	4.00%

The Company's net benefit plan expense is as follows:

(thousands of dollars)	April 2, 2005	April 3, 2004
Current service cost	**270**	797
Interest on accrued benefits	**642**	862
Interest on plan assets	**(408)**	(672)
Amortization of loss	**–**	49
Curtailment gain	**–**	(894)
Net benefit plan expense	**504**	142

The asset allocation of the Company's defined benefit pension plan at the end of fiscal years 2005 and 2004, by asset category, were as follows:

	April 2, 2005	April 3, 2004
Cash and cash equivalents	**31.7%**	9.1%
Fixed income securities	**68.3%**	28.3%
Equities	**0.0%**	62.6%
Total	**100.0%**	100.0%

9. SHARE CAPITAL

Share capital consists of the following:

Authorized

Unlimited Class A preference shares with no par value, voting, convertible into common shares on a one-for-one basis at the option of the shareholder

Unlimited common shares, voting

Issued (common shares)

	April 2, 2005		April 3, 2004	
	Number of shares	Amount $ (thousands)	Number of shares	Amount $ (thousands)
Balance, beginning of period	**23,964,752**	**193,426**	23,964,752	193,426
Issued during the period				
Issued for cash (net of expenses and future income taxes)	**107,600**	**500**	–	–
Options exercised	**9,000**	**48**	–	–
Balance, end of period	**24,081,352**	**193,974**	23,964,752	193,426

On April 20, 2004, the Company issued 107,600 shares from treasury that were purchased by a former officer of the Company for cash proceeds of $0.5 million.

In calculating diluted earnings per share amounts under the treasury stock method, the numerator remains unchanged from the basic earnings per share calculations as the assumed exercise of the Company's stock options do not result in an adjustment to earnings.

The reconciliation of the denominator in calculating diluted earnings per share amounts is as follows:

(in thousands)	April 2, 2005	April 3, 2004
Weighted average number of shares outstanding, basic	**24,067**	23,965
Effect of dilutive securities		
Stock options	**83**	48
Weighted average number of shares outstanding, diluted	**24,150**	24,013

The Company has established an employee stock option plan (the "Plan") for key employees. The number of common shares reserved for issuance under the Plan is 2,157,232. One quarter of the options granted prior to May 21, 2002 were exercisable on the date of issue with the remainder exercisable in equal installments on the anniversary date for the next three years. All grants of options since May 21, 2002 have one fifth of the options granted exercisable one year after the date of issue with the remainder exercisable in equal installments on the anniversary date over the next four years.

Effective March 30, 2003, the Company elected to adopt the new recommendations issued by the CICA relating to stock-based compensation on a prospective basis. In accordance with the new standard, the Company changed its method of accounting for stock options from the intrinsic value method to the fair value method, which estimates the fair value of the stock options granted on the date of grant and expenses this value over the vesting period. During fiscal 2005, $0.2 million was recognized as an expense with the offset recorded in contributed surplus. Any consideration paid by employees on exercise of stock options is credited to share capital, with a corresponding reduction to contributed surplus.

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 assumptions during the periods presented:

	52-week period ended April 2, 2005	53-week period ended April 3, 2004
Risk-free interest rate	**4.0%**	4.6%
Expected volatility	**25.3%**	15.1%
Expected time until exercise	**4 years**	4 years
Expected dividend yield	**0.0%**	0.0%

On a pro forma basis, if the Company had used the fair value method of accounting for stock options issued before March 29, 2003, the Company's net earnings would have decreased to the amounts listed below. The pro forma impact of accounting for these options at fair value will continue to be disclosed until the last of these options vest in 2008.

Pro Forma Earnings (thousands of dollars, except per share data)	**52-week period ended April 2, 2005**	53-week period ended April 3, 2004 (Restated – Note 3)
Net earnings – reported	**11,702**	5,092
Net earnings – pro forma	**11,374**	4,764
Basic net earnings per common share – reported	**$0.49**	$0.21
Basic net earnings per common share – pro forma	**$0.47**	$0.20
Diluted net earnings per common share – reported	**$0.48**	$0.21
Diluted net earnings per common share – pro forma	**$0.47**	$0.20

A summary of the status of the Plan and changes during both periods is presented below:

	April 2, 2005		April 3, 2004	
	Number #	Weighted average exercise price $	Number #	Weighted average exercise price $
Outstanding options, beginning of period	1,134,423	7.81	1,003,629	10.36
Granted	735,000	4.87	473,500	4.66
Forfeited	(442,031)	7.68	(313,556)	9.36
Expired	(19,900)	32.75	(29,150)	28.00
Exercised	(9,000)	4.50	–	–
Outstanding options, end of period	1,398,492	5.97	1,134,423	7.81
Options exercisable, end of period	381,831	8.23	226,696	14.27

Options outstanding and exercisable

	April 2, 2005				
	Outstanding			Exercisable	
Range of exercise prices $	Number #	Weighted average exercise price $	Weighted average remaining contractual life (in years)	Number #	Weighted average exercise price $
4.00 – 5.99	1,125,000	4.77	8.8	233,000	4.78
6.00 – 9.99	230,160	6.53	7.2	108,196	6.60
10.00 – 27.99	6,431	15.80	2.1	6,431	15.80
28.00 – 33.99	25,887	29.89	4.9	25,887	29.89
34.00 – 64.00	11,014	55.31	6.5	8,317	52.64
4.00 – 64.00	1,398,492	5.97	8.4	381,831	8.23

On October 31, 2002, the Company established a Directors' Deferred Stock Unit Plan. Under this plan, directors will receive their annual retainer fees and other board-related compensation in the form of deferred stock units ("DSUs"). The number of shares reserved for issuance under this Plan is 250,000. The Company issued 34,246 DSUs during the period ended April 2, 2005. The value of the outstanding DSUs as at April 2, 2005 was $0.5 million and was recorded in contributed surplus.

10. CONVERTIBLE NOTES

On April 3, 2004, the Company paid $39.4 million to redeem its outstanding Series I and II subordinated convertible notes at face value plus accrued interest.

The Series I notes were originally issued by Old Indigo with a face value of $10.0 million, an interest rate of 8% per annum, and a maturity date of June 30, 2005. The Series II notes were originally issued by Old Indigo with a face value of $20.0 million, an interest rate of prime plus 2% per annum, and a maturity date of June 30, 2005.

When the Company acquired Old Indigo, the Old Indigo Series I and II subordinated convertible notes became convertible into common shares of the Company on the basis of one common share for each $18.93 of principal and interest owing. At the date of acquisition, the fair value of the subordinated convertible notes was allocated between a

liability and equity component. The recorded amount of the liability component was being accreted to its face value over the term of the notes as interest expense. The holder's conversion option was treated as a separate element within equity.

Upon settlement, the Company again computed the fair value of the equity and liability components of the convertible notes. The Company recorded the difference between the fair value and the book value of the liability as an interest expense of $3.5 million, and the difference between the fair value and book value of the equity component of $0.4 million was credited to deficit in fiscal 2004.

11. RESTRUCTURING COSTS

In fiscal 2002, the Company recorded a $40.3 million restructuring charge as a result of the merger between Chapters Inc. and Old Indigo.

During the current fiscal year, the Company paid $0.7 million in restructuring costs and charged this amount against the provision. As at April 2, 2005, the Company had approximately $7.4 million of the restructuring costs that remained unpaid and had been included in accounts payable and accrued liabilities (April 3, 2004 – $8.1 million). The Company completed its assessment on restructuring costs and concluded that only $6.5 million of this provision was required. As a result, the Company recognized $0.9 million into income in the current year. This provision of $6.5 million included estimates for rent subsidies, legal fees, commissions and disposal costs for stores that were identified for closure in the next fiscal year. The Company expects to complete these closures by the end of second quarter in fiscal 2006. When the Company subleases a property, the Company expenses the costs incurred to sublease the property and reduces the provision accordingly.

12. JOINT VENTURES

The Company participates in a joint venture through a 50% equity ownership in the Calendar Club of Canada Limited Partnership to sell calendars and gifts through temporary kiosks.

The following amounts represent the total assets, liabilities, revenue and expenses and cash flows of the Company's joint venture in which the Company participates and its proportionate share therein:

	Total		Proportionate share	
(thousands of dollars)	**2005**	2004	**2005**	2004
Current assets	**7,608**	4,452	**3,804**	2,226
Long-term assets	**1,828**	1,553	**914**	777
Current liabilities	**4,789**	1,767	**2,395**	884
Revenue	**33,122**	29,292	**16,561**	14,646
Expenses	**27,108**	23,046	**13,554**	11,523
Net income	**6,014**	6,246	**3,007**	3,123
Cash flows provided by (used in)				
Operating activities	**8,567**	9,933	**4,284**	4,967
Investing activities	**(799)**	(566)	**(400)**	(283)
Financing activities	**(96)**	(19)	**(48)**	(10)
Net cash flow	**7,672**	9,348	**3,836**	4,674

In August 1999, a joint venture was formed with Barnes and Noble College Bookstore's Canadian Division to manage the Campus Bookstore division. The Company has a 51% equity interest in this newly formed company, Chapters Campus Bookstores Company ("CCBC"). On August 19, 2004, the Company, along with its joint venture partner, transferred the management contracts to operate the five college bookstores of CCBC to a third party. The third party also purchased the inventory and fixed assets of CCBC. As a result of this transaction, the operations of CCBC were deemed discontinued and the results of operations, net of assets and cash flows related to Chapters Campus Bookstores Company, have not been presented separately as they are not material compared to the overall operations of the Company.

13. CONSOLIDATED STATEMENTS OF CASH FLOWS

Supplemental cash flow information:

(thousands of dollars)	52-week period ended April 2, 2005	53-week period ended April 3, 2004
Interest paid	**4,427**	12,520
Income taxes paid (recovered)	**3,049**	(670)
Assets acquired under capital lease	**988**	2,890

14. COMMITMENTS AND CONTINGENCIES

(a) Commitments

As at April 2, 2005, the Company had the following commitments:

(i) Long-term debt repayments

The Company had long-term debt of $37.0 million bearing interest at the bankers' acceptance rate plus 1.75% which resulted in an effective interest rate of 4.32%.

(ii) Operating lease obligations

The Company had operating lease commitments in respect of its stores, support office premises and certain equipment. The leases expire at various dates between 2006 and 2016 and are subject to renewal options in certain cases. Annual store rent consists of a base amount plus additional payments based on store sales.

(iii) Capital lease obligations

The Company had entered into capital lease agreements for certain equipment. The obligations under these capital leases is $3.0 million, of which $1.5 million is included in the current portion of long-term debt.

(millions of dollars)	Long-term debt	Operating leases	Capital leases	Total
2006	12.0	54.4	1.5	67.9
2007	12.0	51.7	1.2	64.9
2008	13.0	46.4	0.3	59.7
2009	–	36.5	–	36.5
2010	–	23.6	–	23.6
Thereafter	–	46.6	–	46.6
Total obligations	37.0	259.2	3.0	299.2

(b) Legal claims

In the normal course of business, the Company becomes involved in various claims and litigation. While the final outcome of such claims and litigation pending as at April 2, 2005 cannot be predicted with certainty, management believes that any such amount would not have a material impact on the Company's financial position.

15. FINANCIAL INSTRUMENTS

The Company uses derivative financial instruments to manage risks of its foreign currency and interest rate exposures. The Company enters into foreign forward exchange contracts to hedge future purchases of U.S. denominated goods and services. The Company also uses interest rate swap agreements to manage the fixed and floating interest rate mix of the Company's total debt portfolio. Counterparty credit risk is considered to be negligible as the Company only deals with highly rated financial institutions.

The fair value of financial instruments is the estimated amount the Company would receive or pay to terminate the contracts at the reporting date. Such fair value estimates are not necessarily indicative of the amounts the Company might receive or pay in actual market transactions. The following methods and assumptions were used to estimate the fair value of each type of financial instrument by reference to various market value data and other valuation techniques, as appropriate:

(i) The fair values of cash and cash equivalents, accounts receivable, income taxes payable, bank indebtedness and accounts payable and accrued liabilities approximate their carrying values given their short-term maturities.

(ii) The fair values of long-term debt is estimated based on the discounted cash payments of the debt at the Company's estimated incremental borrowing rates for debt of the same remaining maturities. The fair value of the long-term debt approximates its carrying value.

(iii) The fair values of interest rate derivatives are estimated by discounting cash payments of the derivatives at market rates for derivatives of the same remaining maturities. At this time, the Company does not intend to terminate the interest rate swap agreement and therefore does not anticipate any impact on earnings arising from the differences between book value and fair value. The fair value of the interest rate swap was $0.1 million in favour of the Company as at April 2, 2005.

(iv) The fair values of foreign forward exchange contracts represent an approximation of the amounts that the Company would have paid to or received from counterparties to unwind its position prior to maturity. The fair value of the foreign exchange forward contracts was $0.6 million in favour of the counterparties as at April 2, 2005.

16. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS

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

Corporate Governance Policies

A presentation of Indigo's corporate governance policies is included in the Management Information Circular which is mailed to all shareholders. If you would like to receive a copy of this information, please contact Investor Relations at Indigo.

Executive Management and Board of Directors

EXECUTIVE MANAGEMENT

Eric Berthold
Senior Vice President, Lifestyles

Doug Caldwell
Chief Technology Officer

Victor DiRisio
Executive Vice President, Supply Chain

Jonathan Ehrlich
Senior Vice President, Online & Alternative Channels

Kathleen Flynn
General Counsel

Deirdre Horgan
Executive Vice President, Marketing

Jim McGill
Chief Financial Officer & Secretary

Lloyd Perlmutter
Executive Vice President, Retail Operations & Customer Experience

Heather Reisman
Chair & Chief Executive Officer

Joel Silver
Senior Vice President, Print Procurement

Tova White
Vice President, Human Resources

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Jack Lawrence
Chairman
Lawrence & Company Inc.

Heather Reisman
Chair & Chief Executive Officer
Indigo Books & Music Inc.

Gerald Schwartz
Chairman, President & CEO
Onex Corporation

Nigel Wright
Managing Director
Onex Corporation

Five Year Summary of Financial Information

(As a result of changes in lease accounting, comparative figures have been restated. See Note 3 to the consolidated financial statements for details)

For the years ended (millions of dollars, except per share data)	April 2, 2005	April 3, 2004	March 29, 2003	March 30, 2002	March 31, 2001
SELECTED INCOME STATEMENT INFORMATION					
Revenues					
Superstores	**532.5**	548.2	528.1	485.8	408.9
Small format stores	**154.9**	169.4	174.0	183.8	195.2
Online	**64.8**	52.1	39.1	34.7	51.1
Other	**35.3**	36.0	38.0	31.4	31.3
Total Revenues	**787.5**	805.7	779.2	735.7	686.5
EBITDA (Operating earnings)	**44.2**	45.2	42.2	36.3	(44.4)
Restructuring and take-over costs (recovery)	**(0.9)**	–	–	40.3	30.0
EBIT	**18.1**	20.8	18.3	4.9	(74.1)
Net earnings (loss) per common share	**0.49**	0.21	0.07	(3.57)	(7.42)
SELECTED BALANCE SHEET INFORMATION					
Working capital	**(34.2)**	(47.3)	(45.7)	(59.1)	(22.2)
Total assets	**393.1**	400.7	394.8	439.8	388.8
Long-term debt (including current portion)	**40.0**	52.4	85.6	112.1	54.0
Shareholders' equity	**88.9**	76.3	72.3	45.5	73.5
Long-term debt / (long-term debt + shareholders' equity)	**0.31:1**	0.41:1	0.54:1	0.71:1	0.42:1
Weighted average number of shares outstanding	**24,067,426**	23,964,752	22,512,643	13,629,541	11,526,705
Common shares outstanding at end of period	**24,081,352**	23,964,752	23,964,752	16,985,106	12,289,588
STORE OPERATING STATISTICS					
Number of stores at end of period					
Superstores	**86**	87	88	90	77
Small format stores	**166**	167	179	187	204
Campus bookstores	**–**	5	6	6	6
Selling square footage at end of period (in thousands)					
Superstores	**2,086**	2,105	2,123	2,164	1,883
Small format stores	**448**	451	476	496	536
Campus bookstores	**–**	10	38	38	38
Comparable store sales					
Superstores	**(0.5%)**	2.7%	5.3%	1.1%	(1.6%)
Small format stores	**(2.3%)**	(0.1%)	(0.2%)	3.7%	(3.0%)
Sales per selling square foot					
Superstores	**255**	260	249	233	229
Small format stores	**346**	376	365	358	352

Investor Information

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STOCK LISTING

Toronto Stock Exchange

TRADING SYMBOL

IDG

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AUDITORS

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ANNUAL MEETING

The Annual Meeting represents an opportunity for shareholders to review and participate in the management of their Company as well as meet with its directors and officers.

Indigo's Annual Meeting will be held on August 31, 2005, 10:00 a.m. at the Toronto Stock Exchange Conference Centre, 130 King Street West, Toronto, Ontario, Canada.

Shareholders are encouraged to attend and guests are welcome.

Une traduction française de ce document est disponible sur demande.

Our Guiding Principles

- We believe that great companies are built over time through the efforts of talented, committed people. We will take the time to build this Company consistent with our beliefs and guiding principles, knowing that the result will be a great and lasting enterprise with the potential for sustained success.
- Quality matters in everything we do. We are always striving to be the very best we know how to be, understanding that in the process we will make some mistakes. From the latter will likely come our best learning.
- Serving and satisfying customers will be our hallmark in all our stores. It is our number one priority. Everyone working with our Company needs to understand how the implications of their actions affect customer satisfaction.
- We believe that in the Information Era the only sustainable competitive advantage is people, therefore everything else can be duplicated. People and organization development are also our priorities. All of our actions will reinforce our belief in the importance and value of our people.
- Profitability and value enhancement are essential to long-term success and must be the focus, in an appropriate manner, at all levels of our organization.
- All those who create value should feel fairly rewarded for their contribution – employees, suppliers and investors.
- We have a responsibility to be respectful of, and to add value to, the communities in which we operate.