ANNUAL REPORT

FOR THE 52-WEEK PERIOD ENDED MARCH 28, 2009

"The road to knowledge begins with the turn of the page."

– Anonymous

Indigo

Books & Music Inc.

www.indigo.ca

## The Indigo Mission

To provide booklovers and those they care about with the most inspiring retail and online environments in the world for books and life enriching products and services.

Indigo operates under the following banners:
*Indigo Books Music & More*, *Chapters*, *The World's Biggest Bookstore*, *Coles*, *SmithBooks*, *Indigospirit*, *The Book Company*, *Pistachio*, *chapters.indigo.ca*, and *shortcovers.com*
The Company employs approximately 6,500 people across the country.

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# Report of the CEO

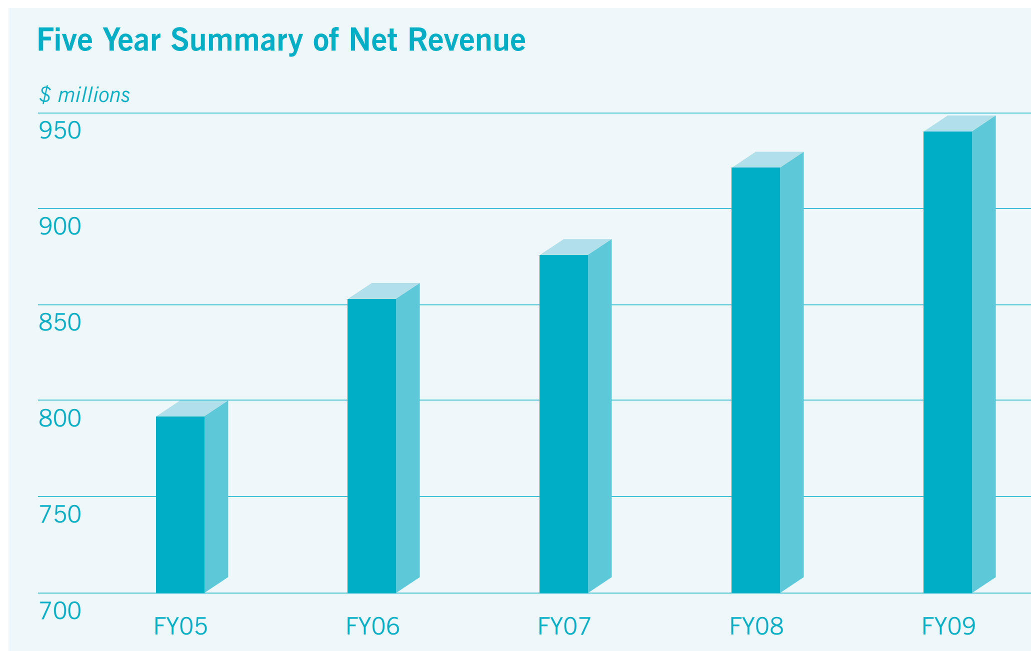
It is, as always, a pleasure for me to be writing this annual letter to our Shareholders.

## The Year in Review

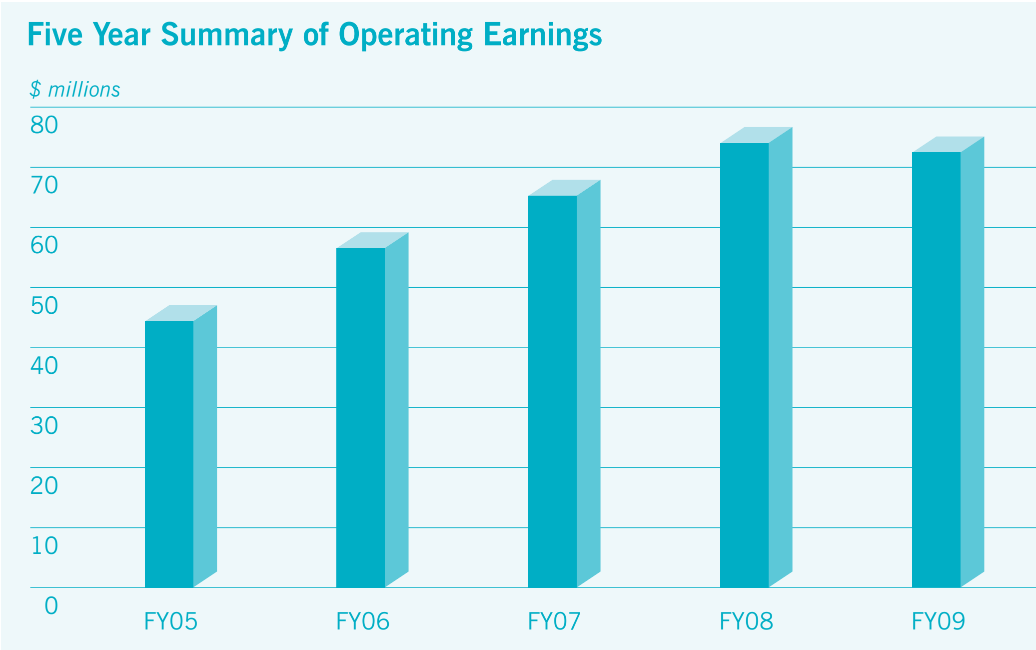
Fiscal 2009 was, for most retailers, a year challenged by stresses in the economic environment. From April until September, Indigo was enjoying its best operating results ever. Each of our channels showed real growth with our small and large format stores performing exceptionally well.

However, the Holiday season did not sustain this momentum. We were impacted by pull backs in consumer spending, a dramatic drop in the Canadian dollar which affected the cost of goods sourced in the United States, and record bad weather. Given how important the Holiday season is to us, it was difficult to achieve the targets we set. Still, for the year in full, the Company performed very solidly relative to almost every other retailer.

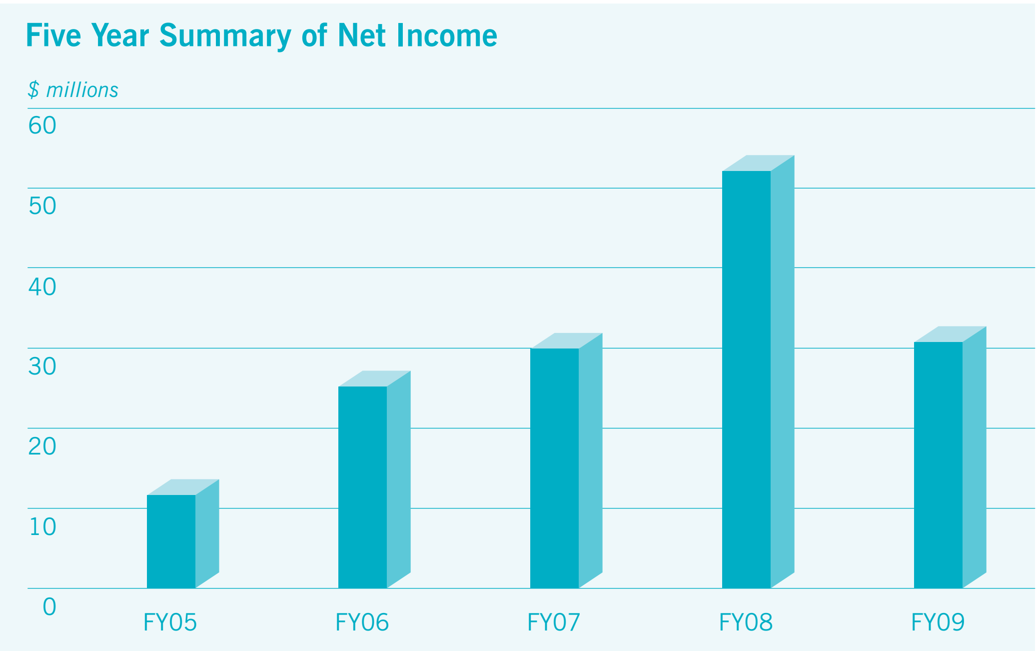
Same store sales in our Indigo and Chapters superstores grew 2.4%, while small format Coles stores posted an impressive 4.3% increase. Our online channel posted 6.0% lower sales impacted by lower book prices and a maturing market. In all, revenue for the year was up 1.9%, once again outperforming all of our North American peers.



Operating earnings held up reasonably well given the dramatic and sudden drop in the Canadian dollar mentioned earlier and operating expenditures we made in two important new businesses – Shortcovers and Pistachio. EBITDA was $72.5 million, down $1.4 million from the previous year.




Net income for the year was $30.7 million. This represents a year-over-year drop of $22 million. This was expected as this year's results include a tax expense of $15 million while last year's results, still benefiting from tax loss carry forwards, included a $9 million tax recovery.



## Store Development

Late in the year we opened four new superstores with another six slated to open in the coming months. Each of these stores represents a rich evolution of our original concept with expanded gift, toy and paper departments, as well as an award winning store design.

In addition, we continued to expand our very successful toy program within the existing superstore network. Thirteen of our superstores now include full-line toy departments. It is worth noting that, in addition to net-new toy sales, books sales in those stores have increased as well. It is clear that we have become a cherished destination for both parents and children.

In the next 24 months we expect to have 30 to 40 of these full-line toy departments across the country making us the largest specialty toy seller in Canada.

We have also become more and more of a destination for teens. This past summer Indigo was "the place to be" for the launch of the final book in the *Twilight* series. The buzz which surrounds teen books is huge and becomes a part of teen culture. We expect to grow the teen segment of our business and we will continue to reach out to learn what additional role we can play for this important group of our customers.

## State of The Art In-store Kiosks

Consistent with our goal of continually evolving our retail environments to respond to the new expectations of our consumers, this year we introduced an advanced in-store kiosk system across our superstore network. This kiosk system, which was entirely designed by us, allows customers to easily search for, research, and locate exactly what they wish to buy. Shortly after introduction, our kiosks won North America's Kioskcom's 2009 Self Service Excellence Award for Best Retail Deployment.

Our objectives for this investment were twofold: to create a more compelling customer experience in store; and to drive higher conversion rates. I am pleased to report that store metrics already demonstrate these objectives are being met.

I would be remiss in not mentioning that, once again, Chapters and Indigo were identified by an external survey of retail brand affection as the Number 1 and Number 2 brands in the country.

## Coles

For many years now people have been predicting the demise of the small format book retail concept. Our experience has been that a continual focus on creating strong relationships between our in-store staff and our customers results in ongoing vibrancy in this format. In fact, this year our Coles stores delivered an amazing 4.3% revenue growth and very positive bottom line results.

## Online – chapters.indigo.ca

Sales through our online channel were challenged this year by intense online discounting, the aforementioned drop in retail book prices, and the maturing of this channel in Canada. We expect the year ahead to be a better year as the dollar stabilizes and we expand our online toy and gift offering consistent with our superstores. What is important to note is that chapters.indigo.ca remains a valued channel to our customers and a strong support to our stores.

## Shortcovers

Late in fiscal 2009, Indigo launched Shortcovers – a totally digital reading destination. Shortcovers' goal is to provide readers with access to digital books, newspapers, magazines, and blogs; and to provide emerging

authors with the opportunity to digitally publish and make their work available to new audiences. We are still in the early stages of developing the experience we envisage but it has been an exciting launch for sure.

Shortcovers is currently available on Blackberry, Apple and Android products and will eventually be available on an even broader range of 3G mobile devices. We believe that moving forward our customers will read both in physical and digital format and we look forward to making Shortcovers one of the most important digital reading destinations in the world.

### Pistachio

This year we also launched Pistachio, an eco-friendly paper, gift and apothecary concept. Pistachio's positioning in the market is, "everyday products that are good for you, and good for the planet".

We opened two test stores pre-Holiday and recently launched the Pistachio paper product line at Barnes & Noble in the U.S. Given the increasing consumer interest in the importance of "living green" we believe Pistachio is the right concept launched at the right time. Initial consumer response has been positive, although there is much to learn for sure. We see this as an important test year for Pistachio and we look forward to reporting on its progress in next year's annual report.

## Strategic Focus

Each year in this section we report on where we will continue to invest in our Company to ensure its medium and long term health.

This year we enter the third year of a three-year plan to position us for success in the rapidly evolving world of media and entertainment which, in fact, is where we "play". A few words on the key environmental factors influencing our thinking, and then a few words on each of our core initiatives.

### A World Gone Digital

It is now well over a decade since the internet became a transformational technology impacting our society. In the broader sense, it changes how we communicate, how we obtain and absorb information, how we entertain ourselves, how we problem solve, and how we imagine and innovate. Essentially it has changed how we live our daily lives.

Part and parcel of this new reality is that content is, and wants to be, digital. This is, without doubt, extremely relevant to a business like ours which sells books, music, newspapers, and magazines. And our strategic focus has addressed, and will continue to address, this reality.

### Being Eco Sensitive

We have now reached a tipping point in our awareness of the importance of living in a manner which is more respectful of the environment – what resources we use, how we use these resources and how we consider the end-to-end impact of our actions. More and more consumers will demand that retailers show respect for the environment in how stores are built and run, how products are made, and what materials are used in the day-to-day operations of our enterprises. This new reality has led us to implement a major Green initiative within the Company and was also an important stimulus for the conceiving of Pistachio.

### An Economy in Stress

The U.S.-led major meltdown in the world economy leaves no one unaffected. Here in Canada the economic headwinds have clearly been felt, although not quite as intensely as in the U.S. Still a much more cautious

consumer and unemployment which may reach double digits clearly suggests that it is a time when special efforts must be made to manage financial resources carefully and thoughtfully.

With these three factors in mind and with the intention of maintaining our excellent balance sheet, we will complete the third year of our strategic plan and accelerate our commitment to our Shortcovers digital business.

## Strategies

### Re-imagine the Indigo/Chapters experience to address evolving consumer values and needs

The goal of our Re-imagine Strategy is twofold: to ensure that we remain an exciting and joyful experience for our consumers; and to ensure that the offering in our physical stores remains rich and compelling. Over the past two years we have consistently introduced new products and new services to meet the needs of our booklovers. This year we will further add to this mix of products and continue to adapt the environment in our new and existing stores to bring us closer to our of goal of being the world's first Cultural Department Store for Booklovers.

### Simplify core processes to drive productivity and quality of work life

Under this heading we have done a number of things over the last two years which have resulted in meaningful improvements in productivity and quality of work life. This year, in an effort to further reduce costs and improve service to our customers, we will be replacing our Warehouse Order Management System and developing a more advanced supply chain to serve both our retail and online businesses

### Achieve Best in Class Employee Engagement

Two years ago we set ourselves the goal of achieving best-in-class employee engagement status and we are pleased to report that this year we achieved this objective both in our Home Office, and in our Warehouse and Distribution Centre. (Retail field scores will not be in until after this report has gone to press but we look forward to strong achievements here as well.) Consistent with our intentions, we invested in training and development, and strengthened overall communication throughout the Company including the launch of *Insight* – our employee magazine.

Notwithstanding these results, we realize that sustaining high levels of employee engagement is a day in and day out, year over year responsibility. Therefore once again we will commit resources to specific initiatives designed to make Indigo one of the best places to work.

### Shortcovers

Shortcovers is perhaps our most important new strategy. Designed to address the emerging world of digitized books and digitized reading, Shortcovers is a global initiative. This year, consumers in Canada will also be able to reach Shortcovers through chapters.indigo.ca. Shortcovers will be accessible on a myriad of devices and will combine the joys of reading with the opportunities to self publish online, and to rate and recommend books. We have set an aggressive game plan for this initiative and we are building out the team that will take it forward.

We should note that we do not think, in any way, that physical books will disappear. On the contrary, we may actually expand the amount of book buying in total. Nevertheless, we are convinced that digital reading will play an important role with our customers and we look forward to seeing this exciting initiative evolve.

### Pistachio

As we noted above, consumers' increasing commitment to living in an environmentally sustainable way, and our own personal interest in this paradigm shift, led us to launch Pistachio. This year we will continue to

develop the Pistachio product line, advance our wholesale program, and build on the retail offering and experience in anticipation of expanding the retail store network.

### Love of Reading Foundation

Our work with public schools across the country through our Love of Reading Foundation has become an integral part of who we are as a Company. This year we brought the amount of money we have contributed to public schools in-need to $7.5 million. We have now touched well over 60 schools and have, without doubt, transformed the learning experience for the thousands of children and teachers in these schools. We remain committed to our long-term goal of getting every Premier in the country to reinstate a level of funding for school books and libraries that will ensure we are equipping each young student with the level of literacy and love of reading necessary to achieve his or her full potential.

I would like to take this opportunity to thank every employee at Indigo and every one of our customers who contributed time and money to our Foundation. You are making a difference – big time!

### Indigogreen

In addition to our Pistachio initiative, Indigo has taken, and will continue to take, many steps to make its operation more environmentally responsible.

We led the way in our industry by creating a policy which encourages publishers to use increasing amounts of recycled paper in the books they publish and we have introduced recyclable materials into our own packaging. In addition: we brought to market a reusable shopping bag for our customers, the profits of which go to our Love of Reading Foundation; we eliminated our bottled water program, replacing it with affordable canteens which consumers can purchase; and we began a program of using more environmentally sensitive materials in the construction and upgrading of our stores.

Next up for this year is a comprehensive environmental audit program of our store network the result of which will be a series of initiatives designed to further reduce our carbon footprint.

## Looking Forward

It would be difficult to predict with certainty just when we will see the economy back in full swing, or how and when digital books will fundamentally change the face of the world for writers, publishers, retailers and consumers. In the midst of these significant forces, what matters most, is the intelligence, focus, integrity and commitment of our Company's leadership and full employee team. I feel confident in reporting that Indigo is fortunate in this regard – the Company is made up of an incredible group of people, with an extraordinary level of commitment to each other, to our customers, and to those in the industry with whom we work. I want to take this opportunity, on behalf of the entire executive team, to thank all of the employees at Indigo for the effort they put forth each day to make us the exceptional Company we are.

And, as always, I want to thank you, our Shareholders, for your continued confidence in Indigo. You have our full and untiring commitment.

**Heather Reisman**
*Chair and Chief Executive Officer*

# 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, Licensed Public 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*

# Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") is prepared as at May 22, 2009 and is based primarily on the consolidated financial statements of Indigo Books & Music Inc. (the "Company" or "Indigo") for the 52-week periods ended March 28, 2009 and March 29, 2008. 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.

## Overview

Indigo is the nation's largest book retailer, operating stores in all 10 provinces and one territory in Canada and offering online sales through its www.chapters.indigo.ca website. As at March 28, 2009, the Company operated 90 superstores under the banners *Chapters*, *Indigo* and the *World's Biggest Bookstore*, 155 small format stores, under the banners *Coles*, *Indigo*, *Indigospirit*, *SmithBooks* and *The Book Company* and two new concept stores under the banner *Pistachio*. During fiscal 2009, the Company opened four superstores, one small format store and two Pistachio stores. The Company closed four small format stores during the fourth quarter of fiscal 2009. The Company also has a 50% interest in Calendar Club of Canada Limited Partnership ("Calendar Club"), which operates seasonal kiosks and year-round stores in shopping malls across Canada. In February 2009, Indigo launched *Shortcovers* (www.shortcovers.com), a new digital destination offering online and mobile service that provides instant access to books, articles and blogs.

In October 2005, Indigo incorporated a separate registered charity under the name Indigo Love of Reading Foundation (the "Foundation"). The Foundation provides new books and learning material to high-needs elementary schools across the country through donations from Indigo, its customers, suppliers and employees.

The weighted average number of common shares outstanding for the current year was 24,674,523 as compared to 24,744,334 last year. As at May 22, 2009, the number of outstanding common shares was 24,526,272 with a book value of $196.5 million. The number of common shares reserved for issuance under the employee stock option plan is 2,202,627. As at March 28, 2009, there were 1,627,145 stock options outstanding with 808,457 of them exercisable.

## Results of Operations

The following three tables summarize selected financial and operational information for the Company for the periods indicated. The classification of financial information presented below is specific to Indigo and may not be comparable to that of other retailers. The selected financial information is derived from the audited consolidated financial statements for the 52-week periods ended March 28, 2009, March 29, 2008 and March 31, 2007.

Key elements of the consolidated statement of earnings for the periods indicated are shown in the following table:

| (millions of dollars) | FY09 | % Revenues | FY08 | % Revenues |
|---|---|---|---|---|
| Revenues | **940.4** | **100.0%** | 922.9 | 100.0% |
| Cost of sales | **530.3** | **56.4%** | 524.7 | 56.9% |
| Cost of operations | **264.5** | **28.1%** | 257.6 | 27.9% |
| Selling and administrative expenses | **73.1** | **7.8%** | 66.7 | 7.2% |
| EBITDA[1] | **72.5** | **7.7%** | 73.9 | 8.0% |

1 Earnings before interest, taxes, depreciation and amortization. Also see "Non-GAAP Financial Measures".

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 March 28, 2009 | 52-week period ended March 29, 2008 | 52-week period ended March 31, 2007 |
|---|---|---|---|
| **Revenues** | | | |
| Superstores | **634,727** | 620,036 | 591,039 |
| Small format stores | **166,225** | 159,724 | 157,111 |
| Online (including store kiosks) | **95,232** | 101,345 | 86,745 |
| Other | **44,215** | 41,773 | 40,148 |
| | **940,399** | 922,878 | 875,043 |
| Net earnings | **30,650** | 52,808 | 30,004 |
| Total assets | **487,506** | 421,004 | 397,267 |
| Long-term debt (including current portion) | **5,006** | 6,028 | 20,490 |
| Basic earnings per share | **$1.24** | $2.13 | $1.23 |
| Diluted earnings per share | **$1.21** | $2.08 | $1.19 |

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

| | 52-week period ended March 28, 2009 | 52-week period ended March 29, 2008 | 52-week period ended March 31, 2007 |
|---|---|---|---|
| **Comparable Store Sales**[1] | | | |
| Superstores | **2.4%** | 4.4% | 2.5% |
| Small format stores | **4.3%** | 3.0% | 2.2% |
| **Stores Opened** | | | |
| Superstores | **4** | – | 2 |
| Small format stores | **1** | 3 | 1 |
| | **5** | 3 | 3 |
| **Stores Closed** | | | |
| Superstores | **–** | 2 | – |
| Small format stores | **4** | 3 | 7 |
| | **4** | 5 | 7 |
| **Number of Stores Open at Year-End** | | | |
| Superstores | **90** | 86 | 88 |
| Small format stores | **155** | 158 | 158 |
| | **245** | 244 | 246 |
| **Selling Square Footage at Year-End** (in thousands) | | | |
| Superstores | **2,110** | 2,042 | 2,090 |
| Small format stores | **415** | 422 | 425 |
| | **2,525** | 2,464 | 2,515 |

1 See "Non-GAAP Financial Measures".

### Retail Price of Books in Canada

The retail price of trade books sold by the Company is largely determined by the book publishers. Given the majority of publishers sell in both Canada and the US, the books are typically dual priced showing both a Canadian list price and a US list price. The Company buys the majority of its trade book product from publishers at a discount off the Canadian list price and in turn sells the book to its customer at the Canadian list price. The publishers often determine the list prices several months in advance of when the books reach the Company's stores which means short-term fluctuations in the exchange rate between the Canadian and US dollar are not reflected in the list price of the Company's product. In periods of stable exchange rates, this does not create an issue for the Company or its customers. In periods of volatile exchange rates, it has the impact of making the Company's Canadian list prices look relatively expensive or inexpensive as compared to the US list price.

During October of 2007 (the previous fiscal year), the Canadian dollar rose significantly in value against the US dollar. This had the effect of making the Company's book product look expensive compared to the US dollar price and resulted in negative responses from its customers. The Company responded to the pricing concerns of its customers by offering significant discounts off the Canadian list prices of its products to bring them more in line with the US list price. The Company received a significant amount of vendor support for this promotional activity.

During October of 2008 (the current fiscal year), the Canadian dollar declined significantly in value against the US dollar. This had the effect of making the Company's book product look inexpensive compared to the US dollar price and resulted in positive responses from its customers. As a result, the Company did not repeat the level of discounting activity it did in the previous year nor did it recognize the same level of vendor support.

Given the value of the Canadian dollar had been rising for several years against the US dollar, the average retail selling price of a book had been declining for the Company over the past years including fiscal 2009. The Company has focused on driving higher unit sales to compensate for the declining price. However, the increase in units has increased the Company's distribution costs in absolute dollar terms and as a percent of revenues.

Since the October 2008 decline in the value of the Canadian dollar versus the US dollar, the Company is seeing publishers increasing the list price of books in Canadian dollars as they print new titles and reprint older titles. This should, over time, have the impact of increasing the average retail price of books sold by the Company.

### Revenue Growth driven by Kids and Lifestyle Businesses

Total consolidated revenues for the 52-week period ended March 28, 2009 increased $17.5 million or 1.9% to $940.4 million from $922.9 million for the 52-week period ended March 29, 2008. The increase in revenues was mostly attributable to (i) the phenomenal success of the *Twilight* series by Stephenie Meyer, (ii) the expansion of the toy business at several superstores, and (iii) the continued growth in the lifestyle business which includes gift and paper products. Revenues from the four new superstores opened at various points in fiscal 2009 were largely offset by the closure of two superstores late in fiscal 2008.

Comparable store sales increased 2.4% in superstores and 4.3% in small format stores in fiscal 2009. Comparable store sales are defined as sales generated by stores that have been open for more than 12 months. It is a key performance indicator for the Company as this measure excludes sales fluctuations due to store closings, permanent relocation and chain expansion. At fiscal year end, the Company operated four additional superstores and three fewer small format stores compared to the previous fiscal year end.

Online sales decreased during fiscal 2009 by 6.1% to $95.2 million for the 52-week period ended March 28, 2009 compared to $101.4 million in the same period last year. The decrease in the online channel was directly attributable to the Company selectively choosing to exit certain unprofitable products.

Revenues from other sources include revenues generated through corporate sales, revenues from the sale of loyalty cards, the Company's proportionate share of revenues generated by Calendar Club, gift card breakage, and revenues from Pistachio, a new concept store which launched in the third quarter of fiscal 2009. Revenues from other sources increased 6.0% from $41.8 million last year to $44.3 million for the current year driven by continued growth in sales of the Company's loyalty card program, an increase in gift card breakage and sales from Pistachio stores.

Revenues by channel are highlighted below:

| (millions of dollars) | FY09 | FY08 | % increase | Comparable store sales % increase |
|---|---|---|---|---|
| Superstores | 634.7 | 620.0 | 2.4 | 2.4 |
| Small format stores | 166.2 | 159.7 | 4.1 | 4.3 |
| Online (including store kiosks) | 95.2 | 101.4 | (6.1) | N/A |
| Other | 44.3 | 41.8 | 6.0 | N/A |
| | 940.4 | 922.9 | 1.9 | 2.8 |

A reconciliation between total revenues and comparable store sales is provided below:

| | Superstores | | Small format stores | |
|---|---|---|---|---|
| (millions of dollars) | 52-week period ended March 28, 2009 | 52-week period ended March 29, 2008 | 52-week period ended March 28, 2009 | 52-week period ended March 29, 2008 |
| Total revenues | 634.7 | 620.0 | 166.2 | 159.7 |
| Adjustments for stores not in both fiscal periods | (18.3) | (18.0) | (2.4) | (2.7) |
| Comparable store sales | 616.4 | 602.0 | 163.8 | 157.0 |

**Cost of Sales (as a Percent of Revenues) Showed Improvement over Last Year**

Cost of sales include the landed cost of goods sold, online shipping costs, inventory shrink and damage provision, less all vendor support programs. As a percent of total revenues, cost of sales decreased 0.5% to 56.4% in fiscal 2009, compared to 56.9% last year. Cost of sales were high in fiscal 2008 primarily because of increased discounts given in response to customer concerns over pricing disparity between US and Canadian list prices and higher than average discounts offered on the blockbuster hit, *Harry Potter and the Deathly Hallows*. As highlighted earlier, the Company did not repeat the same level of discounting in fiscal 2009, nor did it receive the same level of vendor support.

**Cost of Operations Increased Slightly as a Percent of Revenues**

Cost of operations include all store, online, distribution centre, Calendar Club and Pistachio costs. Cost of operations increased $6.9 million primarily due to an increase in occupancy, labour and distribution centre costs. Occupancy costs increased $2.5 million compared to last year primarily due to the opening of four additional superstores in fiscal 2009 and incremental operating costs on the existing store base. Labour costs increased $2.5 million compared to fiscal 2008 as a result of higher minimum wage rates and the opening of the four new superstores. Distribution centre costs increased by $1.8 million, which was primarily attributed to an increase in the number of units moved through the facility during fiscal 2009. As a percent of total revenues, cost of operations increased by 0.2% to 28.1% of sales compared to 27.9% of sales last year.

**Selling and Administrative Expenses (as a Percent of Revenues) Increased in Fiscal 2009**

Selling and administrative expenses include all marketing and head office costs. As a percent of total revenues, selling and administrative expenses increased 0.6% to 7.8% of sales compared to 7.2% of sales last year. In absolute dollar terms, selling and administrative expenses increased $6.4 million compared to fiscal 2008. The increase was primarily due to (i) the Company realizing a loss on foreign exchange compared to a gain on foreign exchange last year, (ii) planned strategic investments in Pistachio and Shortcovers, and (iii) a favourable property tax settlement a year ago which was not repeated in the current year. These increases were partially offset by a recovery of payment processing charges in the second quarter.

**EBITDA Declined Slightly to 7.7% of Revenues**

EBITDA, defined as earnings before interest, taxes, depreciation and amortization decreased $1.4 million to $72.5 million for the 52-week period ended March 28, 2009, compared to $73.9 million for the 52-week period ended March 29, 2008. EBITDA as a percent of revenues decreased to 7.7% this year from 8.0% last year. The decline in EBITDA was the result of higher cost of operations and selling and administrative expenses, as explained above.

**Amortization Decreased in Fiscal 2009**

Amortization for the 52-week period ended March 28, 2009 decreased $1.9 million to $27.9 million, compared to $29.8 million for the 52-week period ended March 29, 2008. Capital expenditures in fiscal 2009 totaled $49.0 million and included $26.1 million on store construction, renovations and equipment, $12.2 million on intangible assets (primarily application software and IT development costs) and $10.7 million on technology equipment, including the Company's new in-store kiosk system. Of the $10.7 million in technology equipment, $2.8 million was financed through capital leases.

**Interest Income Recorded**

Interest income increased $1.2 million compared to the same period last year. The Company generated interest income of $1.1 million in the current year due to its positive cash position compared to an interest expense of $0.1 million last year.

**Income Tax Expense in Fiscal 2009**

The Company recognized an income tax expense of $15.1 million this year compared to an income tax recovery of $8.8 million last year. Given the Company has finished utilizing the majority of its tax loss carryforwards, an income tax expense is being recorded based on its net earnings this year. The Company recorded a non-cash tax recovery in fiscal 2008 due to three major factors: (i) an income tax expense based on year-to-date net earnings, plus (ii) an income tax expense due to corporate income tax rate reductions announced and substantively enacted by the Canadian federal government leading to a reduction in the gross amount of future tax assets, offset by (iii) an income tax recovery resulting from the elimination of the income tax valuation allowance, as the Company determined that it could more likely than not utilize all of its tax loss carryforwards based on expected future earnings and the expiry date of its loss carryforwards.

**Net Earnings Recorded for Fiscal 2009**

The Company recognized net earnings of $30.7 million for the year or $1.24 net earnings per common share, compared to net earnings of $52.8 million or $2.13 net earnings per common share last year. The reduction in net earnings was largely due to the income tax expense recognized this year versus the income tax recovery recorded in the same period last year, as mentioned above.

## Other Comprehensive Income

The Company adopted new accounting standards related to financial instruments on April 1, 2007. The Company had a hedging program in place as at April 1, 2007 whereby it entered into foreign currency contracts to mitigate the risk of fluctuations in the cost of product it purchased in US dollars. Upon adoption of the new Financial Instruments Standards last fiscal year, the Company reclassified $0.1 million to other comprehensive income relating to losses on derivatives designated as cash flow hedges prior to April 1, 2007.

The Company has not entered into any interest rate and foreign currency derivative contracts since the start of the current fiscal year.

## 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.

| | Fiscal quarters ended on or about: | | | |
|---|---|---|---|---|
| (thousands of dollars, except per share data) | June 28 | September 27 | December 27 | March 28 |
| **Fiscal 2009 Revenues** | **190,602** | **205,261** | **330,014** | **214,522** |
| **Net earnings (loss)** | **(1,225)** | **3,188** | **26,770** | **1,917** |
| **Basic earnings (loss) per share** | **$(0.05)** | **$0.13** | **$1.09** | **$0.08** |
| **Diluted earnings (loss) per share** | **$(0.05)** | **$0.13** | **$1.07** | **$0.08** |
| Fiscal 2008 Revenues | 184,917 | 209,173 | 322,552 | 206,236 |
| Net earnings (loss) | (2,840) | 3,339 | 49,179 | 3,130 |
| Basic earnings (loss) per share | $(0.12) | $0.14 | $1.98 | $0.13 |
| Diluted earnings (loss) per share | $(0.12) | $0.13 | $1.94 | $0.12 |

The Company realized growth in consolidated revenues in the fourth quarter of fiscal 2009, which improved $8.3 million or 4.0%, to $214.5 million compared to $206.2 million in the same quarter last year. Sales growth in the fourth quarter benefited from the phenomenal success of the Twilight Series by Stephenie Meyer and the deployment of a new advanced interactive kiosk system found in superstores. The new kiosk system enhances the customer experience by offering a new touch-screen interface, a streamlined way for customers to search for items in-store, discover new products and have items delivered to their home or favourite store. For the fourth quarter, comparable store sales increased 3.8% in superstores and 6.2% in small format stores.

Online sales decreased $1.6 million or 6.5%, to $23.1 million in the fourth quarter this year from $24.7 million last year. The decrease in sales was directly attributable to the Company's decision to selectively exit certain unprofitable products.

Net earnings in the fourth quarter of fiscal 2009 were $1.9 million, compared to $3.1 million in the same quarter last fiscal year. The reduction in net earnings was largely due to the income tax expense recognized this year versus the income tax recovery recorded in the same period last year.

## Overview of Consolidated Balance Sheets

### Total Assets

As at March 28, 2009, total assets were $66.5 million greater than total assets at March 29, 2008. The increase in assets was primarily due to an increase in the Company's cash and cash equivalents, property, plant and equipment and inventory position, partially offset by a reduction in future tax assets. Cash and cash equivalents increased $36.2 million primarily due to cash flows generated from operations in the current fiscal year. Property, plant and equipment increased $14.5 million compared to last year due to expenditures for store and head office construction, renovations, equipment and technology-related projects. The Company's inventory position increased $15.5 million mainly due to the opening of new stores, expansion of gift, paper and toy businesses in fiscal 2009, and early receipt of goods in the fourth quarter for the next fiscal year.

Future tax assets decreased $7.4 million compared to last year. The Company utilized tax loss carry-forwards and other temporary differences, such as capital cost allowance, this year, resulting in a $14.7 million reduction in future tax assets. This decrease was partially offset by $7.3 million of tax loss carry-forwards acquired during the year when the Company purchased a company with non-capital tax losses of $23.1 million.

In March 2009, Indigo purchased a company, the sole asset of which is certain tax losses, from a public company controlled by Mr. Gerald W. Schwartz, who is also the controlling shareholder of Indigo. Indigo acquired this company with $23.1 million of non-capital tax losses in exchange for net cash consideration of $2.9 million. This transaction was recorded at the exchange amount. As a result, the Company recorded a future tax asset of $7.3 million and the difference of $4.4 million between the net cash consideration and the future tax asset was recorded as a deferred credit, included in accounts payable and accrued liabilities. In connection with this transaction, the Company obtained an advanced tax ruling from Canada Revenue Agency, and Grant Thornton LLP, an independent accounting firm retained by the Company's Audit Committee, provided an opinion that the value paid by the Company for the tax losses was fair. The transaction was unanimously approved by the Audit Committee, all the members of which are independent directors.

**Total Liabilities**

As at March 28, 2009, total liabilities were $39.4 million higher than total liabilities at March 29, 2008. The increase in liabilities was primarily due to a $40.0 million increase in accounts payable and accrued liabilities. The increase in accounts payable and accrued liabilities is consistent with the increase in the Company's inventory position, as noted above. The increase in total liabilities was partially offset by a reduction in total debt of $1.0 million.

**Shareholders' Equity**

Shareholders' equity at March 28, 2009 increased $27.1 million compared to March 29, 2008. The increase in shareholders' equity was primarily due to net earnings of $30.7 million in fiscal 2009. It was partially offset by a $2.5 million decrease in share capital due to the repurchase of common shares under the normal course issuer bid. Contributed surplus increased $1.1 million due to the expensing of $1.2 million of employee stock options and directors' deferred stock units, partially offset by a $0.1 million reduction due to the exercise of employee stock options.

**Working Capital and Leverage**

As at March 28, 2009, the Company reported working capital of $87.1 million compared to $76.6 million as at March 29, 2008. The improvement was driven by strong operating results which lead to a higher cash position.

The Company's leverage position (defined as Total Liabilities to Total Shareholders' Equity) remained stable at 1.1:1 at the end of fiscal 2009 as compared to fiscal 2008.

## Overview of Consolidated Statements of Cash Flows

Cash and cash equivalents increased $36.2 million during fiscal 2009 compared to an increase of $42.3 million in fiscal 2008.

**Cash Flows from Operating Activities**

The Company generated positive cash flows from operating activities of $93.9 million during fiscal 2009. This was an increase of $17.0 million over the same period a year ago, when cash flow generated from operating activities was $76.9 million. The positive change in cash flows was primarily due to a $55.3 million increase in outstanding accounts payable and accrued liabilities and $19.1 million decrease in future tax assets. The improvement in cash flow was partially offset by a decline in net earnings of $22.1 million (from $52.8 million last year to net earnings of $30.7 million this year), a $33.3 million increase in the Company's investment in inventory (from a $17.8 million reduction in inventory in fiscal 2008 to a $15.5 million investment in inventory in fiscal 2009), and a $1.7 million growth in accounts receivable.

**Cash Flows Used in Investing Activities**

Net cash flows used in investing activities were $49.2 million in fiscal 2009 compared to $18.8 million in fiscal 2008. In fiscal 2009, total cash spent on capital projects were $49.0 million compared to $19.5 million spent in fiscal 2008 as outlined below:

| (millions of dollars) | FY09 | FY08 |
|---|---|---|
| Store construction, renovations and equipment | 26.1 | 10.1 |
| Technology equipment | 10.7 | 6.1 |
| Intangible assets (primarily application software and IT development costs) | 12.2 | 3.3 |
| | 49.0 | 19.5 |

The Company opened four new superstores and expanded the toy section at several superstores during fiscal 2009. Store renovations are typically done upon lease renewal and at selected points throughout a lease term. The amounts spent in fiscal 2009 and fiscal 2008 are reflective of the average term of leases in the Company's portfolio and the required dates for store renovations.

During fiscal 2009, the Company spent $12.2 million on intangible assets of which $11.5 million was for application software and IT development costs, and $0.7 million was related to the product design costs of Pistachio. The Company also paid $2.9 million for the acquisition of non-capital tax losses, and there was no such expense last year. The Company received $0.7 million of cash proceeds from the disposal of equipment in fiscal 2008.

**Cash Flows Used in Financing Activities**

Net cash flows used in financing activities were $8.5 million in fiscal 2009 compared to $15.7 million in fiscal 2008. The reduction in cash flows used in financing activities was primarily due to $3.8 million repayment of long-term debt in the current year compared to $16.8 million last year. The reduction was partially offset by the $5.0 million repurchase of common shares under the Company's normal course issuer bid.

## 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. Indigo's main sources of capital are cash flow generated from operations, a revolving line of credit and long-term debt. Indigo invests its cash in highly liquid assets. The Company does not invest in asset-backed commercial paper. In the third quarter of fiscal 2009, the Company extended the revolving line of credit for an additional year and reduced the borrowing capacity from $60.0 million to $30.0 million based on lower borrowing needs. As at March 28, 2009, no funds were 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 |
|---|---|---|---|---|---|
| Capital lease obligations | 2.7 | 2.0 | 0.3 | – | 5.0 |
| Operating leases | 60.8 | 102.2 | 63.7 | 38.9 | 265.6 |
| Total obligations | 63.5 | 104.2 | 64.0 | 38.9 | 270.6 |

Based on the Company's liquidity position and cash flow forecast, the Board of Directors approved the payment of a quarterly cash dividend of $0.10 per common share or $0.40 per common share annually, subsequent to its fiscal year end (see Note 15 to the consolidated financial statements). 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, debt service requirements and dividend payments for the next fiscal year. In addition, Indigo has the ability to reduce capital spending to fund debt requirements if necessary; however a long-term decline in capital expenditures may negatively impact revenues and profit growth. Future declaration of quarterly dividends and the establishment of future record and payment dates are subject to the final determination of the Company's Board of Directors. Dividends may be reduced or eliminated if required to maintain appropriate capital resources.

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 flows. In such events, the Company would be required to obtain additional capital as is necessary to satisfy its working capital and debt service requirements from other sources. Alternative sources of capital could result in increased dilution to shareholders and may be on terms that are not favourable to the Company.

## Accounting Policies

**Critical Accounting 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 ("GAAP"). 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 of 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 individual article (stock keeping unit or sku) 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 physical inventory counts. The net result is that inventory is valued at the lower of cost, determined on a moving average cost basis, or market, being net realizable value.

Indigo records provisions for slow-moving and damaged products and for gift, paper and entertainment products that have been marked down based on assumptions about future sales demand, inventory levels and product quality. Management reviews the provisions regularly and assesses whether they are 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 settlements with its vendors.

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.

### Assessment of Impairment of Long-Lived Assets and Goodwill

The Company's long-lived assets consist mainly of property, plant and equipment. Long-lived assets are reviewed by the Company whenever events or changes in circumstances indicate that their carrying values are not recoverable, resulting in a potential impairment. A potential impairment has occurred if the projected future undiscounted cash flows are less than the carrying value of the assets. When this is the case, the impairment loss is measured as the excess of the carrying value of the assets over its fair value, which is determined as the present value of the cash flows being generated from the assets. The evaluation is performed for the lowest level of the group of assets and liabilities with identifiable cash flows that are independent of those of other assets and liabilities.

The recoverability assessment requires judgment and estimates for future generated cash flows. The underlying estimates for future cash flows include estimates for future sales, gross margin rates, expenses and are based upon past and expected performance.

Property, plant and equipment make up a significant amount of the Company's total assets. To the extent that there is a significant change to the Company's assumptions, there may potentially be a significant impact on the Company's consolidated financial statements.

In accordance with Canadian GAAP, the Company does not amortize goodwill. Goodwill is tested for impairment annually or more frequently if there is any indication of impairment. The carrying values of the net assets are compared to the estimated fair values at the reporting unit level. Fair values are estimated based on the discounted cash flow method which depends on variables such as future earnings trends, capital expenditures and the discount rate. Any change in these variables may result in future impairment of goodwill. The Company performed its annual impairment test on March 28, 2009, and the results of this test indicated no impairment of goodwill.

### Gift Cards

The Company sells gift cards to its customers and recognizes the revenue as the gift cards are redeemed. The Company also recognizes revenue from unredeemed gift cards (gift card breakage) if the likelihood of the gift card being redeemed by the customer is considered to be remote. The Company determines its average gift card breakage rate based on historical redemption rates. Once the breakage rate is determined, the resulting revenue is recognized over the estimated period of redemption, commencing when the gift cards are sold, based on historical redemption patterns. Any change in the historical redemption pattern would affect the amount of gift card breakage that the Company recorded on its consolidated statement of earnings.

### 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 estimated 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 derived from internal forecasts, earning/loss trends in recent years, and the expiry date of its loss carryforwards. Based on this information, the Company determines the appropriate amount of income tax valuation allowance that is required to reduce the value of its total loss carryforwards to an amount which it estimates it can more likely than not utilize. As at the end of the current fiscal year, the Company determined that it could more likely than not utilize all of its tax loss carryforwards based on expected future earnings and the expiry date of its loss carryforwards and, therefore, an income tax valuation allowance was not required. Any changes in estimates would affect the income tax expense on the consolidated statement of earnings and future tax assets on the consolidated balance sheets. If the actual amount differs from the current estimates, the future tax value of these loss carryforwards may change significantly and the Company may incur a non-cash tax expense.

## Financial Instruments

During fiscal 2008, Indigo used derivative financial instruments to manage risks of its foreign currency and interest rate exposures. The Company entered into foreign currency derivative contracts to hedge future purchases of US Dollar denominated goods and services. The Company also used interest rate swap agreements to manage the fixed and floating interest rate mix of the Company's total debt portfolio. The risks associated with the use of derivative financial instruments are discussed further under the "Risks and Uncertainties" section. As at the end of fiscal 2009, the Company did not have any interest rate and foreign currency derivative contracts outstanding.

The fair value of financial instruments was the estimated amount the Company would receive or pay to terminate the contracts at the reporting date. Such fair value estimates were not necessarily indicative of the amounts the Company might receive or pay in actual market transactions.

The following methods and assumptions are 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, bank indebtedness and accounts payable and accrued liabilities approximate their carrying values, given their short-term maturities.

The fair value 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.

## Accounting Standards Adopted in Fiscal 2009

### Financial Instruments

Section 3862 and 3863 of the CICA Handbook, "Financial Instruments – Disclosures" and "Financial Instruments – Presentation", replace the existing Section 3861, "Financial Instruments – Disclosures and Presentation". The new sections revise and enhance disclosure requirements, and carry forward unchanged existing presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. These standards were adopted by the Company for the fiscal year beginning March 30, 2008 and its implementation did not have an impact on the classification and valuation of the Company's consolidated financial statements. The resulting disclosures from implementation are presented in Note 3 of the consolidated financial statements.

### Capital Disclosures

Section 1535 of the CICA Handbook, "Capital Disclosures", specifies the disclosure of: (i) the Company's objectives, policies and processes for managing capital; (ii) quantitative information about what it manages as capital; and (iii) whether the Company has complied with any externally imposed capital requirement and the consequences of such non-compliance. This standard was effective for the Company's fiscal year beginning March 30, 2008. The resulting disclosures from implementation are presented in Note 3 of the consolidated financial statements.

### Inventories

The CICA issued Handbook Section 3031, "Inventories" which prescribes the accounting treatment for inventories. This section provides guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories. This standard was adopted by the Company for the fiscal year beginning March 30, 2008. The resulting disclosures from implementation are presented in Note 3 of the consolidated financial statements.

### General Standards of Financial Statement Presentation

The CICA amended Section 1400 of the handbook which requires management to make an assessment of an entity's ability to continue as a going concern when preparing financial statements. In assessing whether the going concern assumption is appropriate, management must take into account all available information about the future, which is at least, but is not limited to, twelve months from the balance sheet date. This standard was adopted by the Company for the fiscal year beginning March 30, 2008 and its implementation did not have an impact on the classification and valuation of the Company's consolidated financial statements.

### Goodwill and Intangible Assets

Section 3064 of the CICA Handbook, "Goodwill and Intangible Assets", replaces the existing Section 3062, "Goodwill and Other Intangible Assets" and Section 3450, "Research and Development Costs". In conjunction with the issuance of this new standard, the CICA has amended Section 1000, "Financial Statement Concepts". These changes clarify the criteria for asset recognition for an internally developed intangible asset and reinforce the distinction between costs that should be expensed and those that should be capitalized. This standard was applied retrospectively by the Company in fiscal 2009, with restatement of prior periods. Upon adoption of this standard, the Company reclassified the net carrying value of its computer software and development costs from property, plant and equipment to intangible assets. The resulting adjustments to the Company's consolidated financial statements are described in Note 3 of the consolidated financial statements.

## New Accounting Pronouncements

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

### Business Combinations

Section 1582 of the CICA Handbook, "Business Combinations", replaces the existing Section 1580, "Business Combinations." The CICA also issued Section 1601, "Consolidated Financial Statements" and Section 1602, "Non-Controlling Interests", which replaces Section 1600, "Consolidated Financial Statements." These new sections are based on the International Accounting Standards Board's ("IASB") International Financial Reporting Standard 3, "Business Combinations" and will replace the existing guidance on business combinations and consolidated financial statements. The objective of the new standards is to harmonize Canadian accounting for business combinations with the international and U.S. accounting standards. The three new standards have to be adopted concurrently and will apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Assets and liabilities that arose from business combinations whose acquisition dates preceded the application of the new standards will not be adjusted upon application of these new standards. Section 1602 should be applied retrospectively except for certain items. The Company is currently assessing whether it will apply the new accounting standards at the beginning of its fiscal 2012 year or elect to early adopt.

### International Financial Reporting Standards

In February 2008, the Canadian Accounting Standards Board confirmed its plan to converge with International Financial Reporting Standards ("IFRS"). The Company must prepare the interim and annual financial statement in accordance with IFRS for fiscal years beginning on or after January 1, 2011. The Company's launch of its IFRS conversion project began in 2008 where it engaged an external consultant to conduct a preliminary diagnosis and scoping exercise. To date, a project team has been established to complete a detail assessment of each standard, including identifying the differences between the Company's current policies and those under IFRS, and determining the financial implications that result from the adoption of these new standards. Project plans are also being developed to address the information technology and data system impacts, disclosure controls and procedures and internal controls over financial reporting.

## 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.

### Credit, Foreign Exchange, and Interest Rate Risks

Foreign exchange risk is largely limited to currency fluctuations between the Canadian and US Dollars. The Company has minimal requirements for Euros, British Pounds, Hong Kong Dollars or other currencies. Indigo historically used foreign currency derivative contracts to hedge its foreign exchange risks. Given Indigo has determined that its foreign currency risk is manageable going forward, the Company decided to stop its hedging program as at the end of last fiscal year.

The Company's interest rate risk is limited to the fluctuation of floating rates on its outstanding operating line. Counterparty credit risk is considered to be negligible as the Company only deals with highly rated financial institutions.

### Leases

The average unexpired lease term of Indigo's superstores and small format stores is approximately 4.6 years and 2.7 years, respectively. 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 supercentre and shopping mall space. Unforeseen increases in occupancy costs, or costs incurred as a result of unanticipated store closing and relocation could unfavourably impact the Company's performance.

### 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 March 28, 2009 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

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

As required by National Instrument 52-109 (Certification of Disclosure in Issuers' Annual and Interim Filings), the CEO and CFO have evaluated, or caused to be evaluated under their supervision the effectiveness of such disclosure controls and procedures. Based on that evaluation, they have concluded that the design and operation of the system of disclosure controls and procedures were effective as at March 28, 2009.

## Internal Control over Financial Reporting

Management is also responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with Canadian generally accepted accounting principles.

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

As required by National Instrument 52-109 (Certification of Disclosure in Issuers' Annual and Interim Filings), the CEO and CFO have evaluated or caused to be evaluated under their supervision the effectiveness of such internal control over financial reporting using the framework established in the Internal Control – Integrated Framework (COSO Framework) published by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that evaluation, they have concluded that the design and operation of the Company's internal control over financial reporting were effective as at March 28, 2009.

## Changes in Internal Control over Financial Reporting

Management has also evaluated whether there were changes in the Company's internal control over financial reporting that occurred during the period beginning on December 28, 2008 and ended on March 28, 2009 that have materially affected, or are reasonably likely to material affect the Company's internal control over financial reporting.

The Company implemented a new work force management software application in March of 2009. The software was implemented to manage the retail labour personnel, which changed the manner in which retail hourly payroll was processed and recorded. Management designed and evaluated the operation of access and change controls within the application to mitigate the risk of error in financial reporting.

With the exception of the new work force management software application mentioned above, management has determined that no other material changes occurred during the period.

## Cautionary Statement Regarding Forward-Looking Statements

The above discussion includes forward-looking statements. All statements other than statements of historical facts included in this discussion that address activities, events or developments that the Company expects or anticipates will or may occur in the future are forward-looking statements. These statements are based on certain assumptions and analysis made by the Company in light of its experience, analysis and its perception of historical trends, current conditions and expected future developments as well as other factors it believes are appropriate in the circumstances. However, whether actual results and developments will conform 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.

## Non-GAAP Financial Measures

The Company prepares its consolidated financial statements in accordance with Canadian generally accepted accounting principles. In order to provide additional insight into the business, the Company has also provided non-GAAP data, including comparable store sales and EBITDA, in the discussion and analysis section above. Neither measure has a standardized meaning prescribed by GAAP, and is therefore specific to Indigo and may not be comparable to similar measures presented by other companies.

Comparable store sales and EBITDA are key indicators used by the Company to measure performance against internal targets and prior period results. Both measures are commonly used by financial analysts and investors to compare Indigo to other retailers. Comparable store sales are defined as sales generated by stores that have been open for more than 12 months. It is a key performance indicator for the Company as this measure excludes sales fluctuations due to store closings, permanent relocation and chain expansion. EBITDA is defined as earnings before interest, taxes, depreciation and amortization.

A reconciliation between comparable store sales and revenues (the most comparable GAAP measure) was included earlier in this report. A reconciliation between EBITDA and earnings before income taxes (the most comparable GAAP measure) is provided below:

| (millions of dollars) | 52-week period ended March 28, 2009 | 52-week period ended March 29, 2008 (Restated – Note 3) |
|---|---|---|
| EBITDA | **72.5** | 73.9 |
| Amortization of of property, plant and equipment | **22.2** | 26.3 |
| Amortization of intangible assets | **5.6** | 3.4 |
| Amortization of pre-opening store costs | **–** | 0.1 |
| Interest on long-term debt and financing charges | **0.3** | 0.8 |
| Interest income on cash and cash equivalents | **(1.4)** | (0.7) |
| Earnings before income taxes | **45.8** | 44.0 |

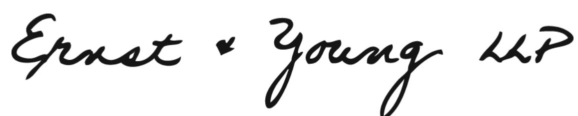
# Auditors' Report

## To the Shareholders of Indigo Books & Music Inc.

We have audited the consolidated balance sheets of Indigo Books & Music Inc. as at March 28, 2009 and March 29, 2008 and the consolidated statements of earnings, retained earnings (deficit), comprehensive income and cash flows for the 52-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 March 28, 2009 and March 29, 2008 and the results of its operations and its cash flows for the 52-week periods then ended in accordance with Canadian generally accepted accounting principles.




Ernst & Young LLP Chartered Accountants
Licensed Public Accountants

Toronto, Canada,
May 21, 2009

# Consolidated Balance Sheets

| (thousands of dollars) | As at March 28, 2009 | As at March 29, 2008 (Restated – Note 3) |
|---|---|---|
| **ASSETS** | | |
| **Current** | | |
| Cash and cash equivalents | **92,169** | 55,933 |
| Accounts receivable | **9,890** | 8,996 |
| Inventories (note 3) | **221,767** | 206,259 |
| Income taxes recoverable | **–** | 21 |
| Prepaid expenses | **5,118** | 4,929 |
| Future tax assets (notes 5 and 14) | **6,181** | 6,745 |
| **Total current assets** | **335,125** | 282,883 |
| Property, plant and equipment (notes 3 and 4) | **72,137** | 57,588 |
| Future tax assets (notes 5 and 14) | **36,422** | 43,250 |
| Intangible assets (notes 3 and 9) | **16,299** | 9,760 |
| Goodwill | **27,523** | 27,523 |
| **Total assets** | **487,506** | 421,004 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| **Current** | | |
| Accounts payable and accrued liabilities (notes 2 and 14) | **233,353** | 193,323 |
| Deferred revenue | **11,612** | 10,350 |
| Income taxes payable | **344** | – |
| Current portion of long-term debt (notes 6 and 12) | **2,734** | 2,648 |
| **Total current liabilities** | **248,043** | 206,321 |
| Long-term accrued liabilities | **6,301** | 7,549 |
| Long-term debt (notes 6 and 12) | **2,272** | 3,380 |
| **Total liabilities** | **256,616** | 217,250 |
| Commitments and contingencies (notes 6 and 12) | | |
| **Shareholders' equity** | | |
| Share capital (note 7) | **196,471** | 198,938 |
| Contributed surplus (note 8) | **3,685** | 2,564 |
| Retained earnings | **30,734** | 2,252 |
| **Total shareholders' equity** | **230,890** | 203,754 |
| **Total liabilities and shareholders' equity** | **487,506** | 421,004 |

See accompanying notes

Heather M. Reisman
Director

Michael Kirby
Director

# Consolidated Statements of Earnings

| (thousands of dollars, except per share data) | 52-week period ended March 28, 2009 | 52-week period ended March 29, 2008 (Restated – Note 3) |
|---|---|---|
| **Revenues** | 940,399 | 922,878 |
| Cost of sales, operations, selling and administration | 867,945 | 848,934 |
| | 72,454 | 73,944 |
| Amortization of property, plant and equipment | 22,223 | 26,322 |
| Amortization of intangible assets (note 9) | 5,638 | 3,343 |
| Amortization of pre-opening store costs | – | 144 |
| | 27,861 | 29,809 |
| Earnings before the undernoted items | 44,593 | 44,135 |
| Interest on long-term debt and financing charges (note 6) | 309 | 786 |
| Interest income on cash and cash equivalents | (1,443) | (704) |
| Earnings before income taxes | 45,727 | 44,053 |
| Income tax expense (recovery) (note 5) | | |
| Current | 344 | – |
| Future | 14,733 | (8,755) |
| | 15,077 | (8,755) |
| **Net earnings** | 30,650 | 52,808 |
| **Net earnings per common share** (notes 7 and 8) | | |
| Basic | $1.24 | $2.13 |
| Diluted | $1.21 | $2.08 |

See accompanying notes

# Consolidated Statements of Retained Earnings (Deficit)

| (thousands of dollars) | 52-week period ended March 28, 2009 | 52-week period ended March 29, 2008 (Restated – Note 3) |
|---|---|---|
| **Retained earnings (deficit), beginning of period, as reported** | **2,252** | (50,537) |
| Transitional adjustment on adoption of new accounting policies | **–** | (19) |
| **Retained earnings (deficit), beginning of period, as restated** | **2,252** | (50,556) |
| Net earnings | **30,650** | 52,808 |
| Shares repurchase excess (note 7) | **(2,168)** | – |
| **Retained earnings, end of period** | **30,734** | 2,252 |

See accompanying notes

# Consolidated Statements of Comprehensive Income

| (thousands of dollars) | 52-week period ended March 28, 2009 | 52-week period ended March 29, 2008 (Restated – Note 3) |
|---|---|---|
| **Net earnings** | **30,650** | 52,808 |
| **Other comprehensive loss, net of tax** | | |
| Reclassification to earnings of losses on derivatives designated as cash flow hedges prior to April 1, 2007 (net of tax – $nil) | – | (144) |
| Other comprehensive loss, net of tax | – | (144) |
| **Comprehensive income** | **30,650** | 52,664 |

See accompanying notes

# Consolidated Statements of Cash Flows

| (thousands of dollars) | 52-week period ended March 28, 2009 | 52-week period ended March 29, 2008 (Restated – Note 3) |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Net earnings | 30,650 | 52,808 |
| Add (deduct) items not affecting cash | | |
| Amortization of property, plant and equipment | 22,223 | 26,466 |
| Stock-based compensation (note 8) | 862 | 751 |
| Directors' compensation (note 8) | 362 | 341 |
| Future tax assets (note 5) | 10,324 | (8,755) |
| Loss on disposal of property, plant and equipment | 30 | 105 |
| Amortization of intangible assets (note 9) | 5,638 | 3,343 |
| Amortization and write-off of deferred financing charges | – | 258 |
| Other | – | (19) |
| Net change in non-cash working capital balances related to operations | | |
| Accounts receivable | (894) | 852 |
| Inventories | (15,508) | 17,800 |
| Prepaid expenses | (189) | (495) |
| Income taxes recoverable/payable | 365 | 173 |
| Deferred revenue | 1,262 | (271) |
| Accounts payable and accrued liabilities | 38,782 | (16,477) |
| **Cash flows from operating activities** | 93,907 | 76,880 |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Purchase of property, plant and equipment | (34,041) | (16,234) |
| Addition of intangible assets (note 9) | (12,176) | (3,298) |
| Proceeds from sale of property, plant and equipment | – | 691 |
| Acquistion of non-capital tax losses (note 14) | (2,932) | – |
| **Cash flows used in investing activities** | (49,149) | (18,841) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Repayment of long-term debt (note 6) | (3,784) | (16,811) |
| Proceeds from share issuances (note 7) | 287 | 1,066 |
| Repurchase of common shares (note 7) | (5,025) | – |
| **Cash flows used in financing activities** | (8,522) | (15,745) |
| **Net increase in cash and cash equivalents during the period** | 36,236 | 42,294 |
| Cash and cash equivalents, beginning of period | 55,933 | 13,639 |
| **Cash and cash equivalents, end of period** | 92,169 | 55,933 |

See accompanying notes

# Notes to Consolidated Financial Statements

March 28, 2009

## 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 10 provinces and one territory in Canada, including 90 superstores (March 29, 2008 – 86) under the *Chapters*, *Indigo* and *World's Biggest Bookstore* names, as well as 155 small format stores (March 29, 2008 – 158) under the banners *Coles*, *Indigo*, *Indigospirit*, *SmithBooks* and *The Book Company* and two new concept stores under the banner *Pistachio*. The Company operates *www.chapters.indigo.ca*, an e-commerce retail destination, which sells books, videos, DVDs, music and toys. In February 2009, Indigo launched *Shortcovers* (www.shortcovers.com), a new digital destination offering online and mobile service that provides instant access to the newest books, articles and blogs. The Company also operates seasonal kiosks and year-round stores in shopping malls across Canada through its Calendar Club of Canada Limited Partnership.

In October 2005, Indigo incorporated a separate registered charity under the name Indigo Love of Reading Foundation (the "Foundation"). The Foundation provides new books and learning material to high-needs elementary schools across the country through donations from Indigo, its customers, suppliers and employees.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of consolidation**

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

**Use of estimates**

The preparation of financial statements in accordance with Canadian GAAP 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 revenues and expenses during the reporting periods. Actual results may differ from those estimates.

**Joint venture**

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

**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.

**Inventories**

Inventories are valued at the lower of cost, determined on a moving average cost basis, and market, being net realizable value. Costs include all direct and reasonable expenditures that are incurred in bringing inventories to their present location and condition. Vendor rebates are recorded as a reduction in the price of the vendor's products and corresponding inventory is recorded net of vendor rebates.

**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.

**Prepaid expenses**

Prepaid expenses include store supplies, rent, license fees and maintenance contracts. Store supplies are expensed as they are being used and other costs are amortized over the term of the contract.

**Property, plant and equipment**

Property, plant and equipment are recorded at cost and amortized over their estimated useful lives on a straight-line basis. The amortization periods are as follows:

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

Long-lived assets are reviewed for impairment when events or changes in circumstances indicate that their carrying value exceeds the sum of the undiscounted cash flows expected from their use and eventual disposition. The evaluation is performed for the lowest level of a group of assets and liabilities. An impairment loss, if required, is measured as the excess of the carrying value of the asset over its fair value. The Company reviews long-lived assets for impairment at least annually.

**Goodwill**

Goodwill represents the excess of the purchase price of an acquired business over the value assigned to the net identifiable assets, including intangible assets, acquired at the date of acquisition. Goodwill is not amortized but is subject to review for impairment at the reporting unit level on an annual basis and at any other time if events occur or circumstances change that suggests goodwill could be impaired. Fair value is determined using the discounted cash flow method.

**Intangible assets**

Intangible assets are recorded at cost and amortized over their estimated useful lives on a straight-line basis. The amortization periods are as follows:

| | |
|---|---|
| Product design costs | 2 years |
| Computer application software | 3 – 5 years |
| Development costs | 3 years |

The Company reviews the intangible assets for impairment at least annually.

**Gift cards**

The Company sells gift cards to its customers and recognizes the revenue as the gift cards are redeemed. The Company also recognizes revenue from unredeemed gift cards (gift card breakage) if the likelihood of the gift card being redeemed by the

customer is considered to be remote. The Company determines its average gift card breakage rate based on historical redemption rates. Once the breakage rate is determined, the resulting revenue is recognized over the estimated period of redemption, commencing when the gift cards are sold, based on historical redemption patterns. Gift card breakage is included in revenues in the Company's consolidated statements of earnings.

The Company recorded $4.6 million in gift card breakage in fiscal 2009, and $2.9 million in gift card breakage in fiscal 2008. As at March 28, 2009, the provision for unredeemed gift card liability is $34.5 million (March 29, 2008 – $32.7 million) and is included in accounts payable and accrued liabilities.

**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 12-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.

**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.

**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 revenues net of sales discounts and returns and is inclusive of amounts invoiced for shipping.

**Leased premises**

The Company conducts a substantial part of its business from leased premises. Leasehold improvements are amortized over the lesser of their economic life or the "lease term", representing the initial lease term and including renewal periods only where renewal has been determined to be reasonably assured.

Leasehold improvements are reviewed for impairment and impairment losses are measured, as described above under property, plant and equipment policy. The Company also uses this lease term to evaluate whether its leases are operating or capital leases. As at March 28, 2009 and March 29, 2008, all of the Company's leases on premises were accounted for as operating leases.

Inducements received from landlords, including leasehold improvement allowances, are amortized over the lease term.

**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.

**Earnings per share**

Basic earnings per share are 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 are calculated in accordance with the treasury stock method and are 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 securities.

**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 foreign exchange rates in effect at the consolidated balance sheet dates with the resultant gains or losses included in net earnings for the period.

**Financial instruments**
The Company revalues certain of its financial assets and liabilities, including derivatives designated in qualifying hedging relationships and embedded derivatives in certain contracts, at fair value at each financial reporting date.

Financial assets and liabilities are classified according to their characteristics and management's intentions for the purposes of ongoing measurement.

Classification for financial assets includes:

a) held-for-trading – measured at fair value with changes in fair value recorded in net earnings;
b) held-to-maturity – recorded at amortized cost using the effective interest rate method, with gains and losses recognized in net earnings in the period that the asset is de-recognized or impaired;
c) available-for-sale – measured at fair value with changes in fair value recognized in other comprehensive income for the current period until realized through de-recognition or impairment; and
d) loans and receivables – recorded at amortized cost using the effective interest rate method, with gains and losses recognized in net earnings in the period that the asset is de-recognized or impaired.

Classification for financial liabilities includes:

a) held-for-trading – measured at fair value with changes in fair value recorded in net earnings; and
b) other – measured at amortized cost using the effective interest rate method, with gains and losses recognized in net earnings in the period that the liability is de-recognized.

The Company's financial assets and liabilities are generally classified and measured as follows:

| Financial Asset/Liability | Category | Measurement |
|---|---|---|
| Cash and cash equivalents | Held for trading | Fair value |
| Accounts receivable | Loans and receivables | Amortized cost |
| Bank indebtedness | Other liabilities | Amortized cost |
| Accounts payable | Other liabilities | Amortized cost |
| Other accrued liabilities | Other liabilities | Amortized cost |
| Long-term debt | Other liabilities | Amortized cost |

Other balance sheet accounts, such as inventories, prepaid expenses, future income taxes, property, plant and equipment, goodwill, intangible assets and deferred revenue are not financial instruments.

Embedded derivatives are separated and measured at fair values if certain criteria are met. Management reviewed all material contracts and determined that the Company does not currently have any significant embedded derivatives that require separate accounting and disclosure.

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, bank indebtedness and accounts payable and accrued liabilities approximate their carrying values given their short maturities.

(ii) The fair value 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.

**Comprehensive income**

Other comprehensive income includes revenues, expenses, gains and losses that, in accordance with primary sources of Canadian GAAP, are recognized in comprehensive income, but excluded from net earnings. The Company reports the "Consolidated Statements of Comprehensive Income" for changes in the fair value of certain of these financial assets and liabilities (i.e., the effective portion of changes in the fair value of a derivative designated in a cash flow hedging relationship). Any "accumulated other comprehensive income" (i.e., the portion of comprehensive income not already included in net earnings) will be presented as a separate line item in shareholders' equity.

**Hedges**

When the Company enters into foreign currency option contracts to hedge future purchases of US dollar denominated goods and services, the fair value of these contracts is included in derivative liabilities. The changes in fair value of these contracts are included in other comprehensive income/loss to the extent the hedges continue to be effective. When the inventory is sold, the corresponding gain or loss deferred in accumulated other comprehensive income/loss is re-classified to cost of sales, operations, selling and administration. To the extent the change in fair value of the derivative is not completely offset by the change in fair value of the hedged item, the ineffective portion of the hedging relationship is recorded immediately in net earnings.

## 3. CHANGES IN ACCOUNTING POLICIES

**Financial Instruments**

Section 3862 and 3863 of the Canadian Institute of Chartered Accountants ("CICA") Handbook, "Financial Instruments – Disclosures" and "Financial Instruments – Presentation", replace the existing Section 3861, "Financial Instruments – Disclosures and Presentation". The new sections revise and enhance disclosure requirements, and carry forward unchanged existing presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. These standards were adopted by the Company for the fiscal year beginning March 30, 2008 and their implementation did not have an impact on the classification and valuation of the Company's consolidated financial statements. The resulting disclosures from implementation are presented below.

### Financial risk management

The Company's activities expose it to a variety of financial risks, including risks related to foreign exchange, interest rate, credit and liquidity.

### Foreign exchange risk

The Company's foreign exchange risk is largely limited to currency fluctuations between the Canadian and US dollar. Decreases in the value of the Canadian dollar relative to the US dollar affect less than 10% of the Company's total cost of purchases and could negatively impact the Company's net earnings. The Company does not use foreign currency derivative contracts to hedge its foreign exchange risk.

### Interest rate risk

The Company's interest rate risk is limited to the fluctuation of floating rates on its outstanding operating line. The Company did not use its operating line and does not use any interest rate swaps to fix the interest rate on its operating line.

### Credit risk

The Company's credit risk is considered to be negligible as the Company only deals with highly rated financial institutions. In addition, the Company has minimal accounts receivable as its customers pay mainly by cash or credit card. The maximum exposure to credit risk at the reporting date is equal to the carrying value of the accounts receivable.

### Liquidity risk

The Company manages liquidity risk by maintaining available financial assets in excess of financial obligations due at any point in time. The Company achieves this objective by maintaining sufficient cash and cash equivalents or through the availability of funding from its revolving line of credit.

### Current liabilities and long-term liabilities

The contractual maturities of the Company's current and long-term liabilities as at March 28, 2009 are as follows:

| (thousands of dollars) | Payments due in the next 90 days | Payments due between 90 days and less than a year | Payments due after 1 year | Total |
|---|---|---|---|---|
| Accounts payable and accrued liabilities | 174,557 | 54,825 | 3,971 | 233,353 |
| Current portion of long-term debt | – | 2,734 | – | 2,734 |
| Long-term debt | – | – | 2,272 | 2,272 |
| Long-term accrued liabilities | – | – | 6,301 | 6,301 |
| Total | 174,557 | 57,559 | 12,544 | 244,660 |

## Capital disclosures

Section 1535 of the CICA Handbook, "Capital Disclosures", specifies the disclosure of: (i) the Company's objectives, policies and processes for managing capital; (ii) quantitative information about what it manages as capital; and (iii) whether the Company has complied with any externally imposed capital requirement and the consequences of such non-compliance. This standard was effective for the Company's fiscal year beginning March 30, 2008. The resulting disclosures from implementation are presented below.

## Capital management

The Company's objectives when managing capital are to safeguard the entity's ability to continue as a going concern while maintaining adequate financial flexibility to invest in new business opportunities that will provide attractive returns to shareholders. The primary activities engaged by the Company to generate attractive returns include the construction and related leasehold improvements of new and relocated stores, the development of new business concepts, and investment in information technology and distribution capacity to support the expansion of the store and online network. The Company's main sources of capital are cash flows generated from operations, a revolving line of credit and long-term debt. This cash flow is used to fund its capital expenditures, working capital needs, debt service requirements, and dividend distribution to shareholders. There were no changes to these objectives during 2009.

The Company monitors its capital structure principally through measuring its total debt to shareholders' equity ratio and ensures its ability to service its debt obligation by tracking its interest and other fixed charge coverage ratios. Total debt is defined as the total of bank indebtedness and long-term debt (including the current portion). The Company has certain debt covenants and is in compliance with those covenants.

The following table summarizes selected capital structure information for the Company for the periods indicated.

| (thousands of dollars) | 52-week period ended March 28, 2009 | 52-week period ended March 29, 2008 |
|---|---|---|
| Current portion of long-term debt | 2,734 | 2,648 |
| Long-term debt | 2,272 | 3,380 |
| Total debt | 5,006 | 6,028 |
| Shareholders' equity | 230,890 | 203,754 |
| Total debt : Shareholders' equity | 0.02:1 | 0.03:1 |

**Inventories**

The CICA issued Handbook Section 3031, "Inventories" which prescribes the accounting treatment for inventories. This section provides guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories. This standard was adopted by the Company for the fiscal year beginning March 30, 2008. The resulting disclosures from implementation are presented below.

Inventories are valued at the lower of cost, determined on a moving average cost basis, and market, being net realizable value. Costs include all direct and reasonable expenditures that are incurred in bringing inventories to their present location and condition. Vendor rebates are recorded as a reduction in the price of the products and corresponding inventory is recorded net of vendor rebates.

The cost of inventories recognized as an expense was $532.4 million in fiscal 2009. The amount of inventory write-downs as a result of net realizable value lower than cost was $1.7 million in fiscal 2009, and there were no reversals of inventory write-downs that were recognized in prior periods. The amount of inventory with net realizable value equal to cost was $1.9 million as at March 28, 2009. The full value of the inventories was pledged as security under the Company's credit agreement with its bank.

**General standards of financial statement presentation**

The CICA amended Section 1400 of the Handbook which requires management to make an assessment of an entity's ability to continue as a going concern when preparing financial statements. In assessing whether the going concern assumption is appropriate, management must take into account all available information about the future, which is at least, but is not limited to, 12 months from the balance sheet date. This standard was adopted by the Company for the fiscal year beginning March 30, 2008 and its implementation did not have an impact on the classification and valuation of the Company's consolidated financial statements.

**Goodwill and intangible assets**

Section 3064 of the CICA Handbook, "Goodwill and Intangible Assets", replaces the existing Section 3062, "Goodwill and Other Intangible Assets" and Section 3450, "Research and Development Costs". In conjunction with the issuance of this new standard, the CICA has amended Section 1000, "Financial Statement Concepts". These changes clarify the criteria for asset recognition for an internally developed intangible asset and reinforce the distinction between costs that should be expensed and those that should be capitalized. This standard was applied retrospectively by the Company in fiscal 2009, with restatement of prior periods. Upon adoption of this standard, the Company reclassified the net carrying value of its computer software and development costs from property, plant and equipment to intangible assets. The resulting adjustments that were recorded in the Company's consolidated financial statements are summarized below:

**Consolidated balance sheets**

| *Increase (decrease)*<br>(thousands of dollars) | As at March 28, 2009 | As at March 29, 2008 |
|---|---|---|
| Property, plant and equipment | (15,681) | (9,760) |
| Intangible assets | 15,681 | 9,760 |

**Consolidated statements of earnings**

| *Increase (decrease)*<br>(thousands of dollars) | 52-week period ended March 28, 2009 | 52-week period ended March 29, 2008 |
|---|---|---|
| Amortization of property, plant and equipment | (5,520) | (3,343) |
| Amortization of intangible assets | 5,520 | 3,343 |

## New Accounting Pronouncements

### Business combinations

Section 1582 of the CICA Handbook, "Business Combinations", replaces the existing Section 1580, "Business Combinations." The CICA also issued Section 1601, "Consolidated Financial Statements" and Section 1602, "Non-Controlling Interests", which replaces Section 1600, "Consolidated Financial Statements." These new sections are based on the International Accounting Standards Board's ("IASB") International Financial Reporting Standard 3, "Business Combinations" and will replace the existing guidance on business combinations and consolidated financial statements. The objective of the new standards is to harmonize Canadian accounting for business combinations with the international and U.S. accounting standards. The three new standards have to be adopted concurrently and will apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Assets and liabilities that arose from business combinations whose acquisition dates preceded the application of the new standards will not be adjusted upon application of these new standards. Section 1602 should be applied retrospectively except for certain items. The Company is currently assessing whether it will apply the new accounting standards at the beginning of its fiscal 2012 year or elect to early adopt.

### International financial reporting standards

In February 2008, the Canadian Accounting Standards Board confirmed its plan to converge with IFRS. The Company must prepare interim and annual financial statements in accordance with IFRS for fiscal years beginning on or after January 1, 2011. The Company's launch of its IFRS conversion project began in 2008 where it engaged an external consultant to conduct a preliminary diagnosis and scoping exercise. To date, a project team has been established to complete a detail assessment of each standard, including identifying the differences between the Company's current policies and those under IFRS, and determining the financial implications that result from the adoption of these new standards. Project plans are also being developed to address the information technology and data system impacts, disclosure controls and procedures and internal controls over financial reporting.

## 4. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

| (thousands of dollars) | March 28, 2009 Cost | March 28, 2009 Accumulated amortization | March 29, 2008 Cost | March 29, 2008 Accumulated amortization |
|---|---|---|---|---|
| Furniture, fixtures and equipment | **124,740** | **96,909** | 114,580 | 89,938 |
| Computer equipment | **63,112** | **51,781** | 55,186 | 47,007 |
| Leasehold improvements | **105,218** | **78,255** | 89,674 | 71,410 |
| Equipment under capital lease | **13,760** | **7,748** | 12,885 | 6,382 |
| | **306,830** | **234,693** | 272,325 | 214,737 |
| Less accumulated amortization | **234,693** | | 214,737 | |
| **Net book value** | **72,137** | | 57,588 | |

As at the end of the year, the Company has $0.7 million (March 29, 2008 – $0.9 million) of leasehold improvements that are not being amortized because the stores are still under construction. The depreciation expense associated with capital leases was $3.3 million (March 29, 2008 – $2.9 million).

## 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) | March 28, 2009 | March 29, 2008 |
|---|---|---|
| **Current future tax assets** | | |
| Reserves and allowances | **6,181** | 6,745 |
| **Net current future tax assets** | **6,181** | 6,745 |

| (thousands of dollars) | March 28, 2009 | March 29, 2008 |
|---|---|---|
| **Non-current future tax assets** | | |
| Tax loss carryforwards | **7,320** | 8,332 |
| Book amortization in excess of cumulative eligible capital deduction | **409** | 416 |
| Book amortization in excess of capital cost allowance | **28,693** | 34,502 |
| **Net non-current future tax assets** | **36,422** | 43,250 |

Significant components of income tax expense (recovery) attributable to continuing operations are as follows:

| (thousands of dollars) | 52-week period ended March 28, 2009 | 52-week period ended March 29, 2008 |
|---|---|---|
| Current income tax expense | 344 | – |
| Future income tax expense relating to origination and reversal of temporary differences | 7,071 | 11,282 |
| Decrease in valuation allowance | – | (27,270) |
| Future income tax expense relating to utilization of loss carryforwards | 7,817 | 4,440 |
| Other, net | (11) | (114) |
| Adjustment to future tax assets resulting from reduction in substantively enacted tax rates | (144) | 2,907 |
| **Total income tax expense (recovery)** | **15,077** | (8,755) |

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

| (thousands of dollars) | 52-week period ended March 28, 2009 | 52-week period ended March 29, 2008 |
|---|---|---|
| Tax at combined federal and provincial tax rates (2009: 32.41%, 2008: 34.45%) | 14,820 | 15,176 |
| Tax effect of expenses not deductible for income tax purposes | 412 | 546 |
| Decrease in valuation allowance | – | (27,270) |
| Adjustment to future tax assets resulting from reduction in substantively enacted tax rates | (144) | 2,907 |
| Other, net | (11) | (114) |
| | 15,077 | (8,755) |

As at March 28, 2009, the Company has combined non-capital loss carryforwards of approximately $23.1 million for income tax purposes that expire in 2029 if not utilized.

## 6. BANK INDEBTEDNESS AND LONG-TERM DEBT

In the first quarter of fiscal 2008, the Company refinanced its debt and reduced the borrowing capacity under the line of credit to $60.0 million based on defined levels of inventories and accounts receivable, bearing interest, at the Company's option, at either the bank's prime rate or the bankers' acceptance rate plus 0.00% to 1.50% depending on certain financial ratios. The revolving line of credit expired on October 15, 2008. In the third quarter of fiscal 2009, the Company extended the revolving line of credit for an additional year and reduced the borrowing capacity from $60.0 million to $30.0 million based on lower borrowing needs. As at March 28, 2009, no funds were drawn against this facility (March 29, 2008 – nil). At March 28, 2009, the Company's interest rate would have been the bankers' acceptance rate plus 1.00% which would have resulted in an effective interest rate of 1.53% (March 29, 2008 – 4.58%).

The revolving line of credit is collateralized by a first-ranking security over the Company's inventories, receivables and intellectual properties, and is dependent upon continued compliance with certain financial covenants. As at March 28, 2009, the Company was compliant with all its banking 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 involved the exchange of 30-day bankers' acceptance floating interest rates for fixed interest rates on a notional amount of $49.0 million. There were reductions in the notional amounts of the derivative agreement that coincided with the principal repayments of the underlying long-term debt. The fixed interest rate on the notional amount was 3.06%. The agreement expired on July 31, 2007, but was terminated in April 2007 as part of the debt refinancing, as noted above.

As at March 28, 2009, the Company had outstanding letters of credit totaling $0.3 million (March 29, 2008 – $0.3 million).

## 7. 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

| | 52-week period ended March 28, 2009 | | 52-week period ended March 29, 2008 | |
|---|---|---|---|---|
| | Number of shares | Amount $ (thousands) | Number of shares | Amount $ (thousands) |
| Balance, beginning of period | **24,843,147** | **198,938** | 24,647,554 | 197,592 |
| Issued during the period | | | | |
| Directors' deferred stock units converted | – | – | 14,964 | 85 |
| Options exercised | **39,750** | **390** | 180,629 | 1,261 |
| Repurchase of common shares | **(356,625)** | **(2,857)** | – | – |
| **Balance, end of period** | **24,526,272** | **196,471** | 24,843,147 | 198,938 |

During fiscal 2008, the Company issued 14,964 shares in exchange for directors' deferred stock units when a Board member retired.

On May 6, 2008, the Company announced its intent to make a normal course issuer bid ("NCIB"), subject to final acceptance of its notice of intention by the Toronto Stock Exchange. The Toronto Stock Exchange approved the NCIB on May 8, 2008. Under the NCIB, Indigo may purchase up to 1,242,157 of its common shares, representing approximately 5% of its total outstanding common shares. Daily purchases are limited to 2,905 common shares, other than block purchase exceptions. During fiscal 2009 the Company repurchased 356,625 common shares at an average price of $14.09 per share for total cash consideration of $5.0 million. The repurchased shares were cancelled and returned to treasury. The cash consideration exceeded the carrying value of the shares repurchased by $2.2 million and the amount was charged to retained earnings.

The Company calculates diluted earnings per share using the treasury stock method. In calculating diluted earnings per share amounts under this method, the numerator remains unchanged from the basic earnings per share calculations as the assumed exercise of the Company's stock options and the conversion of the deferred stock units 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) | 52-week period ended March 28, 2009 | 52-week period ended March 29, 2008 |
|---|---|---|
| Weighted average number of common shares outstanding, basic | 24,675 | 24,744 |
| Effect of dilutive securities | | |
| – Stock options | 390 | 513 |
| – Deferred stock units | 167 | 138 |
| **Weighted average number of common shares outstanding, diluted** | 25,232 | 25,395 |

## 8. STOCK-BASED COMPENSATION

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 2,202,627. 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. Most options granted 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. A small number of options have special vesting schedules that were approved by the Board.

The fair value of stock options that were granted in fiscal 2009 was $0.4 million (2008 – $2.7 million). During the year, $0.9 million (2008 – $0.8 million) was recognized as stock-based compensation 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. In fiscal 2009, $0.1 million (2008 – $0.2 million) was transferred from contributed surplus for stock options that were exercised.

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

| | 52-week period ended March 28, 2009 | 52-week period ended March 29, 2008 |
|---|---|---|
| Risk-free interest rate | 2.7% | 4.2% |
| Expected volatility | 34.7% | 21.3% |
| Expected time until exercise | 5.0 years | 4.0 years |
| Expected dividend yield | 0.0% | 0.0% |

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

| | March 28, 2009 | | March 29, 2008 | |
|---|---|---|---|---|
| | Number # | Weighted average exercise price $ | Number # | Weighted average exercise price $ |
| Outstanding options, beginning of period | 1,649,379 | 11.38 | 1,258,046 | 7.71 |
| Granted | 100,000 | 12.51 | 690,000 | 16.05 |
| Forfeited | (82,484) | 7.87 | (118,038) | 7.89 |
| Exercised | (39,750) | 7.23 | (180,629) | 5.90 |
| **Outstanding options, end of period** | 1,627,145 | 11.73 | 1,649,379 | 11.38 |
| **Options exercisable, end of period** | 808,457 | 9.01 | 549,702 | 7.59 |

**Options outstanding and exercisable**

| | March 28, 2009 | | | | |
|---|---|---|---|---|---|
| | 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 | 366,450 | 4.89 | 4.8 | 366,450 | 4.89 |
| 6.00 – 9.99 | 293,492 | 7.63 | 5.5 | 207,804 | 7.54 |
| 10.00 – 27.99 | 952,576 | 15.10 | 8.3 | 219,576 | 14.80 |
| 28.00 – 33.99 | 6,530 | 32.70 | 0.5 | 6,530 | 32.70 |
| 34.00 – 64.00 | 8,097 | 56.85 | 2.5 | 8,097 | 56.85 |
| 4.00 – 64.00 | 1,627,145 | 11.73 | 7.0 | 808,457 | 9.01 |

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 28,690 DSUs with a value of $0.4 million during the period ended March 28, 2009 (2008 – $0.3 million). The fair value of the outstanding DSUs as at March 28, 2009 was $1.6 million and recorded in contributed surplus.

## 9. INTANGIBLE ASSETS

Intangible assets consist of the following:

| | March 28, 2009 | | March 29, 2008 | |
|---|---|---|---|---|
| (thousands of dollars) | Cost | Accumulated amortization | Cost | Accumulated amortization |
| Product design costs | 736 | 118 | – | – |
| Computer application software | 17,508 | 7,438 | 10,024 | 4,529 |
| Development costs | 32,837 | 27,226 | 28,880 | 24,615 |
| | 51,081 | 34,782 | 38,904 | 29,144 |
| Less accumulated amortization | 34,782 | | 29,144 | |
| Net book value | 16,299 | | 9,760 | |

## 10. JOINT VENTURE

The Company participates in a joint venture through a 50% equity ownership in the Calendar Club of Canada Limited Partnership to sell calendars, games and gifts through seasonal kiosks and year-round stores.

The following amounts represent the total assets, liabilities, revenues 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) | **2009** | 2008 | **2009** | 2008 |
| Current assets | **4,106** | 4,255 | **2,053** | 2,128 |
| Long-term assets | **1,613** | 2,157 | **807** | 1,079 |
| Current liabilities | **3,160** | 3,209 | **1,580** | 1,605 |
| Revenue | **32,006** | 32,158 | **16,003** | 16,079 |
| Expenses | **30,064** | 29,889 | **15,032** | 14,945 |
| **Net earnings** | **1,942** | 2,269 | **971** | 1,134 |
| **Cash flows provided by (used in)** | | | | |
| Operating activities | **2,781** | 2,689 | **1,390** | 1,346 |
| Investing activities | **(42)** | (621) | **(21)** | (311) |
| Financing activities | **(2,586)** | (2,136) | **(1,293)** | (1,068) |
| **Net cash flow** | **153** | (68) | **76** | (33) |

## 11. CONSOLIDATED STATEMENTS OF CASH FLOWS

Supplemental cash flow information:

| (thousands of dollars) | **52-week period ended March 28, 2009** | 52-week period ended March 29, 2008 |
|---|---|---|
| Interest paid (received) | **(1,178)** | 642 |
| Income taxes paid (recovered) | **–** | (173) |
| Assets acquired under capital lease | **2,762** | 2,091 |

## 12. COMMITMENTS AND CONTINGENCIES

### (a) Commitments

As at March 28, 2009, the Company had the following commitments:

(i) *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 2010 and 2020 and are subject to renewal options in certain cases. Annual store rent consists of a base amount plus, in some cases, additional payments based on store sales.

(ii) *Capital lease obligations*

The Company entered into capital lease agreements for certain equipment. The obligations under these capital leases is $5.0 million (2008 – $6.0 million), of which $2.7 million (2008 – $2.6 million) is included in the current portion of long-term debt.

The Company's minimum contractual obligations due over the next five fiscal years and thereafter are summarized below:

| (millions of dollars) | Operating leases | Capital leases | Total |
|---|---|---|---|
| 2010 | 60.8 | 2.7 | 63.5 |
| 2011 | 54.0 | 1.4 | 55.4 |
| 2012 | 48.2 | 0.6 | 48.8 |
| 2013 | 38.4 | 0.3 | 38.7 |
| 2014 | 25.3 | – | 25.3 |
| Thereafter | 38.9 | – | 38.9 |
| Total obligations | 265.6 | 5.0 | 270.6 |

**(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 March 28, 2009 cannot be predicted with certainty, management believes that any such amount would not have a material impact on the Company's financial position.

## 13. ACCUMULATED OTHER COMPREHENSIVE INCOME

Changes in accumulated other comprehensive income during fiscal 2008 are presented as follows:

| (thousands of dollars) | 52-week period ended March 28, 2009 | 52-week period ended March 29, 2008 |
|---|---|---|
| Adjusted opening balance due to adoption of new accounting policies – financial instruments | – | 144 |
| Other comprehensive loss for the period | – | (144) |
| **Balance, end of period** | – | – |

## 14. RELATED PARTY TRANSACTIONS

On March 27, 2009, Indigo purchased a company, the sole asset of which is certain tax losses, from a public company controlled by Mr. Gerald W. Schwartz, who is also the controlling shareholder of Indigo. Indigo acquired this company with $23.1 million of non-capital tax losses in exchange for net cash consideration of $2.9 million. The amount included transaction costs shared between the two companies. This transaction was recorded at the exchange amount. As a result, the Company recorded a future tax asset of $7.3 million and the difference of $4.4 million between the net cash consideration and the future tax asset was recorded as a deferred credit, included in accounts payable and accrued liabilities. As these acquired non-capital losses are utilized, the deferred credit will be proportionately recognized as a reduction of income tax expense.

Indigo engaged Mr. Bruce Mau and his company (Bruce Mau Design) to complete product and store design work for the Company. Mr. Bruce Mau serves on Indigo's Board of Directors. The transaction is part of the normal course of operations for the Company. The transaction is measured at the exchange amount of $0.1 million and expensed as incurred.

## 15. SUBSEQUENT EVENT

On May 22, 2009, the Board of Directors approved the payment of a quarterly cash dividend of $0.10 per common share, or $0.40 per common share annually. The Board declared the first cash dividend of $0.10 per outstanding common share to be paid to shareholders of record as of the close of business on June 15, 2009, with a payment date of June 30, 2009.

# 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

Heather Reisman
*Chair & Chief Executive Officer*

Kay Brekken
*Senior Vice President, Finance & Chief Accounting Officer*

Kathleen Flynn
*General Counsel & Secretary*

Joyce Gray
*Executive Vice President, Retail & Customer Experience*

Deirdre Horgan
*Chief Marketing Officer*

Ross Marancos
*Executive Vice President, Supply Chain*

Jim McGill
*Chief Financial Officer*

Michael Serbinis
*Chief Information Officer*

Joel Silver
*Chief Merchant*

Tova White
*Senior Vice President, Human Resources & Organizational Development*

## BOARD OF DIRECTORS

Kerry Adams
*President*
K. Adams & Associates Limited

Frank Clegg
*Chairman*
Navantis Inc.

Jonathan Deitcher
*Investment Advisor*
RBC Investments

Mitchell Goldhar
*President & Chief Executive Officer*
SmartCentres

James Hall
*Corporate Advisor & Director*

Michael Kirby
*Corporate Director*
Chair of the Mental Health Commission of Canada

Robert Lantos
*Chairman & Chief Executive Officer*
Serendipity Point Films

Bruce Mau
*Chairman & Creative Director*
Bruce Mau Design

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

Gerald Schwartz
*Chairman, President & CEO*
Onex Corporation

# Five Year Summary of Financial Information

| For the years ended (millions of dollars, except share and per share data) | March 28, 2009 | March 29, 2008 | March 31, 2007 | April 1, 2006 | April 2, 2005 |
|---|---|---|---|---|---|
| **SELECTED INCOME STATEMENT INFORMATION** | | | | | |
| Revenues | | | | | |
| Superstores | **634.7** | 620.0 | 591.0 | 573.5 | 532.5 |
| Small format stores | **166.2** | 159.7 | 157.1 | 160.9 | 154.9 |
| Online | **95.2** | 101.4 | 86.7 | 79.5 | 64.8 |
| Other | **44.3** | 41.8 | 40.2 | 37.9 | 37.0 |
| Total Revenues | **940.4** | 922.9 | 875.0 | 851.8 | 789.2 |
| EBITDA[1] | **72.5** | 73.9 | 65.7 | 56.6 | 44.2 |
| Restructuring and take-over costs (recovery) | **–** | – | (0.3) | (2.1) | (0.9) |
| EBIT | **45.8** | 44.1 | 32.7 | 29.6 | 18.1 |
| Net earnings per common share | **$1.24** | $2.13 | $1.23 | $1.05 | $0.49 |
| **SELECTED BALANCE SHEET INFORMATION** | | | | | |
| Working capital | **87.1** | 76.6 | 28.8 | 0.7 | (20.6) |
| Total assets | **487.5** | 421.0 | 397.3 | 390.7 | 392.4 |
| Long-term debt (including current portion) | **5.0** | 6.0 | 20.5 | 31.8 | 39.3 |
| Shareholders' equity | **230.9** | 203.8 | 148.8 | 115.7 | 88.9 |
| Long-term debt/(long-term debt + shareholders' equity) | **0.02:1** | 0.03:1 | 0.12:1 | 0.22:1 | 0.31:1 |
| Weighted average number of shares outstanding | **24,674,523** | 24,744,334 | 24,359,451 | 24,133,726 | 24,067,426 |
| Common shares outstanding at end of period | **24,526,272** | 24,843,147 | 24,647,554 | 24,255,918 | 24,081,352 |
| **STORE OPERATING STATISTICS** | | | | | |
| **Number of stores at end of period** | | | | | |
| Superstores | **90** | 86 | 88 | 86 | 86 |
| Small format stores | **155** | 158 | 158 | 164 | 166 |
| **Selling square footage at end of period (in thousands)** | | | | | |
| Superstores | **2,110** | 2,042 | 2,090 | 2,058 | 2,086 |
| Small format stores | **415** | 422 | 425 | 441 | 448 |
| **Comparable store sales** | | | | | |
| Superstores | **2.4%** | 4.4% | 2.5% | 10.2% | (0.5%) |
| Small format stores | **4.3%** | 3.0% | 2.2% | 4.3% | (2.3%) |
| **Sales per selling square foot** | | | | | |
| Superstores | **301** | 304 | 283 | 279 | 255 |
| Small format stores | **400** | 378 | 370 | 365 | 346 |

1 Earnings before interest, taxes, depreciation, amortization and capital assets write-off. Also see "Non-GAAP Financial Measures".

# Investor Information

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Janet Eger
*Director, Public Relations*
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## STOCK LISTING
Toronto Stock Exchange

## TRADING SYMBOL
IDG

## TRANSFER AGENT AND REGISTRAR
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## AUDITORS
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Ernst & Young Tower
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Toronto, Ontario
Canada M5K 1J7

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

Indigo's Annual Meeting will be held on June 25, 2009 at 10:00 a.m. at The MaRS Centre, South Tower, 101 College Street, Suite 100, Toronto, Ontario, Canada.

Shareholders are encouraged to attend and guests are welcome.

Une traduction française de ce document est disponible sur demande.

## Our Values

- We exist to add joy to customers' lives. We anticipate their needs and exceed their expectations.
- Excellence matters in everything we do.
- Success is only attainable through outstanding people working together in an open environment that promotes knowledge and growth.
- Books, reading, and storytelling are an integral part of advancing society.
- Innovation is the key to growth and can come from anyone, anytime.
- We have a responsibility to give back to the communities in which we operate.

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