SECOND QUARTER REPORT

FOR THE 13-WEEK PERIOD ENDED OCTOBER 2, 2004

"There is no friend as loyal as a book"

ERNEST HEMINGWAY

Indigo

Books & Music Inc.

www.indigo.ca

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Management's Discussion and Analysis

The following discussion and analysis is prepared as at November 8, 2004 and is based primarily on the unaudited consolidated financial statements of Indigo Books & Music Inc. (the "Company" or "Indigo") for the 13-week period ended October 2, 2004 and September 27, 2003. It should be read in conjunction with the consolidated financial statements and notes contained in this Quarterly Report, the audited annual consolidated financial statements and the accompanying notes for the year ended April 3, 2004, and the annual Management's Discussion and Analysis ("MD&A") included in the Company's fiscal 2004 Annual Report. The Annual Report and additional information about the Company, including the Company's Annual Information Form are available online at www.sedar.com.

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

Overview

Indigo is the nation's largest book retailer, operating stores in all ten provinces in Canada and offering online sales through its *www.chapters.indigo.ca* web site. As at October 2, 2004, the Company operated 87 superstores under the banners *Chapters*, *Indigo* and the *World's Biggest Bookstore*, and 164 mall stores, under the banners *Coles*, *Indigo*, *SmithBooks*, and *The Book Company*. The Company opened one mall store and did not close any stores during the second quarter. The Company also has a 50% interest in Calendar Club of Canada Limited Partnership, which operates seasonal kiosks in shopping malls across Canada.

During the quarter, the Company, along with its joint venture partner, transferred the management contracts to operate the five college bookstores of its Chapters Campus Bookstores Company to a third party. The third party also purchased the inventory and fixed assets of this company. As a result of this transaction, the operations of Chapters Campus Bookstores Company were deemed discontinued effective August 19, 2004, the closing date of this transaction.

On May 2, 2004, the Company replaced its procurement, inventory management and financial reporting systems with an integrated SAP Supply Chain system ("SAP"). The Company has experienced normal transition issues associated with a system conversion of this magnitude, including sporadic shortages of some titles in some locations. The Company believes these issues are largely resolved and will not impact the important holiday season.

Results of Operations

Total consolidated revenues for the second quarter decreased $1.6 million (1.0%) from $170.1 million last year to $168.5 million this year. The decrease was due primarily to the discontinuance of the Campus Bookstores Operation which resulted in a $2.2 million drop in revenue as the Company did not benefit from the large fall back-to-school buy which is typical for this type of business. In addition, the Company operated nine fewer mall stores and one fewer superstore during the quarter as compared to the same quarter last year. Excluding the impact of the Campus Bookstores, consolidated revenues increased by 0.3%. Online sales grew 34.7% in the second quarter to $13.9 million compared to $10.3 million in the same quarter last year. The Online sales growth occurred both on the Company's web site as well as the in-store computer kiosk ordering system. Comparable store sales (for stores that were open for more than 12 months) for the quarter were up 0.1% in superstores and down 0.7% in mall stores.

On a year-to-date basis, total consolidated revenues decreased $9.9 million (3.0%) to $324.4 million compared to $334.3 million for the same period last year. This decrease was primarily due to the very strong sales of *Harry Potter* in the first quarter of last year. The Company has not had, nor does it expect to have, a blockbuster title of this magnitude during its current fiscal year that would equate to the sales impact of *Harry Potter* last year. In addition, revenues were negatively impacted by stock shortages associated with the SAP conversion in the first half of this year and the sale of the Campus Bookstores Operation. Year-to-date comparable store sales were down 1.0% for superstores and 3.2% for mall stores. Excluding the sales of *Harry Potter* in the first quarter of last year, comparable store sales for superstores and mall stores were up 0.5% and 0.3%, respectively.

Revenues by channel are highlighted below:

(millions of dollars)	**13-week period ended October 2, 2004**	13-week period ended September 27, 2003	% increase	Comparable store sales % increase
Superstores	**118.0**	119.1	(1.0)	0.1
Mall stores	**32.4**	35.1	(7.7)	(0.7)
Online (including store kiosks)	**13.9**	10.3	34.7	N/A
Campus bookstores	**–**	2.2	(100.0)	N/A
Other	**4.2**	3.4	23.5	N/A
	168.5	170.1	(1.0)	(0.1)

Other revenues include the revenues from the sale of the Company's loyalty cards, Calendar Club revenues, and the revenues from sales to corporate customers. The increase in other revenues was due largely to growth in the Company's loyalty program.

Operating costs including cost of goods sold and selling and administration expenses increased $0.1 million over the same quarter last year. Year-to-date, operating cost have dropped $8.2 million which corresponds to the drop in revenues. As a percentage of sales, year-to-date operating cost are 100.8% versus 100.3% last year.

Cost of goods sold as a percentage of sales during the quarter was 1.0% higher than the same period last year due to higher inventory clearances and discounting activities during the period. On a year-to-date basis, cost of goods sold was consistent with last year.

Selling and administration expenses as a percentage of sales increased by 0.3% and 1.3% for the quarter and year-to-date respectively, due to planned increases in staffing and marketing expenditures in the corporate office in the first two quarters. These increases were partially offset by improvements in shrink. Shrink as a percentage of sales improved by 0.7% both in the second quarter and year-to-date. This is due to the continuous effort of the loss prevention program that was put in place during the last fiscal year.

The Company had an operating loss (defined as revenues less operating costs) of $0.2 million for the quarter as compared to operating earnings of $1.5 million for the same quarter last year. On a year-to-date basis, operating losses were $2.6 million compared to $0.9 million last year. The increase in operating losses is due to lower sales and higher operating costs as a percentage of sales, as described above.

Amortization in the second quarter increased $0.5 million to $6.7 million compared to $6.2 million in the same period last year. On a year-to-date basis, amortization increased $1.4 million to $13.8 million compared to $12.4 million last year. The Company began to amortize SAP development costs on the implementation date of May 2, 2004. Capital expenditures totalled $4.1 million in the second quarter and $4.5 million on a year-to-date basis. Capital expenditures in the second quarter include $1.8 million in store renovations and $2.3 million in technology-related projects.

Interest expense decreased $1.4 million (51.2%) from $2.7 million in the second quarter last year to $1.3 million this year. On a year-to-date basis, interest expense decreased $2.6 million (46.5%) from $5.6 million last year to $3.0 million this year. The decrease in interest expense is due to the refinancing of the Company's debt that was completed at the end of fiscal 2004, resulting in a reduction of the average interest rate on the Company's debt portfolio and lower amortization of financing fees.

Income tax expense decreased to $0.1 million in the second quarter compared to $0.2 million in the same quarter last year. On a year-to-date basis, income tax expense decreased to $0.2 million compared to $0.3 million last year. The decrease in the Company's large corporate tax expense was due to increases in the deductions that are allowed for the calculation of the tax that is owed.

Net loss for the second quarter was $8.2 million ($0.34 per common share) as compared to a net loss of $7.6 million ($0.32 per common share) in the same period last year. On a year-to-date basis, net loss was $19.6 million ($0.81 per common share) compared to $19.1 million ($0.80 per common share) in the same period last year. The increase in net loss was due mainly to the increase in operating losses and amortization which was partially offset by decreases in interest expenses and income tax expense as mentioned above.

Seasonality and Second Quarter Results

Indigo's business is highly seasonal and follows quarterly sales and profit (loss) fluctuation patterns, which are similar to other retailers that are highly dependent on the December holiday selling season. A disproportionate amount of revenues and profits are earned in the third quarter. As a result, second quarter 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), and basic and diluted earnings (loss) per share for the preceding eight fiscal quarters.

	Fiscal quarters							
(thousands of dollars, except per share data)	Q2 Fiscal 2005	Q1 Fiscal 2005	Q4 Fiscal 2004	Q3 Fiscal 2004	Q2 Fiscal 2004	Q1 Fiscal 2004	Q4 Fiscal 2003	Q3 Fiscal 2003
Revenues	168,462	155,947	191,957	279,431	170,080	164,248	174,247	277,454
Net earnings (loss)	(8,242)	(11,336)	(5,295)	28,779	(7,590)	(11,548)	(8,535)	30,771
Basic earnings (loss) per share	$ (0.34)	$ (0.47)	$ (0.22)	$ 1.20	$ (0.32)	$ (0.48)	$ (0.36)	$ 1.28
Diluted earnings (loss) per share	(0.34)	(0.47)	(0.22)	1.12	(0.32)	(0.48)	(0.36)	1.21

Overview of Consolidated Balance Sheets

Total assets at October 2, 2004 were $29.3 million higher than total assets at September 27, 2003 and $25.7 million higher than total assets at April 3, 2004. The $29.3 million increase from the end of the second quarter last year to the end of the second quarter this year was primarily due to higher inventories and future tax assets, which were partially offset by a reduction in goodwill and net capital assets. Inventories increased $29.9 million compared to last year as the Company increased overall purchase levels during the start-up phase of SAP. In addition, returns to vendors were delayed as a result of the SAP conversion. The Company recognized $5.9 million of future tax assets in fiscal 2004 based on the increased likelihood of utilizing its acquired non-capital loss carryforwards and changes in enacted tax rates. The $6.0 million reduction in goodwill was associated with the benefit of the use of these acquired tax losses. Net capital assets decreased by $9.4 million partially due to the net closure of 10 stores over the past year, the conversion of 11 Company-run cafés to Starbucks locations during the first quarter, and the discontinuance of the Campus Bookstores Operation in the second quarter of this year.

The $25.7 million increase in total assets year-to-date was primarily due to an increase in inventory which was offset by a decrease in prepaid expenses and net capital assets. Inventory increased $39.7 million compared to April 3, 2004 as a result of SAP issues as mentioned above. In addition, inventory at the end of the last fiscal year was lower than usual as the Company rationalized its inventory levels in preparation for the SAP conversion. Prepaid expenses decreased $6.1 million as the Company had prepaid some occupancy expenses for April 2004 as a result of the timing of the last fiscal year end.

Total liabilities at October 2, 2004 were $25.8 million higher than total liabilities at September 27, 2003 and $44.6 million higher than the balance at April 3, 2004. The $25.8 million increase from the second quarter last year compared to this year was attributable to an increase in accounts payable of $25.4 million and an increase in deferred revenues of $2.1 million, partially offset by a decrease in total net debt (defined as the total of cash, bank indebtedness, long-term debt and convertible subordinated notes) of $11.3 million. The growth in accounts payable corresponds directly to the increase in inventory levels discussed above, and the increase in deferred revenues is a result of the growth in the Company's loyalty card program as the fees received on the sale of the card are initially recorded as deferred revenue and recognized as revenue over the life of the card.

Year-to-date, total liabilities increased $44.6 million primarily due to an increase in accounts payable resulting from higher inventory levels as described above. In addition, the Company reduced its accounts payable balances significantly towards the end of the last fiscal year in preparation for the SAP conversion.

Shareholders' equity at October 2, 2004 is $3.5 million higher than the shareholders' equity level at September 27, 2003 and $18.9 million lower than the balance at April 3, 2004. The increase of $3.5 million at the end of the second quarter this year compared to the second quarter last year was due largely to an accumulation of net earnings of $3.9 million over the preceding four fiscal quarters. The year-to-date decrease of $18.9 million was due primarily to the

year-to-date net loss of $19.6 million. Other changes to shareholders' equity included an increase in share capital of $0.5 million as a result of issuing 107,600 shares from treasury for purchase by a Company officer during the first quarter (see Note 5 of the consolidated financial statements), and elimination of the $1.9 million equity portion of the convertible notes on April 2, 2004 when the notes were paid off as part of the Company's refinancing efforts. Additionally, in accordance with a new accounting pronouncement, the expensing of stock options and the issuance of Directors' Deferred Stock Units ("DSUs") were recorded as contributed surplus starting in the fourth quarter of the last fiscal year in the cumulative amount of $0.2 million and $0.4 million, respectively.

Overview of Consolidated Statements of Cash Flows

Cash and cash equivalents increased $5.8 million between the first and second quarter of the current fiscal year and $2.0 million year-to-date.

Net cash flows generated from operating activities in the second quarter was $13.9 million despite the loss in the quarter largely because of a $15.5 million reduction in working capital. The reduction in working capital was due to an increase in accounts payable and accrued liabilities of $44.9 million, which was partially offset by a $28.1 million increase in inventory due to increased purchase levels and delayed returns, as discussed earlier.

On a year-to-date basis, net cash flows used in operating activities was $9.2 million due in part to the year-to-date loss of $19.6 million, non-cash amortization of $13.8 million, and a $3.4 million increase in working capital. The increase in working capital was the result of the growth in inventory of $39.7 million exceeding the growth in accounts payable of $30.3 million by $9.4 million, offset by a $6.1 million decrease in prepaid expenses.

Net cash flows used in investing activities were $3.7 million in the second quarter. The Company spent $4.1 million on capital expenditures including $1.8 million for store renovations and $2.3 million for technology-related projects. The Company received cash proceeds of $0.4 million from the sale of the Campus Bookstores assets.

On a year-to-date basis, net cash flows used in investing activities was $3.4 million. The Company spent $4.5 million on capital expenditures including $1.9 million for store renovations and $2.6 million for technology-related projects. The Company received cash proceeds of $0.8 million when it converted 11 Company-operated cafés to Starbucks locations during the first quarter and the $0.4 million from the sale of the Campus Bookstores assets.

Bank indebtedness decreased $4.1 million in the second quarter and increased $14.8 million on a year-to-date basis.

Liquidity and Capital Resources

The Company has a highly seasonal business which generates the majority of its revenues and cash flow during the holiday season. The Company has minimal accounts receivable, as its customers pay largely by cash or credit card and its products are purchased on trade terms with the right to return a significant portion of the products. The Company historically has been a net borrower in the first, second and fourth quarters, and repaid all of its outstanding debt owing on its credit line during the third quarter. The Company's main sources of capital are cash flow generated from operations, a revolving line of credit, and its long-term debt. Under an existing agreement with its bank, the Company can borrow up to $90.0 million on its line of credit. As at October 2, 2004, $68.0 million was drawn against this facility.

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

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

Accounting Policies

Critical Accounting Estimates

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

Company also evaluates its estimates on an ongoing basis. The Company's significant accounting policies are described in Note 2 of the consolidated financial statements in the fiscal 2004 Annual Report and the Company's critical accounting estimates are disclosed in the MD&A section of its fiscal 2004 Annual Report.

In the second quarter of fiscal 2005, there were no significant changes to the inventory obsolescence provision and the method of determination is consistent with that used in previous periods. There were no material changes to the provisions for pension, future tax assets, and restructuring.

New Accounting Standards

During the first quarter of fiscal 2005, the Company adopted the following new accounting guidelines:

Hedging Relationships

The CICA has issued a new accounting guideline on hedging relationships. This guideline requires companies to identify, designate, document and assess the effectiveness of its hedging relationships. The new guideline is applicable to hedging relationships in effect in fiscal years beginning on or after July 1, 2003. The Company has completed the documentation process for all hedges currently in place and there was no material financial impact to the Company's earnings in the first two quarters as a result of adopting this new accounting guideline.

Cash Consideration Received from a Vendor

The Emerging Issues Committee of the CICA has issued a new abstract on accounting for certain consideration received from a vendor. The new abstract will affect the accounting for and the classification of amounts received from a vendor, such as cooperative advertising. Under the new abstract, cash consideration received from a vendor is presumed to be a reduction of the prices of the vendor's products rather than revenue, and should be classified as a reduction in cost of sales, unless certain specific conditions are met. The guidance will apply to all financial statements for annual and interim periods ending on or after August 15, 2004 and is to be applied retroactively. The Company adopted this guideline in the first quarter and there was no material impact on cost of sales and net earnings in the first two quarters.

Inventory

Concurrent with the launch of SAP on May 2, 2004, Indigo changed its accounting policy with respect to inventory valuation. Previously, the Company used the retail inventory method. Under the new cost method, inventory is valued at the lower of cost and net realizable value. The new accounting policy was adopted on a prospective basis, since the necessary financial data for retroactive adoption cannot be reasonably determined. There was no material impact to the Company's earnings in the first two quarters as a result of this change in accounting policy.

Risks and Uncertainties

The risks and uncertainties faced by the Company are substantially the same as those disclosed in the Management's Discussion and Analysis section of its fiscal 2004 Annual Report.

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.

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NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements.

Heather Reisman
Chair & Chief Executive Officer

Jim McGill
Chief Financial Officer & Secretary

Dated as of the 8th day of November, 2004.

Consolidated Balance Sheets

(Unaudited)

(thousands of dollars)	**As at October 2, 2004**	As at September 27, 2003	As at April 3, 2004
ASSETS			
Current			
Cash and cash equivalents	**$ 10,743**	$ –	$ 8,698
Accounts receivable	**6,545**	7,536	6,951
Inventories	**239,076**	209,129	199,421
Prepaid expenses	**6,358**	7,091	12,431
Future tax assets	**3,939**	4,012	3,939
Total current assets	**266,661**	227,768	231,440
Capital assets, net	**93,797**	103,175	103,146
Future tax assets	**12,640**	6,671	12,640
Goodwill	**52,496**	58,458	52,496
Deferred financing fees, net of accumulated amortization of $187 (September 27, 2003 – $3,149; April 3, 2004 – nil)	**825**	1,026	1,012
Total assets	**426,419**	397,098	400,734
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Bank indebtedness	**78,156**	43,638	63,369
Accounts payable and accrued liabilities	**211,107**	185,720	180,813
Income taxes payable	**812**	1,350	1,376
Deferred revenue	**8,750**	6,634	8,732
Current portion long-term debt	**13,183**	53,266	13,183
Total current liabilities	**312,008**	290,608	267,473
Accrued benefit obligations (note 7)	**391**	1,011	328
Long-term debt	**39,259**	1,673	39,263
Convertible notes	**–**	32,580	–
Total liabilities	**351,658**	325,872	307,064
Shareholders' equity			
Share capital (note 5)	**193,926**	193,426	193,426
Contributed surplus (notes 5 and 6)	**607**	–	438
Equity portion of convertible notes	**–**	1,903	–
Deficit	**(119,772)**	(124,103)	(100,194)
Total shareholders' equity	**74,761**	71,226	93,670
Total liabilities and shareholders' equity	**$ 426,419**	$ 397,098	$ 400,734

See accompanying notes

Consolidated Statements of Earnings

(Unaudited)

(thousands of dollars, except per share data)	**13-week period ended October 2, 2004**	13-week period ended September 27, 2003	**26-week period ended October 2, 2004**	26-week period ended September 27, 2003
Revenues	**$ 168,462**	$ 170,080	**$ 324,409**	$ 334,328
Cost of goods sold, selling and administration	**168,629**	168,570	**327,042**	335,207
	(167)	1,510	**(2,633)**	(879)
Amortization of capital assets	**6,692**	6,219	**13,765**	12,389
Loss before the undernoted items	**(6,859)**	(4,709)	**(16,398)**	(13,268)
Interest on long-term debt and financing charges	**430**	1,445	**866**	2,898
Interest on bank indebtedness	**903**	1,286	**2,114**	2,672
Loss before income taxes	**(8,192)**	(7,440)	**(19,378)**	(18,838)
Income tax expense	**50**	150	**200**	300
Net loss for the period	**$ (8,242)**	$ (7,590)	**$ (19,578)**	$ (19,138)
Basic net loss per common share (note 4)	**$ (0.34)**	$ (0.32)	**$ (0.81)**	$ (0.80)
Diluted net loss per common share (note 4)	**$ (0.34)**	$ (0.32)	**$ (0.81)**	$ (0.80)
Weighted average common shares outstanding (note 5)	**24,072**	23,965	**24,062**	23,965

See accompanying notes

Consolidated Statements of Deficit

(Unaudited)

(thousands of dollars)	**26-week period ended October 2, 2004**	26-week period ended September 27, 2003
Deficit, beginning of period	**$ (100,194)**	$ (104,965)
Net loss for the period	**(19,578)**	(19,138)
Deficit, end of period	**$ (119,772)**	$ (124,103)

See accompanying notes

Consolidated Statements of Cash Flows

(Unaudited)

(thousands of dollars)	**13-week period ended October 2, 2004**	13-week period ended September 27, 2003	**26-week period ended October 2, 2004**	26-week period ended September 27, 2003
CASH FLOWS FROM OPERATING ACTIVITIES				
Net loss for the period	**$ (8,242)**	$ (7,590)	**$ (19,578)**	$ (19,138)
Add (deduct) items not affecting cash				
Amortization	**6,692**	6,219	**13,765**	12,389
Stock-based compensation (note 6)	**33**	–	**81**	–
Directors' compensation (note 5)	**39**	–	**88**	–
Loss (gain) on sale of capital assets	**(289)**	5	**(427)**	1,041
Benefit plan credits	**31**	63	**63**	125
Accrued interest on convertible notes	**–**	744	**–**	1,488
Amortization of deferred financing fees	**110**	379	**187**	758
Net change in non-cash working capital balances related to operations				
Accounts receivable	**345**	780	**406**	1,847
Inventories	**(28,101)**	(7,752)	**(39,655)**	(6,674)
Prepaid expenses	**(1,151)**	(860)	**6,073**	(1,428)
Income taxes payable	**(760)**	943	**(564)**	1,531
Deferred revenue	**226**	24	**18**	(201)
Accounts payable and accrued liabilities	**44,947**	3,517	**30,294**	(3,982)
Cash flows provided by (used in) operating activities	**13,880**	(3,528)	**(9,249)**	(12,244)
CASH FLOWS FROM INVESTING ACTIVITIES				
Purchase of capital assets	**(4,056)**	(6,434)	**(4,534)**	(9,773)
Proceeds on sale of capital assets	**357**	–	**1,160**	–
Cash flows used in investing activities	**(3,699)**	(6,434)	**(3,374)**	(9,773)
CASH FLOWS FROM FINANCING ACTIVITIES				
Increase (decrease) in bank indebtedness	**(4,139)**	10,089	**14,787**	22,250
Repayment of long-term debt	**(266)**	(127)	**(619)**	(233)
Proceeds from share issuance (note 5)	**–**	–	**500**	–
Cash flows provided by (used in) financing activities	**(4,405)**	9,962	**14,668**	22,017
Net increase in cash and cash equivalents during the period	**5,776**	–	**2,045**	–
Cash and cash equivalents, beginning of period	**4,967**	–	**8,698**	–
Cash and cash equivalents, end of period	**$ 10,743**	$ –	**$ 10,743**	$ –

See accompanying notes

Notes to the Interim Consolidated Financial Statements

October 2, 2004

(Unaudited)

1. DISCLOSURE

These consolidated interim financial statements do not contain all disclosures required by Canadian generally accepted accounting principles for annual financial statements and accordingly, these financial statements should be read in conjunction with the most recently prepared annual financial statements for the 53-week period ended April 3, 2004. Figures for the 13 and 26 weeks ended October 2, 2004 and September 27, 2003 are unaudited.

2. SEASONALITY OF OPERATIONS

The business of Indigo Books & Music Inc. (the "Company" or "Indigo") follows a seasonal pattern, with sales of merchandise being highest in the third quarter due to consumer holiday buying patterns. As a result, a disproportionate portion of total annual revenues are typically earned in the third quarter. Therefore, the results of operations for the 13 and 26 weeks ended October 2, 2004 and September 27, 2003 are not indicative of the results of other periods.

3. ACCOUNTING POLICIES

These financial statements follow the same accounting policies and methods of their application as the most recent annual financial statements for the 53-week period ended April 3, 2004, except the following:

a) Hedging Relationships

The CICA has issued a new accounting guideline on hedging relationships. This guideline requires companies to identify, designate, document and assess the effectiveness of its hedging relationships. The new guideline is applicable to hedging relationships in effect in fiscal years beginning on or after July 1, 2003. The Company has completed the documentation process for all hedges currently in place and there was no material financial impact to the Company's earnings in the first two quarters as a result of adopting this new accounting guideline.

b) Cash Consideration Received from a Vendor

The Emerging Issues Committee of the CICA has issued a new abstract on

accounting for certain consideration received from a vendor. The new abstract will affect the accounting for and the classification of amounts received from a vendor, such as cooperative advertising. Under the new abstract, cash consideration received from a vendor is presumed to be a reduction of the prices of the vendor's products rather than revenue, and should be classified as a reduction in cost of sales unless certain specific conditions are met. The guidance will apply to all financial statements for annual and interim periods ending on or after August 15, 2004 and is to be applied retroactively. The Company adopted this guideline in the first quarter and there was no material impact on cost of sales and net earnings in the first two quarters.

c) Inventory

Concurrent with the launch of SAP on May 2, 2004, Indigo changed its accounting policy with respect to inventory valuation. Previously, the Company used the retail inventory method. Under the new cost method, inventory is valued at the lower of cost and net realizable value. The new accounting policy was adopted on a prospective basis, since the necessary financial data for retroactive adoption cannot be reasonably determined. There was no material impact to the Company's earnings in the first two quarters as a result of this change in accounting policy.

4. LOSS PER SHARE

Loss per share is calculated based on the weighted average number of common shares outstanding during the period. The Company's stock options were anti-dilutive and therefore were not included in the October 2, 2004 and September 27, 2003 diluted loss per share calculations.

5. SHARE CAPITAL

Share capital consists of the following:

	26-week period ended October 2, 2004		26-week period ended September 27, 2003		53-week period ended April 3, 2004	
	Number of shares	**Amount $ (thousands)**	Number of shares	Amount $ (thousands)	Number of shares	Amount $ (thousands)
Balance, beginning of period	**23,964,752**	**193,426**	23,964,752	193,426	23,964,752	193,426
Issued during the period						
Issued for cash (net of expenses and future income taxes)	**107,600**	**500**	–	–	–	–
Balance, end of period	**24,072,352**	**193,926**	23,964,752	193,426	23,964,752	193,426

On April 20, 2004, the Company issued 107,600 shares from treasury that were purchased by one of the Company's officers for cash proceeds of $0.5 million.

The Company has 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. The Company issued 18,959 deferred stock units valued at $0.1 million during the 26-week period ended October 2, 2004. The value of the outstanding deferred stock units as at October 2, 2004 was $0.4 million and was recorded in contributed surplus.

6. STOCK-BASED COMPENSATION

As at October 2, 2004, 1,260,061 stock options were outstanding with exercise prices ranging from $4.29 to $63.53. Of these outstanding stock options, 298,132 were exercisable (1,168,912 options outstanding, 194,179 exercisable as at September 27, 2003).

Effective March 30, 2003, the Company elected to adopt the new recommendations issued by the CICA relating to stock-based compensation on a prospective basis. In accordance with the new standard, the Company changed its method of accounting for stock options from the intrinsic value method to the fair value method, which estimates the fair value of the stock options granted on the date of grant and expenses this value over the vesting period. During the 26-week period ended October 2, 2004, $0.1 million was recognized as an expense with the offset recorded in contributed surplus. Any consideration paid by employees on exercise of stock options is credited to share capital.

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

	13-week period ended October 2, 2004	13-week period ended September 27, 2003
Risk-free interest rate	**4.1%**	4.7%
Expected volatility	**14.3%**	18.6%
Expected time until exercise	**4 years**	4 years
Expected dividend yield	**0.0%**	0.0%

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

Pro Forma Earnings (thousands of dollars, except per share data)	13-week period ended October 2, 2004	26-week period ended October 2, 2004
Net earnings – reported	**(8,242)**	**(19,578)**
Net earnings – pro forma	**(8,324)**	**(19,742)**
Basic net earnings per common share – reported	**($0.34)**	**($0.81)**
Basic net earnings per common share – pro forma	**($0.35)**	**($0.82)**
Diluted net earnings per common share – reported	**($0.34)**	**($0.81)**
Diluted net earnings per common share – pro forma	**($0.35)**	**($0.82)**

7. ACCRUED BENEFIT OBLIGATIONS

In March 2004, the Company amended the terms of its defined benefit pension plan to effect a wind-up effective June 30, 2004. The Company has not recognized any current service costs nor made any additional contributions to the plan since the wind-up date. The plan was in a deficit position at the end of fiscal 2004 and at the end of the second quarter. The Company intends to fund this deficit in fiscal 2006 when final distributions are made from the plan.

For the 13-week and 26-week periods ended October 2, 2004, the net benefit plan expense was $58,750 and $442,800, respectively.

8. FINANCIAL INSTRUMENTS

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

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

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

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

(iii) The fair values of interest rate derivatives are estimated by discounting cash payments of the derivatives at market rates for derivatives of the same remaining maturities. At this time, the Company does not intend to terminate the interest rate swap agreement and therefore does not anticipate any impact on earnings arising from the differences between book value and fair value. The fair value of the interest rate swap was $0.3 million in favour of the Company as at October 2, 2004; and

(iv) The fair value of foreign exchange derivatives represents an approximation of the amounts that the Company would have paid to or received from counterparties to unwind its position prior to maturity. The fair value of the foreign exchange forward contracts was $1.1 million in favour of the counterparties as at October 2, 2004.

9. CONSOLIDATED STATEMENTS OF CASH FLOWS

Supplemental cash flow information:

(thousands of dollars)	13-week period ended October 2, 2004	13-week period ended September 27, 2003	26-week period ended October 2, 2004	26-week period ended September 27, 2003
Interest paid	**$ 1,330**	$ 1,619	**$ 2,224**	$ 3,314
Income taxes paid (recovered)	**808**	(793)	**761**	(1,229)

10. DISCONTINUED OPERATION

The Company sold its share in the joint venture operation of Chapters Campus Bookstore Company on August 19, 2004. The Company received cash proceeds of $0.4 million for inventory and fixed assets of the operation.

The results of operations, net assets and cash flows of the Chapters Campus Bookstore Company have not been presented as discontinued operation in the consolidated financial statements since they are not material compared to the overall operations of the Company.

The results of discontinued operation for the 13-week and 26-week periods ended October 2, 2004 and September 27, 2003 were as follows:

(thousands of dollars)	**13-week period ended October 2, 2004**	13-week period ended September 27, 2003	**26-week period ended October 2, 2004**	26-week period ended September 27, 2003
Revenue	**$ –**	$ 2,175	**$ 356**	$ 2,933
Expenses	**452**	1,955	**818**	3,152
Income (loss) from discontinued operation	**$ (452)**	$ 220	**$ (462)**	$ (219)
Net earnings (loss) per common share from discontinued operation	**$ (0.02)**	$ 0.01	**$ (0.02)**	$ (0.01)

The net assets of discontinued operation are summarized as follows:

(thousands of dollars)	**As at October 2, 2004**	As at September 27, 2003	As at April 3, 2004
Current assets	**$ 2,408**	$ 3,232	$ 2,020
Long-term assets	**–**	109	96
Current liabilities	**1,785**	1,768	600
Net assets from discontinued operation	**$ 623**	$ 1,573	$ 1,516

The cash flows from discounted operation are summarized as follows:

(thousands of dollars)	**13-week period ended October 2, 2004**	13-week period ended September 27, 2003	**26-week period ended October 2, 2004**	26-week period ended September 27, 2003
Cash flows provided by (used in)				
Operating activities	**$ 807**	$ 2,678	**$ 321**	$ 2,021
Investing activities	**357**	(49)	**357**	7
Financing activities	**–**	(1,076)	**–**	(1,076)
Net cash flows	**$ 1,164**	$ 1,553	**$ 678**	$ 952

11. COMPARATIVE FIGURES

Certain figures from prior periods have been reclassified to conform with current period's presentation.

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