ANNUAL REPORT

FOR THE 52-WEEK PERIOD ENDED MARCH 29, 2003

Dare To Be Great

"The future belongs to those who believe in the beauty of their dreams."

ELEANOR ROOSEVELT

Indigo

Books & Music Inc.

www.indigo.ca

The Indigo Mission

The book-lover's r*etailer of choice

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

Indigo operates under the following banners: *Indigo Books, Music & More*; *Chapters*; *Coles*; *The World's Biggest Bookstore* and *chapters.indigo.ca*. The Company employs 6,700 people across the country.

Table of Contents

2. Report of the CEO
7. Management's Responsibility for Financial Reporting
8. Management's Discussion and Analysis
13. Auditors' Report
14. Consolidated Financial Statements and Notes
33. Corporate Governance Policies
34. Executive Management and Board of Directors
35. Summary of Financial Information
36. Investor Information

Report of the CEO

Dear Shareholder,

It is a pleasure to have this opportunity to review the year just completed and share with you our perspective on the year ahead.

We began the year with one overriding objective – that of returning this company to profitability. I am pleased to report that we have, in fact, achieved this important milestone. Though we are far from the level of profitability we would consider worth celebrating, it feels great to know we hit our immediate term target. Within the Company, we think of it as having reached base camp on our journey to the top of the performance mountain.

On reflection, it has been a year of very hard work, some meaningful achievements, and, as always, some important lessons learned.

Operating Results

Overall we are pleased with the growth of the business in what has been a challenging retail environment. Revenue was up 5.9% to $779 million despite closing two superstores and eight mall stores during the year.

Superstores

Our superstores continued to perform well with comparative store sales up 5.3%. Given additional competition from mass marketers and online sellers, and only modest industry growth, this performance is a testament to the hard and effective work of everyone in our Company. Our focus on keeping the customer experience fresh and relevant through constant improvements in assortment and service appears to be paying dividends.

At year-end we were operating 88 superstores. As our government-required moratorium on new store openings is now over, we are beginning to explore new superstore opportunities.

Mall Stores

Results in our mall stores were mixed. While the first half of the year produced comparative sales growth of 4.8%, beginning in November this trend reversed and we finished the year with an overall 0.2% decrease in comparative store sales. We believe this decline is partially attributable to a change in shopping behaviour – in particular a move away from malls to power centre retailing. This change has been gathering momentum for at least five

years and has intensified with the major expansion of power centre tenants such as Wal-Mart, Sam's Club, Price Club and Home Depot. At the same time, we believe the Coles concept is in need of a rethink and it is our intention to engage in a major effort for this brand during the coming year.

Online

This was a demanding but satisfying year for our online division. The online competitive environment heated up significantly with the launch of Amazon.ca. Still, over the course of the year, we increased our 24-hour title availability to more than one million titles, enhanced functionality on our site, added a gift vertical, and began testing a jewellery vertical. Overall growth for the year was 13%. As soon as our improvements took effect, business soared and year-over-year sales increased to 37% for the last half of the year.

Ancillary Activity

In other interesting developments, we introduced a highly attractive gift card program which saw gift certificate sales grow by 24% on an annual basis and 35% from the time the new program was introduced. We signed up just shy of one million loyalty customers, renovated 20 Chapters stores and 10 Coles stores, and implemented an exciting re-merchandising of our **kids** department. This last effort, implemented in the fourth quarter of the year, is currently driving a 6% increase in sales in the segment.

We completed two rights offerings this year which raised a total of $29.5 million and we paid down $31.0 million in term debt. These initiatives, combined with significant reductions in both inventory and receivables, have given us a much stronger balance sheet on which to build for the future.

Strategic Initiatives

We began the year having committed to move forward with five key company-strengthening initiatives, each of which was identified in my Report to Shareholders last year. I am pleased to report on our progress against these initiatives:

Supply Chain Redesign

Early in the year we committed ourselves to an "end-to-end" redesign of our supply chain. Our objective was, and is simple: to ensure that we have "the right product, in the right place, at the right time, in the right quantities, in excellent condition, purchased at the lowest possible cost."

Achieving this objective requires nothing short of a fundamental redo of our information systems platform and the key processes that make up our total supply chain. This is not a quick fix effort. The approach we took was one which included both short-term "wins" and a more comprehensive system redesign effort which would unfold over an 18-month period.

I am pleased to report that the short-term initiatives we have implemented have lowered costs on all key supply chain variables – inventory costs, return levels and warehousing and logistics costs – while at the same time improving product availability for our customers. In addition, we believe that at least a portion of our sales increase was directly attributable to these inventory management improvements.

While these short-term initiatives were being implemented, our supply chain team has been hard at work on the longer-term changes. After a detailed evaluation of alternatives, we made the decision to install SAP as our supply chain platform. A team of our best and brightest from across the Company has been hard at work on the design, development and organizational changes required to implement our new systems and processes. We expect to go live in the spring of 2004.

Gift Program Expansion

Our customers shop with us for their own needs and also when they are in search of thoughtful gifts. We realized therefore that we had a wonderful opportunity to expand our offering to include an array of products that in one way or another complemented books. This year we meaningfully expanded our gift and paper program. Our efforts in this area proved to be well worthwhile. Our customers have responded with tremendous enthusiasm to our offering and activity in this area contributed to our sales and margin growth this year. We intend to build on this success and double this business in the current year.

EIS (Everyone's Information System)

Consistent with our plans, this year we developed and implemented an advanced enterprise-wide management information system. Our EIS allows employees at all levels of the Company to access relevant and timely performance information related to all key areas of the business.

Re-establish a Leadership Position Online, Leveraging our Bricks and Clicks Position

By the time this year began, we had stopped the serious financial drain which had plagued our online business in the two previous years. Our goal this year was to fully re-establish a strong position with our customers, drive profitability, and prepare for Amazon's inevitable entry into Canada.

As mentioned, we did in fact achieve our sales growth objective. Over the course of the year, we reversed the declining sales trend and by the second half our online business was growing at 37% on a year-over-year basis. This trend has continued into the current year and we have significant plans to further enhance our position in this channel. We also expect to exploit more fully the synergies that come from being both "on-the-ground" and online.

Invent Indigo U

Indigo is first and foremost a people system. More than 6,700 people work in the Company. It is axiomatic that we need to provide our employees with meaningful training and development. This year we committed to developing Indigo U, a multi-track training and development program that would use a combination of "on-the-job" training, computer-based training, mentoring and course work. We made a good deal of progress on the conceptual and development side and we plan to launch Phase I of Indigo U this year. This will be an ongoing development effort.

Portfolio Streamlining

A key objective for this year was to close the seven superstores that represented overlap and overcapacity stemming from the merger of Indigo and Chapters. It is disappointing to report that we were only successful in closing two of the seven stores which we had identified. This is an ongoing effort which we hope will bear more fruit this season.

Looking Forward

As we did last year, the executive team took time in the fourth quarter to set the framework for continued strategic development. Many of the initiatives we began last year will continue through the coming year, including our efforts in **Supply Chain**, **Indigo U**, **Online Expansion**, and **Portfolio Rationalization**.

In addition, we will focus on a few new initiatives including:

- **Loss Prevention:** High on our list of priorities is a major loss prevention initiative. Currently this is an area of challenge for the Company and attention in this area is expected to have a terrific impact on profitability.
- **Coles Repositioning:** As mentioned above, it is our intention to totally rethink the opportunity for this brand.
- **Retailing Excellence:** We have launched a multi-element effort designed to further strengthen the consumer experience and level of satisfaction on each and every visit.

Community Involvement

Embedded in our strategy and reflected in our actions is a commitment to six guiding principles which are noted at the end of this Annual Report. One of these principles articulates our belief in the importance of giving back, in some small but meaningful way, to the communities in which we operate. I am pleased to report that over the course of the year, your company donated $200,000 in cash and product to various community causes. And with most of these initiatives, our employees also gave of their time and spirit. We are proud of these efforts!

One area of involvement that has emerged as having particular meaning to people in our organization is literacy in general and, in particular, the love of reading for children in inner city schools. We are currently expanding a program that began with Church Street Public School in Toronto and I look forward to reporting more on this in my report next year.

Final Thoughts

Last year in these pages I acknowledged that, living in interesting times such as we are, it is hard to know what events may occur. These words are even truer today. As I write this note, we are in the midst of what will undoubtedly be one of the worst summers for tourism that Canada has ever experienced. SARS has, at least in the short term, negatively impacted our image as a great place to visit. Furthermore, the weakening US dollar will make the financial advantage of vacationing in Canada a less compelling opportunity. The economic ripple effect of these conditions will hit hard and will affect our business as it will every specialty retailer.

But, as always, challenging times create opportunity and the impetus to innovate. And I can assure you, it is with this in mind that we continue on our journey to build a truly great Canadian company.

I want to take this opportunity to thank our shareholders who continue to have confidence in our abilities and our vision. To my colleagues on the executive and our entire management team – a special thank you for the tremendous leadership you provided to the entire organization. And finally, to everyone who works with me on the front lines of this Company – thank you for bringing to work each and every day, your energy, your enthusiasm, and your ideas. I am looking forward to a rich and rewarding year ahead.

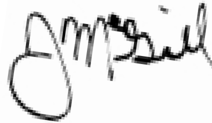
Management's Responsibility for Financial Reporting

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

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

Ernst & Young LLP, Chartered Accountants, serve as Indigo's auditors. The Board of Directors of Indigo, along with the management team, have reviewed and approved the financial statements and information contained within this report. 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.

Heather Reisman
Chair and Chief Executive Officer



Jim McGill
Chief Financial Officer

Management's Discussion and Analysis

The following discussion and analysis is based primarily on the consolidated financial statements of Indigo Books & Music Inc. (the "Company" or "Indigo") for the 52 weeks ended March 29, 2003 and March 30, 2002. It should be read in conjunction with the consolidated financial statements and notes contained in this Annual Report.

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 March 29, 2003, the Company operated 88 superstores under the banners *Chapters*, *Indigo* and the *World's Biggest Bookstore*, and 179 mall stores, under the banners *Coles*, *SmithBooks*, *LibrairieSmith* and *The Book Company*. The Company also has a 51% interest in Chapters Campus Bookstores Company, which operates 6 university and college bookstores, and a 50% interest in Calendar Club of Canada Limited Partnership, which operates seasonal kiosks in shopping malls across Canada.

During the year, the Company closed 2 superstores and 8 mall stores as part of an ongoing initiative to streamline its real estate portfolio and close under-performing locations in over-served markets.

On April 19, 2002, the Company completed an offering of 4,243,841 common shares of the Company at $3.50 per share. The issue, completed by way of an offering of subscription rights to all holders of common shares of the Company, was fully subscribed and resulted in net proceeds of $14.5 million. Net proceeds were used to reduce overall levels of indebtedness.

On September 27, 2002, the Company completed an offering of 2,662,755 common shares of the Company at $5.75 per share. The issue, completed by way of an offering of subscription rights to all holders of common shares of the Company, was fully subscribed and resulted in net proceeds of $15.0 million which were used to fund capital expenditures including store improvements, supply chain re-design, and investment in *www.chapters.indigo.ca*.

The weighted average number of shares outstanding for the year was 22.5 million as compared to 18.6 million last year.

Results of Operations

Total consolidated revenues increased 5.9% to $779.2 million from $735.7 million last year. Comparative store sales were up 5.3% in Chapters and Indigo superstores due to strong in-store customer service efforts as well as meaningful improvements in inventory management and merchandising. Comparative store sales for mall stores were down 0.2%, reflecting a general decline in mall traffic in the second half of the year. Online sales grew 12.6%, driven by improvements in selection and delivery along with increased marketing and promotional activity. Other revenues generated from the sale of the Company's loyalty cards, as well as the Company's proportionate share of revenues from the Calendar Club and Campus Bookstores joint ventures, increased by 21.2%.

Operating earnings increased 13.5% to $42.0 million from $37.0 million last year driven by higher sales, improved margins and reduced warehousing and distribution costs. Amortization decreased to $23.9 million from $31.4 million last year due to the write-down of capital assets.

Net profit for the year was $1.4 million ($0.06 per share) as compared to a net loss of $47.9 million ($2.58 per share) last year. The net loss for fiscal 2002 included restructuring charges of $40.3 million relating to store closures

and other charges associated with the merger of Indigo and Chapters Inc. No such restructuring charges were incurred this year.

The Company's revenues, comparable store sales, store openings, store closings, number of stores and selling square footage at the fiscal year-end are set forth below:

	52-week period ended March 29, 2003	52-week period ended March 30, 2002	52-week period ended March 31, 2001
Revenue (thousands of dollars)			
Superstores	$ 528,122	$ 485,767	$ 408,849
Mall Stores	173,967	183,792	195,199
Other Retail	38,062	31,394	29,995
Indigo Distribution Centre	–	–	1,345
Indigo Online	39,093	34,731	51,091
	$ 779,244	$ 735,684	$ 686,479
Comparable Store Sales			
Superstores	5.3%	1.1%	(1.6%)
Mall Stores	(0.2%)	3.7%	(3.0%)
Stores Opened			
Superstores (opened and acquired)	0	16	7
Mall Stores	0	0	7
Campus Bookstores	0	0	2
	0	16	16
Stores Closed			
Superstores	2	3	0
Mall Stores	8	17	34
	10	20	34
Number of Stores Open at Year-End			
Superstores	88	90	77
Mall Stores	179	187	204
Campus Bookstores	6	6	6
	273	283	287
Selling Square Footage at Year-End (in thousands)			
Superstores	2,123	2,164	1,883
Mall Stores	476	496	536
Campus Bookstores	38	38	38
	2,637	2,698	2,457

Seasonality

The Company's business is highly seasonal and follows quarterly sales and profit (loss) fluctuation patterns, which are similar to other retailers. The following table sets forth revenues and net earnings (loss) for the preceding twenty fiscal quarters.

Revenues and Net Earnings (Loss) for the Fiscal Quarter Ended On About:

(thousands of dollars)	June 30	September 30	December 31	March 31
Fiscal 2003 Revenue	**$ 156,336**	**$ 171,207**	**$ 277,454**	**$ 174,247**
Net Earnings (Loss)	**(13,182)**	**(7,629)**	**30,771**	**(8,535)**
Fiscal 2002 Revenue	$ 135,285	$ 155,870	$ 273,891	$ 170,638
Net Earnings (Loss)	(6,957)	(31,270)	18,799	(28,484)
Fiscal 2001 Revenue	$ 136,880	$ 154,055	$ 247,550	$ 147,994
Net Earnings (Loss)	(12,714)	(7,778)	8,996	(72,976)
Fiscal 2000 Revenue	$ 122,352	$ 148,120	$ 234,695	$ 155,142
Net Earnings (Loss)	(9,449)	27,758	9,733	(10,847)
Fiscal 1999 Revenue	$ 100,692	$ 120,970	$ 210,647	$ 145,571
Net Earnings (Loss)	(3,281)	(1,639)	16,113	(892)

Overview of Consolidated Statements of Financial Position

Total assets decreased by $45.1 million as compared to the fiscal year ended March 30, 2002. Merchandising and supply chain improvements resulted in an overall inventory decrease of $21.0 million despite higher sales, while an increased focus on receivable management contributed to a $3.4 million reduction in the receivables balances. Net capital assets decreased by $8.9 million (amortization of $23.9 million offset by capital expenditures of $14.1 million) as the Company continued its efforts to streamline its real estate portfolio.

Share capital increased by $29.9 million as compared to the fiscal year ended March 30, 2002 due to the issuance of shares as described above.

Total liabilities decreased by $71.6 million as compared to the fiscal year ended March 30, 2002. The Company reduced its net long-term debt by $26.5 million ($31.0 million repayment of long-term debt offset by $3.0 million in deferred interest on outstanding convertible notes). In addition, inventory management and other cost control initiatives contributed to a $35.9 million decrease in bank indebtedness and a $9.0 million decrease in accounts payable and accrued liabilities.

Overview of Consolidated Statements of Cash Flows

Cash decreased by $0.7 million during the year. Operations generated $50.4 million in cash, which was used to fund $14.1 million in investing activities and $37.0 million in financing activities.

Of the cash generated by operations, changes in working capital increased cash by $19.0 million. This increase primarily relates to a decrease in inventory of $21.0 million, a decrease in receivables of $3.4 million, a decrease in income taxes recoverable of $4.8 million, offset by a net decrease in accounts payable and accrued liabilities of $9.0 million.

Net cash used in investing activities consisted of capital expenditures of $14.1 million, including $8.6 million for store renovations and $5.5 million for technology-related projects.

During the year, the Company repaid $31.0 million of long-term debt. In addition, the Company decreased its bank indebtedness by $35.9 million, and issued $29.9 million in equity by way of rights offerings.

Liquidity and Capital Reserves

Based on current operating levels, management expects cash flow generated from operations and its available borrowing capacity under the Company's credit facility to be sufficient to meet its working capital needs and debt service requirements.

However, 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.

Risks and Uncertainties

Competition

The retail bookselling 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 also a source 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 could have an adverse effect on the Company's financial condition. Other variables such as unanticipated increases in merchandise costs, increases in labour costs, unanticipated changes in inventory levels, increases in shipping rates or interruptions in shipping service, higher interest rates, or the success of the Company's strategic initiatives could also unfavourably impact the Company's financial performance. Management believes that the general economic environment will remain soft through the first half of 2003 but will improve and provide opportunities for growth in the latter half of the year.

Leases

The average unexpired lease term of the Company's mall stores is approximately 2.2 years. The Company attempts to renew these leases as they come due on favourable terms and conditions, but is susceptible to volatility in the market for shopping mall space. Unanticipated increases in occupancy costs, store closing costs or relocation expenses could unfavourably impact the Company's performance. With an average unexpired lease term of 7.3 years, the Company's superstores rental expense is expected to remain stable.

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 upon Indigo.

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.

Cautionary Statement Regarding Forward-Looking Statements

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

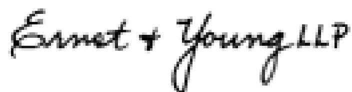
Auditors' Report

To the Shareholders of Indigo Books & Music Inc.

We have audited the consolidated balance sheets of Indigo Books & Music Inc. as at March 29, 2003 and March 30, 2002 and the consolidated statements of earnings (loss), deficit 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 29, 2003 and March 30, 2002 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.



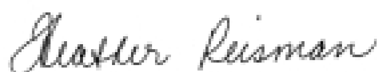
Chartered Accountants
Toronto, Canada,
May 9, 2003

Consolidated Balance Sheets

(thousands of dollars)	As at March 29, 2003	As at March 30, 2002
ASSETS (note 6)		
Current		
Cash and cash equivalents	–	677
Accounts receivable	**9,383**	12,817
Inventories	**202,455**	223,467
Income taxes recoverable	**181**	4,950
Prepaid expenses	**5,663**	4,338
Future tax assets (note 4)	**4,012**	6,538
Total current assets	**221,694**	252,787
Capital assets, net (note 3)	**106,170**	115,041
Future tax assets (note 4)	**6,671**	4,145
Goodwill (notes 5, 9 and 10)	**58,458**	64,570
Deferred financing fees, net of accumulated amortization of $2,391 (March 30, 2002 – $886)	**1,784**	3,289
	394,777	439,832
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Bank indebtedness (note 6)	**21,388**	57,254
Accounts payable and accrued liabilities (note 12)	**189,702**	198,746
Deferred revenue	**6,835**	6,625
Current portion of long-term debt (note 6)	**31,324**	31,000
Total current liabilities	**249,249**	293,625
Accrued benefit obligations (note 7)	**886**	1,306
Long-term debt (note 6)	**23,186**	53,000
Convertible notes (notes 9 and 11)	**31,092**	28,071
Total liabilities	**304,413**	376,002
Commitments and contingencies (note 16)		
Shareholders' equity		
Share capital (note 8)	**193,426**	163,505
Equity portion of convertible notes (notes 9 and 11)	**1,903**	1,903
Deficit	**(104,965)**	(101,578)
Total shareholders' equity	**90,364**	63,830
	394,777	439,832

See accompanying notes

On behalf of the Board:



Heather M. Reisman
Director

Senator Michael Kirby
Director

Consolidated Statements of Earnings (Loss)

(thousands of dollars, except per share data)	**52-week period ended March 29, 2003**	52-week period ended March 30, 2002
Revenue	**779,244**	735,684
Cost of product, purchasing, selling and administration	**737,228**	698,660
	42,016	37,024
Amortization of capital assets	**23,864**	29,839
Amortization of pre-opening store costs	**30**	452
Amortization of goodwill	**–**	1,087
Earnings before the under noted items	**18,122**	5,646
Restructuring and take-over costs (note 12)	**–**	40,316
Interest on long-term debt and financing charges (note 6)	**8,568**	7,576
Interest on bank indebtedness (note 6)	**6,229**	6,782
Earnings (loss) before income taxes and non-controlling interest	**3,325**	(49,028)
Income tax expense (note 4)	**1,900**	600
Earnings (loss) before non-controlling interest	**1,425**	(49,628)
Non-controlling interest	**–**	(1,716)
Net earnings (loss) for the period	**1,425**	(47,912)
Net earnings (loss) per common share		
Basic	**$0.06**	$(2.58)
Diluted	**$0.06**	$(2.58)
Weighted average number of common shares outstanding (note 8)		
Basic	**22,513**	18,552
Diluted	**22,513**	18,552

See accompanying notes

Consolidated Statements of Deficit

(thousands of dollars)	**52-week period ended March 29, 2003**	52-week period ended March 30, 2002
Deficit, beginning of period	**(101,578)**	(53,666)
Goodwill impairment loss (note 5)	**(4,812)**	–
Net earnings (loss) for the period	**1,425**	(47,912)
Deficit, end of period	**(104,965)**	(101,578)

See accompanying notes

Consolidated Statements of Cash Flows

(thousands of dollars)	52-week period ended March 29, 2003	52-week period ended March 30, 2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Net earnings (loss) for the period	**1,425**	(47,912)
Add (deduct) items not affecting cash		
Amortization	**23,894**	31,378
Future income taxes	**1,300**	–
Loss on disposal of capital assets	**643**	76
Benefit plan credit	**(420)**	140
Accrued interest on convertible notes	**3,021**	1,790
Non-controlling interest	**–**	(1,716)
Amortization of deferred financing fees	**1,505**	886
Write-down of capital assets (note 12)	**–**	24,052
	31,368	8,694
Net change in working capital balances related to operations (note 15(a))	**19,026**	(11,268)
Cash flows provided by (used in) operating activities	**50,394**	(2,574)
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisitions net of cash acquired (notes 9 and 10)	**–**	(5,736)
Decrease in short-term investments	**–**	3,850
Purchase of capital assets	**(14,107)**	(9,628)
Cash flows used in investing activities	**(14,107)**	(11,514)
CASH FLOWS FROM FINANCING ACTIVITIES		
Decrease in bank indebtedness	**(35,866)**	(32,498)
Proceeds from share issuances	**29,921**	10,044
Repayment of long-term debt (note 6)	**(31,019)**	(74,000)
Proceeds from issuance of long-term debt (note 6)	**–**	104,000
Financing fees	**–**	(4,175)
Cash flows provided by (used in) financing activities	**(36,964)**	3,371
Net decrease in cash and cash equivalents during the period	**(677)**	(10,717)
Cash and cash equivalents, beginning of period	**677**	11,394
Cash and cash equivalents, end of period	**–**	677

See accompanying notes

Notes to Consolidated Financial Statements

March 29, 2003

1. NATURE OF OPERATIONS

Indigo Books & Music Inc. (the "Company" or "Indigo"), the nation's largest book retailer, was formed as a result of an amalgamation of Chapters Inc. and Indigo Books & Music, Inc. under the laws of the Province of Ontario, pursuant to a certificate of Amalgamation dated August 16, 2001. The Company operates a chain of retail bookstores across all ten provinces in Canada, including 88 (March 30, 2002 – 90) superstores under the *Chapters*, *Indigo*, and *World's Biggest Book Store* names, as well as 179 (March 30, 2002 – 187) mall stores under the *Coles*, *SmithBooks*, *LibrairieSmith*, and *The Book Company* names. The Company operates *www.chapters.indigo.ca*, an e-commerce retail destination, which sells books, video, DVD, music and gifts. The Company also has 6 (March 30, 2002 – 6) university and college bookstores through Chapters Campus Bookstores Company, a joint partnership with Barnes and Noble College Bookstore Canadian Division.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

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

Inventories

Inventories are valued, using the retail inventory method, at the lower of cost and net realizable value less a normal profit margin.

Prepaid expenses

Prepaid expenses include pre-opening store costs. All costs associated with the opening of new stores are deferred and amortized over the respective store's first twelve months of operations.

Capital assets

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

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

Employee future benefits

The cost of pensions and other retirement benefits earned by employees is determined using the projected benefit method prorated on service and management's best estimate of expected plan investment performance, salary escalation, expected cost trends and retirement ages of employees. The discount rate used to determine the accrued benefit obligation is determined by reference to market interest rates at the measurement date on high-quality debt instruments with cash flows that match the timing and amount of expected benefit payments. For purposes of calculating the expected return on plan assets, those assets are valued at fair market value. The excess of the net actuarial

gain (loss) over 10% of the greater of the accrued benefit obligation and the fair market value of plan assets is amortized over the average remaining service life of active employees.

Deferred financing fees

Financing costs are deferred and amortized over the term of the respective indebtedness.

Deferred revenue

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

Income taxes

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

Goodwill

Goodwill represents the excess of the cost over the value assigned to the net identifiable assets acquired at the date of acquisition. The Company adopted The Canadian Institute of Chartered Accountants' ("CICA") new recommendation under Handbook Section 3062, Goodwill and Other Intangible Assets ("Section 3062"), effective March 31, 2002. Pursuant to the new recommendation, goodwill is no longer amortized and is subject to annual review for impairment at the reporting unit level. Fair value is determined using the discounted cash flow method.

Joint ventures

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

Stock-based compensation plan

The Company adopted, effective March 31, 2002, the CICA's new accounting standards for Stock-Based Compensation. This new standard is applied for all options granted under the share option plan on or after the effective date. Options are only available to employees of the Company. The Company has elected to recognize no compensation cost in connection with the plan and to disclose proforma net earnings and earnings per share as if all options granted under the plan are accounted for using the fair value based method. Amounts paid by employees to purchase shares under the plan are credited to share capital.

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.

Use of estimates

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

Revenue recognition

The Company recognizes revenue for product sales when title passes to the customers.

Earnings (loss) per share

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

3. CAPITAL ASSETS

Capital assets consist of the following:

	March 29, 2003		March 30, 2002	
(thousands of dollars)	Cost	Accumulated amortization	Cost	Accumulated amortization
Furniture, fixtures and equipment	**112,566**	**57,429**	111,775	48,476
Computer equipment and development costs	**48,338**	**38,385**	40,753	33,235
Leasehold improvements	**87,575**	**48,006**	84,937	40,713
Equipment under capital lease	**1,529**	**18**	–	–
	250,008	**143,838**	237,465	122,424
Less accumulated amortization	**143,838**		122,424	
Net book value	**106,170**		115,041	

4. INCOME TAXES

Future income taxes reflect the net tax effect 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 29, 2003	March 30, 2002
Current future tax assets		
Deferred contract fee	**93**	339
Reserves and allowances	**3,919**	6,211
Current future tax liabilities		
Pre-opening costs	**–**	(12)
Net current future tax assets	**4,012**	6,538

(thousands of dollars)	March 29, 2003	March 30, 2002
Non-current future tax assets		
Tax loss carryforwards	**59,562**	59,932
Share issue costs	**1,604**	2,067
Book amortization in excess of CEC deduction	**795**	805
Accrued benefit obligations	**291**	466
Book amortization in excess of capital cost allowance	**13,952**	11,079
Non-current future tax assets before valuation allowance	**76,204**	74,349
Valuation allowance	**(69,533)**	(70,204)
Net non-current future tax assets	**6,671**	4,145

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

(thousands of dollars)	52-week period ended March 29, 2003	52-week period ended March 30, 2002
Current income tax expense	**600**	600
Future income tax expense (benefit) relating to origination and reversal of temporary differences	**301**	(40,055)
Increase (decrease) in valuation allowance	**(671)**	40,635
Future income tax benefit resulting from recognition of loss carryforwards	**(97)**	(5,688)
Future income tax expense relating to utilization of tax losses acquired	**1,300**	–
Adjustment to future income tax assets resulting from reduction in substantively enacted tax rates	**467**	5,108
Total income tax expense	**1,900**	600

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

(thousands of dollars)	52-week period ended March 29, 2003	52-week period ended March 30, 2002
Tax at combined federal and provincial tax rates	**1,280**	(20,910)
Tax effect of expenses not deductible for income tax purposes	**125**	125
Expense (benefit) of current year temporary differences not recognized	**(1,767)**	15,662
Tax effect of utilization of tax losses acquired	**1,300**	–
Large Corporations Tax	**600**	600
Reduction in income tax benefits resulting from substantively enacted tax rate reductions	**467**	5,108
Other, net	**(105)**	15
	1,900	600

As at March 29, 2003 the Company has combined non-capital loss carryforwards of approximately $185.1 million for income tax purposes that expire as follows if not utilized:

(thousands of dollars)	March 29, 2003
2004	**3,560**
2005	**18,950**
2006	**35,350**
2007	**95,750**
2008	**21,900**
2009	**5,600**
2010	**4,000**
	185,110

5. GOODWILL

The Company adopted the new recommendations relating to goodwill under CICA Handbook Section 3062 effective March 31, 2002. In accordance with the transitional provisions of Section 3062, the Company is required to complete a two step transitional impairment test to identify if there is impairment to goodwill at March 31, 2002. The Company has completed this test on its two reporting units (Retail and Online) using the discounted cash flow method, and has determined that the carrying value of goodwill for the Online reporting unit exceeded its fair value by $4.8 million. The resulting impairment loss was recognized as a change in accounting policy and charged to opening retained deficit as at March 30, 2002. The Company also performed its annual impairment test on March 29, 2003 and determined that there was no further impairment of goodwill.

As part of the purchase price allocation for the acquisition of Indigo Books & Music, Inc. ("Old Indigo'), no future income tax asset was recognized for the unused tax losses of Old Indigo that existed at the date of acquisition. When unused tax losses acquired in a business combination that were not recognized as a future tax asset by the acquirer at the date of the acquisition are subsequently recognized by the acquirer, the benefit should be applied first to reduce to zero any unamortized goodwill related to the acquisition. In the current year, the Company utilized a portion of the acquired unused tax losses which were not recognized and, accordingly, reduced goodwill by $1.3 million.

The following table presents the impact of the Section 3062 requirement to cease the amortization of goodwill, as if the standard had been in effect beginning April 1, 2001, on net earnings (loss) and on basic and diluted earnings (loss) per common share for the 52 weeks ended March 29, 2003 and March 30, 2002:

(thousands of dollars, except per share data)	52-week period ended March 29, 2003	52-week period ended March 30, 2002
(Net earnings (loss) – reported	**1,425**	(47,912)
Amortization of goodwill	**–**	1,087
Net earnings (loss) – adjusted	**1,425**	(46,825)
Basic net earnings (loss) per common share – reported	**$0.06**	$(2.58)
Diluted net earnings (loss) per common share – reported	**$0.06**	$(2.58)
Basic net earnings (loss) per common share – adjusted	**$0.06**	$(2.52)
Diluted net earnings (loss) per common share – adjusted	**$0.06**	$(2.52)

6. BANK INDEBTEDNESS AND LONG-TERM DEBT

The Company has a credit agreement with a major Canadian chartered bank. The credit agreement provides for:

(i) A revolving line of credit of up to $75.0 million, based on defined levels of inventory and accounts receivable, bearing interest, at the Company's option, at either the bank's prime rate or the bankers acceptance rate plus 0.5% to 3.5% depending on certain financial ratios. The revolving line of credit shall be repaid in full and cancelled on May 31, 2004. As at March 29, 2003, $28.4 million was drawn against this facility;

(ii) Long-term debt of $50.0 million bearing interest at the same rates as the revolving line of credit. The facility is to be repaid as follows; $14.0 million on December 31, 2002, $14.0 million on December 31, 2003, and $22.0 million on May 31, 2004; and

(iii) Long-term debt of $34.0 million bearing interest at the bank's prime rate plus 4.5% per annum. The facility is to be repaid as follows; $17.0 million on December 31, 2002, and $17.0 million on December 31, 2003.

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

On December 31, 2002, $31.0 million of long-term debt matured and was repaid.

In fiscal 2003, the Company entered into capital lease agreements for certain equipment. The obligations under these capital leases amounted to $1.5 million, of which $0.3 million is included in the current portion of long-term debt. The weighted average interest rate of these capital leases is 10%. The payment obligations, net of the interest obligation, for the next three years are $0.3 million, $0.4 million and $0.8 million respectively.

On September 5, 2001, the Company entered into interest rate derivative agreements involving the exchange of prime rate floating interest rates for fixed interest rates on a notional amount of $84.0 million. There are reductions in the notional amounts of the derivative agreements that coincide with principal repayments of the underlying long-term debt. The fixed interest rate on a notional amount of $17.0 million (March 30, 2002 – $34.0 million) is 5.02%, and 5.19% on the remaining notional amount of $36.0 million (March 30, 2002 – $50.0 million). The contracts expire on December 31, 2003 and May 31, 2004 respectively.

On November 8, 2001, the Company entered into interest rate derivative agreements involving the exchange of prime rate floating interest rates for fixed interest rates on a notional amount of $40.0 million. The fixed interest rate is 3.14% and the contracts expire on December 1, 2003.

As at March 29, 2003, the Company has outstanding letters of credit totaling $1.2 million (March 30, 2002 – $1.5 million).

7. ACCRUED BENEFIT OBLIGATIONS

The Company uses actuarial reports prepared by independent actuaries for funding and accounting purposes. The significant actuarial assumptions adopted in measuring the Company's accrued benefit obligations are as follows:

(thousands of dollars)	March 29, 2003	March 30, 2002
Accrued benefit obligations, beginning of period	**10,375**	9,761
Current service cost	**1,210**	1,164
Interest on accrued benefits	**774**	704
Benefits paid	**(1,068)**	(762)
Experience loss (gain)	**1,028**	(492)
Balance, end of period	**12,319**	10,375
Fair value of plan assets, beginning of period	**9,003**	8,595
Employee and employer contributions	**1,749**	1,109
Interest on plan assets	**656**	619
Benefits paid	**(1,068)**	(762)
Experience gain (loss)	**(813)**	(558)
Fair value of plan assets, end of period	**9,527**	9,003
Funded status – plan deficit	**2,792**	1,372
Unamortized loss	**(1,906)**	(66)
Accrued benefit obligations	**886**	1,306

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

	March 29, 2003	March 30, 2002
Weighted average assumptions		
Discount rate	**6.50%**	7.00%
Expected long-term rate of return on plan assets	**7.00%**	7.00%
Rate of compensation increase	**4.00%**	4.00%

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

(thousands of dollars)	March 29, 2003	March 30, 2002
Current service cost	**670**	614
Interest on accrued benefits	**774**	704
Interest on plan assets	**(656)**	(619)
Net benefit plan expense	**788**	699

8. SHARE CAPITAL

Share capital consists of the following:

(thousands of dollars)	**March 29, 2003**	March 30, 2002
Authorized		
Unlimited Class A preference shares, voting, convertible into common shares on a one-for-one basis at the option of the shareholder		
Unlimited common shares, voting		
Issued		
23,964,802 common shares (March 30, 2002 – 16,985,106)	**193,426**	163,505

Common shares issued:

	March 29, 2003		March 30, 2002	
	Number of shares	**Amount $ (thousands)**	Number of shares	Amount $ (thousands)
Balance, beginning of period	**16,985,106**	**163,505**	12,289,588	144,775
Issued during the period				
Issued for cash (net of expenses and future income taxes) (i)	**6,979,696**	**29,921**	3,395,074	9,920
Employee Stock Purchase Plan (ii)	–	–	21,983	124
Options exercised (iii)	–	–	–	–
Issued on acquisition (notes 9 and 10)	–	–	1,278,461	8,686
	6,979,696	**29,921**	4,695,518	18,730
Balance, end of period	**23,964,802**	**193,426**	16,985,106	163,505

(i) On January 14, 2002, the Company completed an offering of 3,395,074 common shares of the Company at $3.00 per share. The issue which was completed by way of an offering of subscription rights to all holders of common shares of the Company, was fully subscribed, resulted in net proceeds of $9.9 million, and was used to fund working capital in connection with the repayment of $20.0 million in long-term debt on December 31, 2001.

On April 19, 2002, the Company completed an offering of 4,243,841 common shares of the Company at $3.50 per share. The issue, which was completed by way of an offering of subscription rights to all holders of common shares of the Company, was fully subscribed, and resulted in net proceeds of $14.5 million, which was used to provide the Company with capital to reduce overall levels of indebtedness.

On July 9, 2002, the Company completed a private placement of 73,100 common shares of the Company at $6.48 per share. The issue was completed with one of the Company's officers.

On September 27, 2002, the Company completed an offering of 2,662,755 common shares of the Company at $5.75 per share. The issue, which was completed by way of an offering of subscription rights to all holders of common shares of the Company, was fully subscribed, and resulted in net proceeds of $15.0 million which was used to fund capital expenditures including store improvements, supply chain re-design, and investment in *www.chapters.indigo.ca*.

Since the exercise price of the January 14 and April 19, 2002 offerings were less than the fair market value of the shares at issuance and the offerings were available to all existing shareholders, the offerings contained a bonus element that is considered to be similar to a stock dividend. As a result, basic and diluted earnings per share have been adjusted retroactively for the bonus element for all periods presented.

(ii) The Company had an Employee Stock Purchase Plan that allowed employees, other than senior management and directors, to purchase up to 10% of their salary in common shares at a 15% discount price from the lesser of the fair market value at the opening or closing price of each six-month period. This plan was discontinued on January 24, 2002.

(iii) On August 26, 1996, the Company established an employee stock option plan (the "Plan") for key employees. The number of common shares reserved for issuance under the Plan is 1,728,500. One quarter of the options granted prior to May 21, 2002 are exercisable on the date of issue with the remainder exercisable in equal installments on the anniversary date for the next three years. All grants of options since May 21, 2002 have one fifth of the options granted exercisable one year after the date of issue with the remainder exercisable in equal installments on the anniversary date over the next four years.

(iv) 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. The number of shares reserved for issuance under the Plan is 250,000. The Company did not issue any deferred stock units during the period ending March 29, 2003.

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

	March 29, 2003		March 30, 2002	
	Number #	Weighted Average exercise price $	Number #	Weighted Average exercise price $
Outstanding options, beginning of period	**382,633**	**30.83**	764,179	22.60
Granted	**863,000**	**5.82**	130,941	47.56
Forfeited	**(178,365)**	**29.72**	(512,487)	22.83
Expired	**(63,639)**	**17.60**	–	–
Outstanding options, end of period	**1,003,629**	**10.36**	382,633	30.83
Options exercisable, end of period	**147,384**		265,040	

Options outstanding and exercisable

	March 29, 2003				
	Outstanding			Exercisable	
Range of exercise prices $	Number #	Weighted average exercise price $	Weighted average remaining contractual life years	Number #	Weighted average exercise price $
4.50-5.99	**323,000**	**4.60**	**9.9**	–	–
6.00-9.99	**527,408**	**6.62**	**9.2**	**41,482**	**7.09**
10.00-27.99	**24,893**	**12.91**	**2.6**	**18,014**	**12.53**
28.00-33.99	**87,127**	**30.31**	**1.4**	**77,464**	**30.48**
34.00-64.00	**41,201**	**59.72**	**7.6**	**10,424**	**56.00**
4.50-64.00	**1,003,629**	**10.36**	**8.5**	**147,384**	**23.51**

Had compensation costs for the stock options issued during the period under the Plan been determined based on the fair value method of accounting for stock based compensation, the Company's net earnings would have decreased to the *pro forma* amounts listed below. The Company's basic and diluted earnings per common share appear to remain constant due to rounding.

(thousands of dollars, except per share data)	52-week period ended March 29, 2003
Net earnings – reported	**1,425**
Net earnings – pro forma	**1,239**
Basic net earnings per common share – reported	**$0.06**
Basic net earnings per common share – pro forma	**$0.06**
Diluted net earnings per common share – reported	**$0.06**
Diluted net earnings per common share – pro forma	**$0.06**

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 for the 52-week period ending March 29, 2003:

Risk free interest rate – 4.5%
Expected volatility – 40.3%
Expected time until exercise – 4.0 years
Expected dividend yield – 0.0%

9. ACQUISITION OF INDIGO BOOKS & MUSIC, INC.

On August 14, 2001 ("date of acquisition"), the Company acquired all of the issued and outstanding shares of "Old Indigo." The aggregate purchase price was $11.9 million pursuant to which the Company issued 528,268 common shares valued at $4.1 million and 97,908 options to purchase common share in exchange for all of Old Indigo's Class A shares, Series I Convertible Preference Shares and options and warrants to purchase common shares outstanding. The value of the 528,268 common shares issued was determined based on the average market price of the Company's common shares over a reasonable period before and after the date the terms of the business combination were agreed and announced. The results of Old Indigo's operations have been included in the consolidated financial statements since the date of acquisition. In addition, the corporate name of the Company was changed from Chapters Inc. to Indigo Books & Music Inc. and the Company's trading symbol on the Toronto Stock Exchange was changed from CHP to IDG.

The acquisition was accounted for using the purchase method. The following table summarizes the fair value of the assets acquired, liabilities assumed and the composition of the purchase price as at the date of acquisition:

(thousands of dollars)	Fiscal 2002
Current assets	22,383
Capital assets	20,530
Goodwill	52,856
Current liabilities	(57,588)
Convertible notes	(26,281)
	11,900

Funded by	
Issuance of common shares	4,147
Equity component of convertible notes and options	1,903
Transaction costs	5,850
	11,900

10. ACQUISITION OF CHAPTERS ONLINE INC.

On October 27, 2001, the Company acquired all of the outstanding shares of Chapters Online Inc. not already owned by the Company. The aggregate purchase price was $4.8 million pursuant to which the Company issued 750,193 common shares valued at $4.5 million. The value of the 750,193 common shares was determined based on the average market price of the Company's common shares over a reasonable period before and after the date the terms of the business combination were agreed and announced. Chapters Online Inc. became a wholly owned subsidiary of Indigo.

The acquisition was accounted for using the purchase method. The following table summarizes the fair value of the assets acquired, liabilities assumed and the composition of the purchase price as at the date of acquisition:

(thousands of dollars)	Fiscal 2002
Current assets	1,190
Capital assets	1,784
Goodwill	4,500
Current liabilities	(2,685)
	4,789
Funded by	
Common shares	4,539
Transaction costs	250
	4,789

11. CONVERTIBLE NOTES

Upon acquisition of Old Indigo by the Company, the Old Indigo Series I and II subordinated convertible notes in the amount of $10.0 million and $20.0 million became convertible into common shares of the Company on the basis of one common share of the Company for each $18.93 of principal and interest owing.

The Series I notes bear interest at 8% per annum and mature on June 30, 2005. The Series II notes bear interest at prime plus 2% per annum and mature on June 30, 2005.

At the date of acquisition, the fair value of the subordinated convertible notes was allocated between a liability and equity component (note 9). The recorded amount of the liability component is being accreted to its face value over the remaining term of the notes as interest expense. The holder's conversion option is treated as a separate element within equity.

12. RESTRUCTURING AND TAKE-OVER COSTS

Restructuring charges for the period ended March 30, 2002 consist of the following:

(thousands of dollars)	Fiscal 2002
Write-down of capital assets	24,052
Provision for store closing and other costs	11,906
Relocation and other costs as a result of acquisition	1,691
Refinancing fee	2,667
	40,316

As at March 29, 2003, approximately $10.6 million of the restructuring and take-over costs remain unpaid and have been included in accounts payable and accrued liabilities (March 30, 2002 – $11.4 million).

13. JOINT VENTURES

In August 1999, a joint venture was formed with Barnes and Noble College Bookstore Canadian Division to manage the Company's Campus Bookstore division. Under the terms of the agreement, the Company contributed assets at a net book value of $4.6 million, consisting primarily of inventory, in return for a promissory note of $2.1 million and a 51% equity interest in the newly formed company, Chapters Campus Bookstores Company.

In addition, the Company participates in a joint venture through a 50% equity ownership in the Calendar Club of Canada Limited Partnership to sell calendars through temporary kiosks during the Christmas season.

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

	Total		Proportionate share	
(thousands of dollars)	**2003**	2002	**2003**	2002
Current assets	**13,959**	13,882	**7,066**	7,029
Long-term assets	**2,496**	1,872	**1,260**	942
Current liabilities	**4,125**	3,646	**2,096**	1,855
Revenue	**44,921**	40,826	**22,659**	20,606
Expenses	**38,488**	35,111	**19,438**	17,691
Net income	**6,433**	5,715	**3,221**	2,915
Cash flows provided by (used in)				
Operating activities	**4,240**	8,281	**2,117**	4,177
Financing activities	**(369)**	(506)	**(184)**	(253)
Investing activities	**225**	(632)	**113**	(316)
Net cash flow	**4,096**	7,143	**2,046**	3,608

14. SEGMENT INFORMATION

As at March 29, 2003, the Company had two reportable segments: retail and online division. The retail division operates a chain of retail bookstores across Canada including superstores, mall stores and college bookstores. The online division is an e-commerce retailer, selling books and other products through the Internet Web site *www.chapters.indigo.ca*. For the period ending March 29, 2003, the online results have been included in the retail division since they are not material for the overall operations of the Company. Set out below is the segmented information for the 52-week period ended March 30, 2002.

	52-week period ended March 30, 2002		
(thousands of dollars)	Retail	Online	Total
Revenue	700,953	34,731	735,684
Earnings (loss) before interest, amortization, income taxes, restructuring charges and non-controlling interest	38,900	(1,876)	37,024
Amortization	26,119	5,259	31,378
Interest expense (income)	14,450	(92)	14,358
Segment loss before income taxes, restructuring charges and non-controlling interest	(1,669)	(7,043)	(8,712)
Segment loss before restructuring charges and non-controlling interest	(2,269)	(7,043)	(9,312)
Segment assets	427,108	5,674	432,782
Capital expenditures	9,560	72	9,632
Goodwill on business combinations	52,856	4,500	57,356

Reconciliation – segment loss

Segment loss before restructuring charges and non-controlling interest	(9,312)
Restructuring charges	(40,316)
Non-controlling interest	1,716
Net loss	(47,912)

Reconciliation – segment assets

	March 30, 2002		
(thousands of dollars)	Retail	Online	Total
Cash and cash equivalents	220	457	677
Accounts receivable	12,265	552	12,817
Inventories	223,467	–	223,467
Prepaid expenses	4,173	165	4,338
Capital assets	115,041	–	115,041
Intercompany receivables	3,633	–	3,633
Other	68,309	4,500	72,809
	427,108	5,674	432,782
Future income tax assets			10,683
Intercompany receivables			(3,633)
			439,832

15. CONSOLIDATED STATEMENTS OF CASH FLOWS

(a) The net change in working capital balances related to operations consists of the following:

(thousands of dollars)	March 29, 2003	March 30, 2002
Accounts receivable	**3,434**	(1,251)
Inventories	**21,012**	(7,467)
Prepaid expenses	**(1,355)**	375
Income taxes recoverable	**4,769**	403
Deferred revenue	**210**	1,028
Accounts payable and accrued liabilities	**(9,044)**	(4,356)
	19,026	(11,268)

(b) Supplemental cash flow information:

(thousands of dollars)	March 29, 2003	March 30, 2002
Interest paid	**10,292**	12,435
Income taxes paid	**279**	916
Assets acquired under capital lease	**1,529**	–

(c) The Company entered into the following non-cash transactions:

(i) During the period ended March 30, 2002, the Company issued 528,268 common shares valued at $4.1 million with respect to the acquisition of Old Indigo (note 9) and 750,193 common shares valued at $4.5 million with respect to the acquisition of all of the outstanding shares of Chapters Online (note 10).

16. COMMITMENTS AND CONTINGENCIES

(a) Operating leases

The Company has operating lease commitments in respect of its stores, support office premises and certain equipment. The leases expire at various dates between 2004 and 2016 and are subject to renewal options in certain cases. Annual store rentals consist of a base amount together with additional payments based on store sales. The base rentals payable under present leases are as follows:

(thousands of dollars)	
2004	66,261
2005	64,226
2006	65,085
2007	65,331
2008	56,284
Thereafter	132,387
	449,574

(b) Legal claims

In fiscal 2003, a former supplier filed a claim in the amount of $8.4 million against the Company. The Company is of the view that the claim is without merit and lacks a factual or legal foundation and the Company intends to vigorously defend the claim. The final outcome of the claim and the amount of losses, if any, cannot be predicted with certainty at this time, however, it is the opinion of management that the resolution of the claim will not have a material adverse effect on the Company's financial position.

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 29, 2003 cannot be predicted with certainty, management believes that any such amount would not have a material impact on the Company's financial position.

17. FINANCIAL INSTRUMENTS

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

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

The fair value of long-term debt and convertible notes are 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. The fair value of the convertible notes is approximately $33.8 million as at March 29, 2003.

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 agreements as at March 29, 2003 was $0.8 million in favour of the counterparties.

18. RELATED PARTY TRANSACTIONS

As at March 29, 2003, the Company has outstanding convertible notes with related parties in the amount of $37.6 million including accrued interest (March 30, 2002 – $34.6 million). During the 52-week period ended March 29, 2003, interest expense related to the convertible notes amounted to $3.0 million (March 30, 2002 – $1.8 million).

19. COMPARATIVE FIGURES

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

Corporate Governance Policies

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

Executive Management and Board of Directors

EXECUTIVE MANAGEMENT

Doug Caldwell
Chief Technology Officer

Susan Croft
Senior Vice President, Human Resources

Victor DiRisio
Senior Vice President, Supply Chain

Peter Drutz
Executive Vice President, Retail

Michael Gagnier
Executive Vice President, Online

Deirdre Horgan
Senior Vice President, Marketing

Jim McGill
Chief Financial Officer

Heather Reisman
Chair & Chief Executive Officer

Kathy Weston
Executive Vice President, Procurement

BOARD OF DIRECTORS

Bruce Birmingham
Corporate Director

Jonathan Deitcher
Investment Advisor
RBC Investments

James Hall
Corporate Director, Private Investor & Consultant

Senator Michael Kirby
Senator
The Senate of Canada

Robert Lantos
President
Serendipity Point Films

Jack Lawrence
Chairman
Lawrence & Company Inc.

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

Gerald Schwartz
Chairman, President & CEO
Onex Corporation

Nigel Wright
Managing Director
Onex Corporation

Summary of Financial Information

For the years ended (millions of dollars except per share data)	**March 29, 2003**	March 30, 2002	March 31, 2001	April 1, 2000	April 3, 1999
SELECT INCOME STATEMENT INFORMATION					
Revenue					
Superstores	**528.1**	485.8	408.9	376.3	296.9
Mall Stores	**174.0**	183.8	195.2	217.8	253.2
Internet	**39.1**	34.7	51.1	38.7	2.0
Other	**38.0**	31.4	31.3	27.5	25.7
Total Revenues	**779.2**	735.7	686.5	660.3	577.9
EBITDA	**42.0**	37.0	(43.3)	(8.9)	41.3
EBIT	**18.1**	5.6	(73.0)	(34.5)	23.3
Restructuring and take-over costs	**–**	40.3	30.0	–	–
Dilution gain on sale of Chapters Online Inc. & Pegasus Wholesale	**–**	–	–	41.1	–
Earnings per weighted average shares outstanding	**0.06**	(3.52)	(7.33)	1.54	1.00
SELECT BALANCE SHEET INFORMATION					
Working capital	**(27.6)**	(40.8)	(4.6)	88.3	9.4
Total assets	**394.8**	439.8	388.8	495.3	351.8
Long-term debt	**85.6**	112.1	54.0	54.0	–
Shareholders' equity	**90.4**	63.8	91.1	165.2	115.2
Long-term debt / (long-term debt + equity)	**0.49:1**	0.64:1	0.37:1	0.25:1	–
Weighted average number of shares outstanding	**22,512,643**	13,629,541	11,526,705	11,133,222	10,295,450
Common shares outstanding at end of period	**23,964,802**	16,985,106	12,289,588	11,358,429	10,310,583
STORE OPERATING STATISTICS					
Number of stores at end of period					
Superstores	**88**	90	77	70	54
Mall Stores	**179**	187	204	231	261
Campus Bookstores	**6**	6	6	4	1
Selling Square footage at end of period (in thousands)					
Superstores	**2,123**	2,164	1,883	1,751	1,484
Mall Stores	**476**	496	536	604	721
Campus Bookstores	**38**	38	38	35	28
Comparable store sales growth					
Superstores	**5.3%**	1.1%	(1.6%)	(3.1%)	3.9%
Mall Stores	**(0.2%)**	3.7%	(3.0%)	(4.0%)	0.7%
Sales per selling square foot					
Superstores	**249**	233	229	244	258
Mall Stores	**365**	358	352	358	339

Investor Information

SUPPORT OFFICE

468 King Street West
Suite 500
Toronto, Ontario
Canada M5V 1L8
Telephone (416) 364-4499
Fax (416) 364-0355
www.chapters.indigo.ca/ir

INVESTOR CONTACT

Jim McGill
Chief Financial Officer
Telephone (416) 640-4856

MEDIA CONTACT

Tracy Nesdoly
Vice President, Communications
Telephone (416) 263-5025

STOCK LISTING

Toronto Stock Exchange

TRADING SYMBOL

IDG

TRANSFER AGENT AND REGISTRAR

CIBC Mellon Trust Company
320 Bay Street
4th Floor
Toronto, Ontario
Canada M5H 4A6
Telephone 1-800-387-0825

AUDITORS

Ernst & Young LLP
Ernst & Young Tower
Toronto-Dominion Centre
Toronto, Ontario
Canada M5K 1J7

ANNUAL MEETING

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

Indigo's Annual Meeting will be held on August 19, 2003, 10:00 a.m. at the Toronto Stock Exchange Conference Centre, 130 King Street West, Toronto, Ontario, Canada.

Shareholders are encouraged to attend and guests are welcome.

Une traduction française de ce document est disponible sur demande.

Our Guiding Principles

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