

Indigo Books & Music Inc.

Annual Information Form

August 6, 2004

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Indigo Books & Music Inc.

CORPORATE STRUCTURE

General

Indigo Books & Music Inc. (“Indigo”) is the largest book retailer in Canada, operating bookstores in all provinces of Canada. Indigo was formed upon the 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. Previously, Chapters Inc. was formed upon the amalgamation of Coles Book Stores Limited and FICG Inc., under the laws of the Province of Ontario, pursuant to a Certificate of Amalgamation dated April 11, 1995. Indigo’s head and registered office is located at 468 King Street West, Toronto, Ontario, M5V 1L8.

Principal Subsidiaries

The following table sets forth the names of the principal subsidiaries (including limited partnerships) of Indigo as of July 29, 2004, the percentage of shares (or interest) owned by Indigo and the jurisdiction of incorporation or continuance of each such subsidiary (or limited partnership).

<u>Name of Subsidiary</u>	<u>Percentage Owned</u>	<u>Jurisdiction of Incorporation or Continuance</u>
Calendar Club of Canada Limited Partnership	50.0%	Delaware, USA
Chapters Campus Bookstores Company	51.0%	Ontario, Canada

DESCRIPTION OF INDIGO

Overview of Business

Indigo sells books and book-related products, including newspapers, magazines, audio books, stationery, music CDs, videos, DVDs, educational and entertainment-oriented software and gifts through its 87 superstores, operating under the names Indigo Books Music & more, Chapters, and the World’s Biggest Bookstore; and 164 mall stores operating under the names Coles, SmithBooks, LibrairieSmith and The Book Company.

Change of Ownership and Significant Acquisition

On February 2, 2001, Trilogy Retail Enterprises, L.P. (“Trilogy”) acquired 7,146,000 common shares of Chapters Inc. (“Chapters”). On August 7, 2001, Chapters shareholders agreed to the merger of Chapters and Indigo Books & Music, Inc. (“Old Indigo”) and on August 14, 2001, this merger (the “Indigo Merger”) took effect. Pursuant to Articles of Amalgamation dated August 16, 2001, Chapters amalgamated with the entity that resulted from the amalgamation of Old Indigo, Indigo Online Inc. and 1475964 Ontario Limited, to continue as “Indigo Books & Music Inc.” Under the terms of the Indigo Merger, Indigo issued 528,268 of its common shares (“Common Shares”) to the holders of the equity interests in Old Indigo. On a fully diluted basis, an aggregate of approximately 2,355,938 Common Shares were issued or issuable, taking into account Old Indigo options and warrants, which were converted into Indigo options and warrants, and Old Indigo convertible debt instruments, which became convertible into Common Shares.

Retail Business

Indigo operates 87 superstores. Superstores are typically ten times the size of Indigo's mall stores, permitting them to carry a vast title selection and provide an inviting ambience.

Indigo operates 164 mall stores in shopping centres, street-front retail areas, airports and shopping concourses throughout Canada, including 145 Coles, 15SmithBooks, 3 The Book Company stores and 1 Indigo mall format store. The mall stores are built on service, convenient locations and selection. Indigo continues to pursue a mall store rationalization program whereby, as leases come up for renewal, Indigo closes under-performing and duplicate stores, as well as mall stores that will be impacted by the opening of a superstore in their markets. At the same time, it is management's belief that profitable opportunities exist within certain markets for the Coles banner.

Indigo is in the process of reviewing its real estate portfolio of superstores with a view to closing under-performing and duplicate stores in the same market. It is anticipated that five to seven large format stores may be closed or downsized over the coming year. Indigo will explore new store opportunities now that restrictions on new store openings under the Consent Order (defined below) have expired.

In September 1997, Indigo entered into a joint venture with Calendar Club L.L.C., a Texas limited liability company, for the purpose of operating temporary seasonal calendar kiosks and stores in Canadian shopping centres under the Calendar Club of Canada name. In April 1999, Indigo entered into a new limited liability partnership (the "Calendar Club Partnership") with Calendar Club L.L.C. and Paris Southern Lights Inc. ("PSL"), a distributor of calendars in Paris, Ontario. Prior to the formation of the Calendar Club Partnership, PSL distributed calendars and operated the Calendar Club kiosks under contract to the joint venture. Calendar Club of Canada currently operates 162 seasonal calendar kiosks as well as in-line game stores.

In August 1999, Indigo, through Chapters Canadian University Bookstores Limited ("CCUBL"), acquired a controlling interest in the merged operations of CCUBL and the Canadian operations of Barnes & Noble College Bookstores Inc. ("B&N College"). The combined campus bookstore division, Chapters Campus Bookstores Company ("CCBC"), manages the bookstores at Niagara College in Welland, Niagara College in Niagara-on-the-Lake, Cambrian College in Sudbury, Northern College in Timmins and Loyalist College in Belleville.

Internet Business

Indigo operates www.chapters.indigo.ca, a leading Canadian destination for online shoppers. The site features a large selection of books, videos, gifts and DVDs at Canadian prices, with a focus on products of interest to Canadians.

Indigo Distribution Centre

Indigo maintains a 306,600 square foot distribution facility in Brampton, Ontario. The facility is used for the distribution of retail products and as a fulfillment centre for the online operations.

Description of the Retail Business

Superstores

Indigo operates its superstores under the names Indigo Books Music & more, Chapters, and the World's Biggest Bookstore in all provinces of Canada. These book superstores are typically about ten

times the size of Indigo's mall stores. In the 53 weeks ended April 3, 2004, these stores accounted for sales of \$548.2 million, representing 68% of total revenues. In the 52 weeks ended March 29, 2003, these stores accounted for sales of \$528.1 million, representing 68% of total revenues. Indigo superstores are designed to be a destination for book consumers, offering an environment that is conducive to browsing and that becomes a part of the local community. Management believes that, as a result of superior title selection, ambiance, convenient hours (generally, 10:00 a.m.-10:00 p.m., seven days per week), competitive pricing and knowledgeable staff, Indigo is well positioned to maintain its status as the leading book superstore operator in Canada.

Large Title Selection. Indigo believes that superstore sales are driven by actual customer browsing of on-hand titles and by customers' expectations that a desired title or subject will be in stock. Indigo's superstores offer a large selection of book titles, covering major and obscure subjects. Indigo has computer kiosks in all Indigo superstores to give retail customers access to much the same inventory of books available to its online shoppers.

Superior Store Design. Superstores are designed to encourage browsing for extended periods, featuring wide aisles, comfortable seating, warm lighting and soft colours. Floor plans partition the stores into manageable areas and lead customers to popular categories such as "fiction", "childrens" and "multi-media".

Real Estate. In fiscal 2004, Indigo closed 1 superstore as part of its ongoing initiative to streamline its real estate portfolio and close under-performing locations in over-served markets. Since April 3, 2004, no superstores have opened or closed. Indigo will explore new store opportunities now that restrictions on new store openings under the Consent Order (defined below) have expired.

The size of an Indigo book superstore is dependent upon the size of the local population and the potential draw of such a store, the demographics of the market and the availability of other locations. Currently, superstores range in size from 11,000 to 67,000 square feet (compared to an average of approximately 2,700 square feet for mall stores), with the majority being between 20,000 and 30,000 square feet. The total superstore selling square footage is 2,105,000. All Indigo superstores are leased.

Mall Stores

Indigo operates its mall stores in all provinces of Canada under the names Coles, SmithBooks, LibrairieSmith, and The Book Company. These stores are typically located in retail shopping centres, street-front retail areas, major airports and central business districts. Coles is the leading mall store chain in Canada in terms of both sales and number of stores. Indigo's mall stores generated combined sales of \$169.4 million in the 53 weeks ended April 3, 2004, representing 21% of total revenues. In the 52 weeks ended March 29, 2003, these stores accounted for sales of \$174.0 million, representing 22% of total revenues.

Convenience Shopping. Indigo's mall stores typically carry approximately 8,000 titles, covering a wide range of book categories, including new releases, bestsellers, mass market paperbacks, trade books, bargain and remaindered books, audio books, calendars, newspapers and magazines. Stores are generally open during the operating hours of the shopping centres in which they are located.

Mall stores rely heavily on impulse and walk-in business. Indigo believes that its recognized national banner names are valuable in attracting walk-by traffic into its stores and that its portfolio of locations in prominent shopping centres, street-front retail areas, airports and other core retail locations across Canada is the most significant factor contributing to their ongoing sales performance.

Real Estate. Indigo operates 164 mall stores comprising 145 stores with the Coles banner, 3 with The Book Company banner, 15 with the SmithBooks banner and 1 Indigo mall format store.. There were 17 mall store closures from April 1, 2001 to March 30, 2002, 8 mall store closures from March 30, 2002 to March 29, 2003 and 13 additional mall store closures from March 30, 2003 to April 3, 2004. Since April 3, 2004, 1 mall store has opened and 4 mall stores have closed.

Indigo's Management believes that many of Indigo's mall stores are located in geographic areas that are too sparsely populated to support a superstore and, accordingly, that Indigo's mall stores will continue to provide a significant source of revenue well into the future.

Loyalty Program

Indigo's *iRewards* customer loyalty program operates at its superstores and at its mall stores and provides members with a discount on all book purchases made online and in stores for which customers pay an annual fee. Indigo believes that the program generates significant customer loyalty and provides customers with a strong incentive to choose Indigo as their preferred retailer of books, music and gifts. The transaction history provided by these programs provides an excellent basis upon which to build targeted, direct marketing programs, as well as a comprehensive database for other direct sales methods such as Internet or catalogue-based sales in the future. The *iRewards* program had a combined total enrollment of approximately 1.0 million members at the end of March, 2004.

Information Systems

In fiscal 2003, Indigo launched a major initiative to upgrade its procurement, supply chain and financial systems using an integrated SAP solution. The Company believes the new system will improve customer service, allow for better merchandising of product, and reduce its distribution and operating costs. The system was implemented on May 2, 2004.

Purchasing

Indigo's category managers have significant book industry experience, each specializing in one or more subject areas, such as fiction, history, architecture and or science. Indigo purchases its books from more than 100 major publishers.

Currently, Indigo has an active list of approximately 250,000 titles. Each year, Indigo's category managers are presented with 60,000 to 75,000 new titles for consideration, of which approximately 25,000 titles are chosen for addition to Indigo's title list, while approximately 20,000 to 25,000 are de-listed annually. In addition, Indigo will special order any book currently in print for customers.

Approximately 85% of all books Indigo purchases are returnable to suppliers for full credit. Indigo is responsible only for transportation and labour costs associated with returning these books. Historically, it has returned approximately 30% of the books purchased under these arrangements. Indigo also purchases non-returnable books and sells them as bargain books.

In order to maximize the average transaction revenues of the customers that visit either mall stores or superstores, Indigo is focusing on the expansion of its gift program. While the sale of books and book-related products will continue to be the single most important product line to Indigo, it is Management's belief that other merchandise can effectively add incremental revenues to existing store sales.

Campus Bookstores

In September 1997, Indigo launched its campus bookstore division, CCUBL. In August 1999, through CCUBL, Indigo acquired a 51% interest in the merged operations of CCUBL and the Canadian operations of B&N College. The combined campus bookstore division, which operates under the new name CCBC, manages the bookstores at Niagara College in Welland, Niagara College in Niagara-on-the-Lake, Cambrian College in Sudbury, Northern College in Timmins and Loyalist College in Belleville.

Seasonal Calendar Kiosks

In September 1997, Indigo entered into a joint venture with Calendar Club L.L.C., a Texas limited liability company, for the purpose of operating temporary seasonal calendar kiosks and stores in Canadian shopping centres under the Calendar Club of Canada name. In April 1999, Indigo entered into the Calendar Club Partnership with Calendar Club L.L.C and PSL. Prior to the formation of the Calendar Club Partnership, PSL distributed calendars and operated the Calendar Club kiosks under contract to the joint venture. Calendar Club of Canada currently operates 162 seasonal calendar kiosks as well as in-line game stores.

Regulatory Environment

The *Investment Canada Act* regulates the acquisition by a non-Canadian of control of a Canadian business, including a business engaged in the publication, distribution or sale of books. Currently, foreign investments to acquire control of an existing Canadian-controlled book publishing, distribution or retailing business are generally not permitted. Acquisitions of a non-Canadian controlled business and indirect acquisitions are subject to review by Heritage Canada, the government agency responsible for determining whether the acquisition is likely to be of net benefit to Canada. As part of that determination, Heritage Canada will typically seek from the foreign investor one or more commitments, such as a commitment to the development of Canadian authors, a commitment to support the infrastructure of the book distribution system in Canada, accessibility of the company's Canadian marketing and distribution infrastructure to interested and compatible Canadian-controlled publishers, and a commitment to education and research through financial and professional assistance to Canadian institutions offering programs in publishing studies. In addition, where the business is Canadian-controlled, other Canadians must be given a full and fair opportunity to acquire the business. In practice, these provisions have not generally been applied to businesses in which bookselling forms only an ancillary component of the business, such as mass merchandisers. A foreign investment to establish a book publishing, distribution or retailing business will generally not be permitted other than as a joint venture controlled by Canadians.

The Book Importation Regulations (the "Regulations") to the *Copyright Act* (Canada) came into force on September 1, 1999. The *Copyright Act* (Canada) and Regulations limit the "parallel importation" of books legitimately produced in another country, which may be imported without the consent of the Canadian copyright owner or exclusive distributor. The Regulations establish notice requirements and distribution criteria that must be met by an exclusive distributor. Where the specified criteria are met, orders may be placed for books only through the Canadian exclusive distributor. The *Copyright Act* (Canada) provides that the parallel importation of books that is not with the consent of the Canadian copyright owner or through the exclusive Canadian distributor constitutes copyright infringement.

Employees

As at April 3, 2004, Indigo employed a total of approximately 6,200 people (on a full-time and part-time basis). The number of part-time booksellers employed by Indigo fluctuates based upon seasonal demand. When hiring new booksellers, Indigo considers a number of factors including customer service

skills, experience and education. New associates participate in a training program that covers all aspects of customer service and selling, including title searches for in-stock and in-print merchandise, merchandising, sorting, operation of point-of-sale terminals and store policies and procedures. As at the date hereof, a collective agreement is in place that covers approximately 86 of Indigo's booksellers at one Toronto location and another collective agreement covers approximately 101 employees at a store located in Montreal.

Trade Names and Trademarks

Indigo is the owner of numerous trademarks and trade names that are registered in Canada, including: !NDIGO and design; INDIGO! BOOKS & MUSIC; INDIGO! KIDS; INDIGO; INDIGO! CAFE; INDIGO BLEND and design; INDIGO AT YOUR SERVICE and design; CHAPTERS (three registrations); CHAPTERS & DESIGN; CHAPTERS BOOKSTORE; CHAPTERS BOOKSTORE CAFE; CHAPTER ONE; CHAPTER 1; CHAPTERS.CA; CHAPTERSONLINE; WWW.CHAPTERS.CA and design (two marks); CROWN BOOKS; THE AVID READER; AVID READER and design; OUR PRICES SPEAK VOLUMES; GREAT BOOKS ARE JUST THE BEGINNING; C and design; L design; COLES NOTES; COLES THE BOOK PEOPLE; COLES THE BOOK PEOPLE! And design; PROSPERO BOOKS; BOOKS and design; COLES THE BOOK PEOPLE!... FOR THE PEOPLE WHO LOVE BOOKS; BOOKTALK; BOOKSAVE; THE BOOK COMPANY and design; COLES; ACTIVE MINDS — COLES FOR KIDS; FIRST IMPRESSIONS; FIRST IMPRESSIONS and design; SOF' SPOT; FORUM HOUSE and design; BOOK BEAT and design; PROSPERO THE BOOK COMPANY; ENTITLEMENT THE BOOK COMPANY; COLES FOR KIDS; WORLD'S BIGGEST BOOKSTORE; WE'RE OPEN IF YOU ARE; THE GARDEN GUILD; CRUICKSHANK'S and design; and VAN TUBERGEN.

STARBUCKS is a registered trademark of the Starbucks Coffee Company.

Description of the Internet Business

Corporate History

Chapters Online Inc. ("Chapters Online") was incorporated under the *Business Corporations Act* (New Brunswick) by Certificate of Incorporation effective July 23, 1999. In August and September 1999, Chapters Online went public on the TSX, with Indigo retaining a 69.9% ownership stake. On October 27, 2001, Indigo acquired all the issued and outstanding shares of Chapters Online not already owned by Indigo. This transaction resulted in the issuance of 750,193 Common Shares to the holders of equity interests of Chapters Online. Thereafter, Chapters Online became a wholly owned subsidiary of Indigo. Immediately following the acquisition, Chapters Online's business was incorporated into Indigo's business. Pursuant to this transaction, Chapters Online filed Articles of Continuance in Ontario on November 5, 2001. On April 3, 2004 Chapters Online was amalgamated with Indigo and the online business is now integrated into the overall business.

Overview of Business

Indigo operates www.chapters.indigo.ca, a leading Canadian destination for online shoppers. The site features a large selection of books, videos, gifts and DVDs at Canadian prices, with a focus on products of interest to Canadians. Chapters Online was the recipient of the Retail Council of Canada's Excellency in Retailing Award 2000 for its achievements as Canada's leading online retailer.

Attracting Customers to the Web Site

Indigo uses its national network of superstores for highly targeted in-store marketing activities that promote the use of its online operations. Computer kiosks located in Indigo superstores and mall stores enable Indigo customers to access Indigo's web site to locate and purchase books that are not in stock in the particular store. *iRewards* members are typically educated book consumers, who represent a valuable target market for online retailers. Indigo has designed its web site so that members of *iRewards* who purchase products on the web site are able to receive discounts on purchases.

Indigo's affiliate program allows other web site owners to link to Indigo's web site and direct their visitors to purchase products from Indigo. Each time a purchase is made by a visitor who has followed an affiliate's link, such affiliate receives a referral fee. Indigo's web site is also designed to allow affiliates to establish links to their web sites quickly and easily.

Building Customer Loyalty

Indigo's web site promotes customer loyalty and repeat purchases by providing an online experience that encourages customers to return frequently. Visitors to the web site are greeted with highlighted subject areas arranged in a simple fashion intended to enhance product search and selection. Indigo offers numerous forms of content to enhance a customer's shopping experience, including cover art, synopses, annotations and reviews by other customers. Special features include bestseller lists, featured books, music and videos, theme presentations, and highlighted books by Canadian authors. Indigo's search engine and sorting capabilities allow consumers to search or "browse" in an intuitive and easy fashion, grouping products according to keywords, titles, authors, artists, actors, and more complex and precise search tools. Indigo's search engine is designed to produce accurate and meaningful results on virtually every search.

Customer service and support are critical to establishing and maintaining long-term relationships with its customers. Indigo seeks to achieve frequent communications with and feedback from its customers in order to improve customer satisfaction. It offers an e-mail address and a toll-free telephone number to enable customers to request information and to encourage feedback and suggestions. Indigo's customer service representatives are available by telephone five days per week year-round, and more during the holiday season. In addition, Indigo has customer service availability via e-mail.

Indigo has designed its systems so that all transactions on its web site are simple and secure. It allows its customers to establish an account online, to store an address book, credit card information and shipping preferences, which can be automatically re-used by customers on repeat purchases. All customer information is encrypted, using advanced security systems, before it is sent to Indigo's secure server.

Indigo enjoys the benefit of its large volume wholesale discounts from its "bricks and mortar" retail stores. The online business does not match the prices of all its competitors, but merchandises effectively with a mix of price competitiveness and a wide selection of products. It offers many bestseller hardcover books at a 30% discount from publishers' list prices. It denominates its prices in Canadian dollars, which provides Canadian customers with certainty in determining price.

Efficient Execution of Customers' Orders

The ability to deliver products to customers efficiently is a critical factor in achieving repeat customer purchases.

Consumers increasingly demand an assured in-stock position and fast delivery from online retailers. In conjunction with the Indigo Distribution Centre and outsourcing agreements with other vendors, Indigo is able to provide shipment on a large number of book, videotape and DVD titles, many of which are available for shipment within 24 hours. It operates a virtual warehouse, whereby customer orders are automatically transmitted to the Indigo Distribution Centre or other third party vendor, where they are packaged and shipped to customers in accordance with their delivery specifications. The Indigo Distribution Centre is Canada's largest book distribution centre, with a 306,600 square-foot facility located in Brampton, Ontario. The Indigo Distribution Centre uses inventory control systems that update its inventory as orders are transmitted from the web site. Each customer receives an e-mail after placing an order that confirms that the order has been received by Indigo and that lists details of their purchase. A second e-mail is sent to each customer, confirming shipping and tracking information.

Technology plays a key role in Indigo's ability to communicate with customers, as well as ensuring that orders are executed accurately and efficiently. Indigo plans to continue to invest in technologies that will enable it to offer its customers a convenient and user-friendly online shopping experience. Its web site and e-commerce platforms use a component architecture design that is fully redundant and rapidly scaleable, allowing it to increase capacity easily and add additional applications. The Q9 Data Centre located in Toronto, Ontario, is the primary host location of Indigo's online operations. Indigo selected this facility because it is highly secure. The hardware components currently utilized by Indigo are principally IBM and Compaq-Intel-based systems, which are designed to permit rapid scaleability while Indigo's systems are operating, avoiding the necessity of system shut-down, and decreasing downtime of Indigo's web site and its order execution capabilities.

Properties

Indigo currently leases all its facilities. The average unexpired term under Indigo's existing mall store leases is approximately 2.3 years, and superstores have an average unexpired lease term of approximately 5.2 years. Indigo has commenced a shorter-term leasing strategy for its mall stores in order to maximize flexibility, hedge against the possibility of shopping centre deterioration and facilitate the implementation of the rationalization strategy related to its mall stores.

Indigo leases its main headquarters at 468 King Street West, Toronto, Ontario, M5V 1L8. Indigo's headquarters are approximately 38,000 square feet in size. Indigo also leases space at 82 Peter Street in Toronto where it currently houses its information technology group.

The Indigo Distribution Centre is currently leasing approximately 306,600 square feet of warehouse space in Brampton, Ontario.

Consent Order Issued by Competition Tribunal

During the course of Trilogy's successful take-over bid, the owners of Trilogy expressed their intent to facilitate the merger negotiations that eventually resulted in the Indigo Merger. The offer by Trilogy and the subsequent merger with Old Indigo was subject to the *Competition Act* (Canada). In order to resolve the concerns of the Commissioner of Competition appointed under the *Competition Act* (Canada), Indigo and Old Indigo agreed to certain structural and behavioural remedies, which took effect upon the issuance of a consent order on June 8, 2001 (the "Consent Order") by the Competition Tribunal established under the *Competition Tribunal Act* (Canada) (the "Competition Tribunal").

The Consent Order requires Indigo to adopt certain terms in its dealings with publishers, and includes limitations on Indigo's new store acquisitions, enforcement of restrictive covenants, opening of new store locations, and participation in the business of wholesaling or distributing books to third parties. The

“Code of Conduct”, which forms part of the Consent Order, provides that Indigo must extend certain commercial terms to publishers, including terms related to discount levels, payment periods for outstanding accounts, and maximum return levels. All disputes related to the Code of Conduct are required to be dealt with according to an expedited arbitration procedure set out in the Code of Conduct. The Code of Conduct will automatically terminate on June 8, 2006. The restrictions on new store acquisitions under the Consent Order came to an end in June 2003.

After the Competition Tribunal has issued an order, it retains jurisdiction to rescind or vary the order if, on application by the Commissioner or a person against whom the order has been made, the Competition Tribunal finds that: (a) the circumstances that led to the making of the order have changed and, in the circumstances that exist at the time the application is made, the order would not have been made or would have been ineffective to achieve its intended purpose; or (b) the Commissioner and the person against whom the order has been made have consented to an alternative order.

Rights Offerings

On April 19, 2002, Indigo completed an offering of 4,243,841 Common Shares at \$3.50 per Common Share. The issue, completed by way of an offering of subscription rights to all holders of Common Shares, 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, Indigo completed an offering of 2,662,755 Common Shares at \$5.75 per Common Share. The issue, completed by way of an offering of subscription rights to all holders of Common Shares, 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.

RISK FACTORS

For a discussion of risk factors relating to Indigo and its business please refer to “MD&A—Risks and Uncertainties”.

DIVIDENDS

Indigo has no fixed dividend policy. Indigo intends to retain earnings to finance the growth and development of its business and does not intend to pay dividends on its Common Shares in the immediate future. The payment of dividends in the future will depend, among other factors, on Indigo's earnings, capital requirements and operating and financial condition, and upon Indigo receiving consent from its lenders.

DESCRIPTION OF CAPITAL STRUCTURE

The authorized share capital of Indigo consists of an unlimited number of Common Shares, of which 24,072,352 Common Shares are issued and outstanding as of the date hereof.

Each Common Share entitles the holder thereof to one vote at meetings of shareholders of Indigo and to participate equally and rateably in any dividends declared on the Common Shares by the Board of Directors of Indigo and in any remaining property or assets of Indigo that may be distributed in the event of voluntary or involuntary liquidation, dissolution or winding-up of Indigo.

CONSTRAINTS

For a discussion of constraints imposed on the ownership of Indigo's securities please refer to "Description of the Retail Business—*Regulatory Environment*".

MARKET FOR SECURITIES

Common shares in the capital of Indigo are listed and posted for trading on the TSX under the symbol IDG. There are currently no other classes of shares in the capital of Indigo issued or outstanding.

The following table sets out the price ranges and volumes traded for Indigo's Common Shares on a monthly basis for each month in fiscal 2004:

	OPEN	HIGH	LOW	CLOSE	VOLUME
April 2003	4.60	4.70	4.30	4.50	161,335
May 2003	4.50	4.75	4.00	4.45	87,117
June 2003	4.45	5.10	4.40	4.81	172,462
July 2003	4.61	5.00	4.50	4.52	44,637
August 2003	4.70	4.95	4.40	4.85	119,250
September 2003	4.97	5.45	4.85	4.91	156,114
October 2003	4.91	5.24	4.60	5.05	176,926
November 2003	5.05	5.55	5.05	5.15	215,263
December 2003	5.25	5.30	5.00	5.20	181,405
January 2004	5.10	5.30	4.90	5.10	371,896
February 2004	5.20	5.30	4.70	4.90	309,724
March 2004	4.95	5.00	4.50	4.70	158,508
April 2004*	4.70	4.71	4.50	4.50	5,367

DIRECTORS AND OFFICERS

The following table and notes thereto state the names and municipalities of residence of all the directors and officers of Indigo as at August 6, 2004, their respective principal occupations, business or employment within the five preceding years, their beneficial ownership of Common Shares and, with respect to the directors, the year in which they became directors of Indigo. Each director will hold office until the next annual meeting of shareholders of Indigo, or until such director's successor is duly elected, unless the office is earlier vacated in accordance with the by-laws of Indigo.

<u>Name and municipality of residence</u>	<u>Position and/or office with Indigo</u>	<u>Present principal occupation, if different from office held</u>	<u>Period during which served as a director</u>	<u>Common Shares beneficially owned or controlled as at July 29, 2003</u>
HEATHER REISMAN Toronto, Ontario	Chair & Chief Executive Officer	n/a	Since February 4, 2001	93,391 Common Shares
BRUCE BIRMINGHAM(1)(2)(3)(4) Oakville, Ontario	Director	Corporate Director	Since May 21, 2002	5,000 Common Shares
JONATHAN DEITCHER..... Toronto, Ontario	Director	Investment Advisor, RBC Investments	Since August 7, 2001	nil Common Shares
JAMES HALL(1)(2)(4)..... Toronto, Ontario	Director	Corporate Director and Adviser	Since August 7, 2001	nil Common Shares
SEN. MICHAEL KIRBY(1)(2)(4)..... Nepean, Ontario	Director	Senator, Senate of Canada	Since February 4, 2001	nil Common Shares

* Data is for April 1-2, 2004.

ROBERT LANTOS	Director	Chairman & Chief Executive Officer, Serendipity Point Films Inc. (film production company)	Since March 19, 2001	5,000 Common Shares
Toronto, Ontario				
R. JOHN (JACK) LAWRENCE	Director	Chairman, Lawrence & Company Inc. (investment management company)	Since March 21, 2001	199,792 Common Shares
Toronto, Ontario				
GERALD SCHWARTZ.....	Director	Chairman, Chief Executive Officer & President, Onex Corporation (diversified industrial company)	Since February 4, 2001	17,855,891 Common Shares(5)
Toronto, Ontario				
NIGEL WRIGHT	Director	Managing Director, Onex Corporation (diversified industrial company)	Since February 4, 2001	3,950 Common Shares
Toronto, Ontario				
ERIC BERTHOLD.....	Senior Vice-President, Lifestyles	n/a	n/a	nil
Toronto, Ontario				
DOUG CALDWELL	Chief Technology Officer	n/a	n/a	74,240 Common Shares
Mississauga, Ontario				
SUE CROFT.....	Executive Vice-President Human Resources and Organization Development	n/a	n/a	nil
Oakville, Ontario				
VICTOR DIRISIO	Executive Vice-President, Supply Chain	n/a	n/a	nil
Toronto, Ontario				
PETER DRUTZ	Executive Vice-President, Retail	n/a	n/a	nil
Richmond Hill, Ontario				
JONATHAN EHRLICH.....	Senior Vice-President, Online and Alternate Channels	n/a	n/a	nil
Toronto, Ontario				
KATHLEEN FLYNN	General Counsel and Assistant Secretary	n/a	n/a	1,000 Common Shares
Toronto, Ontario				
DEIRDRE HORGAN	Executive Vice-President, Marketing	n/a	n/a	nil
Toronto, Ontario				
DAVID MARGOLIS(6).....	President and Chief Operating Officer	n/a	n/a	107,600 Common Shares
Toronto, Ontario				
JIM MCGILL	Chief Financial Officer and Secretary	n/a	n/a	nil
Oakville, Ontario				

(1) Member of Human Resources and Compensation Committee.

(2) Member of Corporate Governance Committee.

(3) Mr. Birmingham was appointed to the Board of Directors on May 21, 2002 following the resignation of Lawrence Tanenbaum as a member of the Board of Directors also effective May 21, 2002.

(4) Member of Audit Committee.

(5) Mr. Schwartz is the principal of Trilogy Retail Enterprises Inc., the General Partner of Trilogy. Trilogy owns directly or indirectly 16,528,167 Common Shares, representing approximately 69.0% of the outstanding Common Shares.

(6) On July 29, 2004, Indigo announced that Mr. Margolis was stepping down as President and Chief Executive Officer for personal reasons. Mr. Margolis will continue to work with Indigo on a consulting basis.

Heather Reisman — Chair & Chief Executive Officer. Ms Reisman has been Chief Executive Officer of Indigo since February 4, 2001. She has also been Chair, Director and Chief Executive Officer of Old

Indigo and its predecessors since June 27, 1996, with the exception of the period of January 19, 2001 to June 19, 2001.

Bruce Birmingham — *Director*. Since March 2002, Mr. Birmingham has been the past President of the Bank of Nova Scotia. Prior to that, he had been President of the Bank of Nova Scotia since 1995.

Jonathan Deitcher — *Director*. Mr. Deitcher has been employed by RBC Dominion Securities since 1977. He was Vice-President and Director from January 1999 to November 2002 and is now an Investment Advisor.

James Hall — *Director*. Mr. Hall has served as a director of a number of public and private companies over the past fifteen years. He is presently chairman and a member of the audit committee of General Donlee Income Fund, a member of the audit committee of Journal Register Company, and chair of the audit committee of TerraVest Income Fund. Mr. Hall was Senior Vice-President and Chief Investment Officer of Working Ventures Canadian Fund Inc. from 1990-2002.

Sen. Michael Kirby — *Director*. From 1994 to 1999, Senator Kirby was the Chairman of the Standing Senate Committee on Banking, Trade and Commerce. He is currently the Chairman of the Standing Senate Committee on Social Affairs, Science and Technology. Senator Kirby is also Chair of the Audit and a member of the Executive Committee of the Bank of Nova Scotia.

Robert Lantos — *Director*. Mr. Lantos is a motion picture producer. He was the co-founder, Chairman and Chief Executive Officer of Alliance Communications Corporation until he sold his controlling interest in the company in 1998.

R. John (Jack) Lawrence — *Director*. Before founding Lawrence & Company in 1996, Mr. Lawrence was Deputy Chairman of Nesbitt Burns Inc., Canada's second largest investment bank, having been Chief Executive Officer of Burns Fry Limited and its predecessor companies for more than 20 years.

Gerald Schwartz — *Director*. Mr. Schwartz founded Onex Corporation, a diversified holding company, in 1983, and its predecessor, in 1977.

Nigel Wright — *Director*. Mr. Wright is Managing Director of Onex Corporation, a diversified industrial company. Prior to 1997 he was a partner of Davies, Ward & Beck, a Toronto law firm.

Eric Berthold — *Senior Vice-President, Lifestyles*. Mr. Berthold joined Indigo Books & Music Inc. in July 2004. Mr. Berthold is responsible for defining Indigo's approach to the Lifestyle category, which includes gifts, paper and more. Prior to joining Indigo, Mr. Berthold was Vice President of Caban, a division of Club Monaco/Polo-Ralph Lauren where he was a founding director of the innovative Home Furnishing and Lifestyle retail concept. Mr. Berthold has also held senior positions on the editorial team of major North American publications such as Food & Wine and House & Garden magazines.

Doug Caldwell — *Chief Technology Officer*. Mr. Caldwell joined Indigo in September 2000 and oversees all technology decisions for Indigo's e-commerce engine and internal technology infrastructure. Previously, Mr. Caldwell spent six years with Microsoft Canada and was Practice Manager for Microsoft Canada's national e-commerce consulting practice.

Sue Croft — *Executive Vice-President, Human Resources and Organization*. Ms Croft joined Indigo in June, 2002. Ms Croft is responsible for the Human Resources and Organization Development strategies, processes and programs. Previously, Ms Croft was Vice-President, Human Resources and Organization Development at Bank of Montreal.

Victor DiRisio — Executive Vice-President, Supply Chain. Mr. Di Risio joined Indigo in August 2002. He is responsible for all logistics and distribution functions and is leading the company-wide business process re-engineering effort and SAP implementation. Prior to joining Indigo, Mr. Di Risio spent 11 years with Procter & Gamble in manufacturing and supply chain roles, where he was responsible for logistics in his last two years.

Peter Drutz — Executive Vice-President, Retail. Mr. Drutz joined Indigo in March 2003. He is responsible for all retail operations throughout the organization. Prior to joining Indigo, he was Vice-President and General Manager, Travel Service Network of American Express.

Jonathan Ehrlich — Senior Vice-President, Online and Alternate Channels. Mr. Ehrlich joined Indigo in November 2003. Prior to Indigo, Mr. Ehrlich was an Entrepreneur-in-Residence at Mosaic Venture Partners, a Co-Founder and Vice President of Marketing for MobShop Inc. and spent several years at CYBERplex interactive media.

Kathleen Flynn — General Counsel and Assistant Secretary. Ms Flynn joined Indigo in February 2000 as Corporate Counsel of Chapters Online and now holds the position of General Counsel of Indigo with responsibility for legal and corporate governance matters. Previously Ms. Flynn was Corporate Counsel with Sears Canada Inc.

Deirdre Horgan — Executive Vice-President, Marketing. Ms Horgan joined Indigo in 1998 and is responsible for overall marketing and brand management in both the store and online businesses. Prior to joining Indigo, she was a management consultant with The Boston Consulting Group.

David Margolis — President and Chief Operating Officer. Mr. Margolis has been President and Chief Operating Officer of Indigo since April 12, 2004. He is the founder of Winners Apparel Ltd. and held the position of President from 1982 to June of 2003.

Jim McGill — Chief Financial Officer and Secretary. Mr. McGill is responsible for all corporate finance and financial reporting-related issues, in addition to real estate and corporate governance matters. Prior to joining Indigo in March 2003, he spent three years building the finance function at Grocery Gateway, a start-up company in the online retailing sector. Prior to that, he spent nine years in the finance group at Purolator, Canada's leading overnight courier company, where he was CFO for his last four years.

CORPORATE GOVERNANCE POLICY

In 1995, the TSX adopted disclosure requirements ("Guidelines") for listed companies with respect to corporate governance. Indigo has the following corporate governance practices.

Board Responsibilities and Composition

The Board of Directors is responsible for the supervision of Indigo management ("Management") and for approving the overall direction of Indigo in a manner which is in the best interests of Indigo. The Board of Directors participates fully in assessing and approving strategic plans and prospective decisions proposed by Management. To ensure that the principal business risks that are borne by Indigo are appropriate, the Board of Directors receives periodic reports from Management of its assessment and management of such risks. The Board of Directors regularly monitors the financial performance of Indigo. This monitoring function often entails review and comment by the Board of Directors on various Management reports. Indigo's internal accounting and control procedures are monitored by the Audit Committee of the Board of Directors on behalf of the Board of Directors. The Audit Committee reviews

detailed financial information contained in Management reports and hears and acts upon the recommendations of Indigo's auditors. In respect of senior Management succession planning, the Board of Directors is involved in identifying candidates from within and outside Indigo to fill senior Management positions.

As a practice, the Board of Directors approves significant corporate communications with shareholders. The Board of Directors currently consists of nine members, all of whom are standing for re-election. Indigo has historically endeavoured to have a sufficient number of directors to encourage a variety of opinions on matters which come before the Board of Directors, while at the same time limiting its membership to a number of directors that facilitates effective and efficient decision making. While there are no specific criteria for Board of Directors membership, Indigo seeks to attract directors with a wealth of business knowledge and a diversity of business experience.

Of the Board of Directors, Messrs. Birmingham, Deitcher, Hall, Kirby, Lantos and Lawrence are considered by the Board of Directors to be "unrelated directors" within the meaning of the Guidelines, as each is "free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act with a view to the best interests of Indigo, other than interests and relationships arising from shareholding". The remaining members are related within the meaning of the Guidelines, Ms Reisman being a member of Management, and Mr. Schwartz being Ms Reisman's spouse, and Mr. Wright being employed by a company controlled by Mr. Schwartz and an officer of Indigo's controlling shareholder. The Board of Directors therefore has a majority of unrelated directors. In determining whether a particular director is or is not a "related director", the Board of Directors examined the factual circumstances of each director and considered them in the context of many factors. A number of directors possess an extensive knowledge of the retailing and distribution businesses in Canada, and their participation as directors contributes to the effectiveness of the Board of Directors.

The Board of Directors believe that six of the directors, or 66.7% of the total number of current directors, are unrelated directors who are free from any interests in or relationships with the significant shareholder or any of its affiliates. The Board of Directors believes that the membership on the Board of Directors of these six directors fairly reflects the investment in Indigo by minority shareholders.

Indigo is controlled by Trilogy which, directly or indirectly, owns approximately 69.0% of the total number of outstanding Common Shares of the Corporation and is a "significant shareholder" within the meaning of the TSX Report.

Board Functioning and Independence

The Board of Directors adopted a corporate governance policy which, among other things, sets out those matters, in addition to those required by statute, which must be brought by the Chief Executive Officer (the "CEO") or other senior Management to the Board of Directors for approval. The Corporate Governance Policy ensures that all major strategic decisions, including any change in the strategic direction of Indigo and acquisitions and/or divestitures of a material nature, will be presented by Management to the Board of Directors for approval. As part of its ongoing activity, the Board of Directors regularly receives and comments upon reports of Management as to the performance of Indigo's business and Management's expectations and planned actions in respect thereto.

Ms Reisman is Chair of the Board of Directors and Chief Executive Officer of Indigo. In the view of the Board of Directors, the fact that Ms Reisman occupies both offices does not impair the ability of the Board of Directors to act independently of Management. They have reached this conclusion for various reasons, including the number of unrelated and independent directors on the Board of Directors.

The Corporate Governance Policy provides a formal position description for the office of the CEO. The Board of Directors has approved formal corporate objectives which the CEO is responsible for achieving. The Board of Directors, the Human Resources and Compensation Committee of the Board of Directors and the CEO engage in regular ongoing dialogue regarding the performance of the senior Management team in achieving Indigo's strategic objectives as recommended by Management and approved by the Board of Directors.

Board Committees

The Board of Directors has an Audit Committee, a Human Resources and Compensation Committee and a Corporate Governance Committee. Each committee has a formal mandate outlining its responsibilities and its obligations to report its recommendations and decisions to the Board of Directors.

In accordance with the Guidelines, the Audit Committee is composed solely of outside directors, all of whom are unrelated directors. The Audit Committee is responsible for the integrity of Indigo's internal accounting and control systems. It receives and reviews the financial statements, annual and special meeting materials and other disclosure documents of Indigo and makes recommendations thereon to the Board of Directors before such statements, materials and documents are approved by the Board of Directors. The Audit Committee communicates directly with Indigo's auditors in order to discuss audit and related matters whenever appropriate.

The Human Resources and Compensation Committee is composed of three outside directors, all of whom are unrelated directors. The Human Resources and Compensation Committee has been charged by the Board of Directors with the responsibility of reviewing and making recommendations to the Board of Directors regarding compensation policies and practices.

The Corporate Governance Committee is composed of three outside directors, all of whom are unrelated. It is responsible for proposing to the full Board of Directors new nominees to the Board of Directors and for assessing directors on an ongoing basis. This committee performs the role which might otherwise be served by a nominating committee, and serves to educate new board members.

Committees are empowered to engage, or to request that Management engage, outside advisors at the expense of Indigo. The Board of Directors would consider any such request by an individual member of the Board of Directors on its merits at the time it was made.

Shareholder Communications

Indigo endeavours to keep all shareholders well informed as to the financial performance of Indigo, primarily by means of its annual and quarterly reports.

Indigo shall provide to any person, upon request, a copy of: (i) the annual information form ("AIF"); and (ii) the comparative financial statements of Indigo for its most recently completed financial year together with the accompanying report of the auditor and one copy of any interim financial statements of Indigo for any subsequent fiscal periods, provided that Indigo may require payment of a reasonable charge if the request is made by a person who is not a security holder of Indigo.

With the approval of the Board of Directors, Management has appointed Ms Heather Reisman, the Chief Executive Officer of Indigo, as the individual responsible for receiving shareholder inquiries and dealing with shareholder concerns. While being guided by regulatory requirements and Indigo's policies with respect to confidentiality and disclosure, Ms. Reisman is available for interviews by stakeholders,

including analysts, the media, and investors. Ms Reisman endeavours to respond promptly and appropriately to all such requests and/or inquiries.

AUDIT COMMITTEE

Audit Committee Charter

1. Purpose

The primary function of the Audit Committee is to assist the Board of Directors in fulfilling its oversight responsibilities by reviewing: the financial information that will be provided to the shareholders and others, the systems of internal controls which management and the Board of Directors have established, and the Company's and its subsidiaries' audit and financial reporting process.

The independent accountants' ultimate responsibility is to the Board of Directors and the Audit Committee, as representatives of the shareholders. These representatives have the ultimate authority to evaluate and, where appropriate, recommend replacement of the external auditors.

The Audit Committee will primarily fulfill these responsibilities by carrying out the activities enumerated in Section 5 of this Charter. The Audit Committee will, at all times, be given full access to the Company's management and records and to the external auditors as necessary to carry out these responsibilities.

2. Composition of Committee

The Audit Committee shall be comprised of three directors, each of whom will be an independent, as contemplated by *Multilateral Instrument 52-110 - Audit Committees*.

All members of the Committee shall be financially literate and thus be able to read and understand fundamental financial statements including a balance sheet, an income statement and a cash flow statement that presents a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the issuer's financial statements.

3. Committee Meetings

The Audit Committee will meet on a quarterly basis and will hold special meetings as circumstances require. The timing of the meetings shall be determined by the Audit Committee.

At all Audit Committee meetings a majority of the members shall constitute a quorum.

4. Relationship with External Auditors

The external auditor shall report directly to the Audit Committee.

5. Responsibilities and Duties

To fulfill its responsibilities and duties, the Audit Committee shall:

- review the accounting principles, policies and practices followed by the Company and its subsidiaries in accounting for and reporting its financial results of operations;
- review the Company's audited annual consolidated financial statements and the unaudited quarterly financial statements prior to publicly disclosing this information. Also review and recommend to the Board for approval any accompanying related documents such as the Annual Information Form or equivalent filings and the Management's Discussion and Analysis prior to publicly disclosing this information;
- review the draft earnings press release quarterly prior to publicly disclosing this information;
- satisfy itself that adequate procedures are in place for the review of the Company's public disclosure of financial information extracted or derived from the Company's financial statements and periodically assess the adequacy of those procedures;
- recommend to the Board of Directors the selection of the external auditors in connection with performing audit, review or attesting services for the Company;
- recommend to the Board of Directors the compensation of the external auditors;
- oversee the work of the external auditors engaged for the purpose of preparing or issuing an auditor's report or performing other audit, review or attest services for the Company, including the resolution of disagreements between management and the external auditors regarding financial reporting;
- obtain, on an annual, basis a formal written statement from the external auditors delineating the relationship between the audit firm and the Company, and review and discuss with the external auditors such relationship to determine the "independence" of the auditors;
- review any management letter prepared by the external auditors concerning the Company's internal financial controls, record keeping and other matters and management's response thereto;
- discuss with the external auditors their views about the quality of the implementation of Canadian Generally Accepted Accounting Principles, with a particular focus on the accounting estimates and judgments made by management and management's selection of accounting principles. Meet in private with appropriate members of management and separately with the external auditors on a regular basis to share perceptions on these matters, discuss any potential concerns and agree upon appropriate action plans. Review with the external auditors their views on the adequacy of the Company's financial personnel;
- approve the scope of the annual audit, the audit plan, the access granted to the Company's records and the co-operation of management in any audit and review function;
- review the effectiveness of the independent audit effort, including approval of the fees charged in connection with, the annual audit, any quarterly reviews and any non-audit services being provided;
- assess the effectiveness of the working relationship of the external auditors with management;

- review the financial risk management policies followed by the Company in operating its business activities and the completeness and fairness of any disclosure thereof. Review the use of derivative financial instruments by the Company;
- review and approve any management decision relating to any potential need for internal auditing, including whether this function should be outsourced and if such function is outsourced, approve the supplier of such service;
- establish procedures for (i) the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls, or auditing matters; and (ii) the confidential, anonymous submission by employees of the Company of concerns regarding questionable accounting or auditing matters;
- review and approve the Company's hiring policies regarding partners, employees and former partners and employees of the present and former external auditors of the Company;
- the Committee will determine the nature of non-audit services the external auditors are prohibited from providing to the Company. The Committee will pre-approve all non-audit services provided by the external auditors to the Company;
- review annually this Audit Committee Charter for adequacy and recommend any changes to the Board;
- report to the Board on the major items covered at each Audit Committee meeting and make recommendations to the Board and management concerning these matters. Annually report to the Board on the effectiveness of the Audit Committee; and
- perform any other activities consistent with this Charter, the Company's Bylaws and governing law as the Committee or the Board deems necessary or appropriate.

6. Authority

The Audit Committee has the authority:

- (a) to engage independent counsel and other advisors as it determines necessary to carry out its duties;
- (b) to set and pay the compensation for any advisors employed by the audit committee; and
- (c) to communicate directly with the internal and external auditors.

Composition of the Audit Committee and Relevant Education and Experience of the Members

The Audit Committee is composed of Bruce Birmingham, James Hall and Senator Michael Kirby, all of whom are independent and financially literate.

Bruce Birmingham is the past President and a former director of The Bank of Nova Scotia. He has served as a director for a variety of banking and related business over the course of his career. Mr. Birmingham holds a Bachelor of Commerce degree and an M.B.A.

Mr. Hall has served as a director of a number of public and private companies over the past fifteen years. He is presently chairman and a member of the audit committee of General Donlee Income Fund, a member of the audit committee of Journal Register Company, and chair of the audit committee of TerraVest Income Fund. A Chartered Accountant, Mr. Hall was Senior Vice-President and Chief Investment Officer of Working Ventures Canadian Fund Inc. from 1990-2002.

Senator Kirby currently serves on the Board of directors of several public companies. He also serves as Chair of the Audit Committee for The Bank of Nova Scotia and Ontario Energy Saving Corporation. He is Vice-Chair of the Accounting Standards Oversight Council of the Canadian Institute of Chartered Accountants. From 1994-1999, he was Chairman of the Standing Senate Committee on Banking, Trade and Commerce.

Pre-Approval Policies and Procedures

All audit committee decisions regarding the engagement of Indigo's auditor for the provision of non-audit services are approved by the Board of Directors.

External Auditor Service Fees

The following table summarizes the Audit, Audit Related, Tax Related and Other Fees (excluding expenses and taxes) of Indigo's Auditor, Ernst & Young LLP for the two most recently completed fiscal years.

	2004	2003
AUDIT FEES	233,500	167,000
AUDIT-RELATED FEES	86,000	55,000
TAX FEES	244,225	229,000
ALL OTHER FEES	nil	nil

In 2004, Audit Related Fees incurred related to the provision of services associated with new accounting pronouncements, tax provisions, and SAP control and security reviews. Tax Fees incurred related to the provision of services associated with Ontario Retail Sales Tax Review, preparation of tax returns and other tax services. In 2003, Audit Related Fees incurred related to the provision of services associated with the prospectus filed. Tax Fees incurred related to the preparation of tax working papers, a commodity tax review and tax compliance services.

TRANSFER AGENTS AND REGISTRARS

Indigo's transfer agent and registrar is CIBC Mellon Trust Company and Indigo's Common Share register is located at their offices at 200 Queens Quay East, Unit 6, Toronto, Ontario, Canada, M5A 4E9.

EXPERTS

As of the date hereof, the partners and associates of our counsel, Torys LLP beneficially own, directly and indirectly, less than 1% of the Common Shares of Indigo. As at the date hereof, the partners and associates of our auditor, Ernst & Young LLP do not beneficially own, directly and indirectly, any Common Shares of Indigo.

SELECTED CONSOLIDATED FINANCIAL INFORMATION

	53-week period ended April 3, 2004	52-week period ended March 29, 2003	52-week period ended March 30, 2002 ⁽²⁾
Statement of Operations			
Data:			
Revenue			
Superstores	548,222	\$528,122	\$485,767
Mall stores	169,450	173,967	183,792
Internet.....	52,062	39,093	34,731
Other	35,982	38,062	31,394
Total.....	805,716	779,244	735,684
Cost of product, purchasing, selling and administration	761,300	737,228	698,660
Earnings (loss) before the following:	44,416	42,016	37,024
Amortization of capital assets.....	24,313	23,864	29,839
Amortization of pre-opening store costs	—	30	452
Amortization of goodwill.....	—	—	1,087
EBIT(1)	20,103	18,122	5,646
Interest on long-term debt and financing charges.....	9,241	8,568	7,576
Interest on current debt.....	5,640	6,229	6,782
Restructuring and take-over costs	—	—	40,316
Earnings (loss) before income taxes & non-controlling interest	5,222	3,325	(49,028)
Income tax benefit (expense)	(876)	(1,900)	(600)
Earnings (loss) before non- controlling interest.....	4,346	1,425	(49,628)
Non-controlling interest	—	—	(1,716)
Net earnings (loss).....	4,346	1,425	(47,912)
Earnings (loss) per share (basic)	0.18	0.06	(2.58)
Earnings (loss) per share (diluted)	0.18	0.06	(2.58)
Cash dividends per share.....	—	—	—
Weighted average number of common shares outstanding	23,965	22,513	18,552
Total Assets	400,734	394,777	439,832
Total Long-Term Debt	52,446	85,602	112,071

- (1) Earnings before interest, taxes, dilution gain, non-recurring expenses, restructuring charges, other costs and non-controlling interest. Not necessarily defined by Canadian generally accepted accounting principles and may not be comparable to similar measures presented by other companies.
- (2) The exercise price of the rights issued in rights offerings was less than the fair market value of the shares at issuance, and changes in accounting rules since the last reporting period now require the issuer to treat the difference as it would a stock dividend. The weighted average number of common shares outstanding and earnings per share figures for those periods have been adjusted accordingly and, as a result, will differ from those reported previously.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATING RESULTS

Overview

Indigo is the nation's largest book retailer, operating stores in all ten provinces in Canada and offering online sales through its www.chapters.indigo.ca web site. As at April 3, 2004, Indigo operated 87 superstores under the banners *Chapters*, *Indigo* and the *World's Biggest Bookstore*, and 167 mall stores, under the banners *Coles*, *SmithBooks*, *LibrairieSmith* and *The Book Company*. Indigo also has a 51% interest in Chapters Campus Bookstores Company, which operates 5 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, Indigo closed 1 superstore and 13 mall stores as part of an ongoing initiative to streamline its real estate portfolio. In June 2003, Indigo also closed the McGill University Bookstore in Montreal as its contract expired and was not renewed. Indigo opened one new mall store during fiscal 2004.

The weighted average number of Common Shares outstanding for the year was approximately 24.0 million as compared to 22.5 million last year. Indigo completed a rights offering for 4,243,841 Common Shares on April 19, 2002 and a rights offering for 2,662,755 Common Shares on September 27, 2002.

On May 2, 2004, Indigo replaced its procurement, inventory management and financial reporting systems with an integrated SAP Supply Chain system ("SAP"). In preparation for the conversion, Indigo rationalized its inventory levels, which impacted cost of sales in the fourth quarter, as well as year end inventory and accounts payable balances. Additional details are provided in subsequent sections of this report.

Results of Operations

Canadian Retail Environment

In 2003, the Canadian economy was impacted by a number of uncontrollable events, including a SARS outbreak in Ontario, a hurricane on the east coast, and forest fires in British Columbia, all of which affected retail sales. A power blackout in Ontario also negatively affected most businesses and forced retailers to close stores for up to three days in August. Despite these events, the Canadian retail sector remains healthy, as evident from rising consumer confidence and strong growth in disposable income and the employment rate.

The book retailing industry continues to remain very competitive. An increasing number of large retailers are broadening their product assortments to include books as part of their offerings, which creates new competition for Indigo. Furthermore, aggressive discounts given by competitors through their retail or online channels provide a challenging operating environment for Indigo.

Revenues

Total consolidated revenues for the 53-week period ended April 3, 2004 increased 3.4% to \$805.7 million from \$779.2 million for the 52-week period ended March 29, 2003. On a normalized 52-week basis, total revenues were up 1.8% compared to the previous year. Comparable store sales (for stores that were open for more than 12 months) were up 2.7% in superstores and down 0.1% in mall stores. Revenues by channel are highlighted below:

<i>(millions of dollars)</i>	FY04	FY03	% increase	% increase normalized for 52 weeks	Comparable store sales % increase
Superstores	548.2	528.1	3.8	2.1	2.7
Mall Stores	169.4	174.0	(2.6)	(4.0)	(0.1)
Online (including store kiosks)	52.1	39.1	33.2	30.9	N/A
Other	36.0	38.0	(5.5)	(6.5)	N/A
	805.7	779.2	3.4	1.8	2.0

A number of factors contributed to the overall growth of the business and helped offset the environmental issues outlined above:

- The release of the latest Harry Potter book contributed to strong growth in the first quarter of fiscal 2004. Sales of this title were nearly 4 times greater than the next largest best seller in fiscal 2004.
- Comparable store sales growth in the superstore channel was driven by a major re-merchandising effort completed in the second quarter of fiscal 2004 and an ongoing focus on sales and service excellence.
- Absolute revenue in mall stores decreased in fiscal 2004 due to the closure of 13 locations during the year. Comparable store sales were flat, consistent with overall mall traffic trends.
- Strong growth in the Online channel was driven by growing consumer acceptance of online shopping in general, along with aggressive pricing, broader product selection, and improved shipping options.
- Other revenue, which includes Indigo's loyalty card program and its proportionate share of joint ventures in campus bookstores and seasonal mall kiosks, decreased due to the closure of the McGill University bookstore when the contract expired in the first quarter of fiscal 2004. Indigo's loyalty card program was re-launched with improved consumer benefits in October 2003, and from November 2003 to the end of the fiscal year, revenue from loyalty customers grew by 7% compared to the same period the previous year.

Cost of Product, Purchasing, Selling and Administration

Operating costs decreased from 94.6% of sales to 94.5% of sales. Material improvements in shrink and labour productivity allowed Indigo to invest in higher sales discounts to match market pricing on selected products and to reduce inventory in selected categories in advance of the SAP conversion.

	FY04 (% Sales)	FY03 (% Sales)
Shrink	2.3	3.0
Retail labour	10.6	11.1
Sales discounts	6.7	5.6

Operating Earnings

Operating earnings, defined as revenues less cost of product, purchasing, selling and administration, increased 5.7% to \$44.4 million from \$42.0 million last year. On a normalized 52-week basis, operating earnings were up 4.1% driven by increased sales and reduced costs as described above.

Amortization

Amortization increased \$0.4 million to \$24.3 million compared to \$23.9 million last year. Capital expenditures in the current year totalled \$19.1 million, and included major investments in store kiosks and SAP.

Interest Expense

Interest expense increased 0.6% to \$14.9 million from \$14.8 million last year. Interest expense in the current year included a debt settlement expense of \$3.5 million relating to the repayment of Indigo's convertible subordinated notes. Excluding this one-time charge, interest expense decreased 23.4% compared to last year due to a reduction in the overall indebtedness level of Indigo.

Net Earnings

Net earnings for the period were \$4.3 million (\$0.18 per Common Share) as compared to net earnings of \$1.4 million (\$0.06 per Common Share) last period. Operating earnings contributed \$2.4 million of the increase and interest and amortization were \$0.5 million higher as noted earlier. Income tax expense was \$1.0 million lower due to the use of tax loss carryforwards, offset by a change in enacted tax rates and a change in Indigo's tax valuation allowance as highlighted in Note 4 of the consolidated financial statements.

Indigo'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:

	53-week period ended April 3, 2004	52-week period ended March 29, 2003	52-week period ended March 30, 2002
Revenues (thousands of dollars)			
Superstores	548,222	528,122	485,767
Mall Stores	169,450	173,967	183,792
Other	35,982	38,062	31,394
Online (including store kiosks)	52,062	39,093	34,731
	805,716	779,244	735,684
Comparable Store Sales			
Superstores	2.7%	5.3%	1.1%
Mall Stores	(0.1%)	(0.2%)	3.7%
Stores Opened			
Superstores (opened and acquired)	—	—	16
Mall Stores	1	—	—
	1	—	16
Stores Closed			
Superstores	1	2	3
Mall Stores	13	8	17
Campus Bookstores	1	—	—
	15	10	20
Number of Stores Open at Year-End			
Superstores	87	88	90
Mall Stores	167	179	187
Campus Bookstores	5	6	6
	259	273	283
Selling Square Footage at Year-End (in thousands)			
Superstores	2,105	2,123	2,164
Mall Stores	451	476	496
Campus Bookstores	10	38	38
	2,566	2,637	2,698

Seasonality and Fourth 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 sales season. A disproportionate amount of revenues and profits are earned in the third quarter. As a result, quarterly performance is not necessarily indicative of Indigo's performance for the rest of the year. The following table sets out revenues, net earnings (loss), basic and diluted earnings (loss) per share for the preceding eight fiscal quarters.

<i>(thousands of dollars) except per share data</i>	Fiscal quarters ended on or about:			
	June 30	September 30	December 31	March 31
Fiscal 2004 Revenues	164,248	170,080	279,431	191,957
Net earnings (loss)	(11,548)	(7,590)	28,779	(5,295)
Basic earnings (loss) per share	\$ (0.48)	\$ (0.32)	\$ 1.20	\$ (0.22)
Diluted earnings (loss) per share	(0.48)	(0.32)	1.12	(0.22)
Fiscal 2003 Revenues	156,336	171,207	277,454	174,247
Net earnings (loss)	(13,182)	(7,629)	30,771	(8,535)
Basic earnings (loss) per share	\$ (0.63)	\$ (0.36)	\$ 1.28	\$ (0.36)
Diluted earnings (loss) per share	(0.63)	(0.36)	1.21	(0.36)

Consolidated revenues for the fourth quarter in fiscal 2004 were up \$17.7 million (10.2%) to \$192.0 million. On a normalized 13-week basis, revenues were up 3.0%. Net earnings were up 38.0% on an absolute basis, and 29.8% on a normalized 13-week basis. Net earnings in the fourth quarter increased relative to the same period last year due to increase revenue, reduced shrink and improved labour productivity as discussed earlier.

Overview of Consolidated Balance Sheets

Total assets increased by \$6.0 million as compared to the fiscal year ended March 29, 2003. This is primarily due to higher future tax assets and prepaid expenses which were offset by a reduction in goodwill and net capital assets. Indigo recognized \$5.9 million of future tax assets this year based on the increased likelihood of utilizing its non-capital loss carryforwards and changes in enacted tax rates. Prepaid expenses increased \$6.8 million compared to fiscal 2003 due to the timing of the fiscal year end date, as Indigo prepaid some occupancy expenses for April 2004. The \$6.0 million reduction in goodwill was associated with the use of tax loss carryforwards acquired during the business combination in fiscal 2002 which were not recognized as future tax assets at the time of the combination. As Indigo used a portion of the acquired unused tax losses this year, the benefit of the use of these losses was applied to reduce unamortized goodwill. Net capital assets decreased by \$3.0 million as Indigo closed a total of 14 stores this year.

Total liabilities increased by \$2.7 million as compared to the fiscal year ended March 29, 2003. The increase was the result of higher income taxes payable and higher deferred revenue because of growth in Indigo's loyalty card program. Total net debt (including cash, bank indebtedness, long-term debt and convertible subordinated notes) remained the same as last year. Indigo repaid \$31.0 million of long-term debt in December and refinanced its remaining term debt and operating line of credit in April 2004. As

part of the refinancing, Indigo incurred \$49.0 million in new long-term debt, which was used to repay existing term debt due in May 2005 and the convertible subordinated notes due in June 2005.

Shareholders' equity increased by \$3.3 million compared to last year due to higher net earnings of \$4.3 million. Share capital remained the same and the equity portion of the convertible notes was eliminated when the convertible subordinated notes were paid off. The expensing of stock options and the issuance of Directors' Deferred Stock Units were recorded as contributed surplus this period in the amount of \$0.1 million and \$0.3 million, respectively.

Overview of Consolidated Statements of Cash Flows

Cash and cash equivalents in fiscal 2004 increased \$8.7 million compared to a cash decrease of \$0.7 million in fiscal 2003. Operating activities generated \$31.2 million in cash. In addition, Indigo increased the use of its operating line by \$42.0 million and incurred \$27.0 million in net new long-term debt. The cash was used to repay \$31.0 million of existing long-term debt and \$39.4 million on Indigo's convertible subordinated notes. An additional \$19.1 million was invested in capital projects as outlined below.

Working capital at year end was \$6.7 million higher than last year due to the timing of prepaid expenses as explained above and lower accounts payable and accrued liabilities. During the year, Indigo paid out \$2.5 million on items relating to restructuring of the Indigo's real estate portfolio, which in turn reduced accrued liabilities. During the period, Indigo reduced its inventory levels from \$202.4 million to \$199.4 million bringing about a corresponding decrease in accounts payable. At the period end, Indigo further reduced its accounts payable in preparation for the SAP conversion.

Net cash used in investing activities consisted of capital expenditures of \$19.1 million in fiscal 2004 versus \$14.1 million in fiscal 2003. The following table presents the capital expenditures over the last 2 years by category:

(millions of dollars)	FY04	FY03
Store renovations	5.9	8.6
Technology-related projects	13.2	5.5

Store renovations are typically done upon lease renewal and at selected points throughout a lease term. The amounts spent in fiscal 2004 and fiscal 2003 are reflective of the average term of leases in Indigo's portfolio. The increase in technology-related projects reflects an investment in SAP and the installation of in-store order kiosks in all mall stores.

Liquidity and Capital Resources

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

Indigo's main sources of capital are cash flow generated from operations, a revolving line of credit and its long-term debt. Under an existing agreement with its bank, Indigo can borrow up to \$90.0 million on its line of credit. As at April 3, 2004, \$53.0 million was drawn against this facility. Indigo's contractual obligations due over the next five years are summarized below:

<i>(millions of dollars)</i>	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years	Total
Long-term debt	12.0	24.0	13.0	—	49.0
Capital lease obligations	1.2	2.3	—	—	3.5
Operating leases	56.8	107.2	83.6	73.5	321.1
Total obligations	70.0	133.5	96.6	73.5	373.6

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

There can be no assurance that operating levels will not deteriorate over the ensuing fiscal year, which could result in Indigo being unable to meet its current working capital and debt service requirements. In addition, other factors, not presently known to management, could materially and adversely affect Indigo's future cash flow. In such events, Indigo 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 Indigo.

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 Indigo 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 Indigo believes to be reasonable under the circumstances. Indigo also evaluates its estimates on an ongoing basis. The significant accounting policies of Indigo are described in Note 2 of the consolidated financial statements.

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

Inventory Valuation

Indigo uses the retail inventory method to account for inventory and cost of sales. Under this method, inventory is separated into similar merchandise categories. All receipts are added into an inventory pool using actual costs, and all sales are removed from the inventory pool using an average margin for the pool. The average margin is continually updated based on the flow of goods into and out of the pool. When Indigo permanently reduces the retail price of an item, there is a corresponding reduction in inventory recognized in the period the markdown is incurred rather than at the time of sale. Indigo reduces inventory for estimated shrinkage that has occurred between annual physical inventory counts. The net result is that inventory is valued at the lower of costs or net realizable value, less a normal profit margin.

In addition, Indigo records an obsolescence provision based on assumptions about future sales demand, customer preferences, inventory levels and product quality. Management reviews the provision regularly and assesses whether it is appropriate based on economic conditions.

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

Pension Plan

The plan obligations and related assets of the pension plan are presented in Note 7 of the consolidated financial statements. The plan obligation is calculated based upon actuarial assumptions on variables such as the discount rate, rate of compensation increase, and the expected long-term rates of return on pension plan assets. The variability of the estimates is discussed in more detail in the "Risks and Uncertainties" section of this MD&A.

Income Taxes

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

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

As part of the purchase price allocation for the acquisition of Indigo Books & Music, Inc. ("Old Indigo"), no future income tax asset was recognized for the unused tax losses of Old Indigo that existed at the date of acquisition. When unused tax losses acquired in a business combination that 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 is applied to reduce any unamortized goodwill related to the acquisition and Indigo incurred a non-cash tax expense in the same amount. As a result, Indigo may incur non-cash tax expense in future years when utilizing this acquired unused non-capital loss carryforwards.

Restructuring Provision

Indigo has a provision for restructuring costs which was established at the time of the merger in fiscal 2002. The provision includes legal fees, commission and disposal cost estimates for 8 stores that were identified for closure at the time of merger but still remain open. These are based on management's best estimates of the costs at which Indigo would be willing to sublease these properties for. Indigo has each of these sites listed with an outside realtor who is actively looking for new tenants to lease these properties. Indigo evaluates any proposals at the time of receipt to determine if the offer is fair based on existing market conditions. Any changes in assumptions, such as prevailing market rent or intention to close a store, could result in the recognition of income or expense on Indigo's consolidated statements of earnings in future years.

New Accounting Standards

The following accounting standard has been adopted by Indigo in the current fiscal year:

Stock-based compensation

Effective March 30, 2003, in accordance with the recommendations issued by the Canadian Institute of Chartered Accountants (“CICA”), Indigo changed its method of accounting for stock options to the fair value method. The fair value of each stock option granted is estimated on the date of the grant using the Black-Scholes option pricing model and expensed over the option’s vesting period. As a result of this change in accounting policy, which was applied prospectively, an expense of \$0.1 million was recorded for the 53-week period ended April 3, 2004 to reflect the fair value of employees’ stock options that were granted and vested during the period. The pro forma impact of options issued before this fiscal year is included in Note 8 of the consolidated financial statements.

Indigo had an option to adopt this standard in fiscal 2005 on a retroactive basis, but consistent with other companies, Indigo decided to adopt the new accounting standard this year.

The following accounting standards and policies will be adopted by Indigo in the next fiscal year:

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. Indigo has completed the documentation process for all hedges currently in place. Management does not believe the prospective implementation of this guideline will have a material financial impact on Indigo.

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. Indigo believes the adoption of this guideline will not have a material impact on sales and net earnings.

Inventory

Effective April 4, 2004, Indigo changed its accounting policy with respect to inventory valuation. Previously, Indigo used the retail inventory method. Under the new method, inventory will be valued at the lower of cost and net realizable value. The new accounting policy is adopted on a prospective basis, since the necessary financial data for retroactive adoption is not reasonably determined.

Financial Instruments

Indigo uses derivative financial instruments to manage the risks of its foreign currency and interest rate exposure. Indigo enters into foreign exchange derivative agreements to hedge future purchases of

U.S. denominated goods and services. Indigo also uses interest rate swap agreements to manage the fixed and floating interest rate mix of Indigo's total debt portfolio. The risks associated with the use of derivative financial instruments are discussed further under the "Risks and Uncertainties" section.

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

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

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

The fair values of interest rate derivatives are estimated by discounting cash payments of the derivatives at market rates for derivatives of the same remaining maturities. Indigo entered into an interest rate swap agreement on April 2, 2004 and the mark-to-market value of the interest rate swap was zero as at April 3, 2004. At this time, Indigo 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.

Indigo did not have any foreign currency derivative agreements in place as at April 3, 2004.

Risks and Uncertainties

Competition

The retail book selling business is highly competitive. Specialty bookstores, independents, other book superstores, regional multi-store operators, supermarkets, drug stores, warehouse clubs, mail order clubs, Internet booksellers, mass merchandisers and other retailers offering books are all sources of competition for Indigo. Aggressive merchandising or discounting by competitors in either the retail or online sectors could reduce Indigo's market share and its operating margins.

Economic Environment

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

External Events

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

Regulatory Environment

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

Foreign Exchange, Interest Rate and Credit Risk

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

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

Leases

The average unexpired lease term of Indigo's mall stores is approximately 2.3 years. Indigo attempts to renew these leases as they come due on favourable terms and conditions, but is susceptible to volatility in the market for shopping mall space. Unanticipated increases in occupancy costs, and the incursion of store closing costs or relocation expenses could unfavourably impact Indigo's performance. With an average unexpired lease term of 5.2 years, Indigo's superstores' rental expense is expected to remain stable.

Pension Plan

Indigo is in the process of winding up its defined benefit plan and disbursing all assets to plan members. The timing of the disbursement is dependent upon regulatory approval. There is no assurance that Indigo's benefit plan assets will be able to earn the assumed rate of return between now and the estimated final settlement of the plan. If actual returns and/or the final settlement date of the plan are different than the current estimates, Indigo may incur a larger settlement expense than anticipated.

Dependence on Key Personnel

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

Legal Proceedings

A former supplier has filed a claim against Indigo in relation to unpaid invoices and to rejected and excessive returns. Indigo is of the view that the claim is without merit and lacks a factual or legal foundation and Indigo 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 Indigo's financial position.

In the normal course of business, Indigo becomes involved in various claims and litigation. While the final outcome of such claims and litigation pending as at April 3, 2004 cannot be predicted with certainty, management believes that any such amount would not have a material impact on Indigo's financial position.

52 Weeks Ended March 29, 2003, Compared to 52 Weeks Ended March 30, 2002

Results of Operations

Total consolidated revenues increased 5.9% in fiscal 2003 to \$779.2 million from \$735.7 million in fiscal 2002. 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 Indigo's loyalty cards, as well as Indigo's proportionate share of revenues from the Calendar Club and Campus Bookstores joint ventures, increased by 21.2%.

Operating earnings increased 13.5% in fiscal 2003 to \$42.0 million from \$37.0 million in fiscal 2002 driven by higher sales, improved margins and reduced warehousing and distribution costs. Amortization decreased to \$23.9 million from \$31.4 million in fiscal 2002 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) in fiscal 2002. 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 in fiscal 2003.

Indigo's revenues, comparable store sale, store openings, store closings, number of stores and square footage at the 2003 fiscal year-end are set forth below:

Revenue (in thousands)			
Superstores	\$ 528,122	\$ 485,767	\$ 408,849
Traditional bookstores.....	\$ 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
Total.....	<u>\$ 779,244</u>	<u>\$ 735,684</u>	<u>\$ 686,479</u>
Comparable store sales			
Superstores	5.3%	1.1%	(1.6%)
Traditional bookstores.....	(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
Total.....	<u>0</u>	<u>16</u>	<u>16</u>
Stores closed			
Superstores	2	3	0
Mall Stores	8	17	34
Total.....	<u>10</u>	<u>20</u>	<u>34</u>
Number of stores opened at year-end			
Superstores	88	90	77
Mall Stores	179	187	204
Campus bookstores	6	6	6

Total.....	<u>273</u>	<u>283</u>	<u>287</u>
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
Total.....	<u>2,637</u>	<u>2,698</u>	<u>2,457</u>

Seasonality

Indigo'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:

	<u>June 30</u>	<u>September 30</u>	<u>December 31</u>	<u>March 31</u>
		(thousands of dollars)		
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 1999 Revenue.....	122,352	148,120	234,695	155,142
Net Earnings (Loss)	(9,449)	27,758	9,733	(10,847)
Fiscal 1998 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 were down \$8.9 million (amortization of \$23.9 million offset by capital expenditures of \$14.1 million) as Indigo 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. Indigo 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, Indigo repaid \$31.0 million of long-term debt. In addition, Indigo decreased its bank indebtedness by \$35.9 million, and issued \$29.9 million in equity by way of rights offerings.

52 Weeks Ended March 30, 2002, Compared to 52 Weeks Ended March 31, 2001

Results of Operations

Total consolidated revenues increased 7.2% to \$735.7 million from \$686.5 million in fiscal 2001. The sales increase was primarily attributable to operating an additional 13 superstores, offset by a sales decrease as a result of operating 17 fewer traditional format stores and lower sales at Chapters Online.

Consolidated earnings before interest, taxes, amortization, restructuring charges, take-over costs and non-controlling interest was \$37.0 million compared to a loss of \$43.3 million in fiscal 2001. This represents an improvement of \$80.3 million.

The consolidated net loss for the year was \$47.9 million (\$3.03 per share) as compared to a net loss of \$84.5 million (\$6.24 per share) in fiscal 2001, a \$36.6 million or a 43.3% improvement.

Excluding restructuring and take-over costs, the net loss was \$7.6 million (\$0.48 per share) as compared to a net loss of \$54.5 million (\$4.02 per share) in fiscal 2001. This represents an improvement of \$46.9 million (\$3.54 per share).

Restructuring and take-over costs of \$40.3 million relate to store closures and other costs associated with the Indigo Merger. Restructuring and take-over costs amounted to \$30.0 million in fiscal 2001. The restructuring and take-over costs are comprised of \$24.0 million in capital asset write downs, \$11.9 million relating to store closings, \$1.7 million relating to relocation and other costs associated with the acquisition and \$2.7 million in refinancing charges. Of the total restructuring and take-over costs, approximately \$15.9 million are cash charges, of which \$6.1 million have been paid. The balance of approximately \$24.4 million relates to non-cash transactions.

Income tax expenses were \$600,000 as compared to an income tax recovery of \$12.7 million in fiscal 2001. The decrease was due to the fact that income tax benefits were not recognized in fiscal 2002 due to cumulative losses in previous periods in accordance with Canadian generally accepted accounting principles.

The weighted average number of shares outstanding for the year were 15.8 million as compared to 13.5 million in fiscal 2001. The increase is a result of the issuance of shares relating to the acquisitions of Old Indigo and the non-controlling interest in Chapters Online, the employee stock purchase plan and the subscription rights offering.

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

	<u>52-week period ended March 30, 2002</u>	<u>52-week period ended March 31, 2001</u>	<u>52-week period ended April 1, 2000</u>
Revenue (in thousands)			
Superstores.....	\$ 485,767	\$ 408,849	\$ 376,307
Traditional bookstores	\$ 183,792	\$ 195,199	\$ 217,771
Other retail	\$ 31,394	\$ 29,995	\$ 27,450
Indigo Distribution Centre.....	-	\$ 1,345	\$ 67
Indigo Online	\$ 34,731	\$ 51,091	\$ 38,714
Total	<u>\$ 735,684</u>	<u>\$ 686,479</u>	<u>\$ 660,309</u>
Comparable store sales			
Superstores.....	1.1%	(1.6%)	(3.1%)
Traditional bookstores	3.7%	(3.0%)	(4.0%)
Stores opened			
Superstores (opened and acquired).....	16	7	16
Traditional bookstores	0	7	0
Campus bookstores	0	2	3
Total	<u>16</u>	<u>16</u>	<u>19</u>
Stores closed			
Superstores.....	3	0	0
Traditional bookstores	17	34	30
Total	<u>20</u>	<u>34</u>	<u>30</u>
Number of stores opened at year-end			
Superstores.....	90	77	70
Traditional bookstores	187	204	231
Campus bookstores	6	6	4
Total	<u>283</u>	<u>287</u>	<u>305</u>
Selling square footage at year-end (in thousands)			
Superstores.....	2,164	1,883	1,751
Traditional bookstores	496	536	604
Campus bookstores	38	38	35
Total	<u>2,698</u>	<u>2,457</u>	<u>2,390</u>

Retail

Sales were \$701.0 million as compared to \$635.4 million in fiscal 2001, an increase of \$65.6 million or 10.3%. Earnings before interest, taxes, amortization and restructuring and take-over costs increased to \$38.9 million from a loss of \$10.2 million in fiscal 2001, an increase of \$49.1 million. The increase, as compared to fiscal 2001, can be attributed to improved gross margin dollars and reduced warehousing and distribution costs offset by higher occupancy and labour costs due to the additional 13 superstores.

Revenues at the Chapters and Indigo superstores, including the World's Biggest Bookstore, grew to \$485.8 million, an 18.8% increase compared to revenue of \$408.9 million in fiscal 2001. The growth in revenue was generated by the operation of 16 additional superstores offset by the closure of 3 such stores, as compared to fiscal 2001 and positive performance on a comparable store basis. Comparative store sales increased 1.1% in fiscal 2002 as compared to a decline of 1.6% in fiscal 2001.

Total traditional store revenues declined to \$183.8 million, a decrease of \$11.4 million or 5.8% in comparison to \$195.2 million in fiscal 2001. The decline in revenue was the result of operating 17 fewer traditional bookstores or approximately 8% less stores as compared to fiscal 2001. The comparative store sales increase of 3.7% during the year was a significant improvement over the 3.0% decline in fiscal 2001. The total number of stores as at the end of fiscal 2002 was 187 as compared to 204 stores in fiscal

2001. This decrease in traditional stores is consistent with the Indigo's strategic direction of reducing its traditional store portfolio.

Other Retail

Other revenues generated from the sale of Indigo's loyalty cards, as well as Indigo's proportionate share of revenues from the Calendar Club and Campus Bookstores joint ventures, were \$31.4 million as compared to \$30.0 million in fiscal 2001.

Online

Revenues were \$34.7 million as compared to \$51.1 million in fiscal 2001, a decrease of \$16.4 million or 32.1%. The decline was attributable to less aggressive marketing, discounting and promotional activities during the year as compared to fiscal 2001. Losses before interest, taxes, amortization and restructuring charges were reduced by \$31.2 million to \$1.9 million due to significant reductions in operating costs as a result of restructuring activities undertaken during fiscal 2002.

Interest Expense

Interest expense during fiscal 2002 increased by \$6.9 million. This was due to a higher average level of bank indebtedness and an increase in long term borrowings.

Seasonality

Indigo'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 from the retail operations only.

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

	<u>June 30</u>	<u>September 30</u>	<u>December 31</u>	<u>March 31</u>
	(thousands of dollars)			
Fiscal 2002 Revenue.....	125,929	148,994	263,505	162,525
Net Earnings (Loss)	(5,080)	(8,358)	20,049	(8,880)
Fiscal 2001 Revenue.....	123,943	140,993	231,478	137,629
Net Earnings (Loss)	(3,773)	444	17,930	(8,755)
Fiscal 2000 Revenue.....	118,683	141,720	222,526	138,599
Net Earnings (Loss)	(4,274)	(1,339)	15,801	472
Fiscal 1999 Revenue.....	100,692	120,970	210,073	144,103
Net Earnings (Loss)	(3,281)	(1,639)	17,066	527
Fiscal 1998 Revenue.....	80,467	93,383	176,931	105,830
Net Earnings (Loss)	(3,449)	(2,143)	14,912	(900)

Overview of Consolidated Statements of Financial Position

Total assets increased by \$51.0 million as compared to the fiscal year ended March 31, 2001. The net increase was primarily due to an increase in inventory of \$29.5 million as a result of operating 13 additional superstores at the end of fiscal 2002, an increase in goodwill of \$56.3 million as a result of the acquisition of Old Indigo and the acquisition of the non-controlling interest in Chapters Online. These increases were offset by a reduction in net capital assets of \$23.8 million, primarily due to restructuring activities in the year and a reduction in cash balances of \$10.7 million.

Total liabilities increased by \$78.3 million as compared to the fiscal year ended March 31, 2001. The net increase was primarily due to a \$4.6 million increase in bank indebtedness, a \$15.8 million increase in accounts payable and accrued liabilities and a \$58.1 million increase in long term debt and convertible debentures.

Primarily as a result of issuing shares as part of the acquisition of Old Indigo, acquisition of the non-controlling interest in Chapters Online, and issuance of shares by way of an offering of subscription rights, share capital increased by \$18.7 million as compared to the fiscal year ended March 31, 2001.

Financing Activities

In August 2001, Indigo re-negotiated its financing arrangements. The amended and restated credit agreement provides for revolving line of credit of up to \$75 million and long-term debt of \$104 million, of which \$54 million was used to repay senior secured notes on August 14, 2001. During fiscal 2002, \$20 million of the long-term debt was repaid in accordance with the credit agreement.

As part of the refinancing arrangements undertaken by Indigo, a refinancing fee of \$2.7 million was paid to the previous senior secured note holders in order to repay the debt before maturity.

Overview of Consolidated Statements of Cash Flows

Cash decreased by \$10.7 million in fiscal 2002 as compared to a \$17.5 million decrease in fiscal 2001. The net decrease in cash in fiscal 2002 was a result of cash used by operations of \$2.6 million, cash used in investing activities of \$11.5 million and cash provided by financing activities of \$3.4 million.

Of the cash used by operations, changes in non-cash working capital decreased cash by \$11.3 million. This decrease primarily relates to an increase in inventory of \$7.5 million, a net decrease in accounts payable and accruals of \$4.4 million, offset by other items amounting to \$0.6 million.

Net cash used in investing activities consisted of capital expenditures of \$9.6 million and outflows relating to the acquisition of Old Indigo and Chapters Online of \$5.7 million, offset by a decrease of short term investments \$3.8 million.

Indigo obtained its financing through a combination of bank financing and an equity issue. During fiscal 2002, Indigo obtained bank financing of \$104.0 million and repaid \$74.0 million of long-term debt. In addition, Indigo decreased its bank indebtedness by \$32.5 million, paid \$4.2 million relating to its refinancing and issued \$10.0 million in equity by way of a rights offering and shares issued through its Employee Stock Purchase Plan.

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 Indigo 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 Indigo 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 Indigo 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 Indigo. 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 Indigo will be realized or, even if substantially realized, that they will have the expected consequences to, or effects on, Indigo.

ADDITIONAL INFORMATION

Additional information, including directors' and officers' remuneration and indebtedness, principal holders of Indigo's securities, options to purchase securities and interests of insiders in material transactions is contained in the Management Information Circular of Indigo dated August 3, 2004. Further information can also be found on SEDAR at www.sedar.com. Additional financial information is provided in Indigo's comparative financial statements for the fiscal year ended April 3, 2004, which are included on pages 19 through 35 of Indigo's 2004 Annual Report.

Copies of the following documents may be obtained, upon request, from the Secretary of Indigo, 468 King Street, Suite 500, Toronto, Ontario, M5V 1L8:

- a) one copy of this Annual Information Form of Indigo, together with one copy of any document, or the pertinent pages of any document, incorporated by reference in this Annual Information Form;
- b) one copy of the consolidated financial statements of Indigo for its most recently completed financial year together with the accompanying report of the auditor and one copy of any interim financial statements of Indigo subsequent to the financial statements for its most recently completed financial year; and
- c) one copy of the Management Information Circular of Indigo dated August 3, 2004.

When the securities of Indigo are in the course of a distribution pursuant to a short form prospectus or a preliminary short form prospectus has been filed by Indigo in respect of a distribution of securities, the foregoing documents will be provided free of charge. At other times, Indigo may require the payment of a reasonable charge if a person who is not a security holder of Indigo makes the request.