ANNUAL REPORT FISCAL 2001

experience the world of Chapters

imagination energy tenacity
respect vision creativity victory
dedication risk integrity spirit
awareness caring inspiration

Chapters

www.chapters.ca

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Report of the Chair

Dear Shareholders,

It is a pleasure for me to be writing to you in my new role as CEO of Chapters.

There is probably little I could tell you about the past year of this Company that you have not already read in one of our national newspapers. It has been a year filled with challenge, change, and a few noteworthy achievements. It has also been a year during which several problems surfaced, each of which must be addressed to put this Company back on a high performance track.

Year End Performance

I took over the leadership of Chapters Inc. on February 4, 2001 in the middle of our fourth quarter. By that time the story of this year's performance had all but been written.

The retail business turned in an acceptable performance with sales up $12.5 million to $634.0 million. Retail operating earnings were up 7.5% reaching a total of $46.2 million. Chapters Online increased sales by 32.0% achieving sales of $51.1 million for the year, bringing combined sales to $685.1 million.

Unfortunately, losses from Pegasus, the wholesale business, and Chapters Online seriously affected the Company's profitability. In addition, an inventory write-down provision of $24.7 million, inventory shrink of $14.7 million, extraordinary restructuring costs of $30 million and costs associated with the previous management's efforts to thwart the Trilogy bid resulted in a net loss for the year of $84.5 million. The inventory write down is attributable to three major factors: non-returnable, inappropriate book and music merchandise which was purchased by Pegasus to address expected third party business which did not materialize; aged inventory which is no longer returnable but which has proved to be unsaleable at regular prices; and gift and paper merchandise which was not well targeted for our customers and also had to be marked down significantly. The extraordinary shrink is attributable to mismanagement of the Pegasus operation.

The numbers however tell only part of the larger story of the Company's strengths, challenges and opportunities. Rather than focus too heavily on the events of the past year, I will use this letter to share my perspective on the current situation and the track ahead.

Strengths

A market leader

Over the last several years Chapters has emerged as the undisputed market leader in our industry. In both "place" and "space" Chapters is the largest retailer of books in the country. The retail network is strong and the brand is well respected by Canadians from coast to coast. On the online side, Chapters.ca has emerged not only as the #1 book e-tailer in the country, but as the top e-tailer overall.

The organization is filled with talented people, many of whom have deep and rich experience in various aspects of the business. Together the people who make up the Chapters employee group have the ability and energy to make this Company rank among the highest performing retailers in the country.

Scale

One of the Company's main strengths is our size. Chapters is in an excellent position to leverage its size to achieve industry leading margins, highly efficient operations, and special advantages to consumers.

With the Company's past focus on growth, little attention was paid to improve the efficiencies and effectiveness of core operations. In addition, the establishment of three distinct operating businesses, Chapters, Chapters Online and Pegasus led to duplication of efforts, poor communications increased staffing and the acquisition of inappropriate merchandise. Difficult relationships with suppliers, further eroded the Company's ability to effectively and appropriately leverage its position.

Now, with the major growth push behind us and a new management team in place, we are in an excellent position to streamline our organization, redesign key areas of the business, re-energize our team, improve our operations and lower overall costs. In other words – benefit from our scale. This process has already begun. Since assuming the leadership of the Company we have exited the wholesale business and fully integrated the facility as our distribution division; we have centralized buying thereby eliminating buying groups at Pegasus and Online, and in total decreased the Company's employee group by 350. There are a number of additional opportunities to improve productivity and these will be our focus in the year ahead.

A highly desirable customer profile

Chapters serves an important segment of the market. Typically our customers have post secondary education, live in households that earn in excess of $65K, want their children to develop a love of learning and reading, and see, particularly our large stores, as great places to shop for personal

pleasure, for gifts, to learn new things, to prepare for travel and to enhance their home environments. It is an intelligent, service sensitive, value driven customer who tends to see our offering as contributing to his or her quality of life with affordable items. Our experience suggests our customers value expanding beyond our core book offering to include other products that also fill these needs. The challenge here is to ensure that as we add product categories, or modify our existing offering, we always keep in mind who are customer really is and what he or she values.

A well-educated, experienced, knowledgeable employee organization

This company has a particularly strong, committed group of employees who care about the business and the industry. My experience over the last few months convinces me that there is a great deal of energy and talent in this organization which has been underutilized. It is reinforcing to see it bubbling to the surface as we clarify our direction and objectives for the year ahead.

Well-respected brand names

Chapters, Coles and The World's Biggest Bookstore are brands with significant equity in their respective market places. We have just completed a major study on our brands and it is quite clear that there is a real commitment on behalf of customers to each of these brands. It is incumbent on us to further strengthen and leverage these brand names to establish even stronger relationships with our customers.

Together, these strengths provide the Company with an excellent foundation on which to build.

The Challenges and Opportunities

Without doubt there are a number of challenges to be addressed. We see these as essentially "opportunities in work clothes". Let me provide a brief summary.

Supply chain

Every aspect of our supply chain is either under stress or unproductively designed. Current supply chain issues within the publishing industry along with our own procurement and logistics issues are negatively impacting our costs and our ability to have: "the right product, in the right place, at the right time and in appropriate quantities". Our industry and our company have lagged behind many others who started in the '80s and '90s to reengineer core processes, streamline product flow, and leverage technology to lower costs and to improve performance, customer satisfaction and profitability.

We have already initiated a major supply chain redesign process which we expect will eventually involve us in changing not only aspects of how we operate but the way in which publishers interact with us. Improvements in this area have the potential to drive sales up, drive the cost of carrying inventory down, and improve return on working capital by a significant amount.

Store productivity

A number of factors have led to lower than targeted sales per square foot and negative same store sales in both our superstores and our mall stores.

On the mall store side of the business, the focus for the last several years has been on streamlining the portfolio and eliminating unprofitable stores. Little or no attention has been paid to training, store design and presentation, merchandising mix, and changes in customer values and needs. Feedback from our store managers and employees confirm there are real opportunities to improve our sales and profitability by rethinking aspects of how we manage this business. There is no doubt the mall business has been affected by the dramatic growth of superstores and discount stores but for the most part, customer traffic has increased in those malls where our stores are located. However, our stores have not kept pace with the quality of the shopping experience being offered by such successful retailers as The Gap, Banana Republic, H_2O, Roots, The Body Shop, etc., all of whom are shopped regularly by our customers. We believe a targeted improvement program in our Coles division will result in improved performance.

On the superstore side a different number of factors have contributed to lower store productivity. Store inventories are "out of balance"; that is – we have too much of the wrong product and not enough of the right product. This is essentially the result of the Pegasus problems of the last year and the build up of non-productive inventory from the past several years. Store productivity has also been affected by over capacity in certain markets, weaknesses in the gift and paper merchandising and the limited time available to fully train employees while the major store buildup was taking place.

Fortunately, these issues are fully resolvable. It will take some time but every day we are making deliberate progress. Our inventory write-down was a critical step towards preparing to cleanse our stores of non-productive stock. In fact, now that the problems have been clearly identified, we can take action in a number of ways to drive store level productivity. Changes in store layout, merchandising standards and our approach to in-store promotion are also being implemented. Early feedback suggests the changes are being received very positively by both employees and customers.

Specific Actions Taken During the Fourth Quarter and First Quarter of this Year

Pegasus

During the last quarter of this year a number of other key initiatives were implemented. First, we exited the Pegasus wholesale business, renamed the warehouse facility as the Chapters Distribution Centre and repositioned its operations to serve Chapters and Chapters Online solely as a logistics operation. A new, experienced logistics management team has been put in place to fundamentally reshape the approach to distribution and overall logistics management. We have already made progress in improving the flow of product and lowering operating costs. Most important, at the time of take-over, morale at the 300,000 sq. ft. facility was close to militant. Since that time there has been a 180 degree turnaround; employees are fully engaged and participating with full energy to turn this facility around. However, some re-design of the Distribution Centre must be completed over the course of the year to fully achieve our cost and performance objectives. This will be addressed.

Chapters Online

On the sales and marketing side, Chapters Online has performed exceptionally well; but it could not continue to sustain the operating losses of the past two years. Over the last three months Chapters Online has reorganized and downsized by approximately 50%. The newly streamlined team is now energized, focused on remedying problems, and looking at cost-effective ways to grow and more effectively leverage the relationship with our stores and our customers. At the end of May, Chapters Online and Indigo Online merged their operations and their web-sites. This, together with other changes and improvements implemented or planned, will result in this being a breakeven, better performing business in the coming year.

Non-productive inventory

During the last quarter of the year the Company made a major effort to identify and liquidate non-performing inventory. Wherever possible product was returned for credit. There was, however, a very significant amount of inventory that could not be returned due to age or condition. All our stores are currently running major inventory "Blowout" sales which will be continued into the summer. Liquidating this inventory was a significant cost to the Company however, it has freed up both capital and store space for the new inventories which are essential to improving performance.

Merger planning

During the entire fourth quarter we were working with the Competition Bureau and with both our Board and the Indigo Board of Directors to advance the process which would allow Chapters and Indigo to merge. Arrangements were made with the Competition Bureau to address their concerns and we are pleased to report that on June 6, 2001 the Competition Tribunal approved the merger.

During the same period we have been working to define the organization which will operate the newly combined company. The newly appointed executive team includes seasoned professionals from both Chapters and Indigo. Employees in both companies have begun working together on key aspects of our go-forward strategy. In a very short time we have made strong progress developing a shared vision among Chapters and Indigo employees. Once combined, the new company will actually operate with less people than were in the Chapters stand-alone organization. Notwithstanding this, I feel confident in saying overall productivity, energy and creativity will be higher than ever.

Integrating these two companies is, we believe, the very best response to certain fundamental problems affecting our performance and opportunities for growth. The merger will allow us to eliminate the over-capacity which exists in certain markets, benefit from the idiosyncratic strength and best practices of both companies, and eliminate dysfunctional, below cost discounting.

Looking Ahead

The year ahead will be one of integration, organization and real estate portfolio streamlining, process improvements and store level merchandising improvements.

It will be a demanding year in terms of workloads and change but it will be a highly productive year. The energy in the Company on the eve of the merger is high and getting stronger every day. My commitment to you our shareholders is to keep our eye firmly on reversing the negative trends of the last 18 months and on building a company capable of sustainable high performance.

I look forward to updating you on our accomplishments in next year's Annual Report and to keeping you posted on a quarterly basis of our progress toward the targets we have established.

Yours sincerely,

Heather Reisman
Chair & Chief Executive Officer

Management's Responsibility for Financial Reporting

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

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

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

Heather Reisman
Chair and Chief Executive Officer

Ian Young
Chief Financial Officer

Management's Discussion and Analysis of Financial Condition and Results

52 Weeks Ended March 31, 2001, Compared to 52 Weeks Ended April 1, 2000

Overview

Chapters Inc. ("the Company") is the nation's largest book retailer, operating stores in all ten provinces in Canada. As of the fiscal year ended March 31, 2001, the Company operated 77 book superstores including 76 *Chapters* superstores and the *World's Biggest Bookstore*, and 204 traditional bookstores, under the names *Coles*, *SmithBooks*, *Classic Books*, *LibrairieSmith* and *The Book Company*.

The Company owns a 69.6% interest in Chapters Online Inc. ("Chapters Online"), a leading e-commerce retailer, which sells books, videos, CDs, DVDs and other products through its Web site chapters.ca and a 100% interest in Pegasus Wholesale Inc. ("Pegasus") now operating as Chapters Distribution Centre, which ceased operating as a national book wholesaler in December 2000, but continues as the principal distribution centre for the retail operation and the principal fulfillment centre for Chapters Online. The Company also manages 6 university and college bookstores through its 51% interest in Chapters Campus Bookstores Company and operated 142 calendar kiosks during the fiscal 2001 Christmas season through a 50% interest in the Calendar Club Limited Partnership, compared to 144 kiosks in the previous fiscal year.

Discussion and Analysis

The following discussion and analysis of the consolidated financial position and results of operations is based primarily on the consolidated financial statements of the Company for the 52 weeks ended March 31, 2001 and the 52 weeks ended April 1, 2000. It should be read in conjunction with the consolidated financial statements and notes contained in this Annual Report. Unless otherwise stated, all amounts in the following discussion are presented in thousands of dollars, with the exception of square footage, number of stores, number of common shares and per share amounts.

Change of Control

On February 2, 2001, Trilogy Retail Enterprises LP ("Trilogy") was successful in acquiring 7,146,000 common shares of the Company. As a result, Trilogy now holds 8,787,894 of the Company's common shares, representing approximately 71.6% of the outstanding common shares. Gerald Schwartz is the indirect beneficial owner of all of the issued and outstanding common shares of Trilogy Retail Enterprises Inc., the general partner of Trilogy, and of Trilogy's sole limited partner. Gerald Schwartz and Heather Reisman are, respectively, the direct and indirect beneficial owners of 739,300 and 1,318,600 common shares of Indigo Books & Music, Inc. ("Indigo"), representing approximately 47% of the issued and outstanding common shares of Indigo. Trilogy stated that, subject to acquiring the necessary regulatory approvals including the filing of a consent order with the Competition Tribunal, the operations of the Company and Indigo would be merged.

In response to the Commissioner of Competition's concerns relating to the acquisition of a majority of the common shares of the Company by Trilogy and the proposed merger of the Company and Indigo and their respective online affiliates (the "Merger"), an agreement was reached amongst these parties pursuant to which certain assets would be offered for sale to *bona fide* third parties. On June 8, 2001, the Competition Tribunal issued the Consent Order approving the Merger.

The Designated Assets to be offered for sale as described by the Consent Order comprise 13 large-format stores (9 Chapters and 4 Indigo stores) and 10 traditional stores located in shopping malls (7 Coles and 3 SmithBooks), certain online assets, certain trade names and Indigo's distribution facility (unless it is closed by Indigo before a sale). The Consent Order also provides that the Company and Indigo will commit to certain minimum acceptable terms of trade with suppliers.

Results of Operations

The Company's results for the fiscal year ended March 31, 2001 have been significantly impacted by a number of events, particularly, non-recurring one-time costs and the ongoing operational issues at both Pegasus and Chapters Online.

On a consolidated basis, sales at $686.5 million increased by $26.2 million or 4.0% over fiscal 2000. Sales increased 2% or $12.5 million to $634.0 million at Chapters Retail while at Chapters Online, sales increased 32% or $12.4 million to $51.1 million. Pegasus third-party sales increased $1.3 million, however, continued operational losses and inefficiencies in Pegasus and Chapters Online, in addition to non-recurring one-time charges of $69.4 million, resulted in a consolidated net loss for the Company of $84.5 million in the year as compared to net earnings of $17.2 million in the previous fiscal year. Net earnings in fiscal 2000 include a dilution gain on sale of Chapters Online and Pegasus of $41.1 million.

The Company could not sustain the continued losses at Pegasus and Chapters Online and accordingly, management has strategically restructured these businesses. As a result, the Company has exited the wholesale distribution business, significantly reduced overheads in both subsidiaries and combined the back office support functions to deliver an efficient and cost-effective service. The costs of these restructuring initiatives, in addition to the costs of the take-over bid, have resulted in the Company recording a one-time charge of $30.0 million (see "Restructuring and Other Costs" below).

Concurrent with the exit from the wholesale business, new management conducted a review of the inventory on hand at Pegasus and in the retail operations. Management concluded that a provision of $24.7 million was necessary to clear inventory originally purchased for the wholesale business and to clear slow moving inventory in the retail chain. Additionally, system process and control problems at Pegasus have resulted in the Company recording a charge of $14.7 million for inventory shrink over and above the historical inventory shrink results of 2.1% of sales. These inventory provisions totaling $39.4 million have been allocated to Chapters Retail and Pegasus in the amounts of $20.3 million and $19.1 million respectively.

During the year, Chapters retail operations continued to improve with sales increasing $12.5 million or 2.0% over the prior fiscal year to $634.0 million. Earnings before interest, taxes, depreciation and amortization ("EBITDA") of $46.2 million, excluding allocated one-time inventory provisions, increased $3.2 million or 7.5% over the prior fiscal year demonstrating the underlying strength of the retail operations. The inventory provisions were $11.9 million for slow moving inventory and $8.4 million for inventory shrink.

Supported by extensive marketing and site development, Chapters Online sales continued to grow in fiscal 2001 to $51.1 million, up $12.4 million or 32.0% over the prior fiscal year. The EBITDA loss for the period is $33.1 million as compared to $35.2 million in fiscal 2000 as cost increases offset sales and gross margin improvements. Excluding allocated inventory provisions, Pegasus recorded an EBITDA loss for fiscal 2001 of $17.0 million, as compared to an EBITDA loss of $16.7 million in fiscal 2000. The inventory provisions were $12.8 million to clear product purchased for the wholesale business and $6.3 million for inventory shrink. Wholesale sales failed to materialize during the year to offset the infrastructure costs established for the anticipated growth in the business.

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

	52-week period ended March 31, 2001	52-week period ended April 1, 2000	53-week period ended April 3, 1999
Revenue (thousands of dollars)			
Superstores	$ 408,849	$ 376,307	$ 296,917
Traditional Bookstores	195,199	217,771	253,204
Other Retail	29,995	27,450	25,717
Pegasus Wholesale	1,345	67	–
Chapters Online	51,091	38,714	2,042
	$ 686,479	$ 660,309	$ 577,880
Comparable Store Sales			
Superstores	(1.6%)	(3.1%)	3.9%
Traditional Bookstores	(3.0%)	(4.0%)	0.7%
Stores Opened			
Superstores	7	16	25
Traditional Bookstores	7	0	1
Campus Bookstores	2	3	0
	16	19	26
Stores Closed			
Superstores	0	0	0
Traditional Bookstores	34	30	45
	34	30	45
Number of Stores Open at Year-End			
Superstores	77	70	54
Traditional Bookstores	204	231	261
Campus Bookstores	6	4	1
	287	305	316
Square Footage at Year-End (in thousands)			
Superstores	2,025	1,883	1,484
Traditional Bookstores	576	649	721
Campus Bookstores	38	35	28
	2,639	2,567	2,233

Chapters Retail

(thousands of dollars)	Fiscal 2001	Fiscal 2000	Variance	% Variance
Sales	634,043	621,528	12,515	2.0%
EBITDA pre-inventory adjustments	46,173	42,938	3,235	7.5%
% sales	7.3%	6.9%	0.4%	
EBITDA post-inventory adjustments	25,873	42,938	(17,065)	(39.7%)
% sales	4.1%	6.9%	(2.8%)	

Superstores

For the 52 weeks ended March 31, 2001, revenues at the 77 Chapters superstores, including the World's Biggest Bookstore, increased to $408.9 million representing 59.5% of total revenues, compared to $376.3 million or 57.0% of total revenues for the 52 weeks ended April 1, 2000. The growth in revenue was generated by the opening of 7 new superstores across Canada, offset partly by a comparable store sales decline of 1.6%. The comparative sales decline was primarily attributable to the Company's "clustering" strategy of opening multiple stores in a market, where new Chapters stores impact existing stores sales. In addition, delivery of product to stores was hampered by a physical back-log at Pegasus caused by system and inefficient processes.

The 7 new superstores opened during the year averaged approximately 20,300 square feet, bringing the total space occupied by superstores to 2,025,000 square feet at the end of fiscal 2001. This compares to 1,883,000 square feet of superstore space at the end of the prior fiscal year.

Traditional Stores

Revenues in the traditional store division declined to $195.2 million representing 28.4% of total revenues in comparison to $217.8 million or 33.0% of total revenues for the 52 weeks ended April 1, 2000. The decline in revenues was the result of the closure of 34 traditional bookstores or approximately 15% of the stores in the division, and a comparable store sales decline of 3.0%. The comparative sales decline was primarily attributable to the impact of superstores opening in close proximity to existing traditional stores and delayed shipment of product from Pegasus.

The 34 traditional stores that closed during the year were locations that were either marginally profitable, duplicate stores in the same mall, or stores impacted by the presence or upcoming opening of a superstore. The Company will be investigating new store design concepts in order to update and revitalize the brand.

Other Retail

Other retail revenues were derived from the sales of membership cards from the Company's Avid Reader and Chapter One loyalty programs, as well as the Company's proportionate share of revenues from the Calendar Club and Campus Bookstores joint ventures. Other retail revenues were $30.0 million or 4.4% of total revenues as compared to $27.5 million or 4.2% of total revenues during the fiscal period last year. The increase in revenues was generated from Campus Bookstores that were in operation for the entire fiscal year compared to a partial fiscal year last year. Revenues in the Calendar Club division which operated 142 calendar kiosks, 2 less than in the prior fiscal year were basically flat to last year. Loyalty card revenues increased over the last fiscal year by $1.4 million as the Company continued to increase its membership base.

Chapters Online

(thousands of dollars)	Fiscal 2001	Fiscal 2000	Variance	% Variance
Sales	**51,091**	38,714	12,377	32.0%
EBITDA	**(33,135)**	(35,218)	2,083	5.9%
% sales	**(64.9%)**	(91.0%)	26.1%	

Revenues from the Company's subsidiary, Chapters Online, grew to $51.1 million or 7.4% of total revenues during the year, as compared to $38.7 million or 5.9% of total revenues in the previous year. The substantial increase in revenues was due to the subsidiary's aggressive marketing program and promotions, resulting in more than 1.1 million cumulative customer accounts by the end of the fiscal year.

During fiscal 2000, Chapters Online broadened its product range, first through the acquisition of www.gardencrazy.com and the launch of the www.villa.ca Web site, offering a range of garden and home products to online shoppers. In fiscal 2001 Chapters Online added consumer electronics and software, through a fulfillment arrangement with RadioShack.

While strong sales growth continued through fiscal 2001, heavy losses persisted and it became clear that additional financing would not be available. In November 2000, Chapters Online took the first steps to significantly reduce costs by terminating 73 employees, primarily in merchandising roles, and initiating cancellation of several portal agreements. Orders received for the 2000 holiday selling season reached record levels but, by November, fulfillment had become a serious bottleneck due to total reliance for procurement and distribution on Pegasus, which had run into acute operating and vendor problems.

On February 2, 2001, with the change in control, a more intensive restructuring was initiated. By March 15, 2001, a further 110 employees had been terminated across all areas and levels of the organization, pricing was revised to eliminate discounting of all but the most prominent titles, and the product assortment was refocused on books, music, videos and DVDs. This latter initiative involved discontinuing consumer electronics and a complete shutdown of the www.villa.ca Web site. Further cost reductions were achieved through elimination of triplicate roles in procurement and information systems among the Company, Chapters Online and Pegasus, as well as a reduction in occupancy costs.

Since February 2001, the priority has been to rectify the serious fulfillment problems of the business. This was addressed in conjunction with the Company and the Chapters Distribution Centre, which had been reorganized to focus entirely on the fulfillment needs of Chapters Retail and the Chapters Online business.

Pegasus (now operating as Chapters Distribution Centre)

(thousands of dollars)	Fiscal 2001	Fiscal 2000	Variance	% Variance
Intersegment sales	130,863	76,684	54,179	70.7%
Third-party sales	1,345	67	1,278	1,907.5%
Total sales	132,208	76,751	55,457	72.3%
EBITDA pre-inventory adjustments	(16,959)	(16,656)	(303)	(1.8%)
% sales	(12.8%)	(21.7%)	8.9%	
EBITDA post-inventory adjustments	(36,059)	(16,656)	(19,403)	(116.5%)
% sales	(27.3%)	(21.7%)	(5.6%)	

During the year, Pegasus did not generate sufficient third-party revenue to justify its continuation as a national book wholesaler in Canada. As a result, on December 8, 2000, the Company announced that Pegasus would cease its wholesale operation and become the Chapters Distribution Centre for the retail operation and the principal fulfillment centre for Chapters Online. In conjunction with this decision, the Company repurchased the 15% non-controlling interest in Pegasus from Canadian General Capital Limited by issuing 491,803 common shares of the Company, equivalent to proceeds of $7,500,000, thereby making Pegasus a wholly owned subsidiary of the Company. The facility was then renamed Chapters Distribution Centre.

Revenues in fiscal 2001 at Chapters Distribution Centre were $132.2 million including $1.3 million to third-party customers compared to $76.8 million including $67,000 to third parties during the six months in operation during the previous fiscal year.

Cost of Product, Purchasing, Selling and Administration

(thousands of dollars)	Fiscal 2001	Fiscal 2000	Fiscal 1999
Chapters Retail	608,170	578,590	530,373
Chapters Online	84,226	73,932	6,207
Pegasus	37,404	16,723	–
	729,800	669,245	536,580

Cost of product, purchasing, selling and administration is principally a function of sales, store expansion activity, marketing and promotional programs to drive Internet sales.

These expenses, including the one-time inventory adjustments of $39.4 million as previously noted, increased in fiscal 2001 by $60.6 million, or 9.0%, to $729.8 million from $669.2 million in fiscal 2000. Excluding the one-time inventory adjustments, these expenses increased $21.2 million or 3.2% over the prior year. The cost increase also included the opening of the 7 new superstores and was offset partly by the closure of 34 traditional stores.

Amortization of Capital Assets

(thousands of dollars)	Fiscal 2001	Fiscal 2000	Fiscal 1999
Chapters Retail	**20,818**	18,466	14,714
Chapters Online	**4,850**	2,953	469
Chapters Distribution Centre	**2,475**	1,468	–
	28,143	22,887	15,183

Amortization of capital assets increased by $5.2 million to $28.1 million in fiscal 2001 over the fiscal period last year. The net change is due to the continued capital spending on superstore openings, development of the chapters.ca Web site and the continued investment in the information technology required to operate the retail business, and a full year's depreciation of the capital assets of Chapters Distribution Centre. The following table details the capital expenditures over the past three years:

(thousands of dollars)	Fiscal 2001	Fiscal 2000	Fiscal 1999
Chapters Retail	**20,913**	42,168	57,164
Chapters Online	**2,228**	7,758	7,238
Chapters Distribution Centre	**1,984**	10,634	–
	25,125	60,560	64,402

Amortization of Pre-Opening Store Costs

Pre-opening store costs have, on average, been reduced in fiscal 2001 compared to the stores opened in fiscal 2000. Pre-opening costs are typically lower for stores opened in markets with an existing Chapters store as a result of lower advertising expenditures.

The costs are amortized over a 12-month period after a new Chapters store is opened. The decrease in amortization of pre-opening costs to $1.0 million from last year's $2.2 million is a function of the lower number of store openings in fiscal 2001.

Amortization of Goodwill

The repurchase of the minority interest in Pegasus in the fourth quarter generated an increase of $7.5 million in goodwill. The addition gave rise to a slightly higher amortization expense of $516,000 compared to $501,000 in fiscal 2000.

Interest on Long-Term and Current Debt

Interest on long-term debt increased by $652,000 in fiscal 2001 as the debt was outstanding for the entire fiscal period in 2001.

Interest expense on current debt increased to $3.6 million in fiscal 2001 compared to $2.9 million in fiscal 2000 primarily due to higher operating line borrowings throughout the fiscal year.

Restructuring and Other Costs

In November and December 2000, the Company initiated certain structural changes that gave rise to expenses principally associated with the restructuring of Chapters Online and Pegasus which ceased its wholesale operation and became a distribution centre for the retail business and a fulfillment centre for Chapters Online.

In addition, the Company incurred legal and professional fees in defending the take-over by Trilogy. As a result of Trilogy's successful bid, additional costs were incurred pursuant to the change of control.

On January 18, 2001, Future Shop Ltd. ("Future Shop") announced its intention to make an offer (the "Future Shop Offer") for 100% of the Chapters Common Shares. In connection with the Future Shop Offer, the Company and Future Shop entered into a support agreement (the"Future Shop Support Agreement") dated as of January 18, 2001 pursuant to which the Company agreed to co-operate with Future Shop with respect to the Future Shop Offer and take all reasonable actions to support the Future Shop Offer. On February 20, 2001, pursuant to the terms of the Future Shop Support Agreement, the Company paid Future Shop a break-up fee of $7.6 million.

Expenses incurred are detailed below:

(thousands of dollars)	Fiscal 2001
Restructuring costs	**13,177**
Take-over costs	**8,812**
Breakup fees	**7,600**
Goodwill write-down – Garden Crazy Ltd.	**377**
	29,966

Dilution Gain on Sale of Chapters Online and Pegasus, Net of Non-Recurring Expenses

	Fiscal 2000		
(thousands of dollars)	Dilution Gain	Non-Recurring Expenses	Total
Sale and subsequent share transactions of Chapters Online	41,167	(1,407)	39,760
Sale of Pegasus' common shares	3,911	(2,583)	1,328
	45,078	(3,990)	41,088

In fiscal 2000, the Company sold 30.4% of its interest in Chapters Online and 15% of its interest in Pegasus for net proceeds, before non-recurring expenses, of $61.5 million and $7.2 million, respectively. As a result, the Company recognized a $45.1 million dilution gain as the net proceeds significantly exceeded the net asset values given up by the Company.

In connection with the sale and separation of Chapters Online and Pegasus, the Company incurred $2.4 million of non-recurring expenses, net of $1.6 million of related tax benefits. These costs were considered necessary to separate the two subsidiaries and included the cost of interim inventory counts, incremental information systems costs, the write-off of certain supply inventory with the Company's old logo imprints, consulting costs to separate the Company's purchasing and accounting functions and the write-off of certain fixed assets and duplicate costs from the former distribution facility.

Income Tax

	Fiscal 2001	Fiscal 2000	Fiscal 1999
Chapters Retail	**2,322**	8,249	11,142
Chapters Online	**–**	(5,170)	(1,940)
Pegasus	**(6,304)**	(9,115)	–
Other	**(8,736)**	(1,583)	–
	(12,718)	(7,619)	9,202

During fiscal 2001, the Company recognized an income tax benefit of $12.7 million compared to $7.6 million in fiscal 2000. The primary reason for the increase relates to an increase in the net loss from operations in fiscal 2001 offset by an increase in current period tax loss benefits not recognized, in the amount of $17.0 million.

Net Earnings (Loss)

	Fiscal 2001	Fiscal 2000	Fiscal 1999
Chapters Retail	**5,846**	10,660	12,673
Chapters Online	**(36,745)**	(32,280)	(2,372)
Pegasus	**(36,892)**	(11,361)	–
Other	**(16,681)**	50,176	–
	(84,472)	17,195	10,301

The Company's operational and financial activities in fiscal 2001 yielded net loss of $84.5 million, a decrease of $101.7 million as compared to earnings of $17.2 million in the previous fiscal year. The impact of last year's dilution gain of $41.1 million and the after-tax restructuring cost of $21.2 million on the current year accounted for $62.3 million of the variance. Excluding the restructuring costs and non-controlling interests, the Company incurred a net loss of $67.8 million consisting of earnings from the retail business of $5.8 million; a net loss of $36.7 million from Chapters Online; and a net loss of $36.9 million from Chapters Distribution Centre. The losses presented from Chapters Online and Pegasus include allocations of related interest and income taxes and exclude the non-controlling interest in the net losses.

The net loss was $7.33 per share for fiscal 2001, including the after tax restructuring costs of $1.84 per share, compared to net earnings of $1.54 per share for the year ended April 1, 2000. The results of Chapters Retail and Pegasus include the previously noted one-time inventory adjustments of $20.3 million and $19.1 million respectively.

Seasonality

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

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

(thousands of dollars)	June 30	September 30	December 31	March 31
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)
Fiscal 1997 revenue	$ 71,679	$ 75,942	$ 153,511	$ 88,634
Net earnings (loss)	(4,088)	(2,555)	14,111	(2,398)

Liquidity and Capital Reserves

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

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

The Company is currently in discussion with lenders regarding a possible re-financing of the Senior Secured Notes on a long-term basis. The availability of this financing in either its existing or re-financed form will be subject to compliance with certain financial covenants.

Cash Flow

Cash used in operating activities amounted to negative $505,000 in fiscal 2001 compared to negative $43.6 million in the previous year. The majority of the cash flow reduction arose from the losses incurred in Chapters Online and Pegasus, offset by improvements in non-cash working capital balances, particularly inventory, in the amount of $75.3 million.

Capital Structure

During the fiscal year ended March 31, 2001, the Company raised $5.2 million through the issuance of 431,004 common shares as a result of employees exercising stock options and purchasing shares through the employee stock purchase plan. The Company also issued 491,803 common shares to repurchase the 15% minority interest of Pegasus.

Capital Investments

Capital expenditures totaled $25.1 million and $60.6 million in fiscal 2001 and fiscal 2000 respectively. The decline was the result of reduced store openings, reduced development costs in the Internet business and completing the build out of the Chapters Distribution Centre after the start-up costs last year.

Risk Factors

Chapters Superstore Operations

The success of the Company's superstore operations will depend on, among other things, the current and anticipated number of competing superstores in a particular market and the ability of the Company to increase the overall profitability of the chain by increasing sales on an absolute and comparative basis, managing inventory levels and focusing on cost containment efforts.

Traditional Bookstore Operations

The Company's traditional bookstores are highly dependent upon conditions in the mall retailing industry, including overall mall traffic and the impact caused by the increasing number of book superstores operating in the Canadian market. The Company will continue to close underperforming, duplicate and negatively impacted stores upon lease expiry to increase the overall profitability of this division.

Internet Operations

The success of Chapters Online will be dependent upon growing consumer acceptance of electronic commerce and the cost of acquiring and retaining the loyalty of customers. In addition, electronic retailing is a highly competitive business as barriers to entry are low. Raising additional funds may also be very difficult given the recent volatility of the capital markets.

Wholesale Operations

Pegasus ceased its wholesale operation in December 2000 and will continue to operate as a cost centre distributing product to the retail stores and providing fulfillment needs for Chapters Retail and Chapters Online.

Leases

The average unexpired lease term of the Company's traditional bookstores is approximately 18 months. As these leases come up for renewal, the Company will attempt to renew the lease for a term, which coincides with the opening of a book superstore in the immediate vicinity. As a result, the traditional bookstore portfolio is susceptible to volatility in the market for shopping mall space. With an average unexpired lease term of 8 years, the Company's superstore rental expense is expected to remain stable.

Competition

The retail bookselling business is highly competitive. Specialty bookstores, independents, other book superstores, regional multi-store operators, supermarkets, drug stores, warehouse clubs, mail order clubs, Internet booksellers, mass merchandisers and other retailers offering books are also a source of competition for the Company.

Economic Environment

Traditionally, retail businesses are highly susceptible to downturns in consumer confidence in the economy. A decline in consumer spending could have an adverse effect on the Company's financial condition. However, the Company believes that the general economic environment will remain positive, and provide opportunities for growth in 2001.

Cautionary Statement Regarding Forward-Looking Statements

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

Auditors' Report

To the Shareholders of Chapters Inc.

We have audited the consolidated balance sheets of Chapters Inc. as at March 31, 2001 and April 1, 2000 and the consolidated statements of earnings (loss), retained earnings (deficit) and cash flows for the 52-week periods then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 2001 and April 1, 2000 and the results of its operations and its cash flows for the 52-week periods then ended in accordance with Canadian generally accepted accounting principles.

Ernst + Young LLP

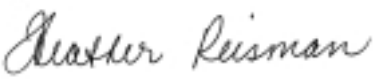
Chartered Accountants
Toronto, Canada
June 8, 2001 (except as to note 19 which is as of June 26, 2001)

Consolidated Balance Sheets

	As at March 31, 2001 $ (thousands)	As at April 1, 2000 $ (thousands)
ASSETS (notes 5 and 7)		
Current		
Cash and cash equivalents	11,394	28,935
Short-term investments	3,850	25,000
Accounts receivable	11,547	15,224
Inventories (note 10)	193,977	269,316
Income taxes receivable	5,353	3,872
Prepaid expenses	4,863	6,139
Future income tax assets (note 4)	5,281	925
Total current assets	236,265	349,411
Capital assets, net (note 3)	138,842	142,238
Future income tax assets (note 4)	5,402	1,791
Deferred pension charges	–	176
Goodwill, net of accumulated amortization of $4,904 (2000 – $4,467) (notes 9 and 11)	8,301	1,694
	388,810	495,310
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Bank indebtedness (note 5)	52,605	69,212
Accounts payable and accrued liabilities (note 11)	182,942	185,750
Deferred revenue	5,272	6,174
Total current liabilities	240,819	261,136
Accrued benefit obligations (note 6)	1,166	–
Long-term debt (note 7)	54,000	54,000
Non-controlling interest	1,716	15,001
Total liabilities	297,701	330,137
Commitments and contingencies (note 16)		
Shareholders' equity		
Share capital (note 8)	144,775	132,044
Retained earnings (deficit)	(53,666)	33,129
Total shareholders' equity	91,109	165,173
	388,810	495,310

See accompanying notes

On behalf of the Board:



Director

Director

Consolidated Statements of Earnings (Loss)

	52-week period ended March 31, 2001 $ (thousands*)	52-week period ended April 1, 2000 $ (thousands*)
Revenue	686,479	660,309
Cost of product, purchasing, selling and administration (note 10)	729,800	669,245
	(43,321)	(8,936)
Amortization of capital assets	28,143	22,887
Amortization of pre-opening store costs	1,033	2,159
Amortization of goodwill	516	501
	29,692	25,547
Loss before the undernoted items	(73,013)	(34,483)
Restructuring and take-over costs (note 11)	29,966	–
Interest on long-term debt (note 7)	3,910	3,258
Interest on bank indebtedness	3,586	2,859
Dilution gain on sale of Chapters Online Inc. and Pegasus Wholesale Inc., net of expenses (note 12)	–	(41,088)
Earnings (loss) before income taxes and non-controlling interest	(110,475)	488
Income tax benefit (note 4)	(12,718)	(7,619)
Earnings (loss) before non-controlling interest	(97,757)	8,107
Non-controlling interest	(13,285)	(9,088)
Net earnings (loss) for the period	(84,472)	17,195
Net earnings (loss) per share		
Basic	$(7.33)	$1.54
Fully diluted	**	$1.50
Weighted average number of common shares outstanding (note 8)		
Basic	11,527	11,133
Fully diluted	**	11,936

* Except per share data

** Fully diluted earnings per share have not been presented as the effects are anti-dilutive.

See accompanying notes

Consolidated Statements of Retained Earnings (Deficit)

	52-week period ended March 31, 2001 $ (thousands)	52-week period ended April 1, 2000 $ (thousands)
Retained earnings, beginning of period	**33,129**	15,934
Adjustment relating to change in accounting policy (note 2)	**(576)**	–
Net earnings (loss) for the period	**(84,472)**	17,195
Dividends paid	**(1,747)**	–
Retained earnings (deficit), end of period	**(53,666)**	33,129

See accompanying notes

Consolidated Statements of Cash Flows

	52-week period ended March 31, 2001 $ (thousands)	52-week period ended April 1, 2000 $ (thousands)
CASH FLOWS FROM OPERATING ACTIVITIES		
Net earnings (loss) for the period	(84,472)	17,195
Add (deduct) items not affecting cash		
Amortization	29,692	25,547
Future income taxes	(7,967)	(4,843)
Loss on disposal of capital assets	316	918
Benefit plan expense	766	499
Non-controlling interest	(13,285)	(9,088)
Write-down of goodwill (note 11)	377	–
Dilution gain on sale of Chapters Online Inc. and Pegasus Wholesale Inc. (note 12)	–	(45,078)
	(74,573)	(14,850)
Net change in non-cash working capital balances (note 15(a))	74,068	(28,701)
Cash used in operating activities	(505)	(43,551)
CASH FLOWS FROM INVESTING ACTIVITIES		
Decrease (increase) in short-term investments	21,150	(25,000)
Purchase of capital assets	(25,125)	(60,560)
Proceeds on disposal of capital assets	62	–
Cash used in investing activities	(3,913)	(85,560)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase (decrease) in bank indebtedness	(16,607)	7,372
Proceeds from share issuance	5,231	32,756
Proceeds from share issuance – Chapters Online Inc. (note 12)	–	61,490
Proceeds from share issuance – Pegasus Wholesale Inc. (note 12)	–	7,234
Repayment of long-term debt	–	(11,125)
Proceeds from issuance of long-term debt	–	54,000
Dividends paid	(1,747)	–
Cash flows from (used in) financing activities	(13,123)	151,727
Net increase (decrease) in cash and cash equivalents during the period	(17,541)	22,616
Cash and cash equivalents, beginning of period	28,935	6,319
Cash and cash equivalents, end of period	11,394	28,935

See accompanying notes

Notes to Consolidated Financial Statements

March 31, 2001

1. NATURE OF OPERATIONS

Chapters Inc. (the "Company") was formed as a result of an amalgamation of Coles and SmithBooks under the Ontario Business Corporations Act and operates a chain of retail bookstores across Canada including 77 (April 1, 2000 – 70) superstores under the *Chapters* and *World's Biggest Bookstore* names, as well as 204 (April 1, 2000 – 231) traditional bookstores under the *Coles*, *SmithBooks*, *LibrairieSmith*, *Classic Bookshop* and *The Book Company* names. The Company also wholly owns and operates Pegasus Wholesale Inc. ("Pegasus"). The Company holds a 69.6% interest in Chapters Online Inc. ("Chapters Online"), an e-commerce retailer. The Company also manages 6 (April 1, 2000 – 4) university and college bookstores through Chapters Campus Bookstores Company, a joint partnership with Barnes and Noble College Bookstore Canadian Division.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include the accounts of the Company and its subsidiary companies.

Inventories

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

Prepaid expenses

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

Capital assets

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

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

Employee future benefits

The Company adopted, on a retroactive basis without restatement, the method of accounting for employee future benefits required by The Canadian Institute of Chartered Accountants' recommendations in Section 3461, Employee Future Benefits. The effect of adopting the new recommendations was to decrease current year opening retained earnings by $576,000.

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

date on high-quality debt instruments with cash flows that match the timing and amount of expected benefit payments. For purposes of calculating the expected return on plan assets, those assets are valued at fair value. The excess of the net actuarial gain (loss) arising after April 2, 2000 over 10% of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service life of active employees.

Deferred revenue

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

Income taxes

The Company uses 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 will be in effect when the differences are expected to reverse.

Goodwill

Goodwill represents the excess of the cost over the value assigned to the net identifiable assets acquired at the date of acquisition and is being amortized on a straight-line basis over 5 to 10 years. The Company assesses the recoverability of goodwill by determining whether the amortization over the remaining life can be recovered through projected undiscounted future operating results.

Joint ventures

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

Stock-based compensation plan

The Company has an employee stock option plan, which is discussed in note 8. No compensation expense is recognized when stock options are issued to employees. Any consideration paid by employees on the exercise of stock options or purchase of stock is credited to share capital.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances with banks and highly liquid investments that are readily convertible to cash with less than three months to maturity at the date of acquisition. Investments comprise money market funds and short-term notes and bear interest at 4% (April 1, 2000 – 4%).

Short-term investments

Short-term investments consist of investments with a maturity date of ninety days or greater at the date of acquisition and are recorded at the lower of cost and market value. Short-term investments consist of a discount note with an interest rate of 5.64% due April 4, 2001 (April 1, 2000 – 5.01% due April 3, 2000).

Use of estimates

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

Revenue recognition

The Company recognizes revenue for product sales, net of estimated returns and promotional discounts, and outbound shipping charges when the products are shipped to customers, which is also when title passes to the customer.

Earnings (loss) per share

The computation of basic earnings (loss) per share is based upon the weighted average number of common shares issued and outstanding during the period. Fully diluted earnings (loss) per share reflects the potential dilution of securities by adding other common stock equivalents in the weighted average number of common shares outstanding for the period, if dilutive, and adjusting the basic earnings with the after-tax profit which would have resulted from the investment of the additional funds that the Company would have received from the exercise of the dilutive common stock equivalents.

3. CAPITAL ASSETS

Capital assets consist of the following:

	March 31, 2001		April 1, 2000	
	Cost $ (thousands)	Accumulated amortization $ (thousands)	Cost $ (thousands)	Accumulated amortization $ (thousands)
Furniture, fixtures and equipment	105,881	38,476	94,478	31,123
Computer equipment and development costs	52,707	34,519	48,639	23,424
Leasehold improvements	89,784	36,535	85,076	31,408
	248,372	109,530	228,193	85,955
Less accumulated amortization	109,530		85,955	
Net book value	138,842		142,238	

4. INCOME TAXES

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

	March 31, 2001 $ (thousands)	April 1, 2000 $ (thousands)
Current future tax assets		
Deferred contract fee	542	690
Reserves and allowances	4,930	–
Unrealized intercompany profits	–	553
Current future tax liabilities		
Pre-opening costs	(191)	(318)
Net current future tax assets	5,281	925

	March 31, 2001 $ (thousands)	April 1, 2000 $ (thousands)
Non-current future tax assets		
Tax loss carryforwards	10,834	5,195
Share issue costs	712	1,435
Book amortization in excess of CEC deduction	485	234
Accrued benefit obligations	505	–
Non-current future tax liabilities		
Capital cost allowance in excess of book amortization	(7,134)	(4,987)
Other	–	(86)
Net non-current future tax assets	5,402	1,791

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

	2001 $ (thousands)	2000 $ (thousands)
Current income tax benefit	(4,914)	(3,450)
Future income tax expense (benefit) relating to origination and reversal of temporary differences	(2,165)	1,046
Future income tax benefit resulting from recognition of loss carryforwards	(6,525)	(5,195)
Adjustment to future income tax assets resulting from reduction in substantively enacted tax rates	886	(20)
Total income tax benefit	(12,718)	(7,619)

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

	2001 $ (thousands)	2000 $ (thousands)
Tax at combined federal and provincial tax rates	(47,837)	217
Tax effect of dilution gain not taxable for income tax purposes	–	(19,740)
Tax effect of expenses not deductible for income tax purposes	4,300	199
Benefit of current period income tax losses not recognized	28,231	11,156
Large Corporations Tax	355	490
Reduction in income tax benefits resulting from substantively enacted tax rate reductions	2,034	–
Other, net	199	59
	(12,718)	(7,619)

The Company has combined non-capital loss carryforwards of $111,858,000 (April 1, 2000 – $35,359,000) for income tax purposes. The Company's non-capital loss carryforwards expire as follows:

	$ (thousands)
2007	35,359
2008	76,499
	111,858

5. BANK INDEBTEDNESS

The Company has, with a major Canadian chartered bank, a demand operating line of credit of up to $80,000,000, calculated monthly, based on defined levels of and collateralized by inventories and accounts receivable. This obligation bears interest, at the Company's option, at the bank's prime rate or banker's acceptance rate plus a 1% stamping fee. The bank's prime rate at March 31, 2001 is 6.75% (April 1, 2000 – 7.0%).

This indebtedness will become a demand obligation on August 26, 2001 if the merger between the Company and Indigo Books & Music, Inc. does not proceed.

As at March 31, 2001, the Company has outstanding letters of credit totaling $984,000 (April 1, 2000 – nil).

6. ACCRUED BENEFIT OBLIGATIONS

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

	March 31, 2001 $ (thousands)
Accrued benefit obligations, beginning of period	**8,765**
Current service cost	**1,152**
Interest on accrued benefits	**665**
Benefits paid	**(821)**
Balance, end of period	**9,761**
Fair value of plan assets, beginning of period	**8,365**
Employee contributions	**484**
Interest on plan assets	**567**
Benefits paid	**(821)**
Fair value of plan assets, end of period	**8,595**
Funded status – plan deficit	**1,166**
Accrued benefit obligations	**1,166**

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

	Pension plans
Weighted average assumptions	
Discount rate	7.00%
Expected long-term rate of return on plan assets	7.00%
Rate of compensation increase	4.50%

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

	2001 $ (thousands)
Current service cost	**668**
Interest on accrued benefits	**665**
Interest on plan assets	**(567)**
Net benefit plan expense	**766**

7. LONG-TERM DEBT (See also note 19(b))

In May 1999, the Company issued $54,000,000 of Senior Secured Notes (the "Notes") at a fixed rate of 7.24%. Interest on these Notes is payable on a quarterly basis. The Notes mature and are repayable on May 31, 2004. The Notes are collateralized by a general security agreement and a general assignment of book debts. The interest expense related to the Notes is $3,910,000 (2000 – $3,258,000). As at March 31, 2001, the fair value of the Notes is approximately $50,000,000.

8. SHARE CAPITAL

Share capital consists of the following:

	March 31, 2001 $ (thousands)	April 1, 2000 $ (thousands)
Authorized		
Unlimited Class A shares, voting, convertible into common shares on a one-for-one basis at the option of the shareholder		
Unlimited common shares, voting		
Issued		
12,281,236 common shares (April 1, 2000 – 11,358,429)	144,775	132,044

Common shares issued:

	March 31, 2001		April 1, 2000	
	Number of shares	Amount $ (thousands)	Number of shares	Amount $ (thousands)
Balance, beginning of period	11,358,429	132,044	10,310,583	99,288
Issued during the year				
(i) Issued for cash (net of expenses and future income taxes)	–	–	1,000,000	31,856
(ii) Employee Stock Purchase Plan	29,576	293	19,013	370
(iii) Options exercised	400,836	4,881	25,728	458
Issued on acquisition (note 9)	491,803	7,500	–	–
Issued to directors for cash	592	57	3,105	72
	922,807	12,731	1,047,846	32,756
Balance, end of period	12,281,236	144,775	11,358,429	132,044

(i) During fiscal 2000, the Company issued 1,000,000 common shares under a short-form prospectus. After deducting underwriting and other costs amounting to $1,613,000, less future income taxes of $726,000, the net amount credited to share capital was $31,856,000.

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

(iii) On August 26, 1996, the Company established an employee stock option plan (the "Plan") for its directors and key employees. The number of common shares reserved for issuance under the Plan is 1,728,500. One quarter of

the options granted are exercisable on the date of issue with the remainder exercisable in equal installments on the anniversary date for the next three years.

Under the Stock Option Plan Agreement, in the event of an offer to purchase shares of the Company which, if accepted, would result in the offeror exercising control of the Company, the Board of Directors could authorize certain non-vested options to become exercisable during the period that the offer is open for acceptance. On December 11, 2000, Trilogy Retail Enterprises L.P. ("Trilogy") issued an offer to purchase 4,888,000 common shares of the Company, which would have resulted in Trilogy exercising control of the Company, if accepted. As a result of the offer, the Board of Directors authorized that all options with an exercise price of $16.80 or less became exercisable during the period that the offer was open for acceptance.

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

	March 31, 2001		April 1, 2000	
	Number #	Weighted Average exercise price $	Number #	Weighted Average exercise price $
Outstanding options, beginning of period	1,011,204	21.21	627,307	20.83
Granted	248,000	12.07	464,750	21.46
Exercised	(400,836)	12.18	(25,728)	17.81
Cancelled	(94,189)	24.37	(55,125)	20.54
Outstanding options, end of period	764,179	22.60	1,011,204	21.21
Options exercisable, end of period	530,670		504,272	

Options outstanding and exercisable
As at March 31, 2001

	Outstanding			Exercisable	
Range of exercise prices $	Number #	Weighted average exercise price $	Weighted average remaining contractual life years	Number #	Weighted average exercise price $
10.75-15.00	173,450	12.18	3.3	89,366	12.83
17.60-20.50	220,779	17.68	1.5	210,779	17.66
26.75-32.75	369,950	30.41	2.7	230,525	29.85
10.75-32.75	764,179	22.60	2.5	530,670	22.24

9. ACQUISITION OF MINORITY SHARE IN PEGASUS

Effective January 14, 2001, the Company entered into a share purchase agreement (the "Agreement") to acquire the outstanding 15% non-controlling interest in Pegasus. Under the terms of the Agreement, the Company issued subscription receipts having an aggregate redemption price of $7,500,000. The subscription receipts were subsequently converted into 491,803 common shares of the Company. The acquisition has been accounted for using the purchase method of accounting. The allocation of the purchase price is based on the fair value of the net identifiable assets of Pegasus.

The total cost of the acquisition was allocated to the net assets acquired on the basis of their fair values as follows:

	$ (thousands)
ASSETS	
Current assets	13,014
Capital assets	2,484
Goodwill	7,500
Current liabilities	(10,488)
Note payable	(4,515)
	7,995

Funded by	March 31, 2001 $ (thousands)
Issuance of subscription receipts	7,500
Restructuring costs	495
	7,995

Restructuring costs are comprised of termination and severance costs. No further restructuring costs relating to Pegasus are anticipated.

10. COST OF PRODUCT

The cost of product, purchasing, selling and administration includes the following amounts:

	2001 $ (thousands)	2000 $ (thousands)
Provision for future markdowns	24,722	2,500
Inventory shrink	28,600	13,300
	53,322	15,800

The provision for future markdowns reflects the clearance of slow moving, non-returnable inventory held at the distribution facility and a provision for damaged stock held in stores. Inventory shrink recorded during the year reflects the actual experience during the year.

11. RESTRUCTURING AND TAKE-OVER COSTS

During fiscal 2001, the Company incurred restructuring and take-over costs consisting of the following:

	$ (thousands)
Restructuring	13,554
Take-over costs	16,412
	29,966

During fiscal 2001, management evaluated the operations of the Company. In an effort to reduce operating costs, the Company restructured its distribution operations, online operations and senior executive management team. Restructuring costs are comprised of approximately $11,101,000 relating to employee termination and severance costs, $377,000 write down of goodwill related to the closure of the gardencrazy.com Web site, and $2,076,000 related to other costs including professional fees. It is anticipated that additional termination and severance costs, if any, will be recognized in the 2002 fiscal year.

Take-over costs are comprised of $8,812,000 of investment advisory, legal and other professional fees associated with the take-over bid by Trilogy, and break-up fees in the amount of $7,600,000 consisting of fees paid, as part of an acquisition offer made by Future Shop Ltd. for 100% of the outstanding shares of the Company. The agreement called for a fee to be paid by the Company in the event that the offer was not accepted. As at March 31, 2001, all break-up fees have been paid and no further cost will be incurred.

As at March 31, 2001, approximately $8,278,000 of the restructuring and take-over costs remain unpaid and have been included in accounts payable and accrued liabilities.

12. ISSUANCE OF EQUITY IN CHAPTERS ONLINE AND PEGASUS

In July 1999, the Company contributed $9,829,000 of net assets consisting primarily of capital assets in exchange for 100% of the common shares of Chapters Online. The Company's interest in Chapters Online was subsequently diluted to 69.6% of all the issued and outstanding shares through the issuance, by Chapters Online of shares to a venture capital fund, an initial public offering, and through the issuance of common shares to purchase all of the assets of Garden Crazy Ltd. The sale of the shares resulted in net proceeds to Chapters Online of $61,490,000. In addition, the Company recorded a gain on the sale of Chapters Online's shares of $39,760,000, net of expenses in the amount of $1,407,000.

In October 1999, the Company incorporated Pegasus, formerly an operating division of the Company. At the time of incorporation, the Company contributed $45,099,000 of net assets consisting of inventory and capital assets in return for a $30,099,000 long-term note and common shares valued at $15,000,000. The Company's interest was subsequently diluted to 85% (82% on a fully diluted basis) of all the issued and outstanding shares of Pegasus. The sale of the shares by Pegasus resulted in net proceeds of $7,234,000. In addition, the Company recorded a gain on the sale of Pegasus' shares of $1,328,000, net of expenses of $2,583,000.

13. JOINT VENTURES

In August 1999, the Company formed a joint venture with Barnes and Noble College Bookstore Canadian Division to manage its Campus Bookstore division. Under the terms of the agreement, the Company contributed assets at a net book value of $4,590,000, consisting primarily of inventory, in return for a promissory note of $2,110,000 and a 51% equity interest in the newly formed company, Chapters Campus Bookstores Company.

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

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

	Total		Proportionate share	
	2001	2000	2001	2000
	$ (thousands)	$ (thousands)	$ (thousands)	$ (thousands)
Current assets	10,564	12,372	5,340	6,246
Long term assets	1,622	2,532	819	1,274
Current liabilities	5,897	7,001	2,972	3,523
Revenue	37,393	32,238	18,885	16,254
Expenses	35,793	29,932	18,090	15,086
Net income	1,600	2,306	795	1,168
Cash flows provided by (used in)				
Operating activities	2,296	8,275	1,152	4,132
Financing activities	(896)	(2,595)	(457)	(1,298)
Investing activities	(2,817)	(1,157)	(1,411)	(582)
Net cash flow	(1,417)	4,523	(716)	2,252

14. SEGMENT INFORMATION

The Company has three reportable segments: Chapters Retail, Chapters Online and Pegasus. Chapters Retail operates a chain of retail bookstores across Canada including superstores, college and traditional bookstores. Chapters Online is an e-commerce retailer, selling books and other products through the internet Web site www.chapters.ca. Pegasus is a national wholesaler of books and other retail products.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based on profit or loss from operations. The Company accounts for intersegment sales and transfers as if the sales or transfers were to third parties, that is, at current market prices. The Company's reportable segments are strategic business units that offer different products through different channels. They are managed separately because each business requires different technology and market strategies. All of the Company's assets are located in Canada. Revenue from the reportable segments are provided in Canada.

Chapters Online has incurred operating losses and has a deficit and working capital deficiency as at March 31, 2001. Continued operations are dependent upon the financial and operational support of the Company, achieving profitable operations, and obtaining financing. The outcome of these matters cannot be predicted at this time.

	March 31, 2001			
	Retail $ (thousands)	Online $ (thousands)	Pegasus $ (thousands)	Total $ (thousands)
Revenue	634,043	51,091	132,208	817,342
Inter-segment revenue	–	–	(130,863)	(130,863)
Revenue from external customers	634,043	51,091	1,345	686,479
Earnings (loss) before interest, amortization and income taxes	25,873	(33,135)	(36,059)	(43,321)
Amortization	22,367	4,850	2,475	29,692
Interest expense (income)	4,070	(1,236)	4,662	7,496
Segment loss before income taxes	(568)	(36,745)	(43,196)	(80,509)
Segment earnings (loss)	5,846	(36,745)	(36,892)	(67,791)
Segment assets	379,713	18,835	42,473	441,021
Capital expenditures	28,413	2,228	1,984	32,625

Reconciliation – segment earnings (loss)

	2001 $ (thousands)
Segment loss	(67,791)
Restructuring and take-over costs	(29,966)
Non-controlling interest	13,285
	(84,472)

Reconciliation – segment assets

	March 31, 2001			
	Retail $ (thousands)	Online $ (thousands)	Pegasus $ (thousands)	Total $ (thousands)
Cash and short-term investments	7,718	7,526	–	15,244
Accounts receivable	10,703	716	128	11,547
Inventories	171,454	1,334	21,189	193,977
Prepaid expenses	4,486	370	7	4,863
Capital assets	113,439	8,889	16,514	138,842
Intercompany receivables and investments in subsidiaries	58,259	–	4,635	62,894
Other	13,654	–	–	13,654
	379,713	18,835	42,473	441,021
Future income tax assets				10,683
Intercompany receivables and investments in subsidiaries				(62,894)
				388,810

	April 1, 2000			
	Retail	Online	Pegasus	Total
	$ (thousands)	$ (thousands)	$ (thousands)	$ (thousands)
Revenue	621,528	38,714	76,751	736,993
Inter-segment revenue	–	–	(76,684)	(76,684)
Revenue from external customers	621,528	38,714	67	660,309
Earnings (loss) before interest, amortization and income taxes	42,938	(35,218)	(16,656)	(8,936)
Amortization	21,047	3,032	1,468	25,547
Interest expense (income)	4,564	(800)	2,353	6,117
Segment profit (loss) before income taxes	17,327	(37,450)	(20,477)	(40,600)
Segment earnings (loss)	10,660	(32,280)	(11,361)	(32,981)
Segment assets	428,443	61,561	123,588	613,592
Capital expenditures	42,168	7,758	10,634	60,560

Reconciliation – segment earnings

	$ (thousands)
Segment loss	(32,981)
Dilution gain on sale of Chapters Online Inc. and Pegasus Wholesale Inc., net of non-recurring expenses	41,088
Non-controlling interest	9,088
	17,195

Reconciliation – segment assets

	April 1, 2000			
	Retail	Online	Pegasus	Total
	$ (thousands)	$ (thousands)	$ (thousands)	$ (thousands)
Cash and short-term investments	8,628	45,307	–	53,935
Accounts receivable	12,139	3,013	72	15,224
Inventories	199,906	–	69,410	269,316
Prepaid expenses	4,619	1,291	229	6,139
Capital assets	113,661	11,573	17,004	142,238
Intercompany receivables and investments in subsidiaries	84,125	–	36,873	120,998
Other	5,365	377	–	5,742
	428,443	61,561	123,588	613,592
Future income tax assets				2,716
Intercompany receivables and investments in subsidiaries				(120,998)
				495,310

15. CONSOLIDATED STATEMENTS OF CASH FLOWS

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

	March 31, 2001 $ (thousands)	April 1, 2000 $ (thousands)
Accounts receivable	3,677	(7,588)
Inventories	75,339	(44,710)
Prepaid expenses	243	(2,965)
Income taxes receivable	(1,481)	(5,756)
Deferred revenue	(902)	1,504
Accounts payable and accrued liabilities	(2,808)	30,814
	74,068	(28,701)

(b) Supplemental cash flow information:

	2001 $ (thousands)	2000 $ (thousands)
Interest paid	8,763	5,639
Income taxes paid	–	1,998

(c) The Company entered into the following non-cash transaction during fiscal 2001:

(i) The Company issued 491,803 common shares valued at $7,500,000 with respect to the acquisition of Pegasus (note 9).

16. COMMITMENTS AND CONTINGENCIES

(a) Operating leases

The Company has operating lease commitments in respect of its stores, support office premises and certain equipment. The leases expire at various dates between 2002 and 2017 and are subject to renewal options in certain cases. Annual store rentals consist of a base amount together with additional payments based on store sales. The base rentals payable under present leases are as follows:

	$ (thousands)
2002	50,072
2003	47,418
2004	44,412
2005	42,707
2006	41,406
Thereafter	147,069
	373,084

(b) Legal claims

The Company is a defendant in a lawsuit involving the use of certain trademarks. Pursuant to an agreement between the Company and Southam Inc. ("Southam"), Southam has indemnified the Company for any loss as a result of this action.

17. FINANCIAL INSTRUMENTS

The financial instruments recorded on the consolidated balance sheets comprise of cash and cash equivalents, short-term investments, accounts receivable, inventories, income taxes receivable and current liabilities. The Company's financial instruments approximate their carrying values due to their short-term nature, except as presented elsewhere in the consolidated financial statements.

18. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the 2001 consolidated financial statements.

19. SUBSEQUENT EVENTS

(a) On June 8, 2001, the Federal Competition Tribunal approved the proposed merger of the Company and Indigo Books & Music, Inc. ("Indigo"). On June 12, 2001, the Board of Directors of both the Company and Indigo approved a plan to merge the companies. This plan will be tabled with the shareholders of the Company for approval. The proposed merged entity has also agreed to adhere to a Code of Conduct for the next five years, and to offer to sell 23 retail bookstores including 13 superstores and 10 traditional bookstores as required by the Federal Competition Tribunal.

(b) The Company is currently in discussion with lenders regarding a possible re-financing of the Notes on a long-term basis (note 7). The availability of this financing in either existing or re-financed form, will be subject to compliance with certain financial covenants.

Corporate Governance Policies

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

Executive Management and Board of Directors

EXECUTIVE MANAGEMENT

Doug Caldwell
Chief Information Systems Officer

Michael Gagnier
President, Retail

Deirdre Horgan
Vice President, Marketing

Heather Reisman
Chair & Chief Executive Officer

Mary-Alice Schmidt
Vice President, Human Resources & Organizational Development

Kathy Weston
Executive Vice President, Procurement

Ian Young
Chief Financial Officer

BOARD OF DIRECTORS

Peter Jewett
Senior Partner
TORYS

Sen. Michael Kirby
Senator
The Senate of Canada

Robert Lantos
Chairman & Chief Executive Officer
Serendipity Point Films

Jack Lawrence
Chairman
Lawrence & Company Inc.

Heather Reisman
Chair & Chief Executive Officer
Chapters Inc.

Gerald Schwartz
Chairman, Chief Executive Officer & President
Onex Corporation

Lawrence Tanenbaum
President
Kilmer Van Nostrand Co. Limited

Nigel Wright
Vice President
Onex Corporation

Summary of Financial Information

For the years ended (millions of dollars except per share)	March 31 2001	April 1 2000	April 3 1999	March 28 1998	March 29 1997	March 30 1996
SELECT INCOME STATEMENT INFORMATION						
Revenue						
Superstores	408.9	376.3	296.9	166.7	74.4	40.0
Traditional Bookstores	195.2	217.8	253.2	278.8	308.1	333.7
Internet	51.1	38.7	2.0	–	–	–
Other	31.3	27.5	25.7	11.1	7.3	5.4
Total Revenues	686.5	660.3	577.9	456.6	389.8	379.1
EBITDA	(43.3)	(8.9)	41.3	32.9	25.5	21.1
EBIT	(73.0)	(34.5)	23.3	19.0	14.9	11.0
Restructuring and take-over costs	30.0	–	–	–	–	–
Dilution gain on sale of Chapters Online Inc. & Pegasus Wholesale	–	41.1	–	–	–	–
Earnings per weighted average shares outstanding	(7.33)	1.54	1.00	0.90	0.82	0.38
SELECT BALANCE SHEET INFORMATION						
Working capital	(4.6)	88.3	9.4	53.6	39.5	14.0
Total assets	388.8	495.3	351.8	219.4	168.2	150.4
Long-term debt	54.0	54.0	–	11.1	31.2	48.6
Shareholders' equity	91.1	165.2	115.2	104.4	52.1	5.9
Long-term debt / (long-term debt + equity)	0.37:1	0.25:1	–	0.10:1	0.37:1	0.89:1
Weighted average number of shares outstanding	11,526,705	11,133,222	10,295,450	9,326,203	6,179,138	5,290,127
Common shares outstanding at end of period	12,281,236	11,358,429	10,310,583	10,284,672	8,190,127	5,290,127
STORE OPERATING STATISTICS						
Number of stores at end of period						
Superstores	77	70	54	29	11	4
Traditional Bookstores	204	231	261	305	335	371
Campus Bookstores	6	4	1	1	–	–
Square footage at end of period (in thousands)						
Superstores	2,025	1,883	1,484	833	341	129
Traditional bookstores	576	649	721	842	909	1,001
Campus bookstores	38	35	28	28	–	–
Comparable store sales growth						
Superstores	(1.6%)	(3.1%)	3.9%	*	*	*
Traditional Bookstores	(3.0%)	(4.0%)	0.7%	(3.4%)	1.1%	0.4%
Sales per square foot						
Superstores	213	227	258	*	*	*
Traditional Bookstores	327	333	339	323	329	331

*Insufficient number of superstores for a meaningful comparison

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Stock Exchange Listing
Toronto Stock Exchange

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

Chapters' Annual and Special Meeting will be held on August 7, 2001 at 10:00 a.m. on the trading floor of The Design Exchange, 234 Bay Street, Toronto, Ontario.

Shareholders are encouraged to attend and guests are welcome.

Une traduction française de ce document est disponible sur demande.

Although the financial information in this Annual Report is for the fiscal year ended March 31, 2001, other information in the text may be current as of the publication date, June 26, 2001. This includes numbers of stores, program launches, etc., except as noted.