

**CHAPTERS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS**

(UNAUDITED)
(in thousands)

	13 WEEKS ENDED		26 WEEKS ENDED	
	Sept. 30, 2000	Oct. 2, 1999 *	Sept. 30, 2000	Oct. 2, 1999 *
OPERATING ACTIVITIES				
Net earnings (loss) for the period	\$ (7,778)	\$ 27,758	\$ (20,492)	\$ 18,309
Add (less) items not affecting cash				
Net gain on sale of Chapters Online Inc.	-	(35,558)	-	(35,558)
Amortization	7,251	5,962	14,274	11,682
Loss on disposal of capital assets	-	-	-	66
Future income taxes	(2,007)	-	(4,183)	(675)
Deferred pension charges	75	75	150	150
Non-controlling interest	(3,483)	(462)	(7,249)	(462)
	<u>(5,942)</u>	<u>(2,225)</u>	<u>(17,500)</u>	<u>(6,488)</u>
Net changes in non-cash working balances related to operations	<u>(5,189)</u>	<u>(1,647)</u>	<u>(14,533)</u>	<u>(52,650)</u>
Cash used in operating activities	<u>(11,131)</u>	<u>(3,872)</u>	<u>(32,033)</u>	<u>(59,138)</u>
INVESTING ACTIVITIES				
Decrease in short term investments	8,933	-	8,933	-
Purchase of capital assets, net	(7,039)	(17,580)	(13,471)	(29,632)
Cash used in investing activities	<u>1,894</u>	<u>(17,580)</u>	<u>(4,538)</u>	<u>(29,632)</u>
FINANCING ACTIVITIES				
Increase (decrease) in bank indebtedness	4,698	21,618	9,988	(1,468)
Proceeds on sale of Chapters Online Inc.	-	54,145	-	54,145
Proceeds on issuance of long-term debt	-	-	-	54,000
Proceeds on issuance of common shares	199	197	199	32,282
Repayment of long-term debt	-	-	-	(2,000)
Cash provided by (used in) financing activities	<u>4,897</u>	<u>75,960</u>	<u>10,187</u>	<u>136,959</u>
Net increase (decrease) in cash during the period	(4,340)	54,508	(26,384)	48,189
Cash, beginning of period	6,891	-	28,935	6,319
Bank indebtedness, end of period	<u>2,551</u>	<u>54,508</u>	<u>2,551</u>	<u>54,508</u>

* Certain balances have been reclassified to conform with the current year's presentation.

**CHAPTERS INC.
CONDENSED BALANCE SHEET**

(UNAUDITED)
(in thousands)

	As at Sept. 30, 2000	As at Oct. 2, 1999 *
	ASSETS	
Cash	2,551	54,508
Short term investments	16,067	-
Accounts receivable	12,578	5,801
Inventories	280,378	265,919
Income taxes receivable	6,669	13,738
Prepaid expenses	5,869	5,954
Future income tax assets	925	-
Total Current Assets	<u>325,037</u>	<u>345,920</u>
Fixed assets, net	142,031	124,868
Future income taxes assets	5,974	-
Deferred pension charges	26	525
Other assets	1,426	1,524
Total Assets	<u>474,494</u>	<u>472,837</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Bank indebtedness	79,200	60,372
Accounts payable and accrued liabilities	182,078	166,949
Deferred revenue	6,584	6,021
Total Current Liabilities	<u>267,862</u>	<u>233,342</u>
Future income tax liabilities	-	1,557
Long-term debt	54,000	54,000
Non-controlling interest	7,752	18,125
Shareholders' equity	144,880	165,813
Total Liabilities and Shareholders' Equity	<u>474,494</u>	<u>472,837</u>

*Certain balances have been reclassified to conform with the current year's presentation.

INVESTOR INFORMATION

CORPORATE OFFICE:

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TRANSFER AGENT AND REGISTRAR:

CIBC Mellon Trust Company
Toronto, Montreal, Winnipeg, Calgary, Vancouver

STOCK LISTING:

Toronto Stock Exchange
(trading symbol CHP)

INQUIRIES:

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Chapters

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**SECOND
QUARTER
REPORT**

**JULY 2, 2000 -
SEPT 30, 2000**

MESSAGE TO SHAREHOLDERS

Over the 2nd fiscal quarter, ended September 30, 2000, Chapters Inc. continued to make significant progress towards increasing productivity and leveraging the synergies between its three distinct businesses - Chapters Retail, Chapters Online, and Pegasus Wholesale. For the first time in its history, Chapters Retail posted positive 2nd quarter earnings, underscoring the strength of the store portfolio, and improvements in inventory and cost management. Chapters Online continues to be a leader in Canadian e-commerce, doubling revenues and tripling gross profit over the previous year. Pegasus Wholesale is currently servicing over 200 school and library accounts contributing to third party revenues.

Total consolidated revenues for the quarter rose to \$154.1 million, a 4.0% increase over revenues of \$148.1 million for the same quarter last year. Consolidated net losses were \$7.8 million or (\$0.68) per share, compared to a loss of \$8.1 million or (\$0.72) per share last year. Chapters Retail had earnings of \$0.4 million or \$0.04 per share in the 2nd quarter compared to a net loss of \$1.3 million or (\$0.12) per share last year. Chapters Online had a \$6.4 million or (\$0.56) per share loss compared to the previous year's \$5.2 million or (\$0.46) per share loss. Pegasus Wholesale had a \$1.8 million or (\$0.16) per share loss compared to last year's \$1.6 million or (\$0.14) per share loss. The weighted average number of shares outstanding during the 2nd quarter was 11.4 million, compared to 11.3 million shares a year ago.

CHAPTERS RETAIL

Revenues from the Chapters book superstores in the 2nd quarter increased by 7.0% to \$92.9 million from \$86.8 million. Comparable superstore sales declined by 1.9%, in part due to the transition period required for implementation of total store planograms and the accelerated rollout of new departments.

Traditional bookstore revenues declined to \$41.2 million from \$47.9 million, primarily due to operating 30 fewer stores in the quarter, and a comparable store sales decline of 5.3%. Other revenues generated from the sale of the company's loyalty cards and Campus Bookstores division were \$6.8 million during the quarter, compared to \$7.1 million last year.

Chapters Retail focused on the introduction of new products and the implementation of new store layouts in preparation for the important Christmas fiscal 3rd quarter. After strong results in test stores, the 'At Home' and 'Under Wrap' departments were rolled out in eight weeks instead of the four months originally planned, so that all Chapters stores would have the new inventory selection in time for the Christmas season.

Chapters Retail continues to reduce inventory, supplies, and staffing costs to improve the bottom line and generate positive earnings per share.

The Company opened a new Chapters in Peterborough, Ontario, bringing the total number of superstores to 72, compared to 64 at this time last year. New Coles stores opened in Kelowna and Nelson, BC, and in Brandon, Manitoba, for a total of 214 traditional stores at the end of the quarter, compared to 244 last year.

CHAPTERS ONLINE

Chapters Online's 2nd quarter revenues doubled to \$12.8 million, from \$6.4 million last year, while gross profit more than tripled to \$3.1 million from \$912,000. Gross margins improved to 24% from 14% a year ago. Operating expenses, including marketing costs, decreased to \$11.6 million, or 91% of revenue, compared to 129% a year ago.

Chapters Inc. holds a 69.6% ownership stake in Chapters Online Inc. For the 2nd quarter, Chapters Inc.'s share of Chapters Online's loss was \$6.4 million or (\$0.56) per share compared to \$5.2 million or (\$0.46) per share for the same quarter in 1999 when the Company owned 100% of Chapters Online.

During the 2nd quarter, Chapters Online entered into an agreement with Alibris to sell used and rare books, contributing 10 million titles to the selection. The Company also launched Chapters.ca Radio, a 23-channel online music station. Chapters Online continues to be a leader in e-commerce in Canada, with top rankings in recent surveys conducted by Deloitte & Touche and Ipsos-Reid.

PEGASUS WHOLESALE

Chapters Inc. holds an 85% stake (82% on a fully diluted basis) in Pegasus Wholesale, Canada's largest national book wholesaler. For the 2nd quarter, Chapters share of Pegasus' loss, net of non-controlling interest, was \$1.8 million or (\$0.16) per share, compared to a loss of \$1.6 million or (\$0.14) per share for the same period last year when Chapters owned 100% of Pegasus. Revenues were \$42.1 million, of which \$0.4 million was generated from third parties.

During the quarter, Pegasus shipped over 125,000 Harry Potter books for the July 8th launch, including 10,000 to Chapters.ca customers for Saturday mail delivery. Pegasus is currently selling to several national general and specialty retailers, as well as over 200 school and library accounts.

ABOUT CHAPTERS INC.

Chapters Inc. is a Canadian company and the largest book retailer in Canada, operating bookstores in all provinces, under the names *Chapters*, *Coles*, *SmithBooks*, and *World's Biggest Bookstore*. Chapters Inc. is majority owner of Chapters Online Inc., operating www.chapters.ca and www.villa.ca. *Chapters.ca* is an online retailer of books, software, music CDs, videos, DVDs, software and video game cartridges, as well as digital downloads and consumer electronics. The *Villa.ca* website features a wide selection of home and garden products. Through *Chapters Campus Bookstores*, the company manages bookstores at McGill University, Cambrian College, and Northern College, and provides service to several other college bookstores. Chapters Inc. is the majority owner of *Pegasus Wholesale Inc.*, a national book wholesaler stocking over 400,000 book titles. Chapters Inc. is listed on the Toronto Stock Exchange under the stock symbol CHP, and included in the TSE's top 300 companies, as well as in the S&P/TSE Canadian SmallCap Index. To learn more about Chapters Inc., please visit www.chaptersinc.com.

CHAPTERS INC. CONSOLIDATED STATEMENTS OF EARNINGS

(UNAUDITED)
(in thousands except share data)

	13 WEEKS ENDED		26 WEEKS ENDED	
	Sept. 30, 2000	Oct. 2, 1999	Sept. 30, 2000	Oct. 2, 1999
Revenue				
Superstores	\$92,868	\$86,757	\$176,274	\$159,784
Traditional bookstores	41,202	47,861	78,683	90,541
Internet	12,754	6,400	25,434	10,069
Other	7,231	7,102	10,544	10,078
	<u>154,055</u>	<u>148,120</u>	<u>290,935</u>	<u>270,472</u>
Cost of product, purchasing, selling and administration	(2,941)	(6,665)	(15,900)	(15,991)
Amortization of capital assets	6,789	5,283	13,331	10,181
Amortization of pre-opening store costs	328	565	675	1,273
Amortization of goodwill	134	114	268	228
	<u>(10,192)</u>	<u>(12,627)</u>	<u>(30,174)</u>	<u>(27,673)</u>
Loss before the undernoted items				
Interest on long-term debt	(978)	(652)	(1,956)	(1,207)
Interest on current debt	(1,148)	(1,245)	(1,890)	(2,388)
Net gain on sale of Chapters Online Inc.	-	35,558	-	35,558
	<u>(12,318)</u>	<u>21,034</u>	<u>(34,020)</u>	<u>4,290</u>
Earnings (loss) before income tax recovery and non-controlling interest				
Income tax recovery	1,057	6,262	6,279	13,557
	<u>(11,261)</u>	<u>27,296</u>	<u>(27,741)</u>	<u>17,847</u>
Net earnings (loss) before non-controlling interest				
Non-controlling interest	3,483	462	7,249	462
Net earnings (loss)	<u>(7,778)</u>	<u>27,758</u>	<u>(20,492)</u>	<u>18,309</u>
Net earnings (loss) per common share				
Basic	(\$0.68)	\$2.45	(\$1.80)	\$1.68
Fully diluted	*	\$2.30	*	\$1.60
Weighted average common shares outstanding				
Basic	11,375	11,331	11,367	10,906
Fully diluted	*	12,155	*	11,657
Summary of basic earnings per common share:				
Chapters Retail	\$0.04	\$(0.12)	\$(0.29)	\$(0.52)
Chapters Online	\$(0.56)	\$(0.46)	\$(1.17)	\$(0.83)
Pegasus Wholesale	\$(0.16)	\$(0.14)	\$(0.34)	\$(0.26)
Corporate	-	\$3.17	-	\$3.29
	<u>\$(0.68)</u>	<u>\$2.45</u>	<u>\$(1.80)</u>	<u>\$1.68</u>

* conversion of options would be anti-dilutive