

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

(UNAUDITED)  
(in thousands)

	13 WEEKS ENDED		39 WEEKS ENDED	
	Dec. 30, 2000	Jan. 1, 2000 *	Dec. 30, 2000	Jan. 1, 2000 *
<b>OPERATING ACTIVITIES</b>				
Net earnings (loss) for the period	\$ 8,996	\$ 9,733	\$ (11,496)	\$ 28,042
Items not affecting cash				
Net gain on sale of Chapters Online Inc.	-	(5,749)	-	(41,307)
Amortization	7,127	6,304	21,401	17,986
Loss on disposal of capital assets	-	-	-	66
Future income taxes	(3,086)	-	(7,269)	(675)
Deferred pension charges	75	75	225	225
Non-controlling interest	(2,275)	(4,008)	(9,524)	(4,470)
	<u>10,837</u>	<u>6,355</u>	<u>(6,663)</u>	<u>(133)</u>
Net changes in non-cash working balances related to operations	<u>71,211</u>	<u>45,945</u>	<u>56,678</u>	<u>(6,705)</u>
Cash provided by (used in) operating activities	<u>82,048</u>	<u>52,300</u>	<u>50,015</u>	<u>(6,838)</u>
<b>INVESTING ACTIVITIES</b>				
Decrease in short term investments	16,067	-	25,000	-
Purchase of capital assets, net	(5,011)	(15,124)	(18,482)	(44,756)
Cash provided by (used in) investing activities	<u>11,056</u>	<u>(15,124)</u>	<u>6,518</u>	<u>(44,756)</u>
<b>FINANCING ACTIVITIES</b>				
Decrease in bank indebtedness	(79,200)	(42,113)	(69,212)	(43,581)
Proceeds on sale of Chapters Online	-	11,216	-	65,361
Proceeds on issuance of long-term debt	-	-	-	54,000
Proceeds on issuance of common shares	19	303	218	32,585
Repayment of long-term debt	-	(9,125)	-	(11,125)
Cash provided by (used in) financing activities	<u>(79,181)</u>	<u>(39,719)</u>	<u>(68,994)</u>	<u>97,240</u>
Net increase (decrease) in cash during the period	13,923	(2,543)	(12,461)	45,646
Cash, beginning of period	<u>2,551</u>	<u>54,508</u>	<u>28,935</u>	<u>6,319</u>
Cash, end of period	<u>\$ 16,474</u>	<u>\$ 51,965</u>	<u>\$ 16,474</u>	<u>\$ 51,965</u>

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

**CHAPTERS INC.  
CONSOLIDATED BALANCE SHEET**

(UNAUDITED)  
(in thousands)

	As at Dec. 30, 2000	As at Jan. 1, 2000 *
<b>ASSETS</b>		
Cash	\$ 16,474	\$ 51,965
Accounts receivable	19,729	10,799
Inventories	297,129	330,487
Prepaid expenses	4,551	5,428
Income tax receivable	-	3,954
Future income tax assets	925	-
Total current assets	<u>338,808</u>	<u>402,633</u>
Fixed assets, net	140,206	134,303
Deferred income tax assets	9,060	-
Other assets	1,243	1,860
Total assets	<u>\$ 489,317</u>	<u>\$ 538,796</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Bank indebtedness	\$ -	\$ 18,259
Accounts payable and accrued liabilities	262,457	263,677
Income tax payable	8,170	-
Deferred revenue	5,318	5,869
Total current liabilities	<u>275,945</u>	<u>287,805</u>
Future income tax liabilities	-	1,557
Long-term debt	54,000	54,000
Non-controlling interest	5,477	19,583
Shareholders' equity	<u>153,895</u>	<u>175,851</u>
Total liabilities and shareholders' equity	<u>\$ 489,317</u>	<u>\$ 538,796</u>

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

**NOTES:**

- On November 28, 2000, Trilogy Retail Enterprises L.P. announced a bid to purchase a controlling interest in Chapters Inc. Subsequent to the quarter end, on February 1, 2001, Trilogy acquired 7,146,000 shares of Chapters or approximately 69.1% of the shares tendered under the bid. Combined with the shares purchased previously, Trilogy now owns 8,787,894 Chapters shares, representing approximately 70.5% of the company's outstanding shares.
- On December 8, 2000, the Board of Directors announced initiatives to acquire the non-controlling interest in Pegasus Wholesale and Chapters Online. Subsequent to the quarter end:
  - On January 29, 2001, the company acquired the non-controlling interest in Pegasus Wholesale Inc by issuing convertible securities that were converted immediately into approximately (subject to post closing adjustment) 480,000 common shares of Chapters. The Chapters shares were valued at \$15.60 per share for a total purchase price of \$7.5 million.
  - The offer to purchase the minority interest in Chapters Online for \$3.40 per share or approximately \$18.4 million was subject to the consent of Chapters' lenders. Despite diligently attempting to obtain the consents, these consents were not obtained and accordingly the offer was withdrawn on February 23, 2001.



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**T H I R D  
QUARTER  
REPORT**

**OCT. 1, 2000 -  
DEC. 30, 2000**

## MESSAGE TO SHAREHOLDERS

The third quarter of Fiscal 2001 saw not only improved sales and operating performance at Chapters Inc. ("Chapters") but the initiation of a number of strategic and organizational changes brought about by the offer of Trilogy Retail Enterprises L.P. ("Trilogy") announced on November 28, 2000 to purchase a controlling interest in Chapters. These changes, which included the offer to purchase the minority shares of both Pegasus Wholesale Inc. ("Pegasus") and Chapters Online Inc. ("Chapters Online"), culminated with the overwhelming acceptance by Chapters shareholders of Trilogy's offer to purchase Chapters shares at \$17 cash per share.

On February 1, 2001, Trilogy acquired 7,146,000 shares of Chapters or approximately 69.1% of the shares tendered under the bid. Combined with the shares it purchased previously, Trilogy now owns 8,787,894 Chapters shares, representing approximately 70.5% of the company's outstanding shares.

The Board of Directors of Chapters declared a special dividend of 50 cents per share to shareholders of record on February 12, 2001. Trilogy has agreed to relinquish and not receive the dividend on the shares of Chapters owned by Trilogy so that the dividend will only be paid on the shares that were not taken up under Trilogy's offer. Following the acquisition, a new Board of Directors of Chapters was appointed on February 4, 2001. The Board of Directors now consists of Ms. Heather Reisman, Mr. Gerald W. Schwartz, Senator Michael Kirby, Mr. Peter Jewett, Mr. Philip Brown, and Mr. Nigel Wright. Ms. Reisman was also appointed CEO of Chapters.

On December 8, 2000, Chapters announced its intention to purchase the minority shares of Pegasus and Chapters Online and exit the book wholesale business. The purchase of the minority interest in Pegasus was completed on January 29, 2001 by the issuance of convertible securities that were converted immediately into approximately (subject to post closing adjustment) 480,000 common shares of Chapters. The Chapters shares were valued at \$15.60 per share for a total purchase price of \$7.5 million. The offer to purchase the minority interest in Chapters Online for \$3.40 per share or approximately \$18.4 million was subject to the consent of Chapters' lenders. Despite diligently attempting to obtain the consents, these consents were not obtained and accordingly the offer was withdrawn on February 23, 2001.

### REVIEW OF OPERATIONS

Chapters Inc.'s 3rd fiscal quarter, ending December 30, 2000 was led by improved sales and operating results at Chapters Retail and Chapters Online. Chapters Retail had substantial increases in revenues, with strong growth in EBITDA generating significant cash flow for the company. Chapters Online combined good holiday sales with significant improvements in gross margin, while reducing operating expenses.

Total consolidated revenues for the 3rd quarter rose to \$247.6 million, a 5.5% increase over revenues of \$234.7 million for the same quarter last year. Consolidated net earnings for the quarter improved significantly to \$9.0 million or \$0.79 per share compared to \$3.9 million or \$0.35 per share last year before the gain on sale of Chapters Online. Chapters Retail had earnings of \$17.9 million in the 3rd quarter compared to \$15.8 million for the same period last year, an increase of 13.3%. Similarly, earnings per share for the quarter at Chapters Retail increased 13.7% to \$1.58 per share as compared to \$1.39 per share in the prior year. Chapters Online had a loss of \$5.0 million or (\$0.45) per share loss compared to the previous fiscal year's \$8.5 million or (\$0.75) per share loss. Pegasus Wholesale had a \$3.9 million or (\$0.34) per share loss compared to last year's \$3.4 million or (\$0.29) per share loss.

### CHAPTERS RETAIL

Revenues from Chapters book superstores increased 11.6% to \$139.8 million during the Christmas quarter, compared with \$125.3 million last year. Comparable Chapters store sales increased during the period by 1.3% due to

the successful launch of the 'At Home' and 'Under Wrap' departments which delivered results above expectations.

Comparable Coles and SmithBooks store sales in the quarter were level with last year at (0.4%). As part of the ongoing rationalization of its traditional store portfolio, the company closed 24 Coles and SmithBooks stores during the year to date, a number consistent with closings for the past few years. Due to the closing of these stores, revenues from Coles and SmithBooks stores declined by (7.3%) during the holiday quarter to \$77.7 million from \$83.8 million.

In the key month of December, Chapters Retail's combined superstore and traditional store sales increased by 5.8% to \$126.2 million compared to \$119.3 in December 1999. December superstore sales increased 13.0% to \$77.3 million, compared with \$68.4 million last year while sales in December for the 57 comparable Chapters stores increased by 3.4%. December sales for comparable Coles and SmithBooks stores increased 4.2%.

The company opened 4 new Chapters stores in Calgary and Edmonton, Alberta; Oshawa, Ontario, and Nanaimo, British Columbia bringing the total to 77, compared to 69 during the 3rd quarter last year. The company also opened new Coles stores in White Rock and Fort St. John, British Columbia; Goderich, Ontario; Antigonish, Nova Scotia and in downtown Toronto in the prime BCE Place location. Chapters operated 217 traditional stores at the end of the 3rd quarter, compared to 243 last year.

### CHAPTERS ONLINE

Chapters Online's 3rd quarter revenues increased 27%, to \$15.5 million compared to \$12.2 million one year ago. Gross margins increased 27% compared to 15% during the same period last year while operating expenses, including marketing costs decreased to \$10.6 million, or 68% of revenue, compared to 110% of revenue last year.

Chapters holds a 69.6% ownership stake in Chapters Online. For the 3rd fiscal quarter, Chapters' share of Chapters Online's loss was \$5.0 million or (\$0.45) per share compared to \$8.5 million or (\$0.75) per share for the same quarter in 1999.

### PEGASUS

For the 3rd quarter, Chapters share of Pegasus' loss, net of non-controlling interest, was \$3.9 million or (\$0.34) per share compared to a loss of \$3.4 million or (\$0.29) per share last year. Revenues were \$48.4 million, of which \$0.6 million were generated from third parties. During the quarter, the loss from operations was flat with last year at (\$5.1 million).

### 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. 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. Chapters Inc. is a publicly traded company, 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.

### INVESTOR INFORMATION

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## CHAPTERS INC. CONSOLIDATED STATEMENTS OF EARNINGS

(UNAUDITED)  
(in thousands except share data)

	13 WEEKS ENDED		39 WEEKS ENDED	
	Dec. 30, 2000	Jan. 1, 2000	Dec. 30, 2000	Jan. 1, 2000
<b>Revenue</b>				
Superstores	\$ 139,838	\$ 125,270	\$ 316,112	\$ 285,054
Traditional bookstores	77,661	83,804	156,344	174,345
Internet	15,481	12,169	40,915	22,238
Other	14,570	13,452	25,114	23,530
	<u>247,550</u>	<u>234,695</u>	<u>538,485</u>	<u>505,167</u>
<b>Cost of product, purchasing, selling and administration</b>	220,302	215,426	527,137	501,889
	<u>27,248</u>	<u>19,269</u>	<u>11,348</u>	<u>3,278</u>
Amortization of capital assets	6,836	5,689	20,167	15,870
Amortization of pre-opening store costs	157	501	832	1,774
Amortization of goodwill	134	114	402	342
Earnings (loss) before the undernoted items	20,121	12,965	(10,053)	(14,708)
Interest on long-term debt	(978)	(978)	(2,934)	(2,185)
Interest on current debt	(1,370)	(518)	(3,260)	(2,906)
Earnings (loss) before the following	17,773	11,469	(16,247)	(19,799)
Net gain on sale of Chapters Online Inc. and Pegasus Wholesale Inc.	-	5,749	-	41,307
Earnings (loss) before income tax expense (recovery) and non-controlling interest	17,773	17,218	(16,247)	21,508
Income tax expense (recovery)	11,052	11,493	4,773	(2,064)
Earnings (loss) before non-controlling interest	6,721	5,725	(21,020)	23,572
Non-controlling interest	2,275	4,008	9,524	4,470
Net earnings (loss)	<u>\$ 8,996</u>	<u>\$ 9,733</u>	<u>\$ (11,496)</u>	<u>\$ 28,042</u>
Net earnings (loss) per common share				
Basic	\$ 0.79	\$ 0.86	\$ (1.01)	\$ 2.57
Fully diluted	\$ 0.74	\$ 0.82	\$ *	\$ 2.45
Weighted average common shares outstanding				
Basic	11,375	11,343	11,369	10,918
Fully diluted	12,518	12,165	*	11,691
Summary: Basic earnings per common share:				
Retail	\$ 1.58	\$ 1.39	\$ 1.29	\$ 0.93
Internet	(0.45)	(0.75)	(1.62)	(1.60)
Wholesale	(0.34)	(0.29)	(0.68)	(0.57)
Gain on sale of Chapters Online Inc. and Pegasus Wholesale Inc.	-	0.51	-	3.81
	<u>\$ 0.79</u>	<u>\$ 0.86</u>	<u>\$ (1.01)</u>	<u>\$ 2.57</u>

\* conversion of options would be anti-dilutive