Investments Today For Continued Earnings Growth

Annual Report 1997

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Company Profile

Staples, Inc. pioneered the office products superstore industry in May 1986 with the opening of its first store in Brighton, Massachusetts. The superstore concept, for the first time, provided the same deep discounted prices to small businesses that had only typically been available to large corporations. Since May of 1986, Staples has expanded very rapidly.

As of January 31, 1998, the Company operated 742 stores in over 100 markets across the United States, Canada and Europe under the names "Staples", "Staples Express", "Business Depot", "Bureau En Gros", "Staples UK" and "Staples Der Büro-Megamarkt". The Company operates a delivery business, "Staples Direct" and also has contract stationer operations under the names "Staples Business Advantage" and "Staples National Advantage" which serve the needs of large regional and national corporations, respectively.

Financial Highlights

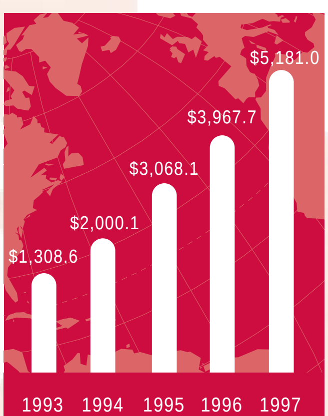
(Dollar Amounts in Thousands, Except Per Share Amounts)

	Fiscal Year				
	1997	1996	1995	1994	1993
Statement of Income Data:					
Sales	$ 5,181,035	$ 3,967,665	$ 3,068,061	$ 2,000,149	$ 1,308,634
Operating income	271,460	204,001	147,813	81,727	37,685
Net income	130,949 (1)	106,420	73,705	39,940	19,452
Earnings per common share (2)	$ .53	$ .44	$ .32	$ .19	$ .10
Earnings per common share - assuming dilution (2)	$ .51	$ .43	$ .31	$ .19	$ .10
Selected Operating Data:					
Stores open	742	557	443	350	230
Average square feet of selling space	11,193,000	7,712,000	5,986,000	4,246,000	2,957,000
Balance Sheet Data:					
Working capital	$ 725,413	$ 548,793	$ 504,330	$ 289,395	$ 214,326
Total assets	2,454,510	1,787,752	1,402,775	1,008,454	650,756
Total long-term debt, less current portion	508,876	391,342	343,647	249,387	123,592
Stockholders' equity	967,611	761,686	611,416	384,990	287,207

(1) *Net income for the year ended January 31, 1998 includes a pre-tax charge of $29,665 resulting from costs incurred in connection with the proposed merger with Office Depot, Inc.*

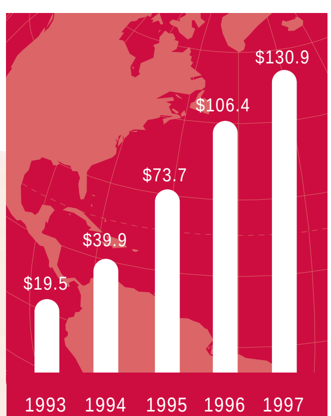
(2) *Earnings per common share have been restated to reflect a 3 for 2 stock split effective January 30, 1998 and for FASB 128.*

The Company's fiscal year is the 52 or 53 weeks ending the Saturday closest to January 31 of the following calendar year. Fiscal year 1995 was a 53 week fiscal year.



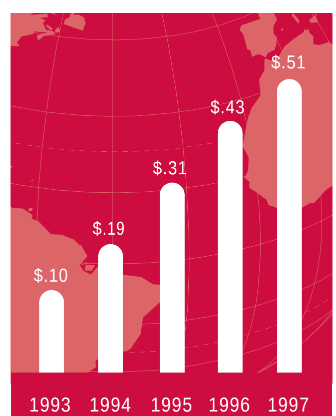
SALES

*CAGR 41%



NET INCOME

*CAGR 61%



EARNINGS PER COMMON SHARE - ASSUMING DILUTION

*CAGR 51%

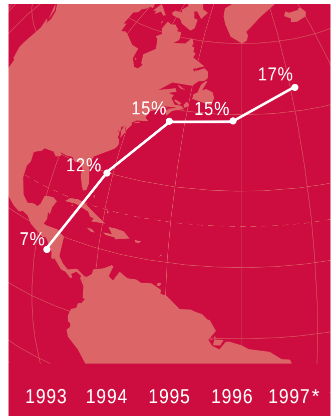
*CAGR=Compound Annual Growth Rate

To Our Shareholders:

Staples enjoyed another year of strong growth, high performance, and investment for the long term. Our fiscal year 1997 revenues (FY '97) exceeded $5 billion, a 31 percent increase over FY '96. Comparable store and delivery sales growth was 10 percent, and the fourth quarter of FY '97 was the 14th consecutive quarter in which we've led the office-superstore industry in this category. We have now recorded 15 consecutive quarters of earnings-per-share growth in excess of 30 percent: one of the best and most consistent performances in all of "big box" retailing.

"...fourth quarter of FY '97 was the 14th consecutive quarter in which we've led the office-superstore industry in this category. We have now recorded 15 consecutive quarters of earnings-per-share growth in excess of 30 percent: one of the best and most consistent performances in all of "big box" retailing."

At the same time, we've generated solid returns on our investments. Each year, we're not only getting bigger, we're getting better. This is the twofold theme of this year's report: strong growth, and more effective execution.



IMPROVING RETURNS

*Excluding merger related charges.

Last spring, the Federal Trade Commission challenged our proposed merger with Office Depot, and our two companies ultimately abandoned our efforts to merge. This was a disappointment, because our two companies' skills and resource bases were highly complementary. But the silver lining was that the failed merger process taught us a lot. I can assure you that much of that learning has already been put to good use — serving our customers better, and strengthening our leadership position in an incredibly dynamic industry.

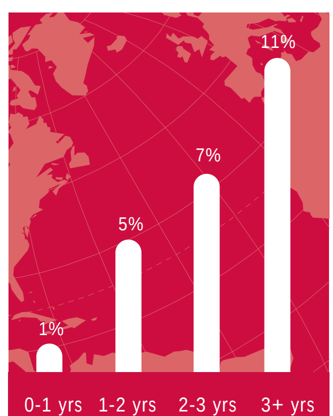
I'll share some more ideas about our industry, and where I think we're headed in the future, in a subsequent section of this letter. But first let me review some of the important developments of FY '97.

1997: INVESTING FOR FUTURE GROWTH

In FY '97, our North American retail organization — 582 U.S. stores and 103 Canadian stores — turned in an outstanding performance. Despite a 28 percent increase in selling area over the previous year, our stores increased their sales-per-selling-square-foot from $353 to $360. This is the direct result of skillful execution at the store level, for which our store managers and associates deserve great credit. Our Canadian operations, in particular, continue to achieve extraordinarily high performance standards.

We grew our North American retail network significantly in this past year. Concentrating on smaller markets — a new and exciting growth arena for us — we opened 129 new stores in the U.S. and Canada. This is important because it represents one of the most crucial investments in the future of our company. The accompanying chart tells the story. After one year, the typical Staples store has broken even and has begun to make money. In each of the following three years thereafter, it steadily has become more profitable. In other words, consistent with this experience, even if Staples stopped building stores tomorrow, our earnings would be expected to keep increasing for several years to come. The 150 North American stores we plan to open in 1998 alone could represent more than $1 billion in annual sales by the year 2001.

"After one year, the typical Staples store has broken even and has begun to make money. In each of the following three years thereafter, it steadily has become more profitable."



STORE OPERATING PROFIT BY AGE

Twelve months ended January 31, 1998

We are constantly updating and fine-tuning the stores in our North American retail network. Two years ago, I reported to you on the success of our "Heartland" store remodeling campaign, in which we retrofitted our existing store base to conform to a larger, more "shoppable" model. Even before we finished converting the whole network to the Heartland model, we began introducing Concept '97 — yet another refinement in store layout and product presentation — in stores across the chain. (Our successful Copy Centers, for example, were made bigger and moved forward in the stores as part of Concept '97.) As a result of this constant updating, our stores are fresh and contemporary, with an average "age" of only 3.6 years. This is a strong platform for effective retail performance.

Meanwhile, we continue to seek out new ways to serve customers through our retail network. Last year, for example, we set up "Technology Centers" on a pilot basis in a very limited number of stores. These centers were conceived as a means of offering technology sales and support (e.g. memory upgrades, peripheral installations, and so on) to our small-business customer. Frankly, we weren't sure this venture would fly. Would our small-business customer — the backbone of our business — see us as a credible source of goods and services in the complex world of technology?

The answer seems to be yes. Our pilot stores were successful enough that we installed Tech Centers in more than 75 of our retail outlets. Many more are now on the way demonstrating our ability to roll out new concepts across the retail network quickly and effectively.

We continue to make major corporate-level investments to support this retail growth. On the marketing side, for example, we launched our first national T.V. ad campaign in 1997, and (based on a USA Today study) quickly ranked among the most popular and most effective national advertisers. In December, we announced an agreement whereby a new state-of-the-art sports/entertainment complex — the STAPLES Center — will be built in downtown Los Angeles adjacent to the city's Convention Center. Our agreement with the L.A. Arena Company gives us marketing, promotional, and signage rights in the new Center for the next 20 years.

"We continue to make major corporate-level investments to support this retail growth. On the marketing side, for example, we launched our first national T.V. ad campaign in 1997, and (based on a USA Today study) almost immediately ranked among the most popular and most effective national advertisers."

On the infrastructure side, our new 840,000-square-foot retail distribution center in Hagerstown, Maryland, began receiving products on February 3, 1997. We recently finished a second major facility in Killingly, Connecticut. When fully operational, our consolidated retail distribution network is expected to support more products and improve in-stock levels. Stores will receive more loads with all products on them, and distribution costs are expected to be lowered.

Staples Contract and Commercial, another key piece of our growing business, will also benefit from the Killingly investment. When that facility comes on line, SCC will take over the Putnam (Connecticut) retail distribution facility — an important step toward the creation of what is planned to be an integrated, multichannel SCC distribution network.

Again, these investments reflect past growth, and position us for future growth. Overall, SCC sales exceeded $1 billion for the first time. Our Staples Direct business grew dramatically in both the U.S. and Canada. Staples National Advantage continues to sign up major new corporate accounts. Staples Business Advantage, our rapidly growing contract entity aimed at mid-sized businesses, launched "Greenfield" operations in two new markets: Pittsburgh and the Washington, D.C. area.

Farther afield, an experienced team of American, Canadian, and European nationals is hard at work bringing the performance of our European operations (40 stores in the U.K., 17 in Germany) up to our North American performance levels. These operations lost money in FY '97, and may not be profitable in the near future. But we believe that we are taking the appropriate steps to make our European investments pay off in the longer term. In FY '97, for example, we completed the purchase of our joint-venture partner's interest in the European operation, set up a Pan-European management structure, and opened seven new stores. We pushed harder for better performance at the store level, as well, and we're seeing some indications of success. Customer counts in our existing European stores rose by an average of 20 percent — a measure that reminds me of the early days of Staples in the U.S.

We remain both realistic and optimistic about Europe. We are concentrating our activities in two countries (Germany and the U.K.) until we are satisfied that we have perfected a successful model for future European expansion. We are now replacing all of our European information systems — only one measure of our confidence that we will eventually see significant increases in our European retail and catalog businesses. We will continue to invest in Europe.

We also made lots of intangible investments in the future during the past fiscal year. For example, when our chief operating officer left in mid-year, we sought out executive talent inside the Company. At that point, three of our most experienced and qualified senior officers – John Mahoney, Ron Sargent, and Joe Vassalluzzo – agreed to take on additional corporate-level responsibilities.

THE STAPLES POINT TEAM

from left to right: (front row) JOSEPH VASSALLUZZO, President, Staples Realty & Development; THOMAS STEMBERG, Chairman & Chief Executive Officer; RONALD SARGENT, President North American Operations; JACK BINGLEMAN, President, Staples International (back row) BRIAN LIGHT, Senior Vice President & Chief Information Officer; SUSAN HOYT, Executive Vice President, Human Resources; JEFFREY LEVITAN, Senior Vice President, Strategic Planning & Business Development; JAMES PETERS, President, U.S. Stores; JOHN MAHONEY, Executive Vice President & Chief Administrative Officer (the following are not pictured above but can be found on the pages noted) RICHARD GENTRY, Executive Vice President of Merchandising (p.12); EDWARD HARSANT, President, The Business Depot, Canada (p.8); JEANNE LEWIS, Senior Vice President of Marketing (p.5)

JEANNE LEWIS, Senior Vice President of Marketing (Point Team member)

Similarly, when our executive vice president for marketing, Todd Krasnow, told me in September of 1996 that he would eventually be leaving Staples to pursue his own entrepreneurial venture, we set in motion a plan whereby his designated successor, Jeanne Lewis, would spend more than a year with Todd, learning the ropes and preparing to take over the marketing responsibility. We also used this opportunity to broaden the corporate communications function, bringing in Elizabeth Allen, an experienced communications executive, to take on this increasingly important job.

Other key new hires included Jim Peters, who has taken over responsibility for our North American retail operation (following Jack Bingleman's departure for Europe), and chief information officer, Brian Light, who adds new depth to our information systems team.

These changes illustrate three important points. First, our succession planning is thorough and effective, and takes into account our continuing dramatic growth. Second, our executive ranks often are deep enough to allow us to promote from within. And third, when necessary, we are able to recruit very strong people from outside and integrate them effectively into the Staples culture. In short, we can "grow our own," and we also can entice talented outsiders to join our ranks.

Growing our own means, among other things, paying careful attention to the training of our Staples associates. This is one key focus of our ongoing "CARE" (Customers, Associates, Real communication, and Execution) initiative. A brand-new initiative, "Staples University," also reflects this emphasis. More like a "virtual school" than a traditional one, Staples University delivers learning opportunities to Staples associates using distance learning, CD ROM-based training materials, satellite video feeds, and other contemporary technologies (as well as more traditional teaching techniques). We are proud of our extensive orientation and training efforts, and we believe that these programs will help our associates better serve our customers. And this will make us an even stronger business.

A LEADER IN A VIBRANT INDUSTRY

Let me make three observations about the industry in which we compete, and how I think our industry and our company are likely to evolve in the near term.

"First, this is, and will continue to be, a great industry. The U.S. office products market, currently estimated at $205 billion, is growing by 10 percent annually."

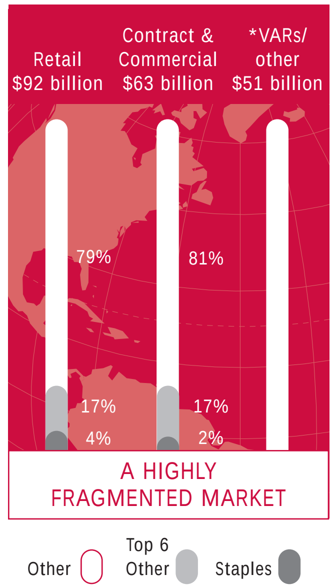
First, this is, and will continue to be, a great industry. The U.S. office products market, currently estimated at $205 billion, is growing by 10 percent (or more than $20 billion!) annually. To be sure, these aggregate numbers include relatively low-margin products such as computers, and are therefore somewhat overstated. But the market for consumable office supplies, which are generally among our more profitable products, is growing by 7 percent each year; and sales of low-margin computers generate sales of higher-margin peripherals and consumables.

Meanwhile, small businesses — whom we are particularly qualified to reach and serve — are growing at four times the rate of large businesses. Fully half of the households in the U.S. will have home offices by the year 2000. In short, our markets still appear underdeveloped, and continue to grow at a dizzying pace.

Second, we have enormous opportunities to grow within this growing market. Today, Staples only has 4 percent of the $92 billion North American retail market for office supplies. We are determined to increase that share substantially, by continuing to offer everyday low prices, and by being customer-focused and service-oriented.

And finally, we think we can grow Staples in other ways. It's clear to us that the "Staples" brand name has great power in the marketplace. In market research, people tell us that "Staples" stands for reducing the cost and hassle of doing business. We are now investigating ways to leverage our brand and broaden our franchise, especially in relation to our 3.5 million (and counting!) small-business customers. We believe that we are uniquely positioned to aggregate the demand that these millions of small companies represent, and use it to venture into entirely new products and services. As our small-business customers benefit, we will benefit, too.

For all these reasons, and many more, we believe that we're in an industry of immense opportunities, which provides Staples with ample opportunities for growth.



*Value Added Reseller

"...we have enormous opportunities to grow within this growing market. Today, Staples only has 4 percent of the $92 billion North American retail market for office supplies. We are determined to increase that share substantially, by continuing to offer everyday low prices, and by being customer-focused and service-oriented."

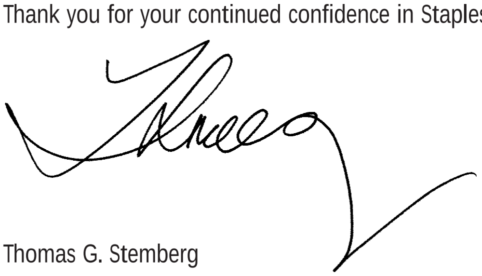
GROWING THROUGH OUR PEOPLE

This year, as you'll see, we're trying something a little different in our annual report. We're sharing with you seven stories about associates who are doing remarkable things for Staples.

These are stories in real time. (That's why they have no endings.) They are unfolding across all the different channels of our business. They feature people with very different skills and from very different backgrounds. But these Staples stories have one important theme in common: They are all about making investments today that are designed to result in earning power tomorrow. I hope you'll find them as exciting as I do.

More than 30,000 people now work for Staples. We are proud of them all. Each and every one of them makes a contribution toward making our company bigger and better. This makes it tough to single out a small number of people for special notice. But it also promises amazing things for the future of Staples — a great company today, and an even better company tomorrow!

Thank you for your continued confidence in Staples.



Thomas G. Stemberg
Chairman of the Board and
Chief Executive Officer

April 3, 1998

Growth: People make it happen!

It's the people of Staples who really make things happen. Throughout all of our businesses we have extraordinary associates who have helped Staples get to where we are today. The stories on the following pages are excellent examples of associates who are doing remarkable things for Staples.

GROWING A RETAIL STORE: GEORGE WHITEHEAD

What does it take to run a Staples store? Execution. What does it take to run a Staples store in a transitional urban neighborhood? More execution.

That's what George Whitehead discovered three and a half years ago, when he took over as store general manager of the Staples store at 9195 Central Avenue in Capital Heights, Maryland. Capital Heights — about ten miles outside of Washington, D.C. — had long since fallen on hard times. Many storefronts in the Central Avenue business district were boarded up. Foot traffic and sales volume were low, and "shrink" (that is, pilferage from the store) was running at three times the company-wide average. Turnover was high, and recruitment of qualified personnel was difficult. By most measures, the store appeared to be in a downward spiral.

GEORGE WHITEHEAD, Store General Manager, Capital Heights, MD

Whitehead had spent more than a decade in retail — most recently with a warehouse club food chain — and was convinced that he had to open up an urgent campaign on several fronts at once. He immediately called a series of monthly store meetings, and laid down some basic principles. First: Staples had clear rules about theft, and Whitehead planned to enforce them vigorously. Second: Retail was all about service to the customer. Unless this store was able to make its customers feel welcome and well-served, Whitehead cautioned, nobody (including himself!) could be sure that his or her job was secure.

Words were soon followed by action. Several thieves were apprehended in the act, and Whitehead came down hard on them. "Once things like that start happening," Whitehead comments, "the word gets around, and the other bad guys decide to stay away."

Shrink declined by a third in 1995, and was cut in half again in 1996. By 1997, Whitehead and his team had cut it to only slightly above the national average for Staples. "And you watch our next inventory numbers," Whitehead says confidently. "We're going to have more good news."

Meanwhile, Whitehead kept up a steady drumbeat about the importance of service. His store and another nearby national retailer were the only stores in the neighborhood that opened early and closed late. Whitehead was determined to get the whole community to see Staples as a valuable resource. "Anything we could do to get us involved in the community, we did," he recalls, sharing credit for this effort with his store management team, his associates, and even his family members. "We got the Staples name out there, and we got the community in here."

Slowly, foot traffic increased — not just during the mid-morning hours, but at all hours. The "resource to the whole community" strategy began to pay off — first little by little, and then in a rush. Between 1995 and 1997, sales volume increased by a factor of two and a half times. "Local people walk in here today," Whitehead says, "and they can't believe how well we're doing. All I say is, 'Uh huh— and wait 'til next year!'"

As for service, Whitehead still savors the day when a senior Staples executive paid a surprise visit to his store. Whitehead recognized the executive immediately, but was tied up with a customer and couldn't greet his high-ranking guest. Several other associates — none of whom had any idea who their newest customer was — immediately stepped up to wait on him. "That executive and I were talking later," Whitehead recalls, "and he said to me, 'You know, George, I've been to several stores today, and I got my best welcome here.'

"And that," Whitehead says with evident pride, "is what this store, and these Staples associates, are all about."

BATTLING THE ELEMENTS: MARTINE DESSUREAULT

At first, to the residents of eastern Canada and the northeastern United States, the January 1998 storm looked like just more bad winter weather. But during the first night of what turned out to be the region's most devastating ice storm on record, tree limbs began cracking off the trees explosively, taking down power lines as they went. Then, unbelievably, the ever-increasing weight of the ice began crushing high-voltage transmission towers. The entire electrical grid in heavily populated areas in two countries simply shut down.

MARTINE DESSUREAULT, Store General Manager, Bureau en Gros, St-Jean-sur-Richelieu, Quebec & EDWARD HARSANT, President, The Business Depot, Canada (Point Team member)

Martine Dessureault, the 34 year old general manager of the Bureau en Gros (Staples) store in the suburb of St-Jean-sur-Richelieu, south of Montreal, soon grasped how serious the situation was — both for her store and for her community.

"The first thing we did," she recalls, "was to get to the store and drain the water out of all the pipes to keep them from bursting." As quickly as possible, around these kinds of emergency measures, she phoned each of her seven full-time associates to make sure they were safe. ("This was a busy time for my cell phone," she says.) She also made plans to place them for the duration of the emergency. "Several went to the nearest Bureau en Gros store that still had power. Several went to work full time in local shelters, in an effort to help the community. And the remainder volunteered for the task of keeping an eye on the store, which had lost all of its security systems as a result of the power outage."

At that point, she continues, she had lots of reasons to try and get some heat into the store. "We not only had to keep the computers from freezing and the products from deteriorating, but we also had to keep our people in the store reasonably comfortable." She hired a heating company to set up a temporary propane heating system, which rendered the store at least warm enough to protect both people and products.

Having stabilized the store as much as possible, Dessureault began looking for additional ways that she and her staff could be helpful to area residents and emergency personnel. On the second day of the emergency, for example, she opened her store for several hours to sell batteries to anxious neighbors. (The electronic cash registers weren't working, of course, which meant that all of these transactions were done by hand.) Dessureault subsequently donated 5,000 packs of batteries to crews working to keep the St. Jean airport open for emergency use.

As the days turned into weeks, Dessureault found other ways to help her friends, neighbors, and customers. When the operators of a shelter at a nearby Air Force base informed her that they were desperate for a supply of pens — the temporary residents of the shelter had been passing the long hours doing crossword puzzles, and had used up all the writing utensils on the base — she sent over 300 boxes of pens. And to shelters with high concentrations of children, many of whom were unhappy and stir-crazy after two or three weeks in a strange environment, she dispatched shipments of crayons, poster boards, scissors, and children's books.

Dessureault may have led her store's efforts to get itself — and to some extent, its community — back on its feet. But she shares credit with all of her associates, all of whom came through the crisis safely, and each of whom made a contribution to overcoming the most serious natural disaster in anyone's memory.

"The hardest thing about it," she says in retrospect, "was not living without electricity, although three weeks of that was not fun. The hardest thing was simply not knowing — not knowing when the power would come back on, and when our lives could start to get back to normal. That was very hard. But we pulled through."

GROWING THE PACIFIC NORTHWEST: DAVID B. IRWIN AND DONALD K. ULVAN

DAVID B. IRWIN, Real Estate Manager and DONALD K. ULVAN, Project Manager, Construction

"For the first year I was out here," recalls Dave Irwin, real estate manager for Staples' Pacific Northwest and Intermountain Region, "I had a nickname back at Corporate: Dances With Wolves. In their eyes, I was out here behind enemy lines, planting the flag and waiting for reinforcements to arrive."

Irwin, 34 years old, was hired in late 1995 to establish a retail network for Staples in the states of Washington, Oregon, Montana, Utah, and Idaho. It was a formidable task. The Company then had no presence at all in the region – no stores, no advertising. "I'd go talk to a landlord," Irwin says of his early days in Seattle, "and they'd say, 'Staples? What exactly do you sell?'"

Both Staples and Irwin saw some urgency to moving quickly in the Pacific Northwest. In contrast to other parts of the country, the population in Irwin's target states is relatively scattered. People are accustomed to driving long distances to shop at regional malls, which are relatively few and far between. The first office products superstore to establish a presence in a market – and especially in a smaller market – was likely to have a huge advantage in that market.

Irwin's first (and so far, only) reinforcements arrived in July 1996, in the person of construction project manager Don Ulvan, then 45 years old. Irwin's job was to find appropriate sites and close the deal; Ulvan's job was to get the store built. But given the fierce competition for good sites in the region, this sequence of activities sometimes got turned around. In Spokane, Washington, for example, Irwin and Ulvan spent some $35,000 pulling a permit and preparing a set of construction drawings before the lease was signed. "The landlord had offers from us and a competitor," Irwin recalls. "He wanted to know who was serious. We put our money down to demonstrate just how serious we were.

"I got a few worried calls from Corporate," Irwin says with a wry smile, "in which they wondered out loud about our plans to remodel a building that we didn't control yet. Fortunately, it went our way in the end."

And although Irwin hasn't always beat out the competition, his track record is more than respectable. In 1995, Staples had no stores in the region. (Its two largest competitors, by contrast, had a total of 60 stores in the region.) By the end of 1996, Irwin and Ulvan had completed 7 stores. By the end of 1997, they had 21 stores to their credit. And if all goes according to plan, they'll have opened at least 40 stores by the end of 1998.

"In 1995, Staples had no stores in the region. ...By the end of 1996, Irwin and Ulvan had completed 7 stores. By the end of 1997, they had 21 stores to their credit. And if all goes according to plan, they'll have opened at least 40 stores by the end of 1998."

One of the biggest challenges they faced was the sheer distances involved. Operating out of rented space in suburban Seattle, Irwin's and Ulvan's average store is 520 miles away. The most distant store in their network – in St. George, Utah – is 1,200 miles away.

It also means that Ulvan spends up to five days per week on airplanes, including more than a few of what he refers to as Four Flight Days. "In Southern California, where I did construction management for Staples before," says Ulvan, "I could do five site inspections in a day. In this region, there are days when I have to work hard to get to and from one site. And meanwhile, of course, Dave is giving me more than I can build in your average 70-hour week."

Both Irwin and Ulvan cite the 'coming soon!' sign as a tool of their trade and a bellwether of their success. "Companies have been known to put up a 'coming soon!' sign in a given neighborhood to scare off competitors," explains Irwin. "In Lewiston, Idaho, for example, one of our competitors not only put up the sign, but also took out ads in the newspaper announcing their impending arrival in Lewiston.

"Well, we put up our own 'coming soon!' sign," he continues, "but we also made sure to sign the lease. And once we signed that lease, our competitor suddenly lost interest in that market. They're still not there.

"I'm thinking," says Irwin happily, "of starting a collection of 'coming soon!' signs."

GROWING TEACHER SUPPLIES: ERIC J. ALWARDT

"I'd love to say supplies for teachers was all my idea," admits product manager Eric Alwardt of the project that he carried through to success. "But it wasn't."

The story begins in 1995, when Staples commissioned an internal study of the feasibility of establishing a small teacher-supply "set" (or focused display area) in the retail network. The study came back highly positive: Each year, it seemed, teachers spent an average of between $400 and $600 of their own money on supplemental products for their classrooms, including bulletin board sets, write-on-wipe-off books and boards, banners, trimmers (colored paper products that teachers use to decorate the edges of blackboards), stickers, and other specialized materials. And this was a huge customer base.

Alwardt, then 32 years old and a fairly recent arrival at Staples, was given the job of putting a small set together. "We knew that the business looked good, and that it was a growing category," Alwardt recalls. "But it was completely different from anything we were doing at that time. Could we make it work in an office superstore context?" Specialized competitors (companies like J.R. Hammett, LearningSmith, and others) were already offering a much larger assortment than Staples ever could. And to complicate matters, Staples was planning on opening a new store in Bellingham, Massachusetts, in three months. Could Alwardt pull his new category together in time for that opening?

Early contacts with manufacturers were discouraging. “But we wanted to offer teachers a real discount from full retail mark-up,” Alwardt emphasizes. Eventually, Alwardt struck a deal with Minneapolis-based Trend Enterprises, which was willing to sell its products to Staples with no restrictions. Stocked exclusively with Trend products, the Bellingham store opened in September 1995 with the new teacher-supplies set displayed in a modest 12-foot run.

“This was a very different kind of product and presentation,” Alwardt recalls. “The set was very SKU-intensive, so we had to develop fixturing that fit the overall requirements of Staples, but also allowed us a broad enough assortment. The 12-foot run wasn’t a lot of space – especially given that this was a category to which some chains were dedicating several thousand square feet!”

The Bellingham teacher-supply section was an immediate hit. After a couple of months, a similar set was established in a second store in Carle Place, New York, where it also did well. At that point, Staples made the decision to put the new products in all new stores, and also began retrofitting existing stores. By the end of 1996, several hundred Staples stores had at least a 12-foot set of teacher’s supplies – and another 50 or so had a more generous 24-foot run.

It’s one thing to double a category’s sales through growth in the overall number of stores carrying that category – which Alwardt and his team did between 1995 and 1996. But it’s a whole other kind of challenge to double comparable store sales in that category, which Alwardt’s team achieved between 1996 and 1997. “One reason is that we’ve been redoing the category every six months,” explains Alwardt. “It’s grown so fast, and we’ve learned so much, that it has paid off to tear the set apart and start over every six months.”

ERIC J. ALWARDT, Product Manager

And this explosive growth is very likely to continue in the future, Alwardt thinks. “It’s been a terrific category,” he says, “but we haven’t even begun to market it yet. Now we’re going to get the word out to teachers: We’re here, and we’ve got what you need!”

Less than three years into the teacher-supply business, Alwardt doesn’t make a lot of sweeping statements about his fast-moving category. He does offer one observation, though. “I really like what we call ‘crossover products,’” he explains. “Those are the ones that parents buy, as well as teachers.

“And so although I’ve always liked stickers,” he confesses with a grin, “now I love stickers!”

GROWING BUSINESS AND ELECTRONICS: JOHN N. JANKOWICH

Sometimes the good ideas bang on your door. Other times, says John Jankowich, you have to go looking for them.

Jankowich, a buyer in the Business and Electronics Division for the past three and a half years, is happy either way – as long as the product he puts into Staples stores serves a customer need. The reason? If it serves a need, it sells.

“My job,” the 31 year old Jankowich explains, “is to feed a $400 million business in electronics and business machines. And that translates into constantly scouring the marketplace for new items and opportunities." But electronics, in particular, is a tough business. Margins are thin. Product lines change quickly, and many of the new products introduced by manufacturers each year simply don't make it in the marketplace. They may work well, look good, have an attractive sticker price – and still not sell.

"You've got to whittle down the list of hundreds of ideas," Jankowich says. "When I look at a new item, I always ask the manufacturer what it does, who the target market is, and why that target market needs this product. What is this machine going to do that will make their lives easier? Using that screen, I can eliminate all but a few of them, and then bet money on those remaining few. Good money."

RICHARD GENTRY, Executive Vice President of Merchandising (Point Team member) with JOHN N. JANKOWICH, Senior Product Manager, Business Machines

One product that Jankowich bet on in 1997 was a videophone aimed at the small-business market. In April, he came across a small article in a trade magazine about a new product by a California-based company called Eight by Eight, Inc. The product hooked into a T.V. and a phone, and – with minimal technical interventions – transmitted video images over a standard phone line. Assuming that a similar unit was installed on the other end of that line, videoconferencing became available to the small-business customer for a fraction of the cost of a high-end videoconferencing system. "It definitely looked like it would fill a niche," Jankowich recalls.

Staples and Eight by Eight soon reached agreement on the terms of a chain-wide roll-out – reflecting Jankowich's confidence in the product. "That's when our real investment begins," says Jankowich. "We invest time, bringing something like this along. We invest money. We invest real estate, in terms of floor space. We invest labor – training people how to sell the product, signing the stores, and so on. These are all investments that we take very, very seriously."

The videophone hit the stores in August, and has since done well enough – almost $1 million in sales – to warrant continued investment by Staples and Eight by Eight. As volume increases, the price is very likely to drop. "I would expect that by this Christmas," Jankowich ventures, "it will be at a retail price point that will get it into the 'grandparent market.' Then we'll really see how far this product can go."

A second product – a small-business postage meter marketed by Pitney-Bowes – came along under Jankowich's watchful eye during this same time period. "My initial reaction," he recalls, "was that this would make a small office easier to run, and could save a customer a lot of money. The more mailing the business did, the more money that business would save."

Because of the complexities inherent in the product (which is actually leased from the U.S. Postal Service), the postage meter has proved harder to sell to retail customers than other business machines. Again, though, Staples continues to invest in the product, in large part because Jankowich continues to see significant potential in and around it. "I'm confident that Pitney-Bowes and the Postal Service will find ways to simplify the deal," he says, "and when they do, this product will find its market. Pitney-Bowes will sell more machines, and the Postal Service will sell more postage.

"And Staples will not only make money on that larger volume," he continues, "but we'll be demonstrating once again to our small-business customers that Staples is the place to come for solutions to real business problems."

Jankowich credits Rich Gentry, executive vice president of merchandising, with giving him ample leeway in his job – and for resisting the temptation to second-guess him. He also tips his hat to the Business and Electronics Division's Inventory Replenishment Group, run by Dave Rizza, which Jankowich describes as the team responsible for actually getting his "offspring" into the stores, and keeping them there until the day that the customer finally decides to go in and buy that videophone.

"I find them," Jankowich concludes, "and Dave Rizza's troops mind them. A good one-two combination!"

GROWING GREENFIELDS: NEIL E. RINGEL

By the mid 1990s, senior executives in Staples' Contract & Commercial division — which includes, among other things, the Company's regional contract stationers — were concerned that there were no attractive acquisition candidates in key markets like New York City and Washington, D.C. Eventually, they hit on an idea: why not grow our own?

This was the genesis of "Greenfields" — Staples' strategy of leveraging existing assets to create contract businesses from the ground up. These new businesses eventually would be combined with acquired companies to create a nationwide network of regional contract stationers.

NEIL E. RINGEL, Regional Vice President, Mid-Atlantic, Staples Business Advantage

To realize this ambitious vision, Staples tapped three individuals, one of whom was Neil Ringel, who originally joined the Company in January 1995 as vice president of operations for Greenfields. "Sounds more impressive than it was," the 33 year old Ringel admits. "It was basically borrowed quarters in South Hackensack, New Jersey, and some extremely ambitious goals."

Chief among these goals was to make Staples a significant player in the New York metropolitan area's middle-market contract arena. Ringel's team had some key advantages, including the Staples name and strong support from Jay Baitler, Evan Stern and other senior SCC executives. But they also faced major obstacles. "People hate change," Ringel says of potential customers. By and large, they only get interested in looking around when their vendor drops the ball. So our job, starting from scratch, was to make sure that we always had a visible presence, so that we'd be there when one of our competitors dropped that ball."

This meant hiring, training, motivating, and setting extraordinarily high targets for a sales force of a half-dozen people. "We asked our people to produce at a very intense rate," Ringel recalls. "And with a lot of help and pushing from us, that's what they wound up doing."

Meanwhile, Staples was coming up with innovations to make this tough job doable. One such innovation, aimed at leveraging the existing retail network, was the Convenience Card. "This card allows you, as my commercial customer, to go into a retail store on weekends, nights, or in emergencies," explains Ringel. "You show the card at transaction time, the associate 'swipes' it through the register, you sign, and bingo — the transaction appears on your monthly statement from me, and charges are apportioned to the appropriate cost center, which helps you keep your accounting straight. It drives paperwork out, and gives you great convenience."

More recently, Greenfields began using "Estimator," a new modeling software developed by Staples' finance group. "It's a great tool for us," Ringel says. "It helps us think in sophisticated ways about the customer we don't yet have. We plug in our best estimates of margin, order size, and buying trends, and come up with an estimate of what the net profitability of that account might be if we got it. So our pricing structure is on target heading into the relationship."

"The New York Greenfield was a success: from zero sales to more than $5 million in sales in just over six months. Based on that success, Ringel and his team were sent into the Washington, D.C. area early in 1996. Impressive results continued..."

The New York Greenfield was a success: from zero sales to more than $5 million in sales in just over six months. Based on that success, Ringel and his team were sent into the Washington, D.C. area early in 1996. Impressive results continued: overall sales up more than 300 percent on an annualized basis between 1995 and 1996, and up another 100 percent last year (on a much bigger base). The third Greenfield set up shop in Pittsburgh in 1997, and Houston and Los Angeles are scheduled to come on line this year.

Today, Neil Ringel spends most of his time managing the SBA Mid-Atlantic region's sales efforts. But he also helps train other members of the rapidly growing Greenfields sales force. In those sessions, he focuses relentlessly on getting people to concentrate on what the customer needs. He uses an interesting visual aid to make the point:

"I take a big piece of duct tape, and I write "SO WHAT?" on it in huge letters. I stick it right in the middle of my forehead. Then I have the sales people come into the room and practice their pitch on me.

"It's very interesting. The pitches I hear are very focused on the kinds of things that a real customer would be interested in!"

GROWING THE SERVICE PLAN BUSINESS: JOHN T. WATSON

"This is a two-part story," says product manager John Watson. "The first is about revamping a business from the ground up. And the second is about implementing that invention."

The business that the 42 year old Watson refers to is the sale of service plans through Staples stores to small-business customers and other consumers. Extended Service Plans (ESPs) have been available on all business machines and computers for seven years at Staples, but it wasn't until this year that the new Computer Protection Plans (CPPs) and Extended Protection Plans (EPPs) were introduced. They have been a tremendous success.

"We analyzed the existing ESPs," Watson recalls, "and we decided that we needed to enhance them in order to get to the point where customers would really get excited about the benefits we offered."

One good suggestion came directly from the associates in the stores: Set up a round-the-clock, toll-free number for customers who had software-related or other technical issues. As a result, when Staples' new CPP was launched in March 1997, it included a toll-free support line.

Meanwhile, Watson was concluding that Staples had outgrown its service-plan vendor (responsible for taking calls from consumers, providing the repairs or product replacements, and managing all of the "back-end" functions of the business). "We wanted to provide the best possible service," Watson recalls, "and do so at a reasonable cost. We assessed all the premiere third-party administrators nationwide, and after long negotiations, we signed up Warrantech, Inc., to take over the business."

Partnering with the Dallas-based Warrantech quickly strengthened the program. Service improved significantly, and Staples' new (but experienced) partner suggested many practical, near-term ways to enhance both CPPs and EPPs for the customer's benefit.

Then came implementation — no simple task, as Watson recalls: "The vendor switch came on August 26, 1997. At the end of that day, when the doors closed at 570 stores around the country, associates swapped out all the point-of-purchase literature, changed signage, replaced all the 'fact tags,' and set up all new SKUs [stock-keeping units] to accommodate the new vendor's products. Meanwhile, of course, we had to keep all the old SKUs open to accommodate returns. We held our breath the next day, wondering what would happen. And what happened was just about perfection. Nationwide, we had only thirteen sales — less than 1/10th of 1 percent! — assigned to the old SKUs. Well, I call that 100 percent execution, and I've never seen anything like it in retail. Anywhere."

JOHN T. WATSON, Director of Product Services &
JOHN F. FORD, Manager of Product Services

Watson's goal, in structuring a business deal, is to create a win-win situation for all participants. "Otherwise," he explains, "it can't succeed, long term." Staples has certainly benefited from his efforts. Warranty sales doubled between 1995 and 1996, and increased by an additional 81 percent between 1996 and 1997 — while gross margins improved dramatically. Associates now receive compensation for selling the service plans. Warrantech looks forward to growing along with Staples in the warranty business. And most important, the customer now gets vastly improved services from Staples.

Watson — just two years into his tenure at Staples — credits his success to four factors. The first, he says, is the company he keeps: colleague John Ford, the regional vice presidents and directors, and the associates in the stores. The second is a systematic approach to the business, developing the tools that enable management to drive the business. The third is a field-based focus. "John Ford and I have spent a ton of time out there in the field," Watson explains, "communicating exactly why and how we're trying to grow this business. And the associates have responded exactly as we hoped they would. No — better!"

And finally, Watson says, he has been given lots of room to move. "John Burke, my boss, gave me the keys to the car, and then he let me drive it," Watson recalls. "Bosses who give you lots of rope, colleagues who are committed to taking care of the customer — all of this was new to me.

"Where I worked before," he continues, "I took risks, too, because you can't grow as an individual or a company without taking risks. But in my former job, even if nine out of ten risks panned out, I'd get shot for the tenth. In the warranty business — and a couple of others we're looking at currently — there's an awful lot of incremental margin opportunity, but you can't get to that income without experimenting. And here, you get to do that. Great company!"

Staples Strategic Business Units

INTERNATIONAL

Staples Der Büro-Megamarkt, Germany

Staples U.K.

NORTH AMERICAN SUPERSTORES

Staples The Office Superstore

Business Depot

Bureau En Gros

CONTRACT & COMMERCIAL

Staples Direct

Staples Business Advantage

Staples National Advantage

RESULTS OF OPERATIONS

Comparison of Fiscal Years Ended January 31, 1998, February 1,1997, and February 3, 1996

General

During the fiscal year ended January 31, 1998, the Company acquired Kingfisher PLC's interests in Staples UK and MAXI-Papier-Markt-GmbH ("MAXI-Papier"). Staples UK and MAXI-Papier operate a chain of office products superstores in the UK and Germany, respectively. As a result of these acquisitions, the Company's ownership interest in Staples UK increased to 100% and its ownership interest in MAXI-Papier increased to approximately 92%. The cash purchase price of approximately $57 million was generated through additional borrowings under the Company's existing revolving credit facility. The transactions were accounted for in accordance with the purchase method of accounting and accordingly, the results of operations of Staples UK and MAXI-Papier have been included in the Company's consolidated financial statements since May, 1997. The excess of the purchase price has been recorded as goodwill and is being amortized on a straight line basis over 40 years. Prior to May 1997, the operating results of Staples UK and MAXI-Papier were accounted for under the equity method.

The earnings per share amounts prior to 1997 have been restated as required to comply with Statement of Financial Accounting Standards No. 128, Earnings Per Share ("FAS 128"). For further discussion of earnings per share and the impact of FAS 128, see the Notes to the Consolidated Financial Statements beginning on Page 26.

The fiscal years ended January 31, 1998 and February 1, 1997 consisted of 52 weeks, while the fiscal year ended February 3, 1996 consisted of 53 weeks.

Sales

Sales increased 31% to $5,181,035,000 in the fiscal year ended January 31, 1998 from $3,967,665,000 in the fiscal year ended February 1, 1997. Sales increased 29% in the fiscal year ended February 1, 1997 from $3,068,061,000 in the fiscal year ended February 3, 1996; excluding the additional week in the fiscal year ended February 3, 1996, sales increased 32%. The growth in each year was attributable to an increase in the number of open stores, increased sales in existing stores and increased sales in the delivery and contract stationer segment. In addition, sales for the fiscal year ended January 31, 1998 included the consolidation of Staples UK and MAXI-Papier. Comparable store and delivery hub sales for the fiscal year ended January 31, 1998 increased 10% over the fiscal year ended February 1, 1997; comparable sales in the contract stationer segment increased 12% over the year ended February 1, 1997. Comparable store and delivery hub sales for the year ended February 1, 1997 increased 14% over the year ended February 3, 1996; comparable sales in the contract stationer segment increased 17% over the year ended February 3, 1996. As of January 31, 1998, February 1, 1997, and February 3, 1996, the Company had 742, 557, and 443 open stores, respectively. The January 31, 1998 total includes 130 stores opened and one store closed during the twelve months ended January 31, 1998 and 56 stores acquired in the UK and Germany as a result of the acquisitions of Staples UK and MAXI-Papier.

Gross Profit

Gross profit was 24.1%, 23.8%, and 22.9% of sales for the fiscal years ended January 31, 1998, February 1, 1997, and February 3, 1996, respectively. The increase in gross profit rate for the years ended January 31, 1998 and February 1, 1997 was primarily due to improved margins in the retail and delivery business segments due to lower product costs from vendors as a result of increased purchase discounts and changes in product mix, as well as the leveraging of fixed distribution center and delivery costs over a larger sales base. This was partially offset by decreases in the margin rates in the retail store segment due to price reductions as well as an increase in the sales of computer hardware (CPUs and laptops), which generate a lower margin rate than other categories, to 8.4% of total sales for the fiscal year ended January 31, 1998 from 7.7% in the year ended February 1, 1997 and 7.5% in the year ended February 3, 1996.

Operating and Selling Expenses

Operating and selling expenses, which consist of payroll, advertising and other operating costs, were 15.1%, 15.0%, and 14.5% of sales for the fiscal years ended January 31, 1998, February 1, 1997, and February 3, 1996, respectively. The increase as a percentage of sales for the years ended January 31, 1998 and February 1, 1997 was primarily due to planned increases in advertising and circulars as well as increases in store labor and costs incurred for the Company's store remodel program in which significant investments have been made in store layouts and signing to improve shopability and enhance customer service. In addition, operating and selling expenses for the fiscal year ended January 31, 1998 include the results of Staples UK and MAXI-Papier, which have higher costs as a percentage of sales due to their early stage of development. These increases were partially offset by reduced costs resulting from the Company's ability to leverage fixed store payroll expenses and other fixed store operating costs as store sales have increased.

Staples UK and MAXI-Papier store expenses are higher than most other Staples stores as a result of their earlier stage of development. While most store expenses vary proportionately with sales, there is a fixed cost component. Because new stores typically generate lower sales than the Company average, the fixed cost component results in higher store operating and selling expenses as a percentage of sales in these stores during their start-up period. During periods when new store openings as a percentage of the base are higher, store operating and selling expenses as a percentage of sales may increase. In addition, as the store base matures, the fixed cost component of operating expenses is leveraged over an increased level of sales, resulting in a decrease in store operating and selling expenses as a percentage of sales. The Company's strategy of continuing to add stores to many existing markets can result in some new stores attracting sales away from existing stores.

Pre-opening Expenses

Pre-opening expenses relating to new store openings, which consist primarily of salaries, supplies, marketing and occupancy costs, are expensed by the Company as incurred and therefore fluctuate from period to period depending on the timing and number of new store openings. Pre-opening expenses averaged $73,000, $72,000, and $58,000 per store for the stores opened in the fiscal years ended January 31, 1998, February 1, 1997, and February 3, 1996, respectively. The increase from the fiscal year ended February 3, 1996 was due primarily to increased marketing expenses as well as higher costs incurred in the initial shipment of products from the distribution centers to new stores.

General and Administrative Expenses

General and administrative expenses as a percentage of sales were 3.5%, 3.4%, and 3.3% in the years ended January 31, 1998, February 1, 1997, and February 3, 1996, respectively. The increase as a percentage of sales for the fiscal years ended January 31, 1998 and February 1, 1997 was primarily due to significant investments in the Company's information systems' staffing and infrastructure, which the Company believes will reduce costs as a percentage of sales in future years. In addition, general and administrative expenses for the fiscal year ended January 31, 1998 include the results of Staples UK and MAXI-Papier, which have higher general and administrative costs as a percentage of sales; as their store bases mature overhead expenses should decrease as a percentage of sales. The overall increase in general and administrative costs were partially offset by the Company's ability to increase sales without proportionately increasing overhead expenses in its core retail business.

Interest and Other Expense, Net

Net interest expense totaled $23,053,000, $19,887,000, and $15,815,000 in the fiscal years ended January 31, 1998, February 1, 1997, and February 3, 1996, respectively. The increase in the fiscal years ended January 31, 1998 and February 1, 1997 was primarily due to increased borrowings, which funded: the increase in store inventories related to new store openings, expanded product assortment, and improvements in in-stock levels; the acquisition of fixed assets for new stores opened and remodeled; continued investments in the information systems and distribution center infrastructure; and additional investments in Staples UK and MAXI-Papier as well as the purchase of them during the fiscal year ended January 31, 1998.

Merger-Related Costs

During the fiscal year ended January 31, 1998, the Company charged to expense certain non-recurring costs consisting primarily of legal, accounting, transaction related costs, such as filing fees, and consulting fees incurred in connection with the proposed merger with Office Depot, Inc.

Equity in Loss of Affiliates

Equity in loss of affiliates is comprised of the Company's share of the losses incurred by Staples UK and MAXI-Papier before the Company's acquisition of these entities in May, 1997. Prior to the acquisitions, the Company's investments in Staples UK and MAXI-Papier were accounted for using the equity method which resulted in the Company's share of losses from operations being included in Equity in Loss of Affiliates. Equity in Loss of Affiliates totaled $5,953,000, $11,073,000, and $12,153,000, in the fiscal years ended January 31, 1998, February 1, 1997, and February 3, 1996, respectively. The decrease in the Equity in Loss of Affiliates for the fiscal year ended January 31, 1998 was due to the acquisition of Staples UK and MAXI-Papier on May 6, 1997 and May 7, 1997. As a result of the acquisitions, the Company's ownership interest of Staples UK increased to 100% and its ownership of MAXI-Papier increased to approximately 92%. The transactions were accounted for in accordance with the purchase method of accounting and accordingly, the results of operations of Staples UK and MAXI-Papier have been included in the Company's consolidated financial statements since the respective acquisition dates.

Income Taxes

The provision for income taxes as a percentage of pre-tax income was 38.5% for each of the fiscal years ended January 31, 1998, February 1, 1997 and February 3, 1996.

LIQUIDITY AND CAPITAL RESOURCES

The Company traditionally uses a combination of cash generated from operations and debt or equity offerings to fund its expansion and acquisition activities. During the fiscal years ended January 31, 1998, February 1, 1997 and February 3, 1996, the Company also utilized its revolving credit facility to support its various growth initiatives.

The Company opened 130 stores, 115 stores, and 94 stores in the fiscal years ended January 31, 1998, February 1, 1997 and February 3, 1996, respectively, and closed one store in each of these fiscal years. In addition, in the fiscal year ended January 31, 1998, 56 stores were added as a result of the acquisition of Staples UK and MAXI-Papier. As the store base matures and becomes more profitable, cash generated from store operations is expected to provide a greater portion of funds required for new store inventories and other working capital requirements. Sales generated by the contract stationer business segment are made under regular credit terms, which require that the Company carry its own receivables from these sales. The Company also utilized capital equipment financings to fund current working capital requirements.

As of January 31, 1998, cash, cash equivalents, and short-term investments totaled $357,904,000, an increase of $251,775,000 from the February 1, 1997 balance of $106,129,000. The principal sources of funds were primarily cash from operations, an increase in accounts payable and accrued expenses of $320,527,000, which financed the increase in merchandise inventory of $227,037,000 related to new store openings, expanded product assortment and improvements in in-stock levels; and cash provided by financing activities of $182,851,000 due primarily to the issuance of $200,000,000 of senior notes on August 12, 1997. These sources were partially offset by the acquisition of property and equipment of $183,133,000 and cash used in the acquisition of Staples UK and MAXI-Papier, net of cash acquired, of $79,325,000.

The Company expects to open approximately 170 stores during fiscal 1998. Management estimates that the Company's cash requirements, including pre-opening expenses, leasehold improvements and fixtures (excluding store inventory financed under net vendor trade terms), will be approximately $1,400,000 for each new store (excluding the cost of any acquisitions of lease rights). Accordingly, the Company expects to use approximately $238,000,000 for store openings during this period. In addition, the Company plans to continue to make investments in information systems, distribution centers and store remodels to improve operational efficiencies and customer service, and may expend additional funds to acquire businesses or lease rights from tenants occupying retail space that is suitable for a Staples store. The Company expects to meet these cash requirements through a combination of operating cash flow and borrowings from its existing revolving line of credit.

The Company issued $200,000,000 of senior notes (the "Notes") on August 12, 1997 with an interest rate of 7.125% payable semi-annually on February 15 and August 15 of each year commencing on February 15, 1998. Net proceeds of approximately $198,000,000 from the sale of the Company's Notes were used for repayment of indebtedness under the Company's revolving credit agreement and for general working capital purposes, including the financing of new store openings, distribution facilities and corporate offices.

Effective November 13, 1997 the Company entered into a new revolving credit facility, effective through November 2002, with a syndicate of banks which provides up to $350,000,000 of available borrowings. Borrowings made pursuant to this facility will bear interest at either the lead bank's prime rate, the federal funds rate plus 0.50%, the LIBOR rate plus a percentage spread based upon certain defined ratios, a competitive bid rate, or a swing line loan rate. This agreement, among other conditions, contains certain restrictive covenants including net worth maintenance, minimum fixed charge interest coverage and limitations on indebtedness, sales of assets, and dividends. As of January 31, 1998, no borrowings were outstanding under the revolving credit agreement. MAXI-Papier also has a revolving credit facility under which $8,746,000 was outstanding as of January 31, 1998. Total cash, short-term investments and available revolving credit amounts totaled $733,916,000 as of January 31, 1998.

The Company expects that its current cash and cash equivalents and funds available under its revolving credit will be sufficient to fund its planned store openings and other recurring operational cash needs for at least the next twelve to eighteen months. The Company is continually evaluating financing possibilities, and it may seek to raise additional funds through any one or a combination of public or private debt or equity-related offerings, dependent upon market conditions, or through additional commercial bank debt arrangements.

INFLATION AND SEASONALITY

While inflation or deflation has not had, and the Company does not expect it to have, a material impact upon operating results, there can be no assurance that the Company's business will not be affected by inflation or deflation in the future. The Company believes that its business is somewhat seasonal, with sales and profitability slightly lower during the first and second quarters of its fiscal year.

FUTURE OPERATING RESULTS

Factors that could affect the Company's future operating results include, without limitation, the following:

The Company operates in a highly competitive marketplace, in which it competes with a variety of retailers, dealers and distributors. The Company competes in most of its geographic markets with other high-volume office supply chains that are similar in concept to the Company in terms of store format, pricing strategy and product selection, such as Office Depot, OfficeMax and Office World as well as mass merchants, such as Wal-Mart, warehouse clubs, computer and electronics superstores, and other discount retailers. In addition, the Company's retail stores, as well as its delivery and contract business, compete with numerous mail order firms, contract stationer businesses and direct manufacturers. Such competitors have increased their presence in the Company's markets in recent years. Some of the Company's current and potential competitors in the office products industry are larger than the Company and have substantially greater financial resources. No assurance can be given that competition will not have an adverse effect on the Company's business.

An important part of the Company's business plan is an aggressive store growth strategy. The Company opened 130 stores in the United States, Canada and Europe in fiscal 1997 and plans to open approximately 170 new stores in fiscal 1998. There can be no assurance that the Company will be able to identify and lease favorable store sites, hire and train employees, and adapt its management and operational systems to the extent necessary to fulfill its expansion plans. The failure to open new stores in accordance with its growth plans could have a material adverse impact on the Company's future sales and profits. Moreover, the Company's expansion strategy is based in part on the continued addition of new stores to its store network in existing markets to take advantage of economies of scale in marketing, distribution and supervision costs; however, this can result in the "cannibalization" of sales of existing stores. In addition, there can be no assurance that the new stores opened by the Company will achieve sales or profit levels commensurate with those of the Company's existing stores.

The Company has experienced and may experience in the future fluctuations in its quarterly operating results. Moreover, there can be no assurance that Staples will continue to realize the earnings growth experienced over recent years, or that earnings in any particular quarter will not fall short of either a prior fiscal quarter or investors' expectations. Factors such as the number of new store openings (pre-opening expenses are expensed as incurred, and newer stores are less profitable than mature stores), the extent to which new stores "cannibalize" sales of existing stores, the mix of products sold, pricing actions of competitors, the level of advertising and promotional expenses, seasonality, and one-time charges associated with acquisitions or other events could contribute to this quarterly variability. In addition, the Company's expense levels are based in part on expectations of future sales levels, and a shortfall in expected sales could therefore result in a disproportionate decrease in the Company's net income.

The Company's business, including sales, number of stores and number of employees, has grown dramatically over the past several years. In addition, the Company has consummated a number of significant acquisitions in the last few years, and may make additional acquisitions in the future. This internal growth, together with the acquisitions made by the Company, have placed significant demand on the management and operational systems of the Company. To manage its growth effectively, the Company will be required to continue to upgrade its operational and financial systems, expand its management team and increase and manage its employee base.

The Company has a presence in international markets in Canada and through its recently acquired operations in Germany and the United Kingdom, and may seek to expand into other international markets in the future. The Company's operations in foreign markets are subject to risks similar to those affecting its U.S. stores, in addition to a number of additional risks inherent in foreign operations, including local customs and competitive conditions, and foreign currency fluctuations. Staples' European operations are currently unprofitable, and there can be no assurance that they will become profitable.

The Company currently expects that its current cash and cash equivalents and funds available under its revolving credit facility will be sufficient to fund its planned store openings and other operating cash needs for at least the next twelve to eighteen months. However, there can be no assurance that the Company will not require additional sources of financing prior to such time, as a result of unanticipated cash needs or opportunities, an expanded growth strategy or disappointing operating results. There also can be no assurance that the additional funds required by the Company, whether within the next twelve to eighteen months or thereafter, will be available to the Company on satisfactory terms.

YEAR 2000

The Company has conducted a comprehensive review of its internal computer systems and applications to identify those that might be affected by the year 2000 issue and has developed an implementation plan to resolve the year 2000 issue. The Company is in the process of correcting or replacing those systems and applications which are not currently year 2000 compliant. The Company believes it will be able to modify or replace its affected systems and applications in time to avoid any material detrimental impact on its operations.

The Company will incur internal staff costs as well as consulting and other expenses related to infrastructure and facilities enhancements necessary to prepare its systems and applications for the year 2000 issue. The preliminary expense estimate for year 2000 corrective and replacement activities ranges from $15 to $20 million, a portion of which would have been incurred as part of normal system and application upgrades.

It is anticipated that all year 2000 compliance efforts will be complete by mid fiscal year 1999, including testing. However, if such modifications and conversions are not completed in a timely manner, the year 2000 issue may have a material impact on the operations of the Company. The Company is also working to ensure that products purchased at Staples, as well as services utilized by Staples, will be year 2000 compliant.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

The Company is exposed to market risk from changes in interest rates and foreign exchange rates. The Company does not use derivative instruments for trading purposes. The Company initiated a risk management control process to monitor the foreign exchange and interest rate risks. The risk management process uses analytical techniques including market value, sensitivity analysis, and value at risk estimates. The Company does not believe that the potential exposure is significant in light of the size of the Company and its business. In addition, the foreign exchange rate can move in the Company's favor. Recent experience has demonstrated that gains on certain days are offset by losses on other days. Therefore, the Company does not expect to incur material losses.

This risk management discussion and the effects of are forward-looking statements. Actual results in the future may differ materially from these projected results due to actual developments in the global financial markets. The analytical methods used by the Company to assess and mitigate risk discussed above should not be considered projections of future events or losses.

Consolidated Balance Sheet

(Dollar Amounts in Thousands, Except Share Data)

	January 31, 1998	February 1, 1997
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 355,238	$ 98,143
Short-term investments	2,666	7,986
Merchandise inventories	1,092,410	813,661
Receivables, net	151,885	167,072
Deferred income taxes	33,108	31,202
Prepaid expenses and other current assets	31,026	33,284
Total current assets	1,666,333	1,151,348
Property and Equipment:		
Land and buildings	117,858	73,070
Leasehold improvements	288,213	231,604
Equipment	257,116	197,258
Furniture and fixtures	168,411	111,967
Total property and equipment	831,598	613,899
Less accumulated depreciation and amortization	257,627	171,042
Net property and equipment	573,971	442,857
Other Assets:		
Lease acquisition costs, net of amortization	43,244	42,552
Investment in affiliates		40,542
Goodwill, net of amortization	139,753	81,306
Deferred income taxes	15,451	16,708
Other	15,758	12,439
Total other assets	214,206	193,547
	$ 2,454,510	$ 1,787,752
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 641,851	$ 421,051
Accrued expenses and other current liabilities	259,290	174,284
Debt maturing within one year	39,779	7,220
Total current liabilities	940,920	602,555
Long-Term Debt	208,876	91,342
Other Long-Term Obligations	37,103	32,169
Convertible Debentures	300,000	300,000
Stockholders' Equity:		
Preferred stock, $.01 par value-authorized 5,000,000 shares; no shares issued		
Common stock, $.0006 par value-authorized 500,000,000 shares; issued 252,169,891 shares at January 31, 1998 and 243,416,063 shares at February 1, 1997	106	98
Additional paid-in capital	593,895	508,868
Cumulative foreign currency translation adjustments	(10,315)	(128)
Unrealized gain on short-term investments	4	11
Retained earnings	384,132	253,183
Less: 59,149 shares of treasury stock, at cost	(346)	(346)
Minority Interest	135	
Total stockholders' equity	967,611	761,686
	$ 2,454,510	$ 1,787,752

See notes to consolidated financial statements.

Consolidated Statements of Income

(Dollar Amounts in Thousands, Except Share Data)

	Fiscal Year Ended		
	January 31, 1998	February 1, 1997	February 3, 1996
Sales	$ 5,181,035	$ 3,967,665	$ 3,068,061
Cost of goods sold and occupancy costs	3,934,172	3,023,279	2,366,183
Gross profit	1,246,863	944,386	701,878
Operating expenses:			
Operating and selling	779,789	594,978	446,324
Pre-opening	9,443	8,299	5,607
General and administrative	182,590	134,817	100,167
Amortization of goodwill	3,581	2,291	1,967
Total operating expenses	975,403	740,385	554,065
Operating income	271,460	204,001	147,813
Other income (expense):			
Interest and other expense, net	(23,053)	(19,887)	(15,815)
Merger-related costs	(29,665)		
Total other income (expense)	(52,718)	(19,887)	(15,815)
Income before equity in loss of affiliates and income taxes	218,742	184,114	131,998
Equity in loss of affiliates	(5,953)	(11,073)	(12,153)
Income before income taxes	212,789	173,041	119,845
Income tax expense	81,924	66,621	46,140
Net income before minority interest	130,865	106,420	73,705
Minority interest	84		
Net income	$ 130,949	$ 106,420	$ 73,705
Earnings per common share			
Net income per common share	$ 0.53	$ 0.44	$ 0.32
Earnings per common share-assuming dilution			
Net income per common share	$ 0.51	$ 0.43	$ 0.31

See notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity

(Dollar Amounts in Thousands, Except Share Data)

For the Fiscal Years Ended January 31, 1998, February 1, 1997 and February 3, 1996

	Common Stock	Additional Paid-In Capital	Cumulative Foreign Currency Translation Adjustments	Unrealized Gain (Loss) on Investments	Minority Interest	Retained Earnings (Deficit)	Treasury Stock
Balances at January 28, 1995	$ 85	$ 314,544	$ (2,205)	$ (93)	$ 0	$ 73,005	$ (346)
Issuance of common stock for stock options exercised	1	11,323					
Tax benefit on exercise of options		11,394					
Contribution of common stock to Employees' 401(k) Savings Plan		1,257					
Sale of common stock under Employee Stock Purchase Plan		5,641					
Conversion of debt to equity	8	114,049					
Unrealized gain on short-term investments, net of tax				125			
Translation adjustments			151				
Issuance of common stock for acquisitions and other transactions	1	8,476				295	
Net income for the year						73,705	
Balances at February 3, 1996	$ 95	$ 466,684	$ (2,054)	$ 32	$ 0	$147,005	$ (346)
Issuance of common stock for stock options exercised	3	13,726					
Tax benefit on exercise of options		16,773					
Contribution of common stock to Employees' 401(k) Savings Plan		1,998					
Sale of common stock under Employee Stock Purchase Plan		8,980					
Issuance of Performance Accelerated Restricted Stock		532					
Unrealized loss on short-term investments, net of tax				(21)			
Translation adjustments			1,926				
Issuance of common stock for acquisitions and other transactions		175				(242)	
Net income for the year						106,420	
Balances at February 1, 1997	$ 98	$ 508,868	$ (128)	$ 11	$ 0	$253,183	$ (346)
Issuance of common stock for stock options exercised	8	32,155					
Tax benefit on exercise of options		32,873					
Contribution of common stock to Employees' 401(k) Savings Plan		2,318					
Sale of common stock under Employee Stock Purchase Plan		10,499					
Issuance of Performance Accelerated Restricted Stock		7,182					
Unrealized loss on short-term investments, net of tax				(7)			
Translation adjustments			(10,187)				
Minority Interest					135		
Net income for the year						130,949	
Balances at January 31,1998	$ 106	$ 593,895	$ (10,315)	$ 4	$ 135	$384,132	$ (346)

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(Dollar Amounts in Thousands)

	Fiscal Year Ended		
	January 31, 1998	February 1, 1997	February 3, 1996
Operating Activities:			
Net income	$ 130,949	$ 106,420	$ 73,705
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Minority interest	(84)		
Depreciation and amortization	83,380	55,948	43,551
Expense from 401(k) and PARS stock contribution	10,409	2,715	1,633
Equity in loss of affiliates	5,953	11,073	12,153
Deferred income taxes benefit/(expense)	3,877	3,137	(13,211)
Change in assets and liabilities, net of effects of purchase of other companies:			
Increase in merchandise inventories	(227,037)	(167,479)	(177,509)
(Increase) decrease in receivables	24,441	(44,523)	(42,129)
(Increase) decrease in prepaid expenses and other assets	(5,059)	(4,349)	1,570
Increase in accounts payable, accrued expenses and other current liabilities	320,527	179,108	57,999
Increase in other long-term obligations	5,544	5,883	2,094
	221,951	41,513	(113,849)
Net cash provided by (used in) operating activities	352,900	147,933	(40,144)
Investing Activities:			
Acquisition of property and equipment	(183,133)	(199,614)	(116,295)
Acquisition of businesses, net of cash acquired	(79,325)		
Proceeds from sales and maturities of short-term investments	9,655	8,800	16,519
Purchase of short-term investments	(4,500)	(4,600)	
Investment in affiliates	(3,788)	(18,629)	(22,088)
Acquisition of lease rights	(2,717)	(5,534)	(2,044)
Other	(12,128)	2,669	1,281
Net cash used in investing activities	(275,936)	(216,908)	(122,627)
Financing Activities:			
Proceeds from sale of capital stock	48,045	21,773	16,964
Proceeds from convertible debentures, net of deferred costs			291,032
Proceeds from borrowings	963,263	1,171,025	1,224,883
Payments on borrowings	(828,457)	(1,124,453)	(1,313,930)
Net cash provided by financing activities	182,851	68,345	218,949
Effect of exchange rate changes on cash	(2,720)	643	142
Net increase in cash and cash equivalents	257,095	13	56,320
Cash and cash equivalents at beginning of period	98,143	98,130	41,810
Cash and cash equivalents at end of period	$ 355,238	$ 98,143	$ 98,130

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

NOTE A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Staples, Inc. and subsidiaries ("the Company") operates a chain of office supply stores and contract stationer/delivery warehouses throughout North America and in Germany and the United Kingdom.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany accounts and transactions are eliminated in consolidation.

Fiscal Year

The Company's fiscal year is the 52 or 53 weeks ending the Saturday closest to January 31. Fiscal years 1997, 1996 and 1995, consisted of the 52 weeks ended January 31, 1998 and February 1, 1997, and the 53 weeks ended February 3, 1996, respectively.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management of the Company to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Short-Term Investments

The Company's securities are classified as available for sale and consist principally of high-grade state and municipal securities having an original maturity of more than three months. The investments are carried at fair value, with the unrealized holding gains and losses reported as a component of the Company's stockholders' equity. The cost of securities sold is based on the specific identification method. No individual issue in the portfolio constitutes greater than one percent of the total assets of the Company.

Merchandise Inventories

Merchandise inventories are valued at the lower of weighted-average cost or market.

Receivables

Receivables relate principally to amounts due from vendors under various incentive and promotional programs and trade receivables financed under regular commercial credit terms. Concentrations of credit risk with respect to trade receivables are limited due to the Company's large number of customers and their dispersions across many industries and geographic regions.

Advertising

The Company expenses the production costs of advertising the first time the advertising takes place, except for the direct-response advertising, which is capitalized and amortized over its expected period of future benefits. Direct-response advertising consists primarily of the direct catalog production costs. The capitalized costs of the advertising are amortized over the six month period following the publication of the catalog in which it appears. At January 31, 1998, direct catalog production costs included in prepaid and other assets totaled $2,794,000. Total advertising and marketing expense was $261,425,000, $189,109,000, $120,288,000 for the years ended January 31, 1998, February 1, 1997 and February 3, 1996, respectively.

Property and Equipment

Property and equipment are recorded at cost. Depreciation and amortization, which includes the amortization of assets recorded under capital lease obligations, are provided using the straight-line method over the estimated useful lives of the assets or the terms of the respective leases. Depreciation and amortization periods are as follows:

Buildings	40 years
Leasehold improvements	10 years or term of lease
Furniture and fixtures	5 to 10 years
Equipment	3 to 10 years

Lease Acquisition Costs

Lease acquisition costs are recorded at cost and amortized on the straight-line method over the respective lease terms, including option renewal periods if renewal of the lease is probable, which range from 5 to 40 years. Accumulated amortization at January 31, 1998 and February 1, 1997 totaled $19,483,000 and $15,432,000, respectively.

Notes to Consolidated Financial Statements

Investment in Affiliates

Investment in affiliates represents cash invested by the Company in foreign affiliates in Germany and the United Kingdom, which were accounted for under the equity method until May 1997, at which time the Company acquired controlling interest in the affiliates (see Note I). As a result, prior to May 1997, the Company accounted for its interests in these affiliates under the equity method and subsequent to May 1997, it has consolidated the affiliates in its financial statements.

Goodwill

Goodwill arising from business acquisitions is amortized on a straight-line basis over 40 years. Accumulated amortization was $10,622,000 and $5,897,000 as of January 31, 1998 and February 1, 1997, respectively. Management periodically evaluates the recoverability of goodwill, which would be adjusted for a permanent decline in value, if any, as measured by the recoverability from projected future cash flows from the acquired businesses.

Pre-opening Costs

Pre-opening costs, which consist primarily of salaries, supplies, marketing and occupancy costs, are charged to expense as incurred.

Private Label Credit Card Receivables

The Company offers a private label credit card which is managed by a financial services company. Under the terms of the agreement, the Company is obligated to pay fees which approximate the financial institution's cost of processing and collecting the receivables, which are non-recourse to the Company.

Foreign Currency Translation

The assets and liabilities of the Company's foreign subsidiaries, The Business Depot Ltd. ("Business Depot"), Staples UK, and MAXI-Papier, are translated into U.S. dollars at current exchange rates as of the balance sheet date, and revenues and expenses are translated at average monthly exchange rates. The resulting translation adjustments, and the net exchange gains and losses resulting from the translation of investments in the Company's European affiliates during the year ended January 31, 1998, are recorded in a separate section of stockholders' equity titled "Cumulative foreign currency translation adjustments".

Stock Option Plans

The Company has adopted Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("FAS 123"). As permitted by FAS 123, the Company continues to account for its stock-based plans under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", and provides pro forma disclosures of the compensation expense determined under the fair value provisions of FAS 123.

Earnings Per Share

In 1997, the Financial Accounting Standards Board issued Statement No. 128, "Earnings per Share" ("FAS 128"). FAS 128 replaced the calculation of primary and fully diluted earnings per share with basic and diluted earnings per share. Unlike primary earnings per share, basic earnings per share excludes any dilutive effects of options, warrants and convertible securities. Diluted earnings per share is very similar to the previously reported fully diluted earnings per share. All earnings per share amounts for all periods have been presented, and where appropriate, restated to conform to the FAS 128 requirements. See Note K for the computation of earnings per share for the years ended January 31, 1998, February 1, 1997 and February 3, 1996.

Fair Value of Financial Instruments

Pursuant to Statement of Financial Accounting Standards No. 107, "Disclosure About Fair Value of Financial Instruments" ("FAS 107"), the Company has estimated the fair value of its financial instruments using the following methods and assumptions:

The carrying amount of cash and cash equivalents, receivables and accounts payable approximates fair value;

The fair values of short-term investments and the 4 1/2% Convertible Subordinated Debentures are based on quoted market prices;

The carrying amounts of the Company's debt approximates fair value, estimated by discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Notes to Consolidated Financial Statements

Long-Lived Assets

The Company has adopted Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets To Be Disposed Of" ("FAS 121"), which requires impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flow estimated to be generated by those assets are less than the assets' carrying amount. The Company has evaluated all long-lived assets and determined that no impairment existed at January 31, 1998 and February 1, 1997, respectively. FAS 121 also addresses the accounting for long-lived assets that are expected to be disposed of.

Comprehensive Income

In June 1997, the Financial Accounting Standards Board issued Statement 130, "Reporting Comprehensive Income" ("FAS 130"). FAS 130 establishes new rules for the reporting and display of comprehensive income and its components; however, adoption in fiscal year 1998 will have no impact on the Company's net income or stockholders' equity. FAS 130 requires unrealized gains or losses on the Company's available-for-sale securities and the foreign currency translation adjustments, which currently are reported in stockholders' equity, to be included in other comprehensive income and the disclosure of total comprehensive income. If the Company adopted FAS 130 for the year ended January 31, 1998, the total of other comprehensive income items and comprehensive income (which includes net income) would be a loss of $10,194,000 and income of $120,755,000, respectively, and would be displayed separately in the consolidated statements of income.

Segment Reporting

In 1997, the Financial Accounting Standards Board issued Statement No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("FAS 131") which changes the way public companies report information about operating segments. The Company will adopt FAS 131 in fiscal year 1998. This statement, which is based on the management approach to segment reporting, establishes requirements to report selected segment information quarterly and to report entity-wide disclosures about products and services, major customers, and the major countries in which the Company holds assets and reports revenues.

NOTE B. INVESTMENTS

The following is a summary of available-for-sale investments as of January 31, 1998 and February 1, 1997 (in thousands):

January 31, 1998	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities	$ 2,659	7	0	$ 2,666

February 1, 1997	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities	$ 7,968	18	0	$ 7,986

There were no sales of investment securities during the year ended January 31, 1998. The reduction in the cost balance resulted from maturities of securities. The net adjustment to unrealized holding gains on available-for-sale securities included as a separate component of stockholders' equity totaled a decrease of $7,000 and $21,000 for the years ended January 31, 1998 and February 1, 1997, respectively.

The amortized cost and estimated fair value of debt and marketable equity securities at January 31, 1998, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because the issuers of securities may have the right to prepay obligations without prepayment penalties.

	Cost	Estimated Fair Value
Due in one year or less	$ 2,659	$ 2,666

NOTE C. LONG-TERM DEBT AND CREDIT AGREEMENT

Long-term debt consists of the following (in thousands):

	January 31, 1998	February 1, 1997
Capital lease obligations and other notes payable in monthly installments with effective interest rates from 4% to 16%; collateralized by the related equipment	$ 14,909	$ 19,062
Note payable with a fixed rate of 6.16%	25,000	25,000
Senior notes with a fixed rate of 7.125%	200,000	0
Revolving lines of credit	8,746	54,500
	$ 248,655	$ 98,562
Less current portion	39,779	7,220
	$ 208,876	$ 91,342

Aggregate annual maturities of long-term debt and capital lease obligations are as follows (in thousands):

Fiscal year:	Total
1998	$ 39,779
1999	2,344
2000	1,332
2001	361
2002	225
Thereafter	204,614
	$ 248,655

Included in property and equipment are capital lease obligations for equipment recorded at the net present value of the minimum lease payments of $25,352,000. Future minimum lease payments of $7,956,000, excluding $2,292,000 of interest, are included in aggregate annual maturities shown above. The Company entered into capital lease agreements totaling $2,770,000 and $2,733,000 during the fiscal years ended January 31, 1998 and February 1, 1997, respectively.

Senior Notes

The Company issued $200,000,000 of senior notes (the "Notes") on August 12, 1997 with an interest rate of 7.125% payable semi-annually on February 15 and August 15 of each year commencing on February 15, 1998. The notes are due August 15, 2007. Net proceeds of approximately $198,000,000 from the sale of the Company's Notes were used for repayment of indebtedness under the Company's revolving credit facility and for general working capital purposes, including the financing of new store openings, distribution facilities and corporate offices.

Credit Agreement

Effective November 13, 1997, the Company entered into a new revolving credit facility, effective through November 2002, with a syndicate of banks which provides up to $350,000,000 of borrowings. Borrowings made pursuant to this facility will bear interest at either the lead bank's prime rate, the federal funds rate plus 0.50%, the LIBOR rate plus a percentage spread based upon certain defined ratios, a competitive bid rate, or a swing line loan rate. This agreement, among other conditions, contains certain restrictive covenants including net worth maintenance, minimum fixed charge interest coverage and limitations on indebtedness, sales of assets, and dividends. As of January 31, 1998, no borrowings were outstanding under the revolving credit facility. MAXI-Papier also has a revolver of which $8,746,000 was outstanding as of January 31, 1998.

Interest paid by the Company totaled $19,518,000, $19,626,000 and $11,946,000 for the fiscal years ended January 31, 1998, February 1, 1997, and February 3, 1996, respectively. Capitalized interest totaled $1,387,000 and $611,000 in the years ended January 31, 1998 and February 1, 1997, respectively.

Interest Rate Swaps

During fiscal 1996 the Company entered into a binding interest rate swap agreement to reduce the impact of increases in interest rates on a portion of its floating-rate debt. The risk to the Company from this swap agreement was that the financial institution that was counterparty to this agreement fail to perform its obligation under the agreement, which would cause the interest rate on the notional amount under this agreement to reflect current market rates rather than the contractual fixed rate. The agreement was with a major financial institution which was expected to fully perform under the terms of the agreement, which mitigated this off-balance sheet risk. At February 1, 1997 the Company had one interest rate swap outstanding. The agreement bound the Company to pay a fixed rate of 5.65% on $25,000,000 of the Company's floating rate debt. In return the Company received payments based on a floating rate on $25,000,000 of the Company's floating rate debt. The floating rate equaled the 3-month LIBOR in effect at any one of the quarterly reset dates. The fair market value of the swap agreement as of February 1, 1997 approximated the carrying value based on quoted market prices. With the issuance of the Notes, the Company was able to repay all outstanding revolving credit loans that were subject to floating rates. Thus, the Company did not see the need to retain this interest rate swap arrangement and terminated it on July 29, 1997.

NOTE D. CONVERTIBLE DEBENTURES

By June 30, 1995, all of the Company's $115,000,000 of 5% Convertible Subordinated Debentures due November 1, 1999 (the "5% Debentures"), were converted into 19,406,250 shares of common stock at a conversion price of $5.93 per share. The total principal amount converted was credited to common stock and additional paid-in capital, net of unamortized expenses of the original debt issue and accrued but unpaid interest.

On October 5, 1995, the Company issued $300,000,000 of 4 1/2% Convertible Subordinated Debentures due October 1, 2000 with interest payable semi-annually (the "4 1/2% Debentures"), which are convertible, at the option of the holder, into Common Stock at a conversion price of $14.67 per share. The 4 1/2% Debentures are redeemable, in whole or in part, at the Company's option at specified redemption prices on or after October 1, 1998 or in the event of certain developments involving U.S. withholding taxes or certification requirements. Costs incurred in connection with the issuance of the 4 1/2% Debentures are included in Other Assets and are being amortized on the interest method over the five year period to maturity. The fair value of the 4 1/2% Debentures at January 31, 1998, based upon quoted market prices, totaled $386,250,000.

NOTE E. STOCKHOLDERS' EQUITY

On December 30, 1997, March 5, 1996 and June 29, 1995 the Board of Directors approved three-for-two splits of the Company's common stock to be effected in the form of 50% stock dividends. The dividends were distributed on January 30, 1998 to shareholders of record as of January 20, 1998, March 25, 1996 to shareholders of record as of March 15, 1996 and July 24, 1995 to shareholders of record as of July 14, 1995, respectively. The consolidated financial statements have been retroactively restated to give effect to these stock splits.

At January 31, 1998, 83,409,662 shares of common stock were reserved for issuance under the Company's stock option, employee stock ownership, 401(k), employee stock purchase and director stock option plans. An additional 20,454,545 shares of common stock are reserved for issuance upon conversion of the Company's 4 1/2% Debentures.

NOTE F. EMPLOYEE BENEFIT PLANS

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations in accounting for its employee stock options because, as discussed below, the alternative fair value accounting provided for under FASB Statement No. 123, "Accounting for Stock-Based Compensation" requires use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, since the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

Employee Stock Purchase Plan

The Company's 1994 Employee Stock Purchase Plan authorizes a total of up to 5,906,250 shares of the Company's common stock to be sold to participating employees. Participating employees may purchase shares of common stock at 85% of its fair market value at the beginning or end of an offering period, whichever is lower, through payroll deductions in an amount not to exceed 10% of an employee's base compensation.

Stock Option Plans

Under the Company's 1992 Equity Incentive Plan ("1992 Plan") the Company may grant to management and key employees incentive and nonqualified options to purchase up to 58,500,000 shares of common stock and Performance Accelerated Restricted Stock ("PARS"). This amount was approved by the shareholders of the Company on June 18, 1997. As of February 27, 1997, the Company's 1987 Stock Option Plan (the "1987 Plan") expired; unexercised options under this plan however remain outstanding. The exercise price of options granted under the plans may not be less than 100% of the fair market value of the Company's common stock at the date of grant. Options generally have an exercise price equal to the fair market value of the common stock on the date of grant. Some options outstanding are exercisable at various percentages of the total shares subject to the option starting one year after the grant, while other options are exercisable in their entirety three to five years after the grant date. All options expire ten years after the grant date, subject to earlier termination in the event of employment termination.

The Company's 1990 Director Stock Option Plan ("Director's Plan") authorizes up to 1,594,688 shares of common stock to be issued to non-employee directors. The exercise price of options granted are equal to the fair market value of the

Company's common stock at the date of grant. Options become exercisable in equal amounts over four years and expire ten years from the date of grant, subject to earlier termination, in certain circumstances, in the event the optionee ceases to serve as a director.

Pro forma information regarding net income and earnings per share is required by FAS 123, which also requires that the information be determined as if the Company has accounted for its employee stock options granted subsequent to January 28, 1995 under the fair valued method of that Statement. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for 1995, 1996, and 1997: risk-free interest rates ranging from 5.49% to 6.12%; volatility factor of the expected market price of the Company's common stock of .30 for fiscal years 1995 and 1996 and .35 for fiscal year 1997; and a weighted-average expected life of the option of 4.0 years for the 1987 Plan and the 1992 Plan and 2.0 to 5.0 years for the Director's Plan.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. For purposes of FAS 123's disclosure requirements, the Employee Stock Purchase Plan is considered a compensatory plan. The expense was calculated based on the fair value of the employees' purchase rights. This was estimated as the difference between the employees' purchase price and the closing price. The Company's pro forma information follows (in thousands except for earnings per share information):

	January 31, 1998	February 1, 1997	February 3, 1996
Pro forma net income	$ 116,804	$ 99,123	$ 69,687
Pro forma earnings per share	$ 0.47	$ 0.41	$ 0.30
Pro forma earnings per common share – assuming dilution	$ 0.46	$ 0.40	$ 0.29

This pro forma impact only takes into account options granted since January 28, 1995 and is likely to increase in future years as additional options are granted and amortized ratably over the vesting period.

Information with respect to options granted under the above plans are as follows:

	Number of Shares	Weighted-Average Exercise Price Per Share
Outstanding at January 28, 1995	31,908,470	$ 3.95
Granted	5,472,810	10.46
Exercised	(3,615,006)	3.27
Canceled	(2,285,888)	5.31
Outstanding at February 3, 1996	31,480,386	$ 4.93
Granted	4,781,291	13.23
Exercised	(4,093,695)	3.43
Canceled	(1,571,412)	7.34
Outstanding at February 1, 1997	30,596,570	$ 6.39
Granted	6,437,705	15.65
Exercised	(6,764,939)	4.17
Canceled	(1,871,922)	11.15
Outstanding at January 31, 1998	28,397,414	$ 8.01

The weighted-average fair values of options granted during the years ended January 31, 1998 and February 1, 1997 were $5.70 and $5.72, respectively. Exercise prices for the options outstanding as of January 31, 1998 ranged from $0.01 to $19.42.

Options to purchase 12,280,890 shares were exercisable at January 31, 1998.

Notes to Consolidated Financial Statements

Performance Accelerated Restricted Stock ("PARS")

PARS are shares of the Company's Common Stock granted outright to employees without cost to the employee. The shares, however, are restricted in that they are not transferable (e.g. they may not be sold) by the employee until they vest, generally after the end of five years. Such vesting date may accelerate if the Company achieves certain compound annual earnings per share growth over a certain number of interim years. If the employee leaves the Company prior to the vesting date for any reason, the PARS shares will be forfeited by the employee and will be returned to the Company. Once the PARS have vested, they become unrestricted and may be transferred and sold like any other Staples shares.

PARS issued in the fiscal year ended January 31, 1998 totaling approximately 675,000 which have a weighted average fair value of $18.71, initially vest on February 1, 2002 or will accelerate on May 1, in 1999, 2000, or 2001 upon attainment of certain compound annual earnings per share targets in the prior fiscal year. PARS totaling approximately 585,000 which have a weighted average fair value of $14.75, issued in fiscal year 1996 will fully vest on May 1, 1998.

In connection with the issuance of the PARS, the Company included $7,496,000 and $532,000 in compensation expense for the fiscal years ended January 31, 1998 and February 1, 1997, respectively.

Employees' 401(k) Savings Plan

Under the Company's Employees' 401(k) Savings Plan (the "401(k) Plan"), and Supplemental Executive Retirement Plan (the "SERP Plan"), the Company may contribute up to a total of 1,668,750 shares of common stock to these plans. The 401(k) Plan is available to all employees of the Company who meet minimum age and length of service requirements. Company contributions are based upon a matching formula applied to employee contributions, with additional contributions made at the discretion of the Board of Directors. In connection with these plans the Company included approximately $2,000,000 in expense for each of the fiscal years ended January 31, 1998 and February 1, 1997.

NOTE G. INCOME TAXES

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components and the approximate tax effect of the Company's deferred tax assets and liabilities as of January 31, 1998 and February 1, 1997, are as follows (in thousands):

	January 31, 1998	February 1, 1997
Deferred Tax Assets:		
Inventory	$ 20,116	$ 22,597
Deferred rent	14,797	7,566
Acquired NOL's	7,132	0
Other net operating loss carryforwards	22,907	5,206
Insurance	5,967	5,756
Employee benefits	5,569	2,545
Other - net	13,660	7,620
Total Deferred Tax Assets	90,148	51,290
Deferred Tax Liabilities:		
Depreciation	(6,687)	(1,922)
Other - net	(4,835)	208
Total Deferred Tax Liabilities	(11,522)	(1,714)
Total Valuation Allowance	(30,067)	(1,666)
Net Deferred Tax Assets	$ 48,559	$ 47,910

Net deferred tax assets of approximately $4,500,000 and $440,000 attributable to businesses acquired during the fiscal years ended January 31, 1998 and February 1, 1997, respectively, were allocated directly to reduce goodwill generated by these acquisitions. The deferred tax assets disclosed as acquired NOL's and other net operating loss carryforwards, totaling $30,000,000, have been fully reserved for due to the uncertainty of the realization of the asset within the local country jurisdiction. Further, if this asset is utilized when income is earned within the foreign jurisdiction, the Company will not have a consolidated tax benefit as the Company will be required to pay U.S. income taxes on the income offset by the foreign NOL.

Notes to Consolidated Financial Statements

For financial reporting purposes, income before taxes includes the following components:

	Fiscal Year Ended		
	January 31, 1998	February 1, 1997	February 3, 1996
Pretax income:			
United States	$ 176,584	$ 149,322	$ 124,487
Foreign	36,205	23,719	(4,642)
	$ 212,789	$ 173,041	$ 119,845

The provision for income taxes consists of the following (in thousands):

	Fiscal Year Ended		
	January 31, 1998	February 1, 1997	February 3, 1996
Current tax expense:			
Federal	$ 53,248	$ 50,546	$ 45,207
State	10,707	12,337	14,144
Foreign	14,092	601	0
	78,047	63,484	59,351
Deferred tax expense (benefit)	3,877	3,137	(13,211)
Total	$ 81,924	$ 66,621	$ 46,140

A reconciliation of the federal statutory tax rate to the Company's effective tax rate is as follows:

	Fiscal Year Ended		
	January 31, 1998	February 1, 1997	February 3, 1996
Federal statutory rate	35.0%	35.0%	35.0%
State taxes, net of federal benefit	6.0%	6.3%	6.3%
Tax exempt interest	(0.5%)	(0.4%)	(0.6%)
Tax benefit of loss carryforward	(0.0%)	(0.2%)	(0.6%)
Federal tax credits	(0.0%)	(0.0%)	(0.9%)
Other	(2.0%)	(2.2%)	(0.7%)
Effective tax rate	38.5%	38.5%	38.5%

Income tax payments were $23,487,877, $45,925,276, and $44,518,000, during fiscal years ended January 31, 1998, February 1, 1997, and February 3, 1996, respectively. The Company has net operating losses of approximately $83,500,000 that can be carried forward indefinitely, $16,500,000 of which is attributable to the Company's increased ownership in MAXI-Papier.

Undistributed earnings of the Company's foreign subsidiaries amounted to approximately $28,000,000 at January 31, 1998. Those earnings are considered to be indefinitely reinvested and, accordingly, no provision for U.S. federal and state income taxes has been provided thereon. Upon distribution of those earnings in the form of dividends or otherwise, the Company would be subject to both U.S. income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable to the various foreign countries. Determination of the amount of unrecognized deferred U.S. income tax liability is not practicable because of the complexities associated with its hypothetical calculation. Withholding taxes of approximately $500,000 would be payable upon remittance of all previously unremitted earnings at January 31, 1998.

NOTE H. LEASES AND OTHER OFF-BALANCE SHEET COMMITMENTS

The Company leases certain retail and support facilities under long-term noncancellable lease agreements. Most lease agreements contain renewal options and rent escalation clauses and require the Company to pay real estate taxes in excess of specified amounts and, in some cases, allow termination within a certain number of years with notice and a fixed payment. Certain agreements provide for contingent rental payments based on sales.

Other long-term obligations at January 31, 1998 include $37,670,000 relating to future rent escalation clauses and lease incentives under certain existing store operating lease arrangements. These rent expenses are recognized on a straight-line method over the respective terms of the leases.

Notes to Consolidated Financial Statements

Future minimum lease commitments for retail and support facilities (including lease commitments for 79 retail stores not yet opened at January 31, 1998) under noncancellable operating leases are due as follows (in thousands):

Fiscal year:	
1998	$ 214,739
1999	219,915
2000	212,964
2001	204,449
2002	193,868
Thereafter	1,504,787
	$ 2,550,722

Rent expense approximated $187,448,000, $136,049,000, and $105,125,000, for the fiscal years ended January 31, 1998, February 1, 1997, and February 3, 1996, respectively.

Letters of credit are issued by the Company during the ordinary course of business through major financial institutions as required by certain vendor contracts. As of January 31, 1998, the Company had available open letters of credit totaling $11,268,000.

NOTE I. SUMMARIZED FINANCIAL INFORMATION OF AFFILIATES

The Company had equity interests in two affiliated companies in Germany and the United Kingdom. On May 6, 1997 and May 7, 1997, the Company acquired Kingfisher PLC's interests in Staples UK and MAXI-Papier-Markt-GmbH ("MAXI-Papier"), respectively. As a result of these acquisitions, the Company's ownership interest of Staples UK increased to 100% and its ownership interest of MAXI-Papier increased to approximately 92%. The cash purchase price of approximately $57 million was generated through additional borrowings under the Company's existing revolving credit and term loan facility. The transactions were accounted for in accordance with the purchase method of accounting and accordingly, the results of operations of Staples UK and MAXI-Papier have been included in the Company's consolidated financial statements since May, 1997. The following is a summary of the significant financial information on a combined 100% basis of affiliated companies accounted for on the equity method.

	12 Months Ended	
	February 1, 1997	February 3, 1996
	(in thousands)	
Current assets	$ 64,858	$ 52,298
Other assets	32,538	33,125
Current liabilities	32,683	29,542
Other liabilities	8,550	15,094
Shareholders' equity	56,163	40,787
Net sales	230,845	154,626
Gross profit	68,500	44,655
Net loss before income taxes	(22,961)	(24,306)

The Company's share of loss for the unconsolidated affiliated companies for the fiscal years ended February 1, 1997 and February 3, 1996 was $11,073,000 and $12,153,000, respectively. Prior to the acquisition, the Company's share of loss in 1997 for the unconsolidated affiliated companies was $5,953,000.

Sales in the Canadian region are primarily generated from retail operations. The sales amounts primarily reflect the rules and regulations of the respective governing tax authorities. Operating income is determined by deducting from net sales the related costs and operating expenses attributed to the region. Identifiable assets include those directly identified with the region. For the years ended January 31, 1998, February 1, 1997 and February 3,1996, sales are $555,753,000, $431,049,000 and $72,299,000, respectively; operating income is $37,171,000, $24,466,000 and a loss of $1,832,000, respectively, and identifiable assets are $276,643,000, $214,595,000 and $156,154,000, respectively.

Notes to Consolidated Financial Statements

NOTE J. QUARTERLY SUMMARY (UNAUDITED)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(In thousands, except per share amounts)			
Fiscal Year Ended January 31, 1998				
Sales	$1,154,994	$1,061,867	$1,414,224	$1,549,950
Gross Profit	268,755	255,512	343,822	378,774
Net income	8,406 (1)	14,803 (1)	43,460	64,280
Earnings per common share				
Net income per common share	0.04	0.06	0.18	0.26
Number of shares used in computing earnings per common share	243,057	244,166	246,831	250,250
Earnings per share - assuming dilution				
Net income per common share	0.03	0.06	0.17 (2)	0.24 (2)
Number of shares used in computing earnings per common share	251,361	253,202	275,578 (2)	279,683 (2)
Fiscal Year Ended February 1, 1997				
Sales	$ 916,800	$ 808,056	$1,078,820	$1,163,989
Gross Profit	208,573	191,071	257,442	287,300
Net income	13,012	14,605	31,921	46,882
Earnings per common share				
Net income per common share	0.05	0.06	0.13	0.19
Number of shares used in computing earnings per common share	238,279	239,780	241,123	242,514
Earnings per share - assuming dilution				
Net income per common share	0.05	0.06	0.13 (2)	0.18 (2)
Number of shares used in computing earnings per common share	248,158	249,611	271,517 (2)	271,373 (2)

(1) Net income for the quarters ended May 3, 1997 and August 2, 1997 include a pre-tax charge of $20,562 and $9,103, respectively, resulting from costs incurred in connection with the proposed merger with Office Depot, Inc.

(2) Earnings per share – assuming dilution is calculated considering the $300 million of 4 1/2% Convertible Subordinated Debentures as common stock equivalents for the quarters ended November 1, 1997, January 31, 1998, November 2, 1996 and February 1, 1997. The Debentures are not considered in the calculation of the earnings per share for the other quarters above as the effect is antidilutive.

Notes to Consolidated Financial Statements

NOTE K. COMPUTATION OF EARNINGS PER COMMON SHARE

The computation of earnings per common share and earnings per common share - assuming dilution, for the fiscal years ended January 31, 1998, February 1, 1997 and February 3, 1996 is as follows (amounts in thousands, except for per share data):

	January 31, 1998	February 1, 1997	February 3, 1996
Numerator:			
Net income	$ 130,949	$ 106,420	$ 73,705
Interest expense on 5% Debentures, net of tax(1)			1,580
Numerator for earnings per common share –– income available to common stockholders	$ 130,949	$ 106,420	$ 75,285
Effect of dilutive securities:			
4 1/2% convertible debentures	9,372		
Numerator for earnings per common share – assuming dilution –– income available to common stockholders after assumed conversion	$ 140,321	$ 106,420	$ 75,285
Denominator:			
Weighted-average shares	246,074,347	240,423,966	234,563,922
Performance accelerated restricted stock	1,553		
Denominator for earnings per common share –– weighted-average shares	246,075,900	240,423,966	234,563,922
Effect of dilutive securities:			
Incremental shares	13,853,001	15,210,213	13,967,838
Windfall shares	(5,339,824)	(5,696,787)	(5,414,767)
Performance accelerated restricted stock	139,730		
4 1/2% convertible debentures	20,454,545		
Dilutive potential common shares	29,107,452	9,513,426	8,553,071
Denominator for earnings per common share – assuming dilution –– adjusted weighted-average shares and assumed conversions	275,183,352	249,937,392	243,116,993
Earnings per common share	$ 0.53	$ 0.44	$ 0.32
Earnings per common share – assuming dilution	$ 0.51	$ 0.43	$ 0.31

(1) The 5% Debentures were substantially converted into common stock on June 30, 1995 (see Note D). For the computation of earnings per common share, this conversion of 19,406,250 shares is assumed to have occurred at the beginning of the fiscal year (January 29, 1995), and is included in the weighted-average shares outstanding for the year. Therefore, the interest expense and amortization of deferred charges related to the 5% Debentures and incurred by the Company through June 30, 1995, net of tax, is added back to reported net income to compute earnings per common share for the fiscal year ended February 3, 1996.

NOTE L. SUBSEQUENT EVENTS FOOTNOTE

On April 7, 1998, the Company entered into an Agreement and Plan of Merger with Quill Corporation (“Quill”). The Merger is structured as a tax-free exchange of shares in which the stockholders of Quill will receive approximately 30 million shares of the Company’s common stock at a combination of fixed and variable prices which would equate to a purchase price of approximately $685 million. The Merger would be accounted for as a pooling of interests. Quill is a privately held company which sells office supplies to businesses in the United States via a mail order catalog, the internet and outbound telemarketing. Quill recorded $550 million in sales for the year ended December 31, 1997.

Report of Independent Auditors

Board of Directors and Shareholders
Staples, Inc.

We have audited the accompanying consolidated balance sheets of Staples, Inc. and subsidiaries as of January 31, 1998 and February 1, 1997, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended January 31, 1998. 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 generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about 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. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Staples, Inc. and subsidiaries at January 31, 1998 and February 1, 1997, and the consolidated results of its operations and its cash flows for each of the three years in the period ended January 31, 1998 in conformity with generally accepted accounting principles.

Ernst + Young LLP

Boston, Massachusetts
March 3, 1998,
except for Note L,
as to which the date
is April 7, 1998

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Executive Vice President and Chief Financial Officer
Campbell Soup Company
Board Committee: Audit

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Board Committee: Corporate Governance

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Manager, Office Technology

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Vice President, International
Information Systems

MARK V. KUNA
Vice President,
Finance, International

THOMAS STENEBRING
Managing Director,
Direct - Europe

Vice Presidents, Canada

DAVID E. BURT
General Counsel & Secretary

DEBBIE A. GILLIS
Vice President,
Information Services

WILLIAM HEFFERNAN
Vice President, Real Estate

DOUGLAS C. LAPHEN
Vice President, Marketing

STEVEN MATYAS
Vice President, Sales &
Operations

MARY E. SAGAT
Vice President, Finance

GERALD G. VACHON
Vice President, Merchandising

G. ALAN WARD
Vice President,
Human Resources

Corporate Information

CORPORATE OFFICES

Staples, Inc.
One Research Drive
Westborough, Massachusetts 01581
Phone: 508.370.8500
Internet Address: www.staples.com

SHAREHOLDER INFORMATION

For a copy of the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 1998 as filed with the Securities and Exchange Commission, please send a written request or telephone the investor hotline: 800.INV.SPL1 (800.468.7751).

Staples, Inc.
Investor Relations Department
One Research Drive
Westborough, Massachusetts 01581

TRANSFER AGENT REGISTRAR

BankBoston is the Transfer Agent and Registrar for the Company's Common Stock and maintains shareholder accounting records. Please contact the Transfer Agent directly concerning changes in address or name or ownership, lost certificates and to consolidate multiple accounts. When corresponding with the Transfer Agent, shareholders should state the exact name(s) in which the Staples stock is registered, the certificate number, as well as what information about the account needs to be changed.

BankBoston
c/o Boston EquiServe, L.P.
Post Office Box 2080
Boston, Massachusetts 02266-8040
Phone: 800.733.5001
Internet address: www.EquiServe.com

INVESTOR RELATIONS

Institutional investors and sell side analysts please contact:

Samuel J. Levenson, C.P.A.
Vice President, Investor Relations
Phone: 508.370.7963
Fax: 508.370.8989
E-mail: sam.levenson@staples.com

Individuals, financial analysts and investment clubs please contact:

Catherine E. Woods
Manager of Investor Relations
Phone: 508.424.7342
Fax: 508.370.8989
E-mail: catherine.woods@staples.com

INDEPENDENT AUDITORS

Ernst & Young LLP
200 Clarendon Street
Boston, Massachusetts 02116

ANNUAL MEETING

The Annual Meeting of Stockholders of Staples, Inc. will be held on June 4, 1998 at 2:00 p.m. at Fleet Bank, 8th floor Conference Center, 75 State Street, Boston, Massachusetts.

PRICE RANGE OF COMMON STOCK AND DIVIDEND POLICY

The Company's Common Stock is traded on the Nasdaq National Market under the symbol "SPLS".

As of January 31, 1998, the number of holders of record of the Company's Common Stock was 10,403.

The following table sets forth for the periods indicated the high and low sale prices per share of the Common Stock on the Nasdaq National Market, as reported by Nasdaq, retroactively adjusted for a three-for-two stock split in January 1998.

FISCAL YEAR ENDED	JANUARY 31, 1998	
	High	Low
First Quarter	$ 17.58	$ 11.75
Second Quarter	17.50	12.83
Third Quarter	19.50	15.33
Fourth Quarter	20.08	15.88

FISCAL YEAR ENDED	FEBRUARY 1, 1997	
	High	Low
First Quarter	$ 14.42	$ 10.67
Second Quarter	14.33	9.59
Third Quarter	15.09	11.25
Fourth Quarter	14.67	11.42

The Company has never paid a cash dividend on its Common Stock. The Company presently intends to retain earnings for use in the operation and expansion of its business and, therefore, does not anticipate paying any cash dividends in the foreseeable future. In addition, the Company's revolving credit agreement restricts the payment of dividends.

Designed by: Mystic View Design, Inc.

Growth: The last word

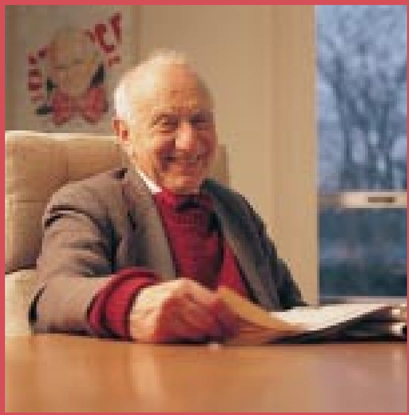
The associates of Staples, Inc. want to take this opportunity to thank two people who have made major contributions to our success over the past twelve years, and who are now moving on to new challenges. Leo Kahn, who recently retired from our board of directors, provided financial backing — and even more important, credibility — to Tom Stemberg's infant office-supply company back in 1985. Todd Krasnow, who stepped down as executive vice president of marketing on January 31, 1998, helped open the first Staples store in Brighton, Massachusetts, on May 1, 1986, practically dragging customers in off the street. He guided our marketing efforts from that day forward.

At this important changing of the guard, we asked Leo and Todd to share their thoughts with our shareholders.

I knew Staples was a winning concept from the start. What I didn't know was how aggressively growth-oriented Tom and his colleagues were going to be. I thought we'd open a store or two a year, and maybe hit a ceiling at 80 stores. But aggressive growth was absolutely the way to go. If you grab the opportunity before everybody and his brother gets in, you get a great edge. That's the first smart thing Staples did.

The broadening of the concept was also critical. Whenever a new concept is put into practice, no matter how well researched it is, it still needs work. The original concept of Staples was a limited number of SKUs, no delivery, no warehousing, no significant credit — and one by one, those restrictions were amended to pursue new opportunities. New channels opened up. New products came in.

But Tom and I both came out of the supermarket field, and I think the supermarket tradition is still strong at Staples. That begins with pleasing the customer, and treating him or her as Number One. Everybody talks that way, but in the supermarket business, which is so competitive, you've really got to do it. Talking about the customer isn't enough — you've got to deliver. Staples knows that.



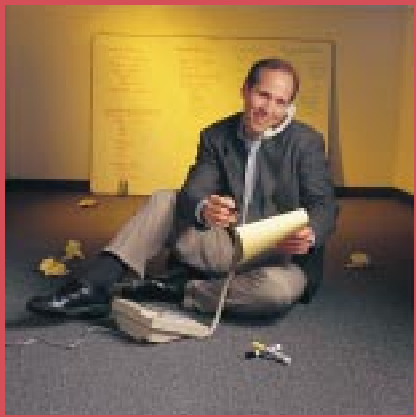
LEO KAHN

When we were first launching this company, Tom used to say, "Dream the dream, but live the reality." For me, reality was hanging signs in the stores, running to the newspaper with ad copy at the last minute, and so on. But even in the day-to-day crunch, we still kept one eye on the dream — which was to build a strong, vital company based on meeting the needs of small businesses.

I always thought of us as living right on the edge — in other words, if we didn't make our numbers, we could get in trouble in a hurry. And that can still be true today. The numbers have gotten bigger, but the people at Staples still know they can't afford to get careless, or sloppy. Mistakes get bigger, along with those big numbers!

For me, Staples has always been a place where people are able to invent interesting careers. They can get the personal satisfaction of dreaming something up, and then seeing that turn into reality. They can see important customer needs getting met that haven't been met before.

This will only be more true in the future. The opportunity for growth continues to be as enormous as it was twelve years ago. And that means an exciting and rewarding future for Staples — its associates, customers, vendors, and shareholders.



TODD KRASNOW

Thank you, and good luck!