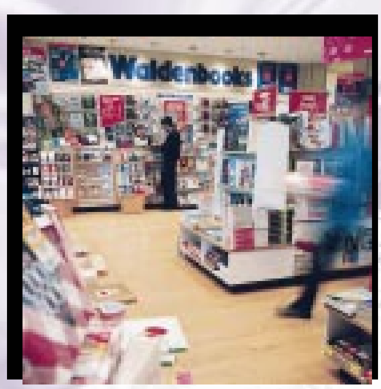
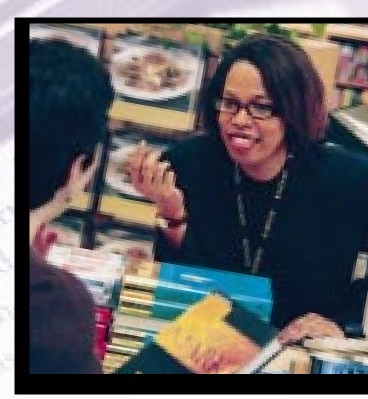
BORDERS GROUP

taking initiative

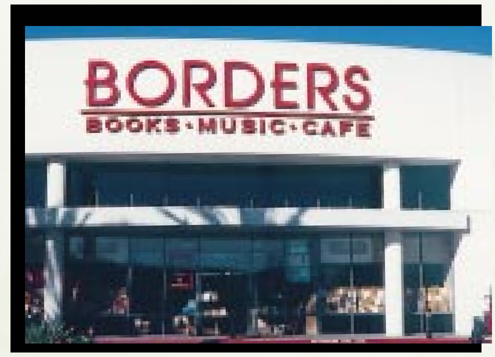
2000 ANNUAL REPORT


Waldenbooks



taking the challenge

At **Borders Group**, we're challenged daily to deliver shareholder value. To achieve this goal, we're taking initiative — looking squarely at our business. Building on what works. Changing what doesn't. Our store model has power. The book, music and video buying experience we deliver is compelling. Retail convergence, our unique and highly effective merger of selling channels, has momentum. Our plan for 2001 is aggressive. Many initiatives launched in 2000 are producing positive results that we will continue to leverage for greater growth. Inside this report, we'll share insight into our key initiatives and illustrate how they will lead Borders Group to drive increased shareholder value.

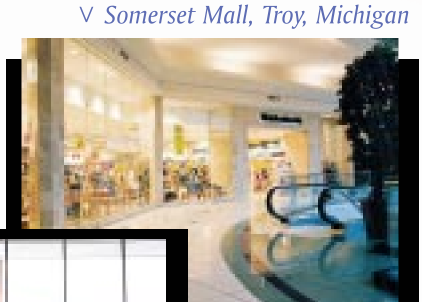


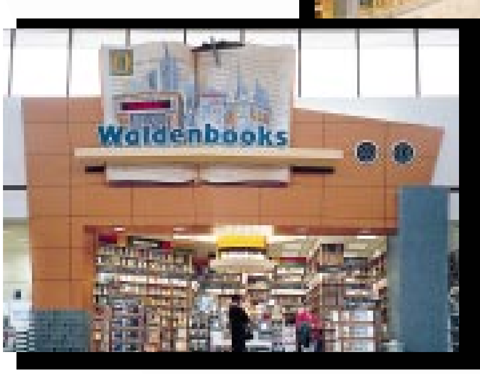
BGI
BORDERS GROUP, INC.

take a look at borders group, inc.

Borders Group is traded on the New York Stock Exchange under the symbol BGP. The company went public in 1995 and last year posted $3.3 billion in revenues supported by 30,000 employees worldwide. >

∨ *Somerset Mall, Troy, Michigan*





∧ *Newark International Airport*

<

As America's favorite mall bookstore, **Waldenbooks** meets our customers' need for convenience through 869 locations covering all 50 U.S. states. Waldenbooks is also landing in a growing number of airports to serve shoppers on the fly. Over three million customers have signed up for our Preferred Reader® loyalty program, and are now also being served by our new preferredreader.com Web site. Waldenbooks leverages its mall expertise to operate hundreds of successful Day By Day seasonal calendar locations each year and continues to provide cash flow and earnings to fund company growth initiatives.

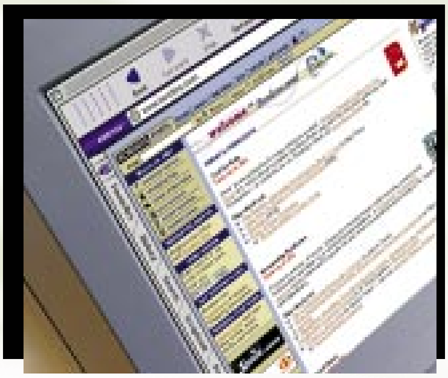
< *San Diego, California*

From Anchorage to Albuquerque, from L.A. to N.Y.C., there are 335 **Borders Books and Music** superstores. Shoppers across the U.S. count on their neighborhood Borders store to provide what's new, what's intriguing and what's unexpected in books, music and video. And there's more geography to claim as we expand domestically throughout the next decade. In fact, we've already identified 200 future Borders store locations in our expansion plans. In 2000, we opened 44 new domestic Borders superstores.

^ *Plaza Las Americas, Puerto Rico*

Borders is the only retailer of its kind expanding **internationally** where the market in English speaking countries for book and music superstores represents an opportunity of approximately $10 billion. In 2000, Borders opened five new superstores outside the contiguous United States. We operate 14 Borders stores overseas in the U.K., Singapore, Australia, New Zealand and Puerto Rico, where we opened our first bilingual store in February 2000. In addition, we own 31 Books etc. stores throughout the U.K.

The Web. Our customers see it as an important shopping option whether it's outside the store through Borders.com or in-store via our exclusive Title Sleuth™ computer stations. It's all about using technology to stay flexible and functional for whatever customers want from their shopping experience. >



Our mission: To be the best-loved provider of books, music, video and other entertainment, educational and informational products and services. To be the world leader in selection, service, innovation, ambiance, community involvement and shareholder value.

financial highlights

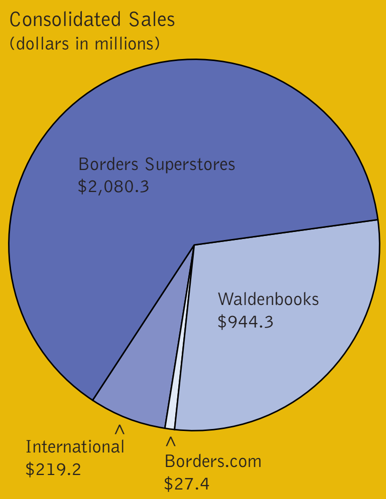
(dollars in millions except per share data)	Jan. 28, 2001	Jan. 23, 2000	Jan. 24, 1999
	Fiscal Year Ended		
Sales[1]	$ 3,271.2	$ 2,968.4	$ 2,595.0
% Increase	10.2%	14.4%	14.5%
Consolidated Net Income (Loss)[2]	$ 96.8	$ 97.4	$ 92.1
Stores	$ 115.2	$ 114.6	$ 102.6
Borders.com	$ (18.4)	$ (17.2)	$ (10.5)
Consolidated Diluted Earnings (Loss) per Share[2]	$ 1.21	$ 1.21	$ 1.12
Stores	$ 1.43	$ 1.42	$ 1.24
Borders.com	$ (.23)	$ (.21)	$ (.13)
Consolidated EBITDA per Share[2][3]	$ 3.32	$ 3.24	$ 2.83
Stores	$ 3.51	$ 3.45	$ 2.98
Borders.com	$ (.19)	$ (.21)	$ (.15)

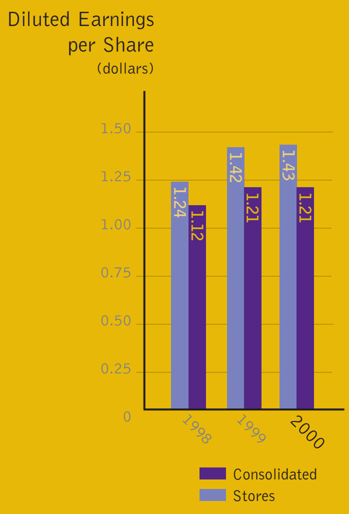
(1) Excludes discontinued operations
(2) Excludes non-recurring charges and discontinued operations
(3) Earnings before interest, taxes, depreciation and amortization

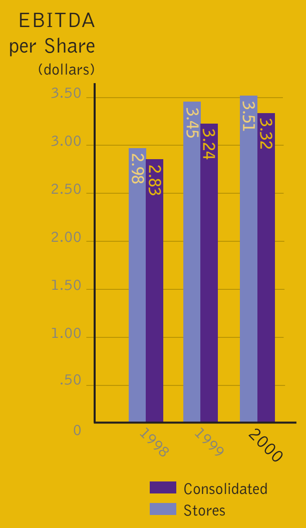
letter to investors

our plan to drive value

Performance. The catalyst that drives shareholder value and the single most important goal motivating Borders Group. While it can be defined in different ways, performance in our business represents the successful interplay of several long-term and short-term factors. These include delivering earnings growth, increasing total and comparable store sales, investing in the development of people and gaining market share, among others. In 2000, we simply did not create the right balance of these factors to achieve the level of performance that we know is possible when Borders Group fully leverages its formidable strengths.







On the sales front, we are proud to have achieved record consolidated sales of $3.3 billion. For the year, sales through Borders stores reached $2.1 billion by year-end, a figure that is 14 percent higher than the prior year. This is a strong achievement that provides momentum for the year ahead.

However, comparable store sales for Borders stores were 2.3 percent, clearly not up to our performance standards. Generating higher same store sales in Borders stores is our greatest challenge and a top priority for 2001. We are confident that an increase will play a significant role in unlocking shareholder value.

Core business growth will be achieved through several strategies, many of which were started in 2000. First is the management and staffing of Borders stores. Over years of rapid growth, Borders has achieved a level of store concentration in key markets, evolving into a force with significant market power. This evolution led us to a store structure that leverages this power and maintains high levels of customer service while also creating career paths for our staff and addressing compensation issues faced by all of retail.

In addition, we are addressing the marketing, merchandising and branding of Borders stores to reinforce our position as the best-in-class source for books, music, video and periodicals. Knowing that our customers love to shop all retail formats, we will also make our brands and their relationship to each other more apparent for gains in all channels.

^ Greg Josefowicz
President and
Chief Executive Officer

> *"Core business growth will be achieved through several strategies, many of which were started in 2000."*

• Performance represents the successful interplay of several long-term and short-term factors.

< Board of Directors
From left to right are Dr. Edna Greene Medford, Associate Professor of History at Howard University; Beth M. Pritchard, President and Chief Executive Officer of Bath & Body Works; Robert F. DiRomualdo, Chairman of Borders Group; Larry Pollock, President and Chief Operating Officer of Cole National Corporation; Gregory P. Josefowicz (seated), President and Chief Executive Officer of Borders Group; Peter R. Formanek, retired President and Chief Operating Officer of Autozone; and George R. Mrkonic (seated front), Vice Chairman of Borders Group. Not pictured: Victor L. Lund, Board Vice Chairman, Albertson's, Inc.

flexibility and functionality

For Borders superstores, the agenda also includes continued expansion of Title Sleuth, our Web-based in-store product search stations. This innovation was rolled out to all stores in the fourth quarter of 2000 as a key component of our convergence strategy. The technology investment to support Title Sleuth is critical. Ultimately, it will give us the flexibility and functionality to someday deliver a wide assortment of customer benefits — including digital distribution of books and music — to be provided as demand evolves. In addition to Title Sleuth, we will drive core business growth through the continued intensification of our Children's category and expansion of the Gifts & Stationery program. These individual efforts, which are detailed throughout this report, have already demonstrated an ability to drive comparable store sales.

The positive results of these initiatives will be extended into additional areas through a recently announced Category Management structure at the corporate level. Category Management tightly bonds the merchandising function with the sales and marketing function at Borders Group. As we apply this process, we are confident it will ultimately help deliver performance by creating a more intense focus on categories from a customer perspective while also requiring measurable goals and specific accountability for meeting them.

While we are mobilizing on these fronts, we will pace our new store growth to 25-30 domestic Borders stores for the year 2001. This allows for complete focus on and attention to enhancing our strong and productive Borders store model while still taking advantage of the opportunity ahead for domestic growth over the next decade. Demographic trends favorable to Borders, such as the continued rise in the number of affluent and highly educated Americans, support our growth thesis.

“We strongly believe we have hit on the formula for driving the kind of performance that increases shareholder value.”

Growth momentum will be carried forward outside the U.S. through continued expansion of our International store program with five to six new store locations planned for 2001. International performed well in 2000, generating total sales for the year of $219 million, an increase of 30 percent. Borders Group will keep International on its path to profitability by leveraging the existing infrastructure and benefiting from store maturation.

The goal at Waldenbooks, which generated sales of $944 million in fiscal 2000, will be to preserve a steady base of earnings and cash flow, while containing costs. Waldenbooks generates significant earnings and cash each year which provide the flexibility to fund growth initiatives and stock repurchasing. In 2000, we bought a total of $6.2 million in stock at an average price of $12.75 per share. Our plan is to continue to buy back stock as long as we believe our share price is undervalued.

Our continued focus on profit at Waldenbooks began in the fourth quarter of 2000 with the cessation of the All Wound Up seasonal toy store operations. It continues with the planned closing of 35-40 underperforming Waldenbooks stores in 2001. A limited number of new Waldenbooks locations will be opened in the coming year.

Our online investment will be channeled to support our in-store platform, while Borders.com will continue to be utilized as a convenience retail channel. We have targeted loss reduction as a major goal in this area. The first step in this process took place in the fourth quarter of 2000 when we wrote off certain hardware and software assets of Borders.com. We took this step with the realization that the direct-to-consumer segment of our online business will not produce profits in the foreseeable future. Therefore, we plan to continue to mitigate losses throughout 2001 via partnerships that take advantage of excess capacity in our industry, specifically in the area of fulfillment.

At Borders Group, we strongly believe we have hit on the formula for driving the kind of performance that increases shareholder value. It is a calculated mix of confidence and investment in our best-in-class Borders stores, a commitment to profitability in our International segment, continued cash generation at Waldenbooks and improvement in the economics of the direct-to-consumer portion of our online business.

Fundamentally, we must do what it takes to create the conditions and the motivation to sell more in an environment that delivers more to our customers.

Gregory P. Josefowicz

Gregory P. Josefowicz
President
Chief Executive Officer

• Category Management focuses on the customer perspective while requiring measurable performance goals and accountability for meeting them.

taking initiative

title sleuth

continuing convergence

Millions of shoppers know Title Sleuth as the innovative self-help computer stations in Borders stores. Using Title Sleuth, customers can get recommendations, locate titles and find out about upcoming store events. But it's much more than that. The technology that powers Title Sleuth also gives Borders Group the potential to capitalize on a number of emerging sales opportunities. From e-books to digital music download. From personalized customer content to direct commerce. Even Web reserve — the option of locating and reserving a title at your favorite Borders store from home, office or anywhere — will someday be made available via Title Sleuth on a timetable that evolves as customer needs do.

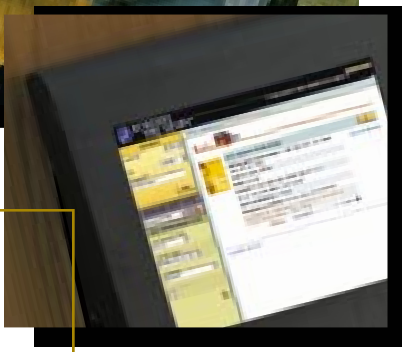
Title Sleuth represents our unique strategic approach. Rather than simply placing access to Borders.com in our stores, Title Sleuth offers a broader solution. It is store specific, finding and even mapping the titles our customers are looking for within their neighborhood store. It's all about immediate shopping gratification for customers — and improving performance for the company.

Even if the item is not in the store, Title Sleuth holds on to the sale by finding it outside the store and meeting the customer need with a special order shipment.

>
There is nothing like Title Sleuth in our segment of retail today. Right now, we're testing its direct commerce capabilities and looking at the options and advantages it gives Borders Group to meet even the most futuristic customer demands.

917,106

searches per week on average



>
Each and every Borders store has five to ten Title Sleuth stations, and they are busy! An impressive 917,106 Title Sleuth searches are conducted on average **each week** by customers in Borders stores across the nation. Shoppers love to track down what they're looking for in-store or out-of-store.

• Technology means having the flexibility and functionality to move quickly to meet customer needs.

taking initiative

international

the path to profitability

Borders Group is the only major retailer of its kind to pursue expansion overseas. There, the potential exists to add a source of revenue from the English speaking countries where the company operates today. The total market in these countries is estimated at $10 billion, one-third the size of the domestic market.

We opened our first International store in 1997 in Singapore. Since then, we've welcomed 13 more stores in the U.K., Australia, New Zealand and Puerto Rico. In addition, we operate 31 Books etc. locations in the U.K. Some of our International stores are among the top performers in terms of sales, chain wide.

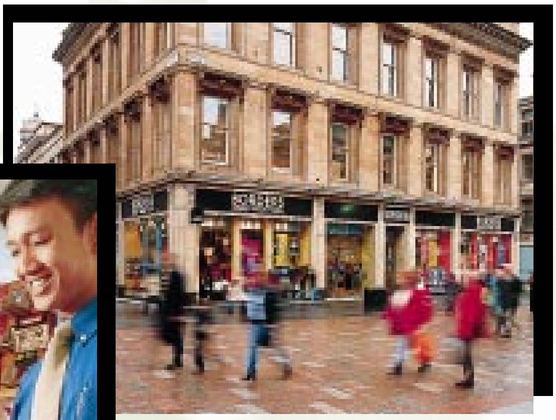
Borders Group plans five to six new International locations for 2001. They will include new stores in Sydney, Australia and Cambridge, England. The Sydney store will add to the attraction of Pitt Street Mall — one of the world's busiest retail districts with weekly foot traffic exceeding one million shoppers. The new U.K. store will be adjacent to the campus of the world-renowned University of Cambridge.

We will keep our International segment moving forward on its path to profitability by growing in established markets, leveraging the existing infrastructure and continuing to improve profits as stores mature.

$10 billion

overseas market opportunity

< **Borders International** stores, such as this one in Singapore, contributed positive net income in the fourth quarter of 2000. Now we're taking steps to move International stores from profit potential to profit realization on a full-year basis.



< **The Borders model is unique** overseas where our stores are as popular in Sydney and Glasgow (pictured above) as they are in Syracuse and Greensboro. We will continue to exchange best store practices across continents.

• International stores will move from profit potential to profit realization.

taking initiative

children's

focus that delivers

The Children's section of Borders is where thousands of kids go each week to giggle with Dr. Seuss, plot with the mischievous Madeline and doze off to "Goodnight Moon." It's also where the company has delivered an impressive same store sales increase over the past year. The increase was achieved by branding — through efforts like our Borders Explorers loyalty program — and intensifying our business focus on the category.

Children's was the first of what are now seven specific categories within books, music, video and beyond in which Borders Group has identified specific performance goals and accountability to drive comparable sales. This Category Management process is designed around customer needs and will extend the success experienced with Children's to other sections of the store.

225,175
kids entertained and educated
through events in Borders stores during 2000.

<
What books would satisfy a budding archeologist who just turned nine? How about a three year old with a curiosity about bugs? The typical Borders store selection of over 26,000 children's book titles can be overwhelming unless you know what you're looking for. That's where staff expertise and our exclusive **Guided Shopping** program come in. It's the solution for those who want to buy just the right thing for the little people in their lives.

^
The Gifts & Stationery section of Borders stores was expanded in 2000 with new items and more of everything from photo frames and greeting cards to wrapping paper and art posters.

taking initiative

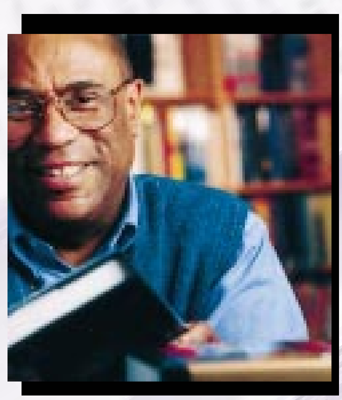
gifts & stationery

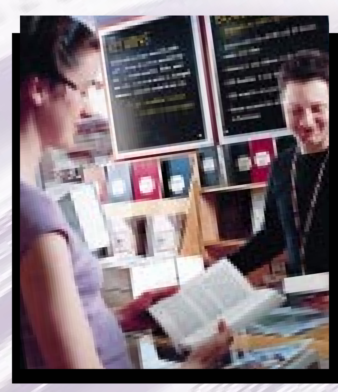
thinking inside the box

Beyond books, music and video, what do customers look for in a Borders store? Certainly, there's gourmet coffee. But there are other opportunities to get more financial bang from inside the box. That's why, in 2000, we expanded the Gifts & Stationery category by adding to our offering of greeting cards, gift wrap, picture frames and stationery. The result: a double-digit percent increase in comparable sales for the category.

In 2001, we will add writing instruments and desk accessories, among other items. In addition, Borders will focus on product presentation to enhance the total Gifts & Stationery shopping environment. And, we'll identify additional inside-the-box opportunities and potential alliances for growth.

• Intensifying and expanding the business focus on categories is a strategy that continues into 2001.





taking initiative

looking forward

a four-point plan

The year ahead will be one of intense and unrelenting focus for Borders Group. Our management team is in place and ready to move ahead with bold plans. In 2001, our full attention will be dedicated to this four-point plan:

- Displaying growth within our core business by increasing comparable store sales at Borders and doing what it takes to maintain our most productive store model and best-in-class status.
- Keeping International stores on the clear path to profit by leveraging our investment to date and growing established markets.
- Preserving Waldenbooks' ability to generate funds that fuel growth company wide while containing costs in this convenience-based mall format.
- Investing in our in-store Web-based technology platform exemplified by Title Sleuth while improving the economics of the direct-to-consumer portion of our online business.

It is our belief that this plan will ultimately help deliver the performance results that the market demands — and will help drive the value our shareholders deserve.

selected consolidated financial and operating data

The information set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations," and the Company's consolidated financial statements and the notes thereto.

(dollars in millions except per share data)

	Fiscal Year Ended				
STATEMENT OF OPERATIONS DATA	Jan. 28, 2001[1]	Jan. 23, 2000	Jan. 24, 1999	Jan. 25, 1998	Jan. 26, 1997
Borders Sales	$2,080.3	$1,823.2	$1,521.0	$1,267.4	$ 979.1
Waldenbooks Sales	944.3	959.1	948.7	970.0	979.7
International Sales	219.2	168.2	120.7	28.6	—
Total Store Sales	3,243.8	2,950.5	2,590.4	2,266.0	1,958.8
Borders.com Sales	27.4	17.9	4.6	—	—
Total Sales	$3,271.2	$2,968.4	$2,595.0	$2,266.0	$1,958.8
Operating Income Before Asset Impairments and Other Writedowns	$ 171.3	$ 171.0	$ 167.3	$ 138.0	$ 103.1
Asset Impairments and Other Writedowns	36.2	—	—	—	—
Operating Income from Continuing Operations	$ 135.1	$ 171.0	$ 167.3	$ 138.0	$ 103.1
Income from Continuing Operations	$ 73.8	$ 94.0	$ 92.1	$ 80.2	$ 57.9
Discontinued Operations, Net of Tax					
Loss from Operations of All Wound Up	$ 10.8	$ 3.7	$ —	$ —	$ —
Loss on Disposition of All Wound Up	$ 19.4	$ —	$ —	$ —	$ —
Net Income	$ 43.6	$ 90.3	$ 92.1	$ 80.2	$ 57.9
Diluted Earnings Per Common Share	$ 0.54	$ 1.13	$ 1.12	$ 0.98	$ 0.70
Diluted Earnings Per Common Share from Continuing Operations	$ 0.92	$ 1.17	$ 1.12	$ 0.98	$ 0.70
Diluted Earnings Per Common Share Before Asset Impairments and Other Writedowns and Discontinued Operations	$ 1.21	$ 1.17	$ 1.12	$ 0.98	$ 0.70
BALANCE SHEET DATA					
Working Capital	$ 217.2	$ 170.3	$ 144.5	$ 137.0	$ 225.1
Total Assets	$2,047.1	$1,914.8	$1,766.6	$1,534.9	$1,211.0
Short-Term Borrowings	$ 143.5	$ 133.4	$ 131.9	$ 122.5	$ 30.0
Long-Term Debt and Capital Lease Obligations, Including Current Portion	$ 15.8	$ 18.8	$ 8.5	$ 10.0	$ 6.7
Shares Subject to Repurchase	$ —	$ —	$ —	$ —	$ 34.1
Stockholders' Equity	$ 846.5	$ 802.6	$ 715.1	$ 598.1	$ 511.4

(1) The Company's 2000 fiscal year consisted of 53 weeks.

Management's Discussion and Analysis of Financial Condition and Results of Operations

General

Borders Group, Inc. (the Company), through its subsidiaries, is the second largest operator of book and music superstores and the largest operator of mall-based bookstores in the world based upon both sales and number of stores. At January 28, 2001, the Company operated 349 superstores primarily under the Borders name, including nine in the United Kingdom, two in Australia, and one each in Singapore, New Zealand, and Puerto Rico. The Company also operated 869 mall-based and other bookstores primarily under the Waldenbooks name, and 31 bookstores under the Books etc. name in the United Kingdom. The Company, through its subsidiary Borders Online, Inc., is also an online retailer of books, music, and video through the operation of its Internet commerce site, Borders.com.

The Company's business strategy is to continue its growth and increase its profitability through (i) the continued expansion and refinement of its Borders superstore operation in the United States and internationally, (ii) the continued focus on opportunistic store openings in its mall-based bookstore operations and expansion of its kiosk operations, (iii) the development of web-based commerce technologies which enhance the customer experience both in-store and online, and (iv) realization of synergies and economies of scale through a combination of certain of its books and music operations.

The Company's fiscal year ends on the Sunday immediately preceding the last Wednesday in January. Fiscal 2000 consisted of 53 weeks and ended on January 28, 2001. Fiscal 1999 and 1998 consisted of 52 weeks and ended on January 23, 2000, and January 24, 1999, respectively. References herein to years are to the Company's fiscal years.

Results of Operations

The following table presents the Company's consolidated statement of operations data, as a percentage of sales, for the three most recent fiscal years.

	Jan. 28, 2001	Jan. 23, 2000	Jan. 24, 1999
RESULTS OF OPERATIONS			
Sales	100.0%	100.0%	100.0%
Cost of merchandise sold (includes occupancy)	72.0	71.7	71.7
Gross margin	28.0	28.3	28.3
Selling, general and administrative expenses	22.5	22.1	21.5
Pre-opening expense	0.2	0.3	0.3
Goodwill amortization	0.1	0.1	0.1
Operating income before asset impairments and other writedowns	5.2	5.8	6.4
Asset impairments and other writedowns	1.1	—	—
Operating income	4.1	5.8	6.4
Interest expense	0.4	0.6	0.6
Income before income tax	3.7	5.2	5.8
Income tax	1.4	2.0	2.3
Income from continuing operations	2.3	3.2	3.5
Discontinued operations, net of tax:			
Loss from operations of All Wound Up	0.4	0.2	—
Loss on disposition of All Wound Up	0.6	—	—
Net Income	1.3%	3.0%	3.5%

Consolidated Results

Consolidated sales increases in fiscal 2000 and 1999 resulted primarily from the opening of new Borders superstores and increases in comparable store sales for Borders superstores.

Consolidated gross margin decreased as a percentage of sales in 2000, but was flat in 1999. The decrease in 2000 was driven by lower gross margin percentages for both the Borders and Waldenbooks segments. Among the reasons for the decrease in gross margin percentage of Borders was a change in sales mix to lower-margin items. The decrease in gross margin percentage of Waldenbooks was due to its fixed expenses (primarily store occupancy expenses) being spread over a smaller store base and lower sales volume in 2000 compared to 1999.

Consolidated selling, general and administrative expenses increased in 2000 and 1999 primarily due to continued spending on the Company's strategic initiatives, primarily international superstores and web-based convergence initiatives. The 1999 increase also included a $5.5 million pre-tax charge related to the resignation of the Company's former Chief Executive Officer.

In the fourth quarter of fiscal 2000, the Company took a pre-tax charge of $36.2 million related to the impairment of certain long-lived assets and other writedowns. The carrying value of long-lived assets are evaluated whenever changes in circumstances indicate the carrying amount of such assets may not be recoverable. In performing such reviews for recoverability, the Company compares the expected cash flows to the carrying value of long-lived assets. If the expected future cash flows are less than the carrying amount of such assets, the Company recognizes an impairment loss for the difference between the carrying amount and their estimated fair value. Fair value is estimated using expected discounted future cash flows. The charge taken in 2000 primarily consisted of $17.7 million for computer hardware and software of Borders.com and $12.5 million for leasehold improvements and furniture and fixtures primarily related to 103 underperforming Walden stores. The remainder of the charge related to employee severance, the costs of certain lease obligations for redundant headquarter buildings, and the write-off of certain equity investments.

Interest expense decreased as a percentage of sales in 2000 as a result of lower consolidated borrowing levels and was flat in 1999.

The effective tax rate for the years presented differed from the federal statutory rate primarily as a result of state income taxes. The Company's effective tax rate was 39.4% in 2000, as compared to 39.1% in 1999. The increase is primarily due to changes in the mix of income subject to tax in the various taxing jurisdictions. In 1998, the effective tax rate was 39.0%.

In January 2001, the Company adopted a plan to discontinue operations of All Wound Up, a seasonal retailer of interactive toys and novelty merchandise the Company had acquired in March 1999. The discontinuance and closure of All Wound Up resulted in an after-tax charge of $19.4 million in the fourth quarter of fiscal 2000, and is reflected in the Consolidated Statements of Operations as a discontinued operation. The charge was substantially non-cash and related primarily to the writeoff of goodwill, inventory and fixed assets.

The Company includes certain distribution and other expenses in its inventory costs, particularly freight, distribution payroll, and certain occupancy expenses. In addition, certain selling, general and administrative expenses are included in inventory costs. These amounts approximate 2% of total inventory.

Segment Results

The Company is organized based upon the following operating segments: domestic Borders stores, Waldenbooks stores, international Borders and Books etc. stores, online retailing through Borders.com, and other (consisting of interest expense and certain corporate governance costs). See Note 13 of the Notes to Consolidated Financial Statements for further information relating to these segments.

(Dollar amounts in millions)

Borders	2000	1999	1998
Sales	$2,080.3	$1,823.2	$1,521.0
Net income	$ 82.6	$ 72.9	$ 52.1
Net income as % of sales	4.0%	4.0%	3.4%
Depreciation and amortization expense	$ 52.9	$ 47.3	$ 42.3
Interest expense	$ 12.8	$ 16.4	$ 16.5
Store openings	44	46	43
Store count	335	291	245

The increases in Borders sales for 2000 and 1999 are primarily the result of new store openings and comparable store sales increases. Borders opened 44 and 46 new stores in 2000 and 1999, respectively, and experienced comparable store sales increases of 2.3% and 5.4% in 2000 and 1999, respectively.

Net income for 2000 and 1999 increased primarily due to store openings and Borders' ability to leverage fixed costs over a larger sales base. As a percentage of sales, net income for 2000 was flat with 1999 despite a decrease in gross margin percentage and an increase in non-payroll store expenses as a percentage of sales. The decrease in gross margin as a percentage of sales was due to a change in sales mix to DVDs and new-release music, a slight increase in promotional costs, and less leverage of store occupancy costs resulting from lower comparable store sales. Non-payroll store expenses as a percentage of sales increased due to lower comparable store sales increases. These items were offset by lower store payroll costs as a percentage of sales. Net income as a percentage of sales for 1999 was greater than 1998 primarily due to an increase in gross margin percentage resulting from improved shrinkage control and merchandise mix.

Depreciation and amortization expense increased in 2000 and 1999 as a result of the depreciation expense recognized on new stores' capital expenditures.

Interest expense decreased in 2000 and 1999 due to lower average borrowing levels.

Waldenbooks	2000	1999	1998
Sales	$944.3	$959.1	$948.7
Net income	$ 40.2	$ 55.5	$ 61.0
Net income as % of sales	4.3%	5.8%	6.4%
Depreciation expense	$ 25.8	$ 23.9	$ 18.8
Interest income	$ 26.2	$ 22.3	$ 18.9
Store Openings	11	39	16
Store Closings	46	35	39
Store Count	869	904	900

The decrease in Waldenbooks sales in 2000 is primarily the result of the decrease in store count during the year, coupled with a comparable store sales decrease of 2.9%. The increase in sales in 1999 is primarily the result of an increase in store count during the year, coupled with a comparable store sales increase of 0.7%.

Net income decreased in 2000 primarily as a result of decreased sales and a $7.8 million after-tax asset impairment charge primarily related to 103 underperforming stores. Net income in 1999 decreased due to a lower gross margin resulting from increased store occupancy expenses. As a percentage of sales, net income for 2000 decreased primarily due to the asset impairment charge and a decrease in gross margin percentage. This was due to increased promotional costs as a percentage of sales, and higher distribution and store occupancy costs as a percentage of sales resulting from the smaller store base and lower sales volume. Net income and net income as a percentage of sales decreased in 1999 primarily due to a lower gross margin percentage resulting from a change in sales mix to lower-margin, best-seller merchandise and increased store occupancy expenses.

Depreciation expense increased in 2000 and 1999 as a result of the depreciation expense recognized on new stores' and refurbished stores' capital.

Interest income increased in 2000 and 1999 as a result of Waldenbooks' continued positive cash flow in the years presented.

International	2000	1999	1998
Sales	$219.2	$168.2	$120.7
Net loss	$ 10.2	$ 7.9	$ 3.2
Net loss as % of sales	4.7%	4.7%	2.7%
Depreciation expense	$ 8.8	$ 6.5	$ 3.5
Interest expense	$ 12.4	$ 8.9	$ 7.4
Superstore Store Openings	5	4	4
Superstore Store Count	14	9	5
Books etc. Store Openings	6	2	4
Books etc. Store Closings	2	1	1
Books etc. Store Count	31	27	26

The increases in International sales for 2000 and 1999 are primarily the result of new superstore openings and comparable store sales increases. In 2000, the Company opened three additional stores in the United Kingdom, one additional store in Australia, and the Company's first store in Puerto Rico. In 1999, three stores were opened in the United Kingdom, as well as the Company's first store in New Zealand.

Net loss for 2000 increased as a result of higher depreciation and interest expense, partially offset by increased operating income generated from the maturation of the prior years' store base. Net loss for 2000 as a percentage of sales remained flat to the prior year. The addition of four new stores in 1999, nearly doubling the superstore count, led to an increased net loss from the prior year. Similar factors led to the change in net loss as a percentage of sales for 1999.

Depreciation and amortization expense increased in 2000 and 1999 as a result of the depreciation expense recognized on new stores' capital expenditures.

Interest expense increased in 2000 and 1999 due to higher average borrowing levels necessary to finance investments in new stores.

Foreign currency transaction gains (losses) were $(0.8) million, $0.2 million, and $0.3 million in 2000, 1999, and 1998, respectively.

Borders.com	2000	1999	1998
Sales	$ 27.4	$17.9	$ 4.6
Net loss	$ 29.7	$17.2	$ 10.5
Net loss as % of sales	108.4%	96.1%	228.3%
Depreciation expense	$ 7.8	$ 5.5	$ 1.9
Interest expense	$ 5.8	$ 4.4	$ 2.7

Borders.com began operations in fiscal 1998. Sales increased 53.1% and 289.1% in 2000 and 1999 respectively.

Net loss for 2000 increased primarily as a result of an $11.3 million after-tax asset impairment charge related to the computer hardware and software at Borders.com. The increased loss in 1999 over 1998 was due to a full year of the site's operating expense versus a partial year in 1998 due to the site's start up in late 1998. The fluctuations in net loss as a percentage of sales are driven by the same factors.

Depreciation expense increased in 2000 and 1999 as a result of the depreciation expense recognized on the capital expenditures required to develop and operate the site and to fulfill customer orders.

Interest expense increased in 2000 and 1999 due to higher average borrowing levels necessary to finance the site's development and operation.

Other	2000	1999	1998
Net loss	$ 9.1	$ 9.3	$ 7.3
Interest expense	$ 8.3	$ 9.2	$ 8.5

Net loss consists of various corporate governance costs and income. The 2000 net loss remained essentially flat with the prior year due to a $3.5 million after-tax charge related to employee severance and the costs of writing off redundant headquarters buildings and certain equity investments. The change in 1999 was primarily due to a $3.4 million after-tax charge related to the resignation of the Company's former Chief Executive Officer. Interest expense represents corporate-level interest costs not charged to the Company's operating segments.

Liquidity and Capital Resources

The Company's principal capital requirements are to fund working capital needs, the opening of new stores, the refurbishment and expansion of existing stores, and continued development of web-based commerce technologies.

Net cash provided by continuing operations in 2000 was $152.8 million, as compared to $181.3 million in 1999. The current year activity primarily reflects income before non-cash charges for depreciation and amortization offset by cash used for inventories as a result of store expansion at Borders. Inventory net of accounts payable increased primarily due to 49 new Borders stores.

Net cash used by discontinued operations represents the cash needed for the operations of All Wound Up in fiscal 2000 and 1999.

Net cash used for investing was primarily for capital expenditures for new stores and the refurbishment of existing stores. Capital expenditures in 2000 primarily reflect the opening of 49 new superstores and 11 new Waldenbooks stores. Additional capital spending in 2000 reflected the development and installation of in-store web-based technology and spending on corporate information technology infrastructure. Capital expenditures in 1999 reflect the opening of 50 new superstores and 39 new Waldenbooks stores. Capital expenditures in 1998 reflected the opening of 47 new superstores, 16 new Waldenbooks stores, a new distribution center and expansion of the home office facility.

Net cash provided by financing in 2000 was $19.5 million, resulting primarily from net borrowings under the Credit Facility and the issuance of common stock under the Company's employee benefit plans. Net cash used for financing in 1999 was $15.0 million, resulting primarily from the repurchase of common stock of $25.4 million, partially offset by the issuance of common stock under the Company's employee benefit plans.

The Company expects capital expenditures will decrease to approximately $110.0 to $120.0 million in 2001, resulting primarily from fewer domestic store openings. In addition, capital expenditures will result from international store openings, refurbishment of a number of existing stores, and investment in information systems streamlining. The Company currently plans to open approximately 25 to 30 domestic Borders superstores, five to seven international stores, and ten new Waldenbooks mall stores in 2001. Average cash requirements for the opening of a domestic prototype Borders books and music superstore are $2.3 million, representing capital expenditures of $1.1 million, inventory requirements, net of related accounts payable, of $1.1 million and $0.1 million of pre-opening costs. Average cash requirements to open a new or expanded Waldenbooks store range from $0.4 million to $0.7 million, depending on the size and format of the store. The Company plans to lease new store locations predominantly under operating leases.

The Company plans to execute its expansion plans for its Borders superstores and other strategic initiatives principally with funds generated from operations and financing through the Lease and Credit Facilities. The Company believes funds generated from operations, borrowings under the Credit Facility and financing through the Lease Facility will be sufficient to fund its anticipated capital requirements for at least the next two to three years. As discussed below, the Credit and Lease Facilities expire in October 2002, but the Company expects to be able to successfully renew the Facilities. The Company believes that its borrowing costs may increase beginning in November 2002, if financial market conditions are unchanged.

The Company currently has a share repurchase program in place with remaining authorization to repurchase approximately $66.8 million. During 2000 and 1999,

$9.2 million and $25.4 million of common stock was repurchased, respectively.

The Company has a $472.8 million multicurrency credit agreement (the Credit Facility) which expires in October 2002. Borrowings under the Credit Facility bear interest at a base rate or an increment over LIBOR at the Company's option. The Credit Facility contains covenants which limit, among other things, the Company's ability to incur indebtedness, grant liens, make acquisitions, merge, declare dividends, dispose of assets, issue or repurchase its common stock in excess of $100.0 million (plus any proceeds and tax benefits resulting from stock option exercises and tax benefits resulting from restricted shares purchased by employees from the Company), and require the Company to meet certain financial measures regarding fixed charge coverage, leverage and tangible net worth. The Company is prohibited under the Credit Facility from paying cash dividends on common shares.

The Company has a $175.0 million lease financing facility (the Lease Facility) to finance new stores and other property through operating leases which expires in October 2002. The Lease Facility provides financing to lessors through loans from a third party lender for up to 95% of a project cost. It is expected that lessors will make equity contributions approximating 5% of each project. Independent of its obligations as lessee, the Company guarantees payment when due of all amounts required to be paid to the third party lender. The principal amount guaranteed will be limited to approximately 89% of the original cost of a project, so long as the Company is not in default under the lease relating to such project. The Lease Facility contains covenants and events of default that are similar to those contained in the Credit Facility described above.

There were 40 properties financed through the Lease Facility, with a financed value of $163.1 million, at January 28, 2001. Management believes that the rental payments for properties financed through the Lease Facility may be lower than those which the Company could obtain elsewhere due to, among other factors, (i) the lower borrowing rates available to the Company's landlords under the facility, and (ii) the fact that rental payments for properties financed through the facility do not include amortization of the principal amounts of the landlords' indebtedness related to the properties. Rental payments relating to such properties will be adjusted when permanent financing is obtained to reflect the interest rates available at the time of the refinancing and the amortization of principal. In October 2000, the Company transferred four properties previously financed under the Lease Facility, with a total financed value of $13.8 million, to a new temporary facility with terms similar to those of the Lease Facility. In February 2001, two of these properties were transferred back to the Lease Facility, and two were permanently financed through operating leases. Also in February 2001, ten additional properties previously financed through the Lease Facility with a total financed value of $44.6 million were permanently financed through operating leases.

During 1994, the Company entered into agreements in which leases with respect to four Borders' locations serve as collateral for certain mortgage pass-through certificates. These mortgage pass-through certificates include a provision requiring the Company to repurchase the underlying mortgage notes in certain events, including the failure by the Company to make payments of rent under the related leases, the failure by Kmart Corporation (the former parent of the Company) to maintain required investment grade ratings or the termination of the guarantee by Kmart of the Company's obligations under the related leases (which would require mutual consent of Kmart and Borders). In the event the Company is required to repurchase all of the underlying mortgage notes, the Company would be obligated to pay approximately $36.6 million. The Company would expect to fund this obligation through its line of credit.

The Company is subject to risk resulting from interest rate fluctuations, as interest on the Company's borrowings is principally based on variable rates. The Company's objective in managing its exposure to interest rate fluctuations is to limit the impact of interest rate changes on earnings and cash flows and to lower its overall borrowing costs. The Company primarily utilizes interest rate swaps and collars to achieve this objective, effectively converting a portion of its variable-rate exposures to fixed interest rates.

LIBOR is the rate upon which the Company's variable rate debt, and its payments under the Lease Facility, are principally based. If LIBOR were to increase 1% for the full year in 2001 as compared to the end of 2000, the Company's after-tax earnings, after considering the effects of its interest rate swap agreements, would decrease $0.7 million based on the Company's expected average outstanding debt, including its indirect borrowings under the Lease Facility, as of January 28, 2001.

A portion of the Company's operations takes place in foreign jurisdictions, primarily the United Kingdom, Australia, New Zealand and Singapore. As a result, the Company's financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in the foreign markets in which the Company operates. The Company has generally not used derivative instruments to manage this risk.

Seasonality

The Company's business is highly seasonal, with sales significantly higher and substantially all operating income realized during the fourth quarter, which includes the Christmas selling season. The information below excludes discontinued operations and asset impairments and other writedowns.

	Fiscal 2000 Quarter Ended			
(Dollars in Millions)	April	July	October	January
Sales	$679.7	$698.4	$701.0	$1,192.1
Operating income (loss)	3.4	3.4	(0.1)	164.6
% of full year:				
Sales	20.8%	21.4%	21.4%	36.4%
Operating income	2.0	2.0	0.0	96.0

	Fiscal 1999 Quarter Ended			
(Dollars in Millions)	April	July	October	January
Sales	$617.9	$628.6	$651.1	$1,070.8
Operating income (loss)	(2.4)	1.8	5.8	165.8
% of full year:				
Sales	20.8%	21.2%	21.9%	36.1%
Operating income	(1.4)	1.1	3.4	96.9

	Fiscal 1998 Quarter Ended			
(Dollars in Millions)	April	July	October	January
Sales	$545.3	$546.0	$558.3	$ 945.4
Operating income	9.0	7.9	3.2	147.2
% of full year:				
Sales	21.0%	21.1%	21.5%	36.4%
Operating income	5.4	4.7	1.9	88.0

Other Matters

Subsequent Event

Subsequent to the Company's fiscal year-end, the Company entered into an agreement with Ingram Book Group ("Ingram"), a wholesaler of books, spoken audio and magazines, pursuant to which Ingram will provide book fulfillment services for the Company's special order and online sales. The transaction includes the sale of approximately $12.0 million of the Company's book inventory to Ingram, and will result in an after-tax charge of approximately $15.0 to $20.0 million to be taken in the first quarter of fiscal 2001. This charge is substantially non-cash and is primarily related to the writedown of assets used by the current Company-owned facility to fulfill special order and online sales, including warehouse equipment, hardware and software, and a reduction of recorded inventory.

consolidated statements of operations

(dollars in millions except per share data)	Fiscal Year Ended Jan. 28, 2001	Jan. 23, 2000	Jan. 24, 1999
Sales	$3,271.2	$2,968.4	$2,595.0
Cost of merchandise sold (includes occupancy)	2,354.5	2,127.6	1,859.4
Gross margin	916.7	840.8	735.6
Selling, general and administrative expenses	736.2	659.2	557.6
Pre-opening expense	6.4	7.8	7.8
Asset impairments and other writedowns	36.2	—	—
Goodwill amortization	2.8	2.8	2.9
Operating income	135.1	171.0	167.3
Interest expense	13.1	16.6	16.2
Income from continuing operations before income tax	122.0	154.4	151.1
Income tax provision	48.2	60.4	59.0
Income from continuing operations	$ 73.8	$ 94.0	$ 92.1
Discontinued operations (Note 3)			
Loss from operations of All Wound Up, net of income tax credits of $7.0 and $2.4	10.8	3.7	—
Loss on disposition of All Wound Up, net of deferred income tax credit of $8.9	19.4	—	—
Net income	$ 43.6	$ 90.3	$ 92.1
Earnings (loss) per common share data (Note 2)			
Diluted earnings (loss) per common share:			
Continuing operations	$ 0.92	$ 1.17	$ 1.12
Discontinued operations	(0.38)	(0.04)	—
Net diluted earnings per common share	$ 0.54	$ 1.13	$ 1.12
Basic earnings (loss) per common share:			
Continuing operations	$ 0.94	$ 1.21	$ 1.20
Discontinued operations	(0.38)	(0.05)	—
Net basic earnings per common share	$ 0.56	$ 1.16	$ 1.20

See accompanying Notes to Consolidated Financial Statements.

consolidated balance sheets

(dollars in millions except share amounts)	Fiscal Year Ended Jan. 28, 2001	Jan. 23, 2000
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 59.1	$ 41.6
Merchandise inventories	1,201.2	1,077.7
Accounts receivable and other current assets	73.7	68.9
Deferred income taxes	1.1	10.0
Total Current Assets	1,335.1	1,198.2
Property and equipment, net	562.3	558.2
Other assets	34.2	36.5
Deferred income taxes	22.3	0.1
Goodwill, net of accumulated amortization of $53.1 and $49.5, respectively	93.2	121.8
	$2,047.1	$1,914.8
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Short-term borrowings and current portion of long-term debt	$ 144.4	$ 136.1
Trade accounts payable	623.6	580.4
Accrued payroll and other liabilities	256.6	232.2
Taxes, including income taxes	93.3	79.2
Total Current Liabilities	1,117.9	1,027.9
Long-term debt and capital lease obligations	15.0	16.2
Other long-term liabilities	67.7	68.1
Commitments and contingencies (Note 7)	—	—
Total Liabilities	1,200.6	1,112.2
Stockholders' Equity:		
Common stock, 200,000,000 shares authorized; 78,649,501 and 77,687,829 shares issued and outstanding at January 28, 2001 and January 23, 2000, respectively	685.2	679.6
Deferred compensation and officer receivables	(1.0)	(3.9)
Accumulated other comprehensive income (loss)	(8.0)	0.2
Retained earnings	170.3	126.7
Total Stockholders' Equity	846.5	802.6
	$2,047.1	$1,914.8

See accompanying Notes to Consolidated Financial Statements.

consolidated statements of cash flows

(dollars in millions)	Fiscal Year Ended Jan. 28, 2001	Jan. 23, 2000	Jan. 24, 1999
Cash provided by (used for):			
Operations			
Income from continuing operations	$ 73.8	$ 94.0	$ 92.1
Adjustments to reconcile net income to operating cash flows:			
Depreciation and amortization	95.3	83.5	66.7
(Increase) decrease in deferred income taxes	(4.6)	7.4	10.2
Increase (decrease) in other long-term assets and liabilities	6.0	8.2	1.9
Asset impairments and other writedowns	23.0	—	—
Cash provided by (used for) current assets and current liabilities:			
Increase in inventories	(136.5)	(50.4)	(140.5)
Increase (decrease) in accounts payable	45.0	(29.2)	126.5
Increase in taxes payable	35.2	60.8	2.9
Other — net	15.6	7.0	6.4
Net cash provided by continuing operations	152.8	181.3	166.2
Net cash used for discontinued operations	(14.2)	(8.3)	—
Net cash provided by operations	138.6	173.0	166.2
Investing			
Capital expenditures	(138.7)	(143.5)	(179.8)
Net investing activities of discontinued operations	(2.4)	(15.7)	—
Net cash used for investing	(141.1)	(159.2)	(179.8)
Financing			
Repayment of long-term debt and capital lease obligations	(4.2)	(1.2)	(4.6)
Increase in capital lease obligations	—	0.5	3.0
Repayment of debt assumed in acquisition	—	(2.0)	—
Proceeds from construction funding	—	—	1.3
Net funding from credit facility	21.4	1.5	9.4
Issuance of common stock	11.5	11.6	33.9
Repurchase of common stock	(9.2)	(25.4)	(51.7)
Net cash provided by (used for) financing	19.5	(15.0)	(8.7)
Effect of exchange rates on cash and equivalents	0.5	—	—
Net increase (decrease) in cash and equivalents	17.5	(1.2)	(22.3)
Cash and equivalents at beginning of year	41.6	42.8	65.1
Cash and equivalents at end of year	$ 59.1	$ 41.6	$ 42.8
Supplemental Cash Flow Disclosures:			
Interest paid	$ 15.8	$ 18.0	$ 16.2
Income taxes paid	$ 38.6	$ 6.4	$ 42.1
Debt and liabilities assumed in business acquisition	$ —	$ 6.5	$ —

See accompanying Notes to Consolidated Financial Statements.

consolidated statements of stockholders' equity

(dollars in millions except share amounts)	Common Stock Shares	Common Stock Amount	Deferred Compensation and Officer Receivables	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total
Balance at January 25, 1998	75,395,998	$661.0	$(6.3)	$(0.9)	$ (55.7)	$598.1
Net income	—	—	—	—	92.1	92.1
Issuance of common stock	4,171,059	38.3	(6.6)	—	—	31.7
Repurchase and retirement of common stock	(1,871,933)	(51.7)	—	—	—	(51.7)
Tax benefit of equity compensation	—	39.7	—	—	—	39.7
Change in receivables and deferred compensation	—	—	5.2	—	—	5.2
Balance at January 24, 1999	77,695,124	$687.3	$(7.7)	$(0.9)	$ 36.4	$715.1
Net income	—	—	—	—	90.3	90.3
Foreign currency translation adjustments	—	—	—	1.1	—	1.1
Comprehensive income						91.4
Issuance of common stock	2,444,055	11.5	—	—	—	11.5
Repurchase and retirement of common stock	(2,451,350)	(25.4)	—	—	—	(25.4)
Tax benefit of equity compensation	—	6.2	—	—	—	6.2
Change in receivables and deferred compensation	—	—	3.8	—	—	3.8
Balance at January 23, 2000	77,687,829	$679.6	$(3.9)	$ 0.2	$126.7	$802.6
Net income	—	—	—	—	43.6	43.6
Foreign currency translation adjustments	—	—	—	(8.2)	—	(8.2)
Comprehensive income						35.4
Issuance of common stock	1,596,475	11.5	—	—	—	11.5
Repurchase and retirement of common stock	(634,803)	(9.2)	—	—	—	(9.2)
Tax benefit of equity compensation	—	3.3	—	—	—	3.3
Change in receivables and deferred compensation	—	—	2.9	—	—	2.9
Balance at January 28, 2001	78,649,501	$685.2	$(1.0)	$(8.0)	$170.3	$846.5

See accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

(Dollars in Millions Except Per Common Share Data)

Note 1 – Summary of Significant Accounting Policies

Nature of Business: Borders Group, Inc. (the Company), through its subsidiaries, operates book and music superstores, mall-based bookstores and other bookstores in the United States, United Kingdom, Australia, Singapore, New Zealand and Puerto Rico. The Company, through its subsidiary Borders Online, Inc., is also an online retailer of books, music, and video through the operation of its Internet commerce site, Borders.com. The Company's subsidiaries include Borders, Inc. (Borders), Walden Book Company, Inc. (Walden), Borders (UK) Limited (formerly Books etc.) and Borders Online, Inc.

Principles of Consolidation: The consolidated financial statements include the accounts of the Company and all majority-owned subsidiaries. All significant intercompany transactions and balances have been eliminated.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fiscal Year: The Company's fiscal year ends on the Sunday immediately preceding the last Wednesday in January. Fiscal 2000 consisted of 53 weeks and ended on January 28, 2001. Fiscal 1999 and 1998 consisted of 52 weeks and ended on January 23, 2000, and January 24, 1999, respectively.

Foreign Currency and Translation of Foreign Subsidiaries: All assets and liabilities of the Company's foreign operations are translated into U.S. dollars at fiscal period-end exchange rates. Income and expense items are translated at average exchange rates prevailing during the year. The resulting translation adjustments are recorded as a component of stockholders' equity and other comprehensive income. The functional currencies of the Companies' foreign operations are the respective local currencies. Foreign currency translation gains/(losses) were $(0.8), $0.2, and $0.3 in 2000, 1999, and 1998, respectively.

Cash and Equivalents: Cash and equivalents include short-term investments with original maturities of 90 days or less.

Inventories: Merchandise inventories are valued on a first-in, first-out (FIFO) basis at the lower of cost or market using the retail inventory method. The Company includes certain distribution and other expenses in its inventory costs, totaling $87.7 and $79.8 as of January 28, 2001, and January 23, 2000, respectively.

Property and Equipment: Property and equipment are recorded at cost, including capitalized interest, and depreciated over their estimated useful lives on a straight-line basis for financial statement purposes and on accelerated methods for income tax purposes. Most store properties are leased and improvements are amortized over the term of the lease, generally over 5 to 20 years. Other annual rates used in computing depreciation for financial statement purposes are 2% to 3% for buildings and 10% to 33% for other fixtures and equipment. Amortization of assets under capital leases is included in depreciation expense.

During fiscal 1999, the Company shortened the estimated depreciable lives of certain categories of personal computer equipment to three years and extended the estimated depreciable lives of certain store fixtures up to ten years. The Company believes that these changes better reflect the useful lives of these assets. The Company accounted for this as a change in estimate; accordingly, the Company will utilize the new depreciable lives prospectively. These changes did not have a material impact on the Company's financial position or results of operations during fiscal 2000 or 1999.

The carrying value of long-lived assets and certain identifiable intangible assets are evaluated whenever changes in circumstances indicate the carrying amount of such assets may not be recoverable.

Goodwill: Goodwill is amortized over 20 to 40 years on a straight-line basis. The Company evaluates the recoverability of goodwill using a fair value methodology whenever events or changes in circumstances indicate that the carrying amount of goodwill may not be recoverable. This methodology is applied separately to each of the businesses for which the Company has recorded goodwill. In determining the fair value, the median price/earnings (P/E) multiple for similar growth retail companies, or the median earnings before depreciation and amortization, interest and taxes (EBITDA) multiple for mature companies, is calculated based upon actual quoted market prices per share and analysts' consensus earnings estimates for these companies. The applicable multiple is applied to earnings or EBITDA to arrive at an overall fair value of the respective companies. The Company evaluates any indicated impairment as temporary or permanent, and records appropriate charges (if any) to operations for permanent impairments.

Financial Instruments: The recorded values of the Company's financial instruments, which include accounts receivable, accounts payable, and indebtedness, approximate their fair values.

The Company has entered into interest rate swap and collar agreements to reduce the impact of changes in interest rates on its variable-rate debt and amounts outstanding under the Lease Facility. The net cash amounts paid or received by the Company resulting from these agreements are recognized as an adjustment to interest expense in the period to which the amounts paid or received relate.

Revenue: Revenue is recognized, net of estimated returns, at the point of sale for all of the Company's segments except Borders.com, which recognizes revenue upon the shipment of merchandise to customers.

Pre-Opening and Closing Costs: In fiscal 1999, the Company adopted the American Institute of Certified Public Accountants' Statement of Position (SOP) 98-5, "Reporting on the Costs of Start-Up Activities," which requires store pre-opening costs to be expensed as incurred. The Company had expensed store pre-opening costs in the first fiscal month of a store's operations. This SOP does not permit restatement of amounts recorded prior to the adoption of the SOP; however, adoption of this SOP did not have a material impact on the Company's financial position, results of operations, or liquidity in fiscal 2000 or fiscal 1999.

When the decision to close a store is made, the Company provides for the future net lease obligation and other expenses directly related to discontinuance of operations of the store.

Preferred Reader Program: Walden sells memberships in its Preferred Reader Program, which offers members discounts on purchases and other benefits. Membership fees are deferred and recognized over the 12-month membership period.

Equity-Based Compensation: The Company accounts for equity-based compensation under the guidance of APB No. 25. See Note 11 for discussion of the pro forma net income calculated under FAS 123.

New Accounting Guidance: In June 1998, the Financial Accounting Standards Board issued Statement No. 133, "Accounting For Derivative Instruments and Hedging Activities (FAS 133), as amended by Statement Nos. 137 and 138, which the Company adopted effective January 29, 2001. Changes in derivative fair values will either be recognized in earnings as offsets to the changes in fair value of related hedged assets, liabilities and firm commitments or, for forecasted transactions, deferred and recorded as a component of other stockholders' equity until the hedged transactions occur and are recognized in earnings. The ineffective portion of a hedging derivative's change in fair value will be immediately recognized in earnings. The effect of adopting FAS 133 was not material to the Company's financial position or results of operations.

Reclassifications: Certain prior year amounts have been reclassified to conform to fiscal 2000 presentation.

Note 2 – Weighted-Average Shares Outstanding

Weighted-average shares outstanding are calculated as follows (thousands):

	2000	1999	1998
Weighted-average common shares outstanding—basic earnings per share	78,374	77,577	76,631
Dilutive effect of employee stock options	1,914	2,641	5,872
Weighted-average common shares outstanding—diluted earnings per share	80,288	80,218	82,503

Unexercised employee stock options to purchase 14.3 million, 10.2 million and 9.1 million common shares as of January 28, 2001, January 23, 2000, and January 24, 1999, respectively, were not included in the weighted-average shares outstanding calculation because to do so would have been antidilutive.

Note 3 – Discontinued Operations

In March 1999, the Company purchased All Wound Up, a seasonal retailer of interactive toys and novelty merchandise for a purchase price of $19.7 (excluding debt repayment), allocated primarily to fixed assets, inventory, and goodwill. The acquisition has been accounted for as a purchase.

In January 2001, the Company adopted a plan to discontinue operations of All Wound Up. Accordingly, the operating results of the All Wound Up operations, including a writeoff of leasehold improvements, equipment and deferred charges of approximately $19.4, have been segregated from continuing operations and reported as a separate line item on the statement of operations. The Company has restated its prior financial statements to present the operating results of All Wound Up as a discontinued operation.

Operating results (exclusive of the aforementioned provisions) from discontinued operations are as follows:

	2000	1999
Net sales	$ 23.2	$30.8
Costs and expenses:		
Cost of sales	25.4	20.5
Selling, general and administrative expenses	12.0	14.4
Goodwill	0.9	0.7
Operating loss	(15.1)	(4.8)
Other deductions	2.7	1.3
Loss before income tax	(17.8)	(6.1)
Income tax credit	(7.0)	(2.4)
Net loss from operations	$(10.8)	$ (3.7)

The components of net assets of discontinued operations included in the Company's consolidated balance sheets at January 28, 2001, and January 23, 2000, are as follows:

	2000	1999
Net assets	$14.6	$31.6
Net liabilities	2.7	8.3
	$11.9	$23.3

Note 4 – Asset Impairments and Other Writedowns

In the fourth quarter of fiscal 2000, the Company took a pre-tax charge of $36.2 related to the impairment of certain long-lived assets and other writedowns. The carrying value of long-lived assets are evaluated whenever changes in circumstances indicate the carrying amount of such assets may not be recoverable. In performing such reviews for recoverability, the Company compares the expected cash flows to the carrying value of long-lived assets. If the expected future cash flows are less than the carrying amount of such assets, the Company recognizes an impairment loss for the difference between the carrying amount and their estimated fair value. Fair value is estimated using expected discounted future cash flows. The charge taken in 2000 primarily consisted of $17.7 for computer hardware and software of Borders.com and $12.5 for leasehold improvements and furniture and fixtures of underperforming Walden stores. The remainder of the charge was related to employee severance, the costs of certain lease obligations for redundant headquarter buildings, and the writeoff of certain equity investments.

Note 5 – Property and Equipment

Property and equipment consists of the following:

	2000	1999
Property and equipment:		
Land	$ 10.2	$ 10.2
Buildings	3.5	5.3
Leasehold improvements	339.6	307.8
Furniture and fixtures	712.1	593.9
Construction in progress	12.8	36.4
	1,078.2	953.6
Less—accumulated depreciation and amortization	(515.9)	(395.4)
Property and equipment, net	$ 562.3	$ 558.2

Note 6 – Income Taxes

The income tax provision from continuing operations consists of the following:

	2000	1999	1998
Current:			
Federal	$46.0	$45.4	$40.9
State and local	5.3	7.4	7.9
Foreign	0.3	0.2	—
Deferred:			
Federal	(0.6)	10.2	11.7
State and local	1.0	0.7	—
Foreign	(3.8)	(3.5)	(1.5)
Total income tax provision	$48.2	$60.4	$59.0

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

	2000	1999	1998
Federal statutory rate	$42.8	$54.0	$52.9
State and local taxes, net of federal tax benefit	4.1	5.3	5.2
Other	1.3	1.1	0.9
Total income tax provision	$48.2	$60.4	$59.0

Deferred tax assets and liabilities resulted from the following:

	2000	1999
Deferred tax assets:		
Federal benefit for state deferred taxes	$ 1.7	$ 0.9
Accruals and other current liabilities	3.9	8.6
Deferred revenue	6.1	7.0
Other long-term liabilities	3.1	2.6
Deferred compensation	7.2	8.1
Deferred rent	21.2	19.4
Net operating losses	8.2	5.0
Asset impairments and other writedowns	25.2	6.3
Total deferred tax assets	76.6	57.9
Deferred tax liabilities:		
Inventory	12.2	9.1
Property and equipment	37.9	35.3
Other	3.1	3.4
Total deferred tax liabilities	53.2	47.8
Net deferred tax assets	$ 23.4	$ 10.1

The Company has tax net operating loss carryforwards in foreign jurisdictions totaling $28.4 as of January 28, 2001, $16.3 as of January 23, 2000, and $5.7 as of January 24, 1999. These losses have an indefinite carryforward period.

Note 7 – Commitments and Contingencies

During 1994, the Company entered into agreements in which leases with respect to four Borders' locations serve as collateral for certain mortgage pass-through certificates. These mortgage pass-through certificates include a provision requiring the Company to repurchase the underlying mortgage notes in certain events, including the failure by the Company to make payments of rent under the related leases, the failure by Kmart Corporation to maintain required investment grade ratings or the termination of the guarantee by Kmart Corporation of the Company's obligations under the related leases (which would require the mutual consent of Kmart Corporation and Borders). In the event the Company is required to repurchase all of the underlying mortgage notes, the Company would be obligated to pay approximately $36.6.

In March 1998, the American Booksellers Association ("ABA") and 26 independent bookstores filed a lawsuit in the United States District Court for the Northern District of California against the Company and Barnes & Noble, Inc. alleging violations of the Robinson-Patman Act, the California Unfair Trade Practice Act and the California Unfair Competition Act. The Complaint seeks injunctive and declaratory relief; treble damages on behalf of each of the bookstore plaintiffs, and, with respect to the California bookstore plaintiffs, any other damages permitted by California law; disgorgement of money, property and gains wrongfully obtained in connection with the purchase of books for resale, or offered for resale, in California from March 18, 1994, until the action is completed and prejudgment interest on any amounts awarded in the action, as well as attorney fees and costs. The plaintiffs have provided a report estimating damages against the Company, exclusive of interest, as follows: (i) between an aggregate of approximately $2.8 and approximately $3.3 (before trebling) with respect to the Robinson-Patman Act claims of the 26 independent bookseller plaintiffs, and (ii) between an aggregate of approximately $5.5 and approximately $6.4 with respect to the disgorgement claims under California law for the geographic areas of the California plaintiffs. The Company's pleadings in the action deny any liability to plaintiffs, and the Company disputes plaintiffs' claims of damages. On November 16, 2000, the court granted the motion of the Company and Barnes & Noble to dismiss the disgorgement claims brought by the ABA under California law on behalf of independent booksellers in the state of California who are not named in the litigation. On March 19, 2001, the court dismissed all of the damage claims of the plaintiffs. The trial of the remaining claims is scheduled for April 9, 2001. The Company intends to vigorously defend the action.

The Intimate Bookshop, Inc. ("Intimate") and Lucky, Inc. have instituted actions against the Company and Waldenbooks, respectfully, containing allegations and claims similar to those contained in the ABA litigation described above. The Intimate Amended Complaint alleges that Intimate has suffered $11.3 or more in damages and requests treble damages, injunctive and declaratory relief, interest, costs, attorneys' fees and other unspecified relief. The Lucky, Inc. Amended Complaint alleges that the plaintiffs have suffered more than $75,000 in damages and requests treble damages, injunctive and declaratory relief, interest, costs, attorneys' fees and other unspecified relief. The Company intends to vigorously defend these actions.

Two former employees, individually and on behalf of a purported class, consisting of all current and former employees who worked as assistant managers in Borders stores at any time between April 10, 1996, and the present, have filed an action against Borders in the Superior Court of California for the County of San Francisco. The action alleges that the individual plaintiffs and the purported class members worked hours for which they were entitled to receive, but did not receive, overtime compensation under California law, and that they were classified as "exempt" store management employees but were forced to work more than 50% of their time in non-exempt tasks. The Amended Complaint alleges violations of the California Labor Code and the California Business and Professions Code. The relief sought includes compensatory and punitive damages, penalties, preliminary and permanent injunctions requiring Borders to pay overtime compensation as required under California and Federal law, prejudgment interest, costs and attorneys fees and such other relief as the court deems proper. The Company intends to vigorously defend the action, including contesting the certification of the action as a class action.

The Company has not included any liability in its financial statements in connection with the lawsuits described above and has expensed as incurred all costs to date.

In addition to the matters described above, the Company is from time to time involved in or affected by other litigation incidental to the conduct of its businesses. The Company does not believe that any such other litigation will have a material adverse effect on its liquidity, financial position or results of operations.

Note 8 – Debt

The Company has a $472.8 multicurrency credit agreement (the Credit Facility) which expires in October 2002. Borrowings under the Credit Facility bear interest at a base rate or an increment over LIBOR at the Company's option. The Credit Facility contains covenants which limit, among other things, the Company's ability to incur indebtedness, grant liens, make acquisitions, merge, declare dividends, dispose of assets, issue or repurchase its common stock in excess of $100.0 (plus any proceeds and tax benefits resulting from stock option exercises and tax benefits resulting from restricted shares purchased by employees from the Company), and require the Company to meet certain financial measures regarding fixed charge coverage, leverage and tangible net worth. The Company is prohibited under the Credit Facility from paying cash dividends on common shares. The Company had borrowings outstanding under the Credit Facility of $143.5 at January 28, 2001, and $133.4 at January 23, 2000. The weighted average interest rate in 2000 and 1999 was approximately 6.8% and 5.7%, respectively.

The Company's long-term debt obligations consist of capital lease liabilities at January 28, 2001. Scheduled principal payments and capitalized lease obligations as of January 28, 2001 are as follows: 2001 — $0.9; 2002 — $0.8; 2003 — $0.8; 2004 — $0.8; 2005 — $0.8; 2006 and, thereafter, — $11.7.

Note 9 – Leases

Operating Leases: The Company conducts operations primarily in leased facilities. Store leases are generally for terms of 5 to 20 years. Borders' leases generally contain multiple three to five-year renewal options which allow Borders the option to extend the life of the leases up to 25 years beyond the initial noncancellable term. Walden's leases generally do not contain renewal options. Certain leases provide for additional rental payments based on a percentage of sales in excess of a specified base. Also, certain leases provide for the payment by the Company of executory costs (taxes, maintenance and insurance).

Lease Commitments: Future minimum lease payments under operating leases at January 28, 2001, total $260.4 in 2001, $247.9 in 2002, $228.4 in 2003, $208.1 in 2004, $193.1 in 2005, $1,793.0 in all later years and, in the aggregate, total $2,930.9.

Rental Expenses: A summary of operating lease rental expense and short-term rentals follows:

	2000	1999	1998
Rental Expenses:			
Minimum rentals	$277.7	$252.6	$222.3
Percentage rentals	2.0	2.0	2.3
Total	$279.7	$254.6	$224.6

Capitalized Leases: The Company accounts for three stores and certain computer equipment under capital leases. At January 28, 2001, the Company's commitments under leases accounted for as capital leases aggregated $15.8.

Lease Financing Facility: The Company has a $175.0 lease financing facility (the Lease Facility) to finance new stores and other property through operating leases, which expires in October 2002. The Lease Facility provides financing to lessors through loans from a third party lender for up to 95% of a project cost. It is expected that lessors will make equity contributions approximating 5% of each project. Independent of its obligations as lessee, the Company guarantees payment when due of all amounts required to be paid to the third party lender. The principal amount guaranteed is limited to approximately 89% of the original cost of a project so long as the Company is not in default under the lease relating to such project. The Lease Facility contains covenants and events of default that are similar to those contained in the Credit Facility described above. There was $163.1 and $162.9 outstanding under the Lease Facility at January 28, 2001, and January 23, 2000, respectively. In October 2000, the Company transferred four properties previously financed under the Lease Facility with a total financed value of

$13.8 to a new temporary facility with terms similar to those of the Lease Facility. In February 2001, two of these properties were transferred back to the Lease Facility, and two were permanently financed through operating leases. Also in February 2001, ten additional properties previously financed through the Lease Facility with a total financed value of $44.6 were permanently financed through operating leases.

Note 10 – Employee Benefit Plans

Employee Savings Plan: Employees of the Company who meet certain requirements as to age and service are eligible to participate in the Company's Savings Plan. The Company's expense related to this plan was $3.2, $2.9 and $2.5 for 2000, 1999 and 1998, respectively.

Note 11 – Stock-Based Benefit Plans

Stock Option Plans: The Company has various stock option plans pursuant to which the Company may grant options to purchase its common stock. The exercise price of options granted under these plans will generally not be less than the fair value per share of the Company's common stock at the date of grant with vesting periods up to six years from grant date and maximum option terms up to ten years from grant date. Options have been granted under the plans to all full-time employees of the Company and its subsidiaries with 30 days or more of service. At January 28, 2001, the Company has 34.5 million shares authorized for the grant of stock options under these plans.

Stock Purchase Plans: The Company has a management stock purchase plan (the Management Plan) and an employee stock purchase plan (the Employee Plan). Under the Management Plan, the Company's senior management personnel are required to use 20%, and may use up to 100%, of their annual incentive bonuses to purchase restricted shares of the Company's common stock, at a 20% discount from the fair value of the same number of unrestricted shares of common stock. Restricted shares of common stock purchased under the Management Plan will generally be restricted from sale or transfer for three years from date of purchase. The Employee Plan allows the Company's associates not covered under the Management Plan to purchase shares of the Company's common stock at a 15% discount from their fair market value.

The Company recognizes compensation expense for the discount on restricted shares of common stock purchased under the Management Plan. Such discounts are recognized as expense on a straight-line basis over the three-year period during which the shares are restricted from sale or transfer. The Company is not required to record compensation expense with respect to shares purchased under the Employee Plan.

A summary of the information relative to the Company's stock option plans follows:

(Number of Shares in Thousands)	Number of Shares	Weighted Average Exercise Price
Outstanding at January 25, 1998	21,297	16.58
Granted	3,549	27.17
Exercised	3,759	9.57
Forfeited	1,901	22.51
Outstanding at January 24, 1999	19,186	19.36
Granted	5,468	14.49
Exercised	2,181	7.53
Forfeited	3,909	21.24
Outstanding at January 23, 2000	18,564	18.89
Granted	4,811	13.25
Exercised	1,397	7.52
Forfeited	4,324	20.80
Outstanding at January 28, 2001	17,654	17.82
Balance exercisable at:		
January 24, 1999	5,365	11.87
January 23, 2000	4,639	14.26
January 28, 2001	6,803	16.80

The weighted-average fair values of options at their grant date where the exercise price equals the market price on the grant date were $5.17, $5.84 and $11.52 in 2000, 1999 and 1998, respectively.

As permitted, the Company has adopted the disclosure-only option of Financial Accounting Standards Board Statement No. 123, "Accounting for Stock Based Compensation" (FAS 123). The pro forma net income had the Company adopted the fair-value accounting provisions of FAS 123 would have been $31.6, $68.3 and $72.6 in 2000, 1999, and 1998, respectively. Pro forma diluted and basic earnings per share would have been $0.39, $0.85 and $0.88 and $0.40, $0.88, and $0.95 in 2000, 1999 and 1998, respectively.

The Black-Scholes option valuation model was used to calculate the fair market value of the options at the grant date for the purpose of disclosures required by FAS 123. The following assumptions were used in the calculation:

	2000	1999	1998
Risk-Free Interest Rate	4.8–6.8%	4.9–6.7%	4.2–6.8%
Expected Life	2.5–10 years	3–10 years	3–10 years
Expected Volatility	33.3–40.9%	33.3–40.3%	33.3–40.7%
Expected Dividends	0%	0%	0%

The following table summarizes the information regarding stock options outstanding at January 28, 2001 (number of shares in thousands):

	Outstanding			Exercisable	
Range of Exercise Prices	Number of Shares	Weighted Average Remaining Life	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
$ 6.81–$10.22	2,993	4.4	$ 8.69	2,231	$ 8.69
$10.23–$13.63	4,154	5.5	12.78	137	12.31
$13.64–$17.03	3,809	7.4	14.54	1,704	14.53
$17.04–$20.44	1,226	5.0	17.60	750	17.55
$20.45–$27.25	1,081	5.5	24.11	731	24.11
$27.26–$30.66	3,456	6.7	29.79	926	29.75
$30.67–$34.06	935	6.9	31.64	324	31.36

A summary of the information relative to the Company's stock purchase plans follows:

(Number of Shares in Thousands)	Number of Shares	Weighted Average Purchase Price	Weighted Average at Grant Date FMV
Stock Issued Under Stock Purchase Plans			
Management Plan			
1998	68	19.52	24.40
1999	106	10.91	13.64
2000	13	10.56	13.21
Employee Plan			
1998	115	24.78	29.15
1999	118	12.79	15.05
2000	65	12.38	14.56

Note 12 – Financial Instruments

The Company enters into interest rate swap and collar agreements to reduce the impact of changes in interest rates on its variable-rate debt and amounts outstanding under the Lease Facility. The swap agreements are contracts to exchange variable-rate for fixed-interest payments periodically over the life of the agreements without the exchange of the underlying notional amounts. The collar agreements are contracts to effectively limit the variability of interest on a portion of the Company's variable-rate debt. The notional amounts of these agreements are used to measure interest paid or received and do not represent the amount of exposure to credit loss.

As of January 28, 2001, and January 23, 2000, the Company had the following interest rate instruments in effect:

January 28, 2001

	Notional Amount	Strike Rate	Period	Fair Market Value
Interest Rate Swaps	$50.0	6.0%	1/00-1/01	$0.0
	$75.0	5.7%	1/00-1/03	$0.7
	$33.0(a)	6.6%	10/98-10/03	$0.7
	$33.0(a)	6.9%	9/98-9/03	$1.3

(a) Notional amount is the U.S. Dollar equivalent of 20.0 British Pounds.

January 23, 2000

	Notional Amount	Strike Rate	Period	Fair Market Value
Interest Rate Swaps	$175.0	4.6%	1/99-1/00	$0.1
	$ 33.0(a)	6.6%	10/98-10/03	$0.3
	$ 33.0(a)	6.9%	9/98-9/03	$0.2
Interest Rate Collar	$100.0	4.1%-5.5%	1/99-12/00	$0.7

(a) Notional amount is the U.S. Dollar equivalent of 20.0 British Pounds.

During fiscal 2001, the Company entered into interest rate swaps with notional amounts of $50.0 and $100.0, which effectively converted variable rate U.S. dollar-denominated borrowings to fixed rates of 5.1% and 5.2%, respectively. These swap agreements expire one year from the date the Company entered into the agreements.

Note 13 – Segment Information

The Company is organized based upon the following operating segments: domestic Borders stores, international Borders and Books etc. stores, Walden stores, online retailing through Borders.com, and other (consisting of interest expense and certain corporate governance costs).

The accounting policies of the segments are the same as those described in the "Summary of Significant Accounting Policies." Segment data includes charges allocating all corporate headquarters costs to each segment. Transactions between segments, consisting principally of inventory transfers, are recorded primarily at cost. The Company evaluates the performance of its segments and allocates resources to them based on anticipated future contribution. Amounts relating to All Wound Up have been reclassified from the Waldenbooks segment to discontinued operations.

	2000	1999	1998
Sales:			
Borders	$2,080.3	$1,823.2	$1,521.0
Waldenbooks	944.3	959.1	948.7
International	219.2	168.2	120.7
Total stores	3,243.8	2,950.5	2,590.4
Borders.com	27.4	17.9	4.6
Total continuing operations	3,271.2	2,968.4	2,595.0
Interest expense (income):			
Borders	12.8	16.4	16.5
Waldenbooks	(26.2)	(22.3)	(18.9)
International	12.4	8.9	7.4
Other	8.3	9.2	8.5
Total stores	7.3	12.2	13.5
Borders.com	5.8	4.4	2.7
Total continuing operations	13.1	16.6	16.2
Income tax expense (benefit):			
Borders	52.8	48.4	34.6
Waldenbooks	24.2	34.7	36.8
International	(6.8)	(5.8)	(3.8)
Other	(5.2)	(6.7)	(2.4)
Total stores	65.0	70.6	65.2
Borders.com	(16.8)	(10.2)	(6.2)
Total continuing operations	48.2	60.4	59.0
Depreciation and amortization expense:			
Borders	52.9	47.3	42.3
Waldenbooks	25.8	23.9	18.8
International	8.8	6.5	3.5
Other	—	0.3	0.2
Total stores	87.5	78.0	64.8
Borders.com	7.8	5.5	1.9
Total continuing operations	95.3	83.5	66.7
Net income (loss):			
Borders	82.6	72.9	52.1
Waldenbooks	40.2	55.5	61.0
International	(10.2)	(7.9)	(3.2)
Other	(9.1)	(9.3)	(7.3)
Total stores	103.5	111.2	102.6
Borders.com	(29.7)	(17.2)	(10.5)
Total continuing operations	73.8	94.0	92.1
Discontinued operations	(30.2)	(3.7)	—
Total net income (loss)	43.6	90.3	92.1

	2000	1999
Total assets:		
Borders	$1,264.7	$1,136.7
Waldenbooks	432.0	416.0
International	216.1	200.9
Other	75.4	72.6
Total stores	1,988.2	1,826.2
Borders.com	44.3	57.0
Total continuing operations	2,032.5	1,883.2
Discontinued operations	14.6	31.6
Total assets	2,047.1	1,914.8
Capital expenditures:		
Borders	$ 81.2	$ 64.1
Waldenbooks	19.3	26.5
International	16.0	24.4
Other	15.8	17.1
Total stores	132.3	132.1
Borders.com	6.4	11.4
Total continuing operations	138.7	143.5
Discontinued operations	2.4	1.2
Total capital expenditures	141.1	144.7

Total assets for the "Other" operating segment include certain corporate headquarters asset balances which have not been allocated to the other segments; however, depreciation expense associated with such assets has been allocated to the other segments.

Long-lived assets by geographic area are as follows:

	2000	1999	1998
Long-lived assets:			
Domestic	$566.8	$567.9	$510.8
International	145.2	148.7	122.5
	712.0	716.6	633.3

Note 14 – Subsequent Event

Subsequent to the Company's fiscal year-end, the Company entered into an agreement with Ingram Book Group ("Ingram"), a wholesaler of books, spoken audio and magazines, pursuant to which Ingram will provide book fulfillment services for the Company's special order and online sales. The transaction includes the sale of approximately $12.0 of the Company's book inventory to Ingram, and will result in an after-tax charge of approximately $15.0 to $20.0 to be taken in the first quarter of fiscal 2001. This charge is substantially non-cash and is primarily related to the writedown of assets used by the current Company-owned facility to fulfill special order and online sales, including warehouse equipment, hardware and software, and a reduction of recorded inventory.

Note 15 – Unaudited Quarterly Financial Data

(Dollars in Millions Except Per Share Amounts)	Fiscal 2000 Quarter Ended April	July	October	January
Sales	$679.7	$698.4	$701.0	$1,192.1
Cost of merchandise sold (includes occupancy)	503.9	518.0	523.7	808.9
Operating income (loss)	3.5	3.4	(0.1)	128.3
Income (loss) from continuing operations	0.7	—	(2.6)	75.7
Net income (loss)	(0.9)	(1.6)	(5.0)	51.1
Diluted earnings (loss) per common share from continuing operations	0.01	—	(0.03)	0.95
Basic earnings (loss) per common share from continuing operations	0.01	—	(0.03)	0.96

	Fiscal 1999 Quarter Ended April	July	October	January
Sales	$617.9	$628.6	$651.1	$1,070.8
Cost of merchandise sold (includes occupancy)	456.7	467.2	479.5	724.2
Operating income (loss)	(2.4)	1.8	5.8	165.8
Income (loss) from continuing operations	(4.0)	(1.6)	0.7	98.9
Net income (loss)	(4.1)	(2.6)	(1.5)	98.5
Diluted earnings (loss) per common share from continuing operations	(0.05)	(0.02)	0.01	1.23
Basic earnings (loss) per common share from continuing operations	(0.05)	(0.02)	0.01	1.28

Earnings per share amounts for each quarter are required to be computed independently and may not equal the amount computed for the total year.

Report of Independent Auditors

To the Board of Directors and Stockholders of Borders Group, Inc.

We have audited the accompanying consolidated balance sheet of Borders Group, Inc. as of January 28, 2001, and the related consolidated statement of operations, stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The consolidated balance sheet of Borders Group, Inc. as of January 24, 1999, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the two years in the period ended January 24, 1999, were audited by other independent accountants whose report dated March 6, 2000, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States. 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 audit provides a reasonable basis for our opinion.

In our opinion, the January 28, 2001 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Borders Group, Inc. at January 28, 2001, and the consolidated results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP

Detroit, Michigan
March 15, 2001

stockholders' information

Board of Directors

Robert F. DiRomualdo
Chairman of the Board
Borders Group, Inc.

Gregory P. Josefowicz
President and
Chief Executive Officer
Borders Group, Inc.

George R. Mrkonic
Vice Chairman
Borders Group, Inc.

Peter R. Formanek
Retired President and
Chief Operating Officer
Autozone

Victor L. Lund
Vice Chairman of the Board
Albertson's, Inc.

Dr. Edna Greene Medford
Associate Professor of History,
former Director of the
Undergraduate Program
in History, and Associate
Director of History for the
African Burial Ground Project
Howard University

Larry Pollock
President and
Chief Operating Officer
Cole National Corporation

Beth M. Pritchard
President and
Chief Executive Officer
Bath & Body Works

Executive Officers

Robert F. DiRomualdo
Chairman of the Board

Gregory P. Josefowicz
President and
Chief Executive Officer

George R. Mrkonic
Vice Chairman

Bruce A. Quinnell
Vice Chairman

Vincent E. Altruda
President
Borders International Stores

Thomas D. Carney
Vice President, General Counsel
and Secretary

Tamara L. Heim
President
Borders Stores and
Borders.com

Ronald S. Staffieri
President
Waldenbooks Stores

Edward W. Wilhelm
Senior Vice President and
Chief Financial Officer

Kathryn L. Winkelhaus
President
Borders Group
Merchandising and Distribution

Stockholder Information

Corporate Headquarters
Borders Group, Inc.
100 Phoenix Drive
Ann Arbor, Michigan 48108
(734) 477-1100

Independent Accountants
Ernst & Young LLP
500 Woodward Avenue
Detroit, Michigan 48226

Registrar and
Stock Transfer Agent
First Chicago Trust Company
A division of EquiServe
P.O. Box 2500
Jersey City, NJ 07303
(800) 446-2617

Common Stock
The Company's Common Stock trades on the New York Stock Exchange under the symbol BGP.

Annual Meeting
Borders Group, Inc.'s annual meeting of stockholders will be held on May 17, 2001 at 11:30 a.m. Central time at The Palmer House Hilton, 17 East Monroe Street, Chicago, Illinois 60603.

Market Price for
Common Stock
The following table sets forth for the period indicated the high and low market prices for the Common Stock on the New York Stock Exchange.

2000	High	Low
Q1	$17.25	$11.19
Q2	$18.50	$13.38
Q3	$14.44	$12.56
Q4	$13.94	$11.38

As of March 6, 2001, there were approximately 4,206 holders of the Company's Common Stock. This number excludes individual stockholders holding stock under nominee security position listings.

Dividends

The Company has not declared any cash dividends and intends to retain its earnings to finance future growth. Therefore, the Company does not anticipate paying any cash dividends in the foreseeable future. The declaration and payment of dividends, if any, is subject to the discretion of the Board of Directors of the Company and to certain limitations under the Michigan Business Corporation Act. In addition, the Company's ability to pay dividends is restricted by certain agreements to which the Company is a party. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources."

Stockholders' Inquiries

For information about Borders Group, Inc. and its subsidiaries, including Annual Reports, Form 10-K and 10-Q documents and other available financial information, please send your request to:
Borders Group, Inc.
Investor Relations
100 Phoenix Drive
Ann Arbor, Michigan 48108
Phone: (734) 477-1794
Fax: (734) 477-1901

Information can also be obtained via the Internet by visiting the Borders Web site at www.bordersgroupinc.com or via fax by calling Company News On-Call at (800) 758-5804, ext. 106169.

Safe Harbor Statement

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. One can identify these forward-looking statements by the use of words such as "expects," "anticipates," "plans," "agenda," "will," "estimates," "believes," "may," "indicates," "forecasts," "focusing," "guidance," "outlook," "projects," "initiatives," "strives," "seeks," "goals," "anticipate," "looks," "should," and other words of similar meaning. One can also identify them by the fact that they do not relate strictly to historical or current facts. These statements are likely to address the Company's growth strategy, future financial performance (including sales and earnings projections), shareholder value, share repurchases, strategic alternatives, potential partnership arrangements, marketing and expansion plans, retail convergence initiatives, such as the rollout of Title Sleuth and related capabilities, and the impact of growth initiatives. These statements are subject to risks and uncertainties that could cause actual results to differ materially from the Company's forward-looking statements. Please refer to the Company's annual, quarterly and periodic reports on file with the SEC for a detailed discussion of such risks and uncertainties. The Company does not undertake any obligation to update forward-looking statements.

Change in Accountant

On October 20, 2000, the Company's Board of Directors, acting upon the recommendation of the Audit Committee of the Board, voted to dismiss its independent auditor, PricewaterhouseCoopers LLP ("PwC"). The reports of PwC on the Company's financial statements for the 1999 and 1998 fiscal years did not contain any adverse opinion or a disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope or accounting principles. During the 1999 or 1998 fiscal years and the period through October 20, 2000, there were no disagreements between the Company and PwC on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of PwC, would have caused it to make reference to the subject matter of the disagreements in connection with its reports on financial statements. In addition, during the 1998 and 1999 fiscal years and the period through October 20, 2000, there were no "reportable events" within the meaning of Item 304 of the Securities and Exchange Commission's regulation S-K. The Company retained the accounting firm of Ernst & Young LLP (E&Y) on October 20, 2000, to make an examination of the financial statements of the Company for the 2000 fiscal year.

BGI
BORDERS GROUP, INC.

100 Phoenix Drive
Ann Arbor, Michigan 48108 USA