



le château

**QUARTERLY REPORT**  
FOR THE THREE MONTHS ENDED  
**APRIL 29, 2006**

## MESSAGE TO SHAREHOLDERS

On behalf of the Board of Directors, I am pleased to provide the results of Le Château Inc. for the first quarter ended April 29, 2006.

Sales increased 1.0% to \$61.2 million for the first quarter ended April 29, 2006, compared with sales of \$60.6 million for the first quarter ended April 30, 2005. Comparable store sales decreased by 4.3% in the first quarter of 2006 compared with the same period a year ago.

Net earnings for the first quarter were \$2.7 million or \$0.45 per share compared to \$4.6 million or \$0.79 per share last year.

Sales and profit figures were impacted by the closing of our *JUNIOR GIRL* division, the rapid introduction of a major footwear department across the chain, a full corporate strategic review, and other factors which softened our focus on giving customers precisely what they want. Although our first quarter results still show impressive profits, management has dedicated significant resources on the product side to accelerate growth in sales and profits.

For the first five weeks ended June 3, 2006, total retail sales increased 0.1% and same store sales decreased 4.1% compared to the same period last year.

At the Board of Directors meeting held June 8, 2006, a quarterly cash dividend of \$0.25 was declared on the Class A subordinate voting and Class B voting shares outstanding, representing the 51<sup>st</sup> consecutive dividend declared by Le Château. It is payable on August 8, 2006 to shareholders of record at the close of business on July 14, 2006.

I wish to thank our employees, customers, suppliers and our shareholders for their continued support.



Herschel H. Segal  
Chairman of the Board and Chief Executive Officer  
June 8, 2006

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis (MD&A) should be read in conjunction with the unaudited interim consolidated financial statements for the three months ended April 29, 2006 and the audited consolidated financial statements and MD&A for the year ended January 28, 2006. The risks and uncertainties faced by the Company are substantially the same as those outlined in the annual MD&A contained in the Company's 2005 Annual Report. The MD&A has been prepared as at June 8, 2006.

### Results of Operations

Sales increased 1.0% to reach \$61.2 million for the first quarter ended April 29, 2006 as compared with \$60.6 million last year. Comparable store sales decreased 4.3% during the first quarter as compared with a 16.9% increase for the same period last year. During the quarter, the Company opened two new stores and expanded 12 existing locations, resulting in the addition of 37,000 square feet to the Le Château network.

As the Company executes its strategy of broadening its customer base, the Company expects that its business will become less seasonal. However, retail sales are traditionally higher in the third and fourth quarters due to the back-to-school period and the Christmas season, respectively. In addition, fourth quarter earnings results are usually reduced by post Christmas sale promotions.

During the first quarter, the Company continued to re-align existing real estate to maximize profitability by re-assigning space from the *JUNIOR GIRL* clothing division to other more profitable divisions. This profit optimization strategy commenced two years ago. The Company plans to completely phase out of this division by the end of June 2006. The Footwear and Men's Divisions will be the primary beneficiaries of this real estate.

Net earnings for the quarter were \$2,719,000 or \$0.45 per share compared to \$4,638,000 or \$0.79 per share for the same period last year. Earnings before interest, income taxes, depreciation and amortization (EBITDA) were \$7,361,000 compared to \$9,889,000 for the first quarter last year. Included in the first quarter expenses are approximately \$535,000 of costs relating to the ongoing strategic review.

Net earnings attributable to Canadian operations amounted to \$3,109,000 or \$0.52 per share for the first quarter, compared to \$4,739,000 or \$0.81 per share the previous year. The U.S. operations reported a net loss \$390,000 Cdn or \$(0.07) Cdn per share for the period, compared to a net loss of \$101,000 Cdn or \$(0.02) Cdn per share for the same period a year ago.

As previously announced on March 14, 2006, the Company engaged Genuity Capital Markets to assist in evaluating various strategic alternatives, including, but not limited to, a sale of the Company, a business combination or a capital reorganization. The process continues and there can be no assurance that any transaction or other action will result.

### Dividends and Outstanding Share Data

On June 8, 2006, the Board of Directors declared a quarterly dividend of \$0.25 per Class A subordinate voting share and Class B voting share. This dividend is payable on August 8, 2006 to shareholders of record at the close of business on July 14, 2006.

This dividend payment represents the 51<sup>st</sup> consecutive quarterly dividend declared by Le Château.

As at June 8, 2006, there were 3,986,601 Class A subordinate and 2,040,000 Class B voting shares outstanding. Further, there are 486,890 stock options outstanding with exercise prices ranging from \$6.01 to \$46.99, of which 153,490 are exercisable.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

### Liquidity and Capital Resources

Cash flow from operations decreased to \$6.7 million for the first quarter of 2006, from \$7.8 million last year, mainly as a result of lower net earnings reported for the quarter.

Capital expenditures for the first quarter amounted to \$11.2 million, compared to \$12.1 million for the same period last year and related primarily to the opening of two new stores and the renovation of 17 existing stores. Capital expenditures were financed with cash and cash equivalents.

### Financial Position

Working capital stood at \$52.7 million at the end of the first quarter of 2006, compared to \$41.7 million as at April 30, 2005 and \$60.5 million as at January 28, 2006.

Inventories increased to \$37.2 million at the end of the first quarter, from \$32.7 million a year earlier, due primarily to the 11% increase in square footage when compared to the same period last year.

Long-term debt and capital lease obligations, including the current portions, increased to \$19.8 million from \$12.4 million as at April 30, 2005, after the additional long term financing of \$13.0 million obtained during the second half of 2005. The long-term debt to equity ratio increased to 0.19:1 as at April 29, 2006 from 0.14:1 the previous year.

### Accounting Policies

#### Critical Accounting Estimates:

The Company's critical accounting estimates are substantially the same as those disclosed in the Management's Discussion and Analysis section of its 2005 Annual Report.

#### Accounting Standards Implemented in 2006:

There were no new accounting standards implemented during the first quarter of 2006.

### Supplementary Measures

In addition to discussing earnings measures in accordance with Canadian generally accepted accounting principles ("GAAP"), this MD&A provides earnings before interest, income taxes, depreciation and amortization ("EBITDA") as a supplementary earnings measure. Depreciation and amortization include the write-off of fixed assets. EBITDA is provided to assist readers in determining the ability of the Company to generate cash from operations and to cover financial charges. It is also widely used for valuation purposes.

This MD&A also discloses cash flow from operations as a supplementary measure. Cash flow from operations is defined as cash flow from operating activities before the net change in non-cash working capital items related to operations. This measure provides an indication of the Company's ability to generate cash flows without considering certain timing and other factors causing variations in non-cash items.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

The following table reconciles EBITDA to GAAP measures disclosed in the unaudited interim consolidated statements of earnings for the periods ended April 29, 2006 and April 30, 2005:

<i>(in thousands of dollars)</i>	For the three months ended	
	April 29, 2006	April 30, 2005
Earnings before income taxes	\$ 4,219	\$ 7,218
Depreciation and amortization	3,198	2,620
Write-off of fixed assets	51	44
Interest on long-term debt and capital lease obligations	304	193
Interest income	(411)	(186)
<b>EBITDA</b>	<b>7,361</b>	<b>9,889</b>

The above measures do not have a standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies.

### Forward-looking Statements

This "Management's Discussion and Analysis" may contain forward-looking statements relating to the Company and/or the environment in which it operates that are based on the Company's expectations, estimates and forecasts. These statements are not guarantees of future performance and involve risks and uncertainties that are difficult to predict and/or are beyond the Company's control. A number of factors may cause actual outcomes and results to differ materially from those expressed. These factors include those set forth in other public filings of the Company. Therefore, readers should not place undue reliance on these forward-looking statements. In addition, these forward-looking statements speak only as of the date made and the Company disavows any intention or obligation to update or revise any such statements as a result of any event, circumstance or otherwise.

Factors which could cause actual results or events to differ materially from current expectations include, among other things: the ability of the Company to successfully implement its strategic initiatives and whether such strategic initiatives will yield the expected benefits; competitive conditions in the businesses in which the Company participates; changes in consumer spending; general economic conditions and normal business uncertainty; customer preferences towards product offerings; seasonal weather patterns; fluctuations in foreign currency exchange rates; changes in the Company's relationship with its suppliers; interest rate fluctuations and other changes in borrowing costs; and changes in laws, rules and regulations applicable to the Company.

FINANCIAL HIGHLIGHTS

(Unaudited)

(In units except where otherwise stated)

	April 29, 2006	April 30, 2005
Working capital (\$,000)	\$ 52,693	\$ 41,744
Current ratio	2.60	2.51
Quick ratio	1.47	1.33
Long-term debt to equity *	0.19	0.14
Capital expenditures at end of quarter (\$,000)	\$ 11,237	\$ 12,070
Number of stores at end of quarter	187	176
Total number of square feet (,000)	799	723
Book value per share	\$ 17.71	\$ 15.02

\* Including capital leases and current portion of debt. Excluding deferred lease inducements.

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands of dollars)

	As at April 29, 2006	As at April 30, 2005	As at January 28, 2006
<b>ASSETS</b>			
<b>Current</b>			
Cash and cash equivalents	\$ 5,808	\$ 33,592	\$ 17,979
Short-term investments	37,276	–	43,083
Accounts receivable and prepaid expenses	4,512	3,078	3,746
Income taxes refundable	796	–	–
Inventories	37,249	32,708	35,444
<b>Total current assets</b>	<b>85,641</b>	<b>69,378</b>	<b>100,252</b>
Fixed assets	73,972	60,137	65,984
	\$ 159,613	\$ 129,515	\$ 166,236
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Current</b>			
Accounts payable and accrued liabilities	\$ 24,563	\$ 21,310	\$ 27,668
Dividend payable	1,507	1,039	1,507
Income taxes payable	–	1,017	3,740
Current portion of capital lease obligations	2,674	1,421	2,634
Current portion of long-term debt	4,204	2,847	4,212
<b>Total current liabilities</b>	<b>32,948</b>	<b>27,634</b>	<b>39,761</b>
Capital lease obligations	3,655	1,965	4,339
Long-term debt	9,251	6,131	10,326
Future income taxes	2,365	1,695	2,365
Deferred lease inducements	4,671	3,012	4,200
<b>Total liabilities</b>	<b>52,890</b>	<b>40,437</b>	<b>60,991</b>
<b>Shareholders' Equity</b>			
Capital stock	27,212	26,628	27,210
Contributed surplus	722	–	458
Retained earnings	78,789	62,450	77,577
<b>Total shareholders' equity</b>	<b>106,723</b>	<b>89,078</b>	<b>105,245</b>
	\$ 159,613	\$ 129,515	\$ 166,236

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

<i>(Unaudited)</i> <i>(In thousands of dollars)</i>	For the three months ended	
	April 29, 2006	April 30, 2005
Balance, beginning of period	\$ 77,577	\$ 58,851
Net earnings	2,719	4,638
	80,296	63,489
Dividends	1,507	1,039
<b>Balance, end of period</b>	<b>\$ 78,789</b>	<b>\$ 62,450</b>

CONSOLIDATED STATEMENTS OF EARNINGS

<i>(Unaudited)</i> <i>(In thousands of dollars, except per share data)</i>	For the three months ended	
	April 29, 2006	April 30, 2005
<b>Sales</b>	<b>\$ 61,187</b>	<b>\$ 60,601</b>
<b>Cost of sales and expenses</b>		
Cost of sales and selling, general and administrative	53,826	50,712
Depreciation and amortization	3,198	2,620
Write-off of fixed assets	51	44
Interest on long-term debt and capital lease obligations	304	193
Interest income	(411)	(186)
	56,968	53,383
Earnings before income taxes	4,219	7,218
Provision for income taxes	1,500	2,580
<b>Net earnings</b>	<b>\$ 2,719</b>	<b>\$ 4,638</b>
<b>Net earnings per share</b>		
Basic	\$ 0.45	\$ 0.79
Diluted	0.43	0.76
Weighted average number of shares outstanding ('000)	6,026	5,880

CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>(Unaudited)</i> <i>(In thousands of dollars)</i>	For the three months ended	
	April 29, 2006	April 30, 2005
<b>OPERATING ACTIVITIES</b>		
Net earnings	\$ 2,719	\$ 4,638
Adjustments to determine net cash from operating activities		
Depreciation and amortization	3,198	2,620
Write-off of fixed assets	51	44
Amortization of deferred lease inducements	(179)	(148)
Deferred lease inducements	650	673
Stock-based compensation	264	–
	6,703	7,827
Net change in non-cash working capital items related to operations	(10,212)	(6,297)
<b>Cash flows related to operating activities</b>	<b>(3,509)</b>	<b>1,530</b>
<b>FINANCING ACTIVITIES</b>		
Repayment of capital lease obligations	(644)	(342)
Repayment of long-term debt	(1,083)	(719)
Issue of capital stock	2	235
Dividends paid	(1,507)	(1,027)
<b>Cash flows related to financing activities</b>	<b>(3,232)</b>	<b>(1,853)</b>
<b>INVESTING ACTIVITIES</b>		
Decrease in short-term investments	5,807	–
Additions to fixed assets	(11,237)	(12,070)
<b>Cash flows related to investing activities</b>	<b>(5,430)</b>	<b>(12,070)</b>
Decrease in cash and cash equivalents	(12,171)	(12,393)
Cash and cash equivalents, beginning of period	17,979	45,985
<b>Cash and cash equivalents, end of period</b>	<b>\$ 5,808</b>	<b>\$ 33,592</b>
<b>Supplementary information:</b>		
Interest paid during the period	\$ 304	\$ 193
Income taxes paid during the period, net	6,038	3,487

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Tabular figures in thousands of dollars except share information)

1. Disclosure

These interim consolidated financial statements (the “financial statements”) do not include all disclosures required by Canadian generally accepted accounting principles for annual financial statements and accordingly, the financial statements should be read in conjunction with the most recently prepared annual financial statements for the 52-week period ended January 28, 2006.

As the Company executes its strategy of broadening its customer base, the Company expects that its business will become less seasonal. However, retail sales are traditionally higher in the third and fourth quarters due to the back-to-school period and the Christmas season, respectively. In addition, fourth quarter earnings results are usually reduced by post Christmas sale promotions.

2. Accounting Policies

These financial statements follow the same accounting policies and methods of their application as the most recent annual financial statements for the 52-week period ended January 28, 2006.

3. Short-term Investments

Short-term investments include investments with original maturity terms of 90 days or more. Short-term investments are carried at the lower of cost and market value. All short-term investments are denominated in Canadian dollars. The fair value of the short-term investments approximates their carrying value.

As at April 29, 2006, the weighted average effective interest rate was 3.53% and their maturity dates vary over periods ending up to July 27, 2006.

4. Capital Stock

As at June 8, 2006, there were 3,986,601 Class A subordinate and 2,040,000 Class B voting shares outstanding. Further, there are 486,890 stock options outstanding with exercise prices ranging from \$6.01 to \$46.99, of which 153,490 are exercisable. Further details are provided in note 9 of the consolidated financial statements contained in the 2005 Annual Report.

400 shares (2005 – 61,550 shares) were issued pursuant to the exercising of stock options for cash consideration of \$1,500 (2005 - \$235,000) for the three months ended April 29, 2006.

During the three-month periods ended April 29, 2006 and April 30, 2005, the Company granted no stock options. The compensation cost related to stock options granted after January 25, 2003 is recorded in the unaudited interim consolidated statements of earnings. For the three-month period ended April 29, 2006, the stock-based compensation cost amounted to \$264,000 (Nil for the same period last year) and is recorded in operating expenses in the Company's unaudited interim consolidated statements of earnings and credited to contributed surplus on the Company's unaudited interim consolidated balance sheets.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. Earnings per Share

The numbers of shares used in the earnings per share calculation is as follows:

	For the three months ended	
	April 29, 2006	April 30, 2005
Weighted average number of shares outstanding - basic	6,026,289	5,880,070
Dilutive effect of stock options	224,619	189,222
Weighted average number of shares outstanding - diluted	6,250,908	6,069,292

6. Segmented Information

	For the three months ended	
	April 29, 2006	April 30, 2005
<b>Sales by country</b>		
Canada	\$ 59,392	\$ 58,685
United States	1,795	1,916
	\$ 61,187	\$ 60,601
<b>Sales by division</b>		
Ladies' Clothing	\$ 34,946	\$ 34,843
Men's Clothing	8,312	7,241
<i>JUNIOR GIRL</i> Clothing	1,182	2,673
Footwear	7,204	5,259
Accessories	9,543	10,585
	\$ 61,187	\$ 60,601
<b>Net earnings (loss)</b>		
Canada	\$ 3,109	\$ 4,739
United States	(390)	(101)
	\$ 2,719	\$ 4,638
<b>Identifiable assets</b>		
Canada	\$ 154,668	\$ 125,330
United States	4,945	4,185
	\$ 159,613	\$ 129,515