



le château



QUARTERLY REPORT
FOR THE SIX MONTHS ENDED
JULY 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 second quarter ended July 29, 2006.

Sales increased 4.2% to \$71.9 million for the second quarter ended July 29, 2006, compared to the second quarter ended July 30, 2005. Comparable store sales decreased by 0.9% in the second quarter of 2006 compared with the same period a year ago, reflecting a marked improvement from first quarter performance. Net earnings for the second quarter were \$5.4 million or \$0.90 per share compared to \$6.2 million or \$1.05 per share last year.

We are back on track to achieving our growth objectives, continuing to target margins in line with the global leaders of our industry. We have closed the under-performing *JUNIOR GIRL* division and replaced it with higher margin Footwear and Men's divisions, both of which have demonstrated marked year-over-year improvement. This trend is continuing into the beginning of the third quarter of fiscal 2007. For the period July 30, 2006 to September 6, 2006, total retail sales increased 6.5% and comparable store sales increased 2.6%. Excluding the *JUNIOR GIRL* division, comparable store sales were up 8.1% during this period. Our accessories division continues to lag last year's outstanding performance but we are confident that corrective measures have been taken and improved results should follow by the fourth quarter.

Looking at the year ahead, I foresee further growth in our profit margins. One of our major objectives is to take the company's 47-year tradition of vertical integration to an even higher level of rapid execution and replenishment. We now have the expertise and systems to identify trends and bring new styling to our customers within two weeks of design conception. This up-to-the-minute approach to retailing, supported by talented managers and designers, can only grow Le Château's competitive advantage and enable us to remain distinctly ahead of the fashion curve.

At the Board of Directors meeting held September 7, 2006, a quarterly cash dividend of \$0.25 was declared on the Class A subordinate voting and Class B voting shares outstanding, representing the 52nd consecutive dividend declared by Le Château. It is payable on November 6, 2006 to shareholders of record at the close of business on October 20, 2006.

Also today, the Board of Directors approved the appointment of Ms. Jane Silverstone Segal as the Chief Executive Officer. Ms. Silverstone Segal has served continuously over the past twenty-seven years in the sales and buying departments, as President, and most recently as Vice-Chairperson of the Company. While I have relinquished this role, I will continue to provide active strategic direction as Executive Chairman.

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



Herschel H. Segal
Executive Chairman of the Board
September 7, 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 six months ended July 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 September 7, 2006.

Results of Operations

Sales increased 4.2% to reach \$71.9 million for the second quarter ended July 29, 2006 as compared with \$69.0 million last year. Comparable store sales decreased 0.9% during the second quarter as compared with a 16.3% increase for the same period last year. On a year-to-date basis, sales increased 2.7% to \$133.1 million as compared with \$129.6 million last year. Comparable sales decreased 2.4% for the first six months as compared to a 16.6% increase last year. Year-to-date, the Company opened three new stores and expanded 12 existing locations, resulting in the addition of 45,000 square feet to the Le Château network.

During the second quarter, the Company completed the closure of its *JUNIOR GIRL* division and reassigned the remaining space to the Footwear and Men's divisions. Excluding *JUNIOR GIRL* sales, comparable store sales increased 2.5% for the quarter, reflecting the positive growth of the Ladies, Men's and Footwear divisions. The growth achieved by each of these divisions in the second quarter was an improvement over that realized by each in the first quarter. This trend is continuing into the beginning of the third quarter of fiscal 2007. For the period July 30, 2006 to September 6, 2006, total retail sales increased 6.5% and comparable store sales increased 2.6%. Excluding the *JUNIOR GIRL* division, comparable store sales were up 8.1% during this period.

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.

Net earnings for the second quarter were \$5.4 million or \$0.90 per share compared to \$6.2 million or \$1.05 per share for the same period last year. For the six months ended July 29, 2006, net earnings were \$8.2 million or \$1.35 per share compared to \$10.9 million or \$1.84 per share the previous year.

Earnings before interest, income taxes, depreciation and amortization (EBITDA) for the second quarter were \$12.1 million or 16.9% of sales compared to \$12.4 million or 17.9% of sales last year. Included in the second quarter expenses are approximately \$175,000 of costs relating to the Genuity assignment. For the six month period ended July 29, 2006 approximately \$710,000 of costs related to the strategic review and to the Genuity assignment.

Net earnings attributable to Canadian operations amounted to \$5.7 million or \$0.94 per share for the second quarter, compared to \$6.3 million or \$1.07 per share the previous year. The U.S. operations reported a net loss of \$224,000 Cdn or \$0.04 Cdn per share for the period, compared to a net loss of \$99,000 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. These include, but are not limited to, a sale of the Company, a business combination, a capital reorganization or conversion into an income trust. While there can be no assurance that any transaction or other action will result, the Board of Directors remains committed to pursuing this process and enhancing shareholder value.

Dividends and Outstanding Share Data

On September 7, 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 November 6, 2006 to shareholders of record at the close of business on October 20, 2006.

This dividend payment represents the 52nd consecutive quarterly dividend declared by Le Château.

As at September 7, 2006, there were 3,995,201 Class A subordinate and 2,040,000 Class B voting shares outstanding. Further, there are 478,290 stock options outstanding with exercise prices ranging from \$6.01 to \$46.99, of which 144,890 are exercisable.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Liquidity and Capital Resources

Cash flow from operations amounted to \$9.5 million for the second quarter of 2006, compared with \$9.8 million for the same period last year. On a year-to-date basis, cash flow from operations decreased to \$16.2 million from \$17.6 million the previous year, mainly as a result of lower net earnings reported for the period.

Capital expenditures for the second quarter amounted to \$5.0 million, compared to \$5.3 million for the same period last year. Capital expenditures for the first six months of 2006 totalled \$16.2 million, compared to \$17.3 million for the same period last year and related primarily to the opening of three new stores and the renovation of 26 existing stores. Capital expenditures were financed with cash and cash equivalents.

Financial Position

Working capital stood at \$54.2 million at the end of the second quarter of 2006, compared to \$44.5 million as at July 30, 2005 and \$60.5 million as at January 28, 2006.

Inventories increased to \$40.9 million at the end of the second quarter, from \$38.2 million a year earlier, due primarily to the 8% 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 \$18.1 million from \$11.3 million as at July 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 0.16:1 as at July 29, 2006 from 0.12:1 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)

Supplementary Measures (continued)

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

<i>(in thousands of dollars)</i>	For the three months ended		For the six months ended	
	July 29, 2006	July 30, 2006	July 29, 2006	July 30, 2005
Earnings before income taxes	\$ 8,482	\$ 9,660	\$ 12,701	\$ 16,878
Depreciation and amortization	3,426	2,715	6,624	5,335
Write-off of fixed assets	328	28	379	72
Interest on long-term debt and capital lease obligations	281	177	585	370
Interest income	(392)	(208)	(803)	(394)
EBITDA	\$ 12,125	\$ 12,372	\$ 19,486	\$ 22,261

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

Disclosure Controls and Procedures

As of July 29, 2006, an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures was conducted by and under the supervision of the Company's management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"). Based upon the evaluation, the CEO and CFO concluded that as of such date the Company's disclosure controls and procedures, as defined in Multilateral Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings, were effective such that information required to be disclosed in reports that are filed or submitted under Canadian securities legislation is properly recorded, processed, summarized and reported within the time periods specified in those rules and forms.

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)

	July 29, 2006	July 30, 2005
Working capital (\$,000)	\$ 54,166	\$ 44,542
Current ratio	2.60	2.49
Quick ratio	1.39	1.21
Long-term debt to equity *	0.16	0.12
Capital expenditures (\$,000)	\$ 16,192	\$ 17,331
Number of stores at end of quarter	188	181
Total number of square feet (,000)	807	747
Book value per share	\$ 18.40	\$ 15.84

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

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands of dollars)

	As at July 29, 2006	As at July 30, 2005	As at January 28, 2006
ASSETS			
Current			
Cash and cash equivalents	\$ 36,607	\$ 32,799	\$ 17,979
Short-term investments	6,000	–	43,083
Accounts receivable and prepaid expenses	3,312	3,547	3,746
Income taxes refundable	1,131	–	–
Inventories	40,895	38,165	35,444
Total current assets	87,945	74,511	100,252
Fixed assets	75,173	62,655	65,984
	\$ 163,118	\$ 137,166	\$ 166,236
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Accounts payable and accrued liabilities	\$ 25,386	\$ 22,494	\$ 27,668
Dividend payable	1,507	1,046	1,507
Income taxes payable	–	2,302	3,740
Current portion of capital lease obligations	2,620	1,443	2,634
Current portion of long-term debt	4,266	2,684	4,212
Total current liabilities	33,779	29,969	39,761
Capital lease obligations	3,056	1,596	4,339
Long-term debt	8,160	5,564	10,326
Future income taxes	2,313	1,695	2,365
Deferred lease inducements	4,777	3,720	4,200
Total liabilities	52,085	42,544	60,991
Shareholders' Equity			
Capital stock	27,365	26,856	27,210
Contributed surplus	954	122	458
Retained earnings	82,714	67,644	77,577
Total shareholders' equity	111,033	94,622	105,245
	\$ 163,118	\$ 137,166	\$ 166,236

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

<i>(Unaudited)</i> <i>(In thousands of dollars)</i>	For the three months ended		For the six months ended	
	July 29, 2006	July 30, 2005	July 29, 2006	July 30, 2005
Balance, beginning of period	\$ 78,789	\$ 62,450	\$ 77,577	\$ 58,851
Net earnings	5,432	6,240	8,151	10,878
	84,221	68,690	85,728	69,729
Dividends	1,507	1,046	3,014	2,085
Balance, end of period	\$ 82,714	\$ 67,644	\$ 82,714	\$ 67,644

CONSOLIDATED STATEMENTS OF EARNINGS

<i>(Unaudited)</i> <i>(In thousands of dollars, except per share data)</i>	For the three months ended		For the six months ended	
	July 29, 2006	July 30, 2005	July 29, 2006	July 30, 2005
Sales	\$ 71,892	\$ 69,007	\$ 133,079	\$ 129,608
Cost of sales and expenses				
Cost of sales and selling, general and administrative	59,767	56,635	113,593	107,347
Depreciation and amortization	3,426	2,715	6,624	5,335
Write-off of fixed assets	328	28	379	72
Interest on long-term debt and capital lease obligations	281	177	585	370
Interest income	(392)	(208)	(803)	(394)
	63,410	59,347	120,378	112,730
Earnings before income taxes	8,482	9,660	12,701	16,878
Provision for income taxes	3,050	3,420	4,550	6,000
Net earnings	\$ 5,432	\$ 6,240	\$ 8,151	\$ 10,878
Net earnings per share				
Basic	\$ 0.90	\$ 1.05	\$ 1.35	\$ 1.84
Diluted	0.87	1.01	1.31	1.78
Weighted average number of shares outstanding ('000)	6,028	5,953	6,027	5,917

CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>(Unaudited)</i>	For the three months ended		For the six months ended	
<i>(In thousands of dollars)</i>	July 29, 2006	July 30, 2005	July 29, 2006	July 30, 2005
OPERATING ACTIVITIES				
Net earnings	\$ 5,432	\$ 6,240	\$ 8,151	\$ 10,878
Adjustments to determine net cash from operating activities				
Depreciation and amortization	3,426	2,715	6,624	5,335
Write-off of fixed assets	328	28	379	72
Amortization of deferred lease inducements	(228)	(150)	(407)	(298)
Deferred lease inducements	334	858	984	1,531
Stock-based compensation	232	122	496	122
Future income taxes	(52)	-	(52)	-
	9,472	9,813	16,175	17,640
Net change in non-cash working capital items related to operations	(1,958)	(3,457)	(12,170)	(9,754)
Cash flows related to operating activities	7,514	6,356	4,005	7,886
FINANCING ACTIVITIES				
Repayment of capital lease obligations	(653)	(347)	(1,297)	(689)
Repayment of long-term debt	(1,029)	(730)	(2,112)	(1,449)
Issue of capital stock	153	228	155	463
Dividends paid	(1,507)	(1,039)	(3,014)	(2,066)
Cash flows related to financing activities	(3,036)	(1,888)	(6,268)	(3,741)
INVESTING ACTIVITIES				
Decrease in short-term investments	31,276	-	37,083	-
Additions to fixed assets	(4,955)	(5,261)	(16,192)	(17,331)
Cash flows related to investing activities	26,321	(5,261)	20,891	(17,331)
Increase (decrease) in cash and cash equivalents	30,799	(793)	18,628	(13,186)
Cash and cash equivalents, beginning of period	5,808	33,592	17,979	45,985
Cash and cash equivalents, end of period	\$ 36,607	\$ 32,799	\$ 36,607	\$ 32,799
Supplementary information:				
Interest paid during the period	\$ 281	\$ 177	\$ 585	\$ 370
Income taxes paid during the period, net	3,186	2,151	9,224	5,638

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 July 29, 2006, the weighted average effective interest rate was 4.25% and their maturity dates vary over periods ending up to September 1, 2006.

4. Long-term debt and Capital Lease Obligations

During the second quarter the Company signed a new credit facility in the amount of \$20 million, available until June 30, 2007, to finance the renovation and re-fixturing of various stores. Drawdowns under this facility are repayable over 60 months and will bear interest at a fixed rate based on the financial institution’s three year leasing rate. This facility is collateralized by the store fixtures and equipment financed.

The Company’s outstanding debt with this institution, in the amount of \$5.7 million, reduces the amount available under this facility thereby leaving a balance available of \$14.3 million as at July 29, 2006. As at September 7, 2006, no amounts had been drawn under this facility.

5. Capital Stock

As at September 7, 2006, there were 3,995,201 Class A subordinate and 2,040,000 Class B voting shares outstanding. Further, there are 478,290 stock options outstanding with exercise prices ranging from \$6.01 to \$46.99, of which 144,890 are exercisable. Further details are provided in note 9 of the consolidated financial statements contained in the 2005 Annual Report.

8,600 shares (2005 – 46,050 shares) were issued pursuant to the exercising of stock options for cash consideration of \$153,200 (2005 – \$228,000) for the three months ended July 29, 2006. For the six months ended July 29, 2006, there were 9,000 shares (2005 – 107,600 shares) issued for cash consideration of \$154,700 (2005 – \$463,000)

During the three and six-month periods ended July 29, 2006, Company granted no stock options (203,500 options granted for the three and six-month periods ended July 30, 2005). 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 July 29, 2006, the stock-based compensation cost amounted to \$232,000 (\$122,000 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.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. Capital Stock (continued)

on the Company's unaudited interim consolidated balance sheets. For the six-month period ended July 29, 2006, the stock-based compensation cost amounted to \$496,000 (\$122,000 for the same period last year).

6. Earnings per Share

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

	For the three months ended		For the six months ended	
	July 29, 2006	July 30, 2005	July 29, 2006	July 30, 2005
Weighted average number of shares outstanding - basic	6,027,735	5,953,440	6,027,012	5,916,756
Dilutive effect of stock options	198,350	200,832	211,484	195,027
Weighted average number of shares outstanding - diluted	6,226,085	6,154,272	6,238,496	6,111,783

7. Segmented Information

	For the three months ended		For the six months ended	
	July 29, 2006	July 30, 2005	July 29, 2006	July 30, 2005
Sales by country				
Canada	\$ 69,913	\$ 67,100	\$ 129,305	\$ 125,785
United States	1,979	1,907	3,774	3,823
	\$ 71,892	\$ 69,007	\$ 133,079	\$ 129,608
Sales by division				
Ladies' Clothing	\$ 39,673	\$ 37,349	\$ 74,619	\$ 72,192
Men's Clothing	10,821	9,025	19,133	16,266
JUNIOR GIRL Clothing	407	2,657	1,589	5,330
Footwear	9,874	6,673	17,078	11,932
Accessories	11,117	13,303	20,660	23,888
	\$ 71,892	\$ 69,007	\$ 133,079	\$ 129,608
Net earnings (loss)				
Canada	\$ 5,656	\$ 6,339	\$ 8,765	\$ 11,078
United States	(224)	(99)	(614)	(200)
	\$ 5,432	\$ 6,240	\$ 8,151	\$ 10,878
Identifiable assets				
Canada	\$ 158,098	\$ 133,058	\$ 158,098	\$ 133,058
United States	5,020	4,108	5,020	4,108
	\$ 163,118	\$ 137,166	\$ 163,118	\$ 137,166