



le château

**QUARTERLY REPORT**

FOR THE NINE MONTHS  
ENDED OCTOBER 28, 2006

## MESSAGE TO SHAREHOLDERS

On behalf of the Board of Directors, I am pleased to provide the results of Le Château Inc. for the third quarter ended October 28, 2006.

Sales increased 12.4% to \$77.8 million for the third quarter ended October 28, 2006 as compared with sales of \$69.2 million for the third quarter ended October 29, 2005. Comparable store sales increased by 6.8% in the third quarter of 2006 compared with the same period a year ago. Net earnings for the third quarter increased 36.0% to \$8.4 million or \$1.38 per share compared to \$6.1 million or \$1.03 per share last year. This trend is continuing into the beginning of the fourth quarter of fiscal 2007. For the first four weeks ended November 25, 2006, total retail sales have increased 11.5% and comparable store sales have increased 7.1% compared to the same period a year ago.

At the Board of Directors meeting held on November 30, 2006, we declared two dividends for the holders of Class A subordinate voting shares and Class B voting shares. The Board of Directors increased the regular quarterly dividend by 50% to \$0.375 per share and declared a one-time dividend of \$3.00 per share. Both dividends are payable on February 13, 2007 to the shareholders of record at the close of business on January 30, 2007.

The growth objectives we set for the current year are now showing tangible results. We have seen substantial revenue increases in the third quarter in our Ladies' Clothing, Men's Clothing and Footwear divisions, and these improvements validate the strategy we implemented to increase the size of our stores to accommodate the expansion of the Men's and Footwear divisions. To build on this success, the entire management team under the direction of our CEO, Jane Silverstone Segal, will continue to improve productivity in all divisions.

We are therefore confident in increasing our regular quarterly dividend and declaring this one-time dividend. The Company continues to maintain a conservative financial position with sufficient resources to cover its capital expenditures program and other financial commitments.

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



Herschel H. Segal  
Executive Chairman of the Board  
November 30, 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 nine months ended October 28, 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 November 30, 2006.

### Results of Operations

Sales increased 12.4% to reach \$77.8 million for the third quarter ended October 28, 2006 as compared with \$69.2 million last year. Comparable store sales increased 6.8% as compared to the same period last year. On a year-to-date basis, sales increased 6.1% to \$210.9 million as compared with \$198.8 million last year. Comparable sales increased by 0.8% for the first nine months over the same period a year ago. Year-to-date, the Company opened 8 new stores and expanded 19 existing locations, resulting in the addition of 83,000 square feet or 11% 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.

Net earnings for the third quarter increased 36.0% to \$8.4 million or \$1.38 per share compared to \$6.1 million or \$1.03 per share for the same period last year. For the nine months ended October 28, 2006, net earnings were \$16.5 million or \$2.74 per share compared to \$17.0 million or \$2.87 per share the previous year. Included in expenses for the first nine months were costs of approximately \$732,000 relating to the strategic review.

Earnings before interest, income taxes, depreciation and amortization (EBITDA) for the third quarter increased 29.9% to \$16.3 million or 20.9% of sales, compared to \$12.5 million or 18.1% of sales last year. For the first nine months earnings before interest, income taxes, depreciation and amortization (EBITDA) were \$35.7 million or 16.9% of sales, compared to \$34.8 million or 17.5% of sales last year.

Net earnings attributable to Canadian operations amounted to \$8.6 million or \$1.42 per share for the third quarter, compared to \$6.4 million or \$1.07 per share the previous year. The U.S. operations reported a net loss of \$241,000 Cdn or \$(0.04) Cdn per share for the period, compared to a net loss of \$245,000 Cdn or \$(0.04) Cdn per share for the same period a year ago.

The Company continues to evaluate various strategic alternatives. These include, but are not limited to, a sale of the Company, a business combination or a capital reorganization. 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 November 30, 2006, the Board of Directors declared two dividends for the holders of Class A subordinate voting shares and Class B voting shares. The Board of Directors increased the regular quarterly dividend by 50% to \$0.375 per share and declared a one-time dividend of \$3.00 per share. Both dividends are payable on February 13, 2007 to the shareholders of record at the close of business on January 30, 2007.

The regular dividend payment represents the 53<sup>rd</sup> consecutive quarterly dividend declared by Le Château.

As at November 30, 2006, there were 3,996,501 Class A subordinate and 2,040,000 Class B voting shares outstanding. Further, there are 476,990 stock options outstanding with exercise prices ranging from \$6.01 to \$46.99, of which 182,190 are exercisable.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

### Liquidity and Capital Resources

Cash flow from operations amounted to \$12.6 million for the third quarter of 2006, compared with \$9.2 million for the same period last year, mainly as a result of higher net earnings reported for the period. On a year-to-date basis, cash flow from operations increased to \$28.7 million from \$26.8 million the previous year.

Capital expenditures for the third quarter amounted to \$6.7 million, compared to \$5.7 million for the same period last year. Capital expenditures for the first nine months of 2006 totalled \$22.9 million, compared to \$23.1 million for the same period last year and related primarily to the opening of 8 new stores and the renovation of 28 existing stores. Capital expenditures were financed with cash and cash equivalents.

### Financial Position

Working capital stood at \$57.0 million at the end of the third quarter of 2006, compared to \$52.3 million as at October 29, 2005 and \$60.5 million as at January 28, 2006.

Inventories increased to \$45.5 million at the end of the third quarter, from \$43.0 million a year earlier, due primarily to the 10% increase in square footage when compared to the same period last year.

Long-term debt and capital lease obligations, including the current portions, amounted to \$16.4 million as at October 28, 2006, compared with \$18.3 million as at October 29, 2005. The long-term debt to equity ratio decreased to 0.14:1 as at October 28, 2006 from 0.18:1 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 in the first nine months 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 for public companies in our industry.

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 nine-month periods ended October 28, 2006 and October 29, 2005:

<i>(in thousands of dollars)</i>	For the three months ended		For the nine months ended	
	October 28, 2006	October 29, 2005	October 28, 2006	October 29, 2005
Earnings before income taxes	\$ 12,847	\$ 9,505	\$ 25,548	\$ 26,383
Depreciation and amortization	3,431	2,815	10,055	8,150
Write-off of fixed assets	126	234	505	306
Interest on long-term debt and capital lease obligations	261	164	846	534
Interest income	(407)	(199)	(1,210)	(593)
<b>EBITDA</b>	<b>\$ 16,258</b>	<b>\$ 12,519</b>	<b>\$ 35,744</b>	<b>\$ 34,780</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.

Disclosure Controls and Procedures

As of October 28, 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)

	October 28, 2006	October 29, 2005
Working capital (\$,000)	\$ 56,997	\$ 52,282
Current ratio	2.52	2.53
Quick ratio	1.31	1.27
Long-term debt to equity *	0.14	0.18
Capital expenditures (\$,000)	\$ 22,895	\$ 23,067
Number of stores at end of quarter	193	186
Total number of square feet (,000)	845	766
Book value per share	\$ 19.57	\$ 16.68

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

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands of dollars)

	As at October 28, 2006	As at October 29, 2005	As at January 28, 2006
<b>ASSETS</b>			
<b>Current</b>			
Cash and cash equivalents	\$ 7,841	\$ 25,187	\$ 17,979
Short-term investments	37,175	14,894	43,083
Accounts receivable and prepaid expenses	4,071	3,343	3,746
Inventories	45,456	43,011	35,444
<b>Total current assets</b>	<b>94,543</b>	<b>86,435</b>	<b>100,252</b>
Fixed assets	78,319	65,342	65,984
	\$ 172,862	\$ 151,777	\$ 166,236
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Current</b>			
Accounts payable and accrued liabilities	\$ 29,008	\$ 24,960	\$ 27,668
Dividend payable	1,509	-	1,507
Income taxes payable	324	3,523	3,740
Current portion of capital lease obligations	2,376	1,466	2,634
Current portion of long-term debt	4,329	4,204	4,212
<b>Total current liabilities</b>	<b>37,546</b>	<b>34,153</b>	<b>39,761</b>
Capital lease obligations	2,636	1,221	4,339
Long-term debt	7,055	11,384	10,326
Future income taxes	2,313	1,695	2,365
Deferred lease inducements	5,188	3,595	4,200
<b>Total liabilities</b>	<b>54,738</b>	<b>52,048</b>	<b>60,991</b>
<b>Shareholders' Equity</b>			
Capital stock	27,383	26,886	27,210
Contributed surplus	1,184	251	458
Retained earnings	89,557	72,592	77,577
<b>Total shareholders' equity</b>	<b>118,124</b>	<b>99,729</b>	<b>105,245</b>
	\$ 172,862	\$ 151,777	\$ 166,236

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

<i>(Unaudited)</i> <i>(In thousands of dollars)</i>	For the three months ended		For the nine months ended	
	October 28, 2006	October 29, 2005	October 28, 2006	October 29, 2005
Balance, beginning of period	\$ 82,714	\$ 67,644	\$ 77,577	\$ 58,851
Net earnings	8,352	6,143	16,503	17,021
	91,066	73,787	94,080	75,872
Dividends	1,509	1,195	4,523	3,280
<b>Balance, end of period</b>	<b>\$ 89,557</b>	<b>\$ 72,592</b>	<b>\$ 89,557</b>	<b>\$ 72,592</b>

CONSOLIDATED STATEMENTS OF EARNINGS

<i>(Unaudited)</i> <i>(In thousands of dollars, except per share data)</i>	For the three months ended		For the nine months ended	
	October 28, 2006	October 29, 2005	October 28, 2006	October 29, 2005
<b>Sales</b>	<b>\$ 77,841</b>	<b>\$ 69,231</b>	<b>\$ 210,920</b>	<b>\$ 198,839</b>
<b>Cost of sales and expenses</b>				
Cost of sales and selling, general and administrative	61,583	56,712	175,176	164,059
Depreciation and amortization	3,431	2,815	10,055	8,150
Write-off of fixed assets	126	234	505	306
Interest on long-term debt and capital lease obligations	261	164	846	534
Interest income	(407)	(199)	(1,210)	(593)
	64,994	59,726	185,372	172,456
Earnings before income taxes	12,847	9,505	25,548	26,383
Provision for income taxes	4,495	3,362	9,045	9,362
<b>Net earnings</b>	<b>\$ 8,352</b>	<b>\$ 6,143</b>	<b>\$ 16,503</b>	<b>\$ 17,021</b>
<b>Net earnings per share</b>				
Basic	\$ 1.38	\$ 1.03	\$ 2.74	\$ 2.87
Diluted	1.35	0.99	2.65	2.77
<b>Weighted average number of shares outstanding ('000)</b>	<b>6,036</b>	<b>5,977</b>	<b>6,030</b>	<b>5,937</b>

CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>(Unaudited)</i>	For the three months ended		For the nine months ended	
<i>(In thousands of dollars)</i>	October 28, 2006	October 29, 2005	October 28, 2006	October 29, 2005
<b>OPERATING ACTIVITIES</b>				
Net earnings	\$ 8,352	\$ 6,143	\$ 16,503	\$ 17,021
Adjustments to determine net cash from operating activities				
Depreciation and amortization	3,431	2,815	10,055	8,150
Write-off of fixed assets	126	234	505	306
Amortization of deferred lease inducements	(203)	(219)	(610)	(517)
Deferred lease inducements	614	94	1,598	1,625
Stock-based compensation	230	129	726	251
Future income taxes	-	-	(52)	-
	12,550	9,196	28,725	26,836
Net change in non-cash working capital items related to operations	(243)	(955)	(12,413)	(10,709)
<b>Cash flows related to operating activities</b>	<b>12,307</b>	<b>8,241</b>	<b>16,312</b>	<b>16,127</b>
<b>FINANCING ACTIVITIES</b>				
Repayment of capital lease obligations	(664)	(352)	(1,961)	(1,041)
Proceeds of long-term debt	-	8,081	-	8,081
Repayment of long-term debt	(1,042)	(741)	(3,154)	(2,190)
Issue of capital stock	18	30	173	493
Dividends paid	(1,507)	(2,241)	(4,521)	(4,307)
<b>Cash flows related to financing activities</b>	<b>(3,195)</b>	<b>(4,777)</b>	<b>(9,463)</b>	<b>1,036</b>
<b>INVESTING ACTIVITIES</b>				
Decrease (increase) in short-term investments	(31,175)	(14,894)	5,908	(14,894)
Additions to fixed assets	(6,703)	(5,736)	(22,895)	(23,067)
<b>Cash flows related to investing activities</b>	<b>(37,878)</b>	<b>(20,630)</b>	<b>(16,987)</b>	<b>(37,961)</b>
<b>Decrease in cash and cash equivalents</b>	<b>(28,766)</b>	<b>(7,612)</b>	<b>(10,138)</b>	<b>(20,798)</b>
Cash and cash equivalents, beginning of period	36,607	32,799	17,979	45,985
<b>Cash and cash equivalents, end of period</b>	<b>\$ 7,841</b>	<b>\$ 25,187</b>	<b>\$ 7,841</b>	<b>\$ 25,187</b>
<b>Supplementary information:</b>				
Interest paid during the period	\$ 261	\$ 164	\$ 846	\$ 534
Income taxes paid during the period, net	3,041	2,141	12,265	7,779

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 October 28, 2006, the weighted average effective interest rate was 4.26% and their maturity dates vary over periods ending up to March 8, 2007.

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 \$5.0 million, reduces the amount available under this facility thereby leaving a balance available of \$15.0 million as at October 28, 2006. As at November 30, 2006, no amounts had been drawn under this facility.

5. Capital Stock

As at November 30, 2006, there were 3,996,501 Class A subordinate and 2,040,000 Class B voting shares outstanding. Further, there are 476,990 stock options outstanding with exercise prices ranging from \$6.01 to \$46.99, of which 182,190 are exercisable. Further details are provided in note 9 of the consolidated financial statements contained in the 2005 Annual Report.

1,300 shares (2005 – 4,300 shares) were issued pursuant to the exercising of stock options for cash consideration of \$18,000 (2005 – \$30,000) for the three months ended October 28, 2006. For the nine months ended October 28, 2006, there were 10,300 shares (2005 – 111,900 shares) issued for cash consideration of \$173,000 (2005 – \$493,000)

During the three and nine-month periods ended October 28, 2006, the Company granted no stock options. For the three and nine-month periods ended October 29, 2005, the Company granted NIL and 203,500 options, respectively. 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 October 28, 2006, the stock-based compensation cost amounted to \$230,000 (\$129,000 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 on the Company’s unaudited interim consolidated balance sheets. For the nine-month period ended October 28, 2006, the stock-based compensation cost amounted to \$726,000 (\$251,000 for the same period last year).

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)

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 nine months ended	
	October 28, 2006	October 29, 2005	October 28, 2006	October 29, 2005
Weighted average number of shares outstanding - basic	6,035,715	5,977,346	6,029,913	5,936,953
Dilutive effect of stock options	168,829	245,148	197,266	211,734
Weighted average number of shares outstanding - diluted	6,204,544	6,222,494	6,227,179	6,148,687

7. Segmented Information

	For the three months ended		For the nine months ended	
	October 28, 2006	October 29, 2005	October 28, 2006	October 29, 2005
<b>Sales by country</b>				
Canada	\$ 75,729	\$ 67,502	\$ 205,034	\$ 193,287
United States	2,112	1,729	5,886	5,552
	\$ 77,841	\$ 69,231	\$ 210,920	\$ 198,839
<b>Sales by division</b>				
Ladies' Clothing	\$ 44,090	\$ 37,959	\$ 118,709	\$ 110,151
Men's Clothing	11,376	9,037	30,509	25,303
JUNIOR GIRL Clothing	232	2,907	1,821	8,237
Footwear	9,824	6,223	26,902	18,155
Accessories	12,319	13,105	32,979	36,993
	\$ 77,841	\$ 69,231	\$ 210,920	\$ 198,839
<b>Net earnings (loss)</b>				
Canada	\$ 8,593	\$ 6,388	\$ 17,358	\$ 17,466
United States	(241)	(245)	(855)	(445)
	\$ 8,352	\$ 6,143	\$ 16,503	\$ 17,021
<b>Identifiable assets</b>				
Canada	\$ 167,448	\$ 146,292	\$ 167,448	\$ 146,292
United States	5,414	5,485	5,414	5,485
	\$ 172,862	\$ 151,777	\$ 172,862	\$ 151,777

8. Subsequent Event

On November 30, 2006, the Board of Directors declared a one-time dividend of \$3.00 per Class A subordinate voting share and Class B voting share. The dividend is payable on February 13, 2007 to the shareholders of record at the close of business on January 30, 2007.