

# QUARTERLY REPORT

For the six months ended July 26, 2003



le château

## 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 26, 2003.

Sales increased 5.0% to \$54,180,000 for the second quarter ended July 26, 2003, compared with sales of \$51,597,000 for the same period last year. Comparable store sales increased by 2.4% in the second quarter of 2003 compared with the same period a year ago.

The Company recorded net earnings for the second quarter of \$2,543,000 or \$0.50 per share compared to \$2,422,000 or \$0.49 per share for the same period the previous year. Net earnings attributable to Canadian operations amounted to \$2,828,000 or \$0.55 per share, whereas a net loss of \$285,000 Cdn or \$(0.05) Cdn per share was recorded for the U.S. operations.

For the first six months of the year, sales rose 5.2% to \$99,450,000, compared to \$94,557,000 last year. Net earnings for the six-month period totalled \$2,924,000 or \$0.58 per share, compared to \$2,765,000 or \$0.56 per share the previous year. Comparable store sales were up 3.3% over the same period a year ago.

For the first seven weeks of the third quarter, total retail sales decreased 6.8% and same store sales decreased 9.2% compared to the same period last year.

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  
September 19, 2003

## 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 26, 2003 and the audited consolidated financial statements and MD & A for the year ended January 25, 2003. 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 2002 Annual Report.*

### Results of Operations

Sales increased 5.0% to reach \$54.2 million for the second quarter ended July 26, 2003, due primarily to an increase in comparable store sales of 2.4%. On a year-to-date basis, sales increased 5.2% to \$99.5 million with comparable store sales growing 3.3%.

The Company's business follows a seasonal pattern, with retail sales traditionally being higher in the third and fourth quarters due to the back-to-school period and the Christmas season, respectively.

Net earnings for the second quarter totalled \$2,543,000 or \$0.50 per share, compared to \$2,422,000 or \$0.49 per share last year, an increase of 5.0%. For the six months ended July 26, 2003, net earnings amounted to \$2,924,000 or \$0.58 per share, compared to \$2,765,000 or \$0.56 per share the previous year.

Net earnings attributable to Canadian operations amounted to \$2,828,000 or \$0.55 per share for the second quarter, while the U.S. reported a net loss \$285,000 Cdn or \$(0.05) Cdn per share. On a year-to-date basis, net earnings attributable to Canadian operations amounted to \$3,714,000 or \$0.73 per share, whereas a net loss of \$790,000 Cdn or \$(0.15) Cdn per share was recorded for the U.S. operations.

Cost of sales, buying and occupancy expenses, as a percentage of sales, decreased to 61.9% from 63.0% in the second quarter and on a year-to-date basis, decreased to 62.6% from 64.1%, primarily due to higher merchandise margins. Selling, general and administrative expenses, as a percentage of sales, increased to 26.5% from 26.0% for the second quarter and increased to 28.3% from 27.4% for the six months ended July 26, 2003, due mainly to the additional marketing initiatives undertaken in the first half of the year.

### Dividends

On July 11, 2003, Le Château declared a quarterly dividend of \$0.10 per share on the Class A Subordinate Voting and Class B Voting shares. This is the 39<sup>th</sup> consecutive dividend paid by Le Château, and was paid on September 8, 2003 to shareholders of record at the close of business on August 15, 2003.

### Liquidity and Capital Resources

Cash flow from operations rose to \$4.5 million in 2003, from \$4.0 million last year, mainly as a result of higher net earnings reported for the quarter as well as higher depreciation and amortization expense. On a year-to-date basis, cash flow from operations increased to \$6.7 million from \$5.9 million the previous year.

Capital expenditures for the second quarter amounted \$1.5 million, compared to \$2.9 million last year. Capital expenditures for the six months of 2003 totalled \$6.1 million, compared to \$4.9 million last year and related primarily to the opening of four new stores and the renovation of existing stores.

### Financial Position

Working capital stood at \$21.7 million at the end of the second quarter of 2003, compared to \$13.6 million as at July 27, 2002 and \$18.4 million as at January 25, 2003.

Long-term debt and capital lease obligations, including the current portions, increased to \$6.7 from \$3.2 million in 2002, after the additional long-term financing of \$4.0 million and the repayment of \$1.5 million during the first six months of 2003. The long-term debt to equity ratio remained conservative at 0.12:1, compared to 0.07:1 the previous year.

### Forward-looking Statements

This news release 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.

FINANCIAL HIGHLIGHTS

(Unaudited)

(In units except where otherwise stated)

	July 26, 2003		July 27, 2002	
Working capital (\$,000)	\$	21,743	\$	13,598
Current ratio		2.19		1.59
Quick ratio		0.42		0.08
Long-term debt to equity *		0.12		0.07
Capital expenditures (\$,000)	\$	6,093	\$	4,926
Number of stores at end of quarter		164		161
Total number of square feet (,000)		637		595
Book value per share	\$	10.44	\$	9.54

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

CONSOLIDATED BALANCE SHEETS

	(Unaudited) As at July 26, 2003		(Unaudited) As at July 27, 2002		(Audited) As at January 25, 2003	
<i>(In thousands of dollars)</i>						
<b>ASSETS</b>						
<b>Current</b>						
Cash and cash equivalents	\$	4,901	\$	-	\$	15,040
Accounts receivable and prepaid expenses		1,948		1,795		1,169
Income taxes refundable		227		-		-
Inventories		32,386		34,925		25,482
Loan to director		566		120		-
<b>Total current assets</b>		<b>40,028</b>		<b>36,840</b>		<b>41,691</b>
Loan to director		-		566		566
Fixed assets		40,356		38,074		38,262
	\$	<b>80,384</b>	\$	<b>75,480</b>	\$	<b>80,519</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>						
<b>Current</b>						
Bank indebtedness	\$	-	\$	2,814	\$	-
Accounts payable and accrued liabilities		15,400		16,486		17,609
Dividend payable		516		499		503
Income taxes payable		-		1,125		2,877
Current portion of capital lease obligations		1,120		1,467		776
Current portion of long-term debt		1,249		851		1,483
<b>Total current liabilities</b>		<b>18,285</b>		<b>23,242</b>		<b>23,248</b>
Capital lease obligations		3,104		316		212
Long-term debt		1,226		536		1,766
Future income taxes		1,888		1,772		1,888
Deferred lease inducements		1,995		2,029		1,913
<b>Total liabilities</b>		<b>26,498</b>		<b>27,895</b>		<b>29,027</b>
<b>Shareholders' Equity</b>						
Capital stock		14,179		13,568		13,680
Retained earnings		39,707		34,017		37,812
<b>Total shareholders' equity</b>		<b>53,886</b>		<b>47,585</b>		<b>51,492</b>
	\$	<b>80,384</b>	\$	<b>75,480</b>	\$	<b>80,519</b>

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

(Unaudited)

(In thousands of dollars)

	For the three months ended				For the six months ended			
	July 26, 2003		July 27, 2002		July 26, 2003		July 27, 2002	
Balance, beginning of period	\$	37,680	\$	32,094	\$	37,812	\$	32,249
Net earnings		2,543		2,422		2,924		2,765
		40,223		34,516		40,736		35,014
Dividends		516		499		1,029		997
<b>Balance, end of period</b>	<b>\$</b>	<b>39,707</b>	<b>\$</b>	<b>34,017</b>	<b>\$</b>	<b>39,707</b>	<b>\$</b>	<b>34,017</b>

CONSOLIDATED STATEMENT 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 26, 2003	July 27, 2002	July 26, 2003	July 27, 2002
<b>Sales</b>	\$ 54,180	\$ 51,597	\$ 99,450	\$ 94,557
<b>Cost of sales and expenses</b>				
Cost of sales, buying and occupancy	33,559	32,497	62,229	60,608
Selling, general and administrative	14,364	13,438	28,113	25,921
Interest	63	77	130	160
Depreciation and amortization	2,028	1,672	3,986	3,288
Write-off of fixed assets	13	25	13	25
	50,027	47,709	94,471	90,002
Earnings before income taxes	4,153	3,888	4,979	4,555
Provision for income taxes	1,610	1,466	2,055	1,790
<b>Net earnings</b>	\$ 2,543	\$ 2,422	\$ 2,924	\$ 2,765
<b>Net earnings per share</b>				
Basic	\$ 0.50	\$ 0.49	\$ 0.58	\$ 0.56
Diluted	0.48	0.47	0.55	0.54
<b>Weighted average number of shares outstanding ('000)</b>	5,127	4,984	5,076	4,964

CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>(Unaudited)</i> <i>(In thousands of dollars)</i>	For the three months ended		For the six months ended	
	July 26, 2003	July 27, 2002	July 26, 2003	July 27, 2002
<b>OPERATING ACTIVITIES</b>				
Net earnings	\$ 2,543	\$ 2,422	\$ 2,924	\$ 2,765
Adjustments to determine net cash from operating activities				
Depreciation and amortization	2,028	1,672	3,986	3,288
Write-off of fixed assets	13	25	13	25
Amortization of deferred lease inducements	(109)	(98)	(216)	(195)
	4,475	4,021	6,707	5,883
Net change in non-cash working capital items related to operations	(3,022)	(4,560)	(12,996)	(11,418)
<b>Cash flows from operating activities</b>	1,453	(539)	(6,289)	(5,535)
<b>FINANCING ACTIVITIES</b>				
Increase in bank indebtedness	-	2,814	-	2,814
Proceeds of capital leases	3,970	-	3,970	-
Repayment of capital lease obligations	(368)	(374)	(734)	(742)
Repayment of long-term debt	(434)	(289)	(774)	(572)
Deferred lease inducements	182	-	298	-
Issue of capital stock	486	61	499	123
Dividends paid	(513)	(498)	(1,016)	(992)
<b>Cash flows from financing activities</b>	3,323	1,714	2,243	631
<b>INVESTING ACTIVITIES</b>				
Additions to fixed assets	(1,494)	(2,871)	(6,093)	(4,926)
<b>Cash flows from investing activities</b>	(1,494)	(2,871)	(6,093)	(4,926)
<b>Increase (decrease) in cash and cash equivalents</b>	3,282	(1,696)	(10,139)	(9,830)
Cash and cash equivalents, beginning of period	1,619	1,696	15,040	9,830
<b>Cash and cash equivalents, end of period</b>	\$ 4,901	\$ -	\$ 4,901	\$ -
<b>Supplementary information:</b>				
Interest paid during the period	\$ 63	\$ 77	\$ 130	\$ 160
Income taxes paid during the period, net	1,308	569	5,143	2,541

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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 25, 2003.

The Company's business follows a seasonal pattern, with retail sales traditionally being higher in the third and fourth quarters due to the back-to-school period and the Christmas season, respectively.

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 25, 2003.

3. Capital Stock

As at September 19, 2003, there were 2,142,851 Class A subordinate and 3,020,000 Class B voting shares outstanding. Further, there are 514,140 stock options outstanding with exercise prices ranging from \$2.33 to \$8.88. Of these outstanding options, 192,520 are exercisable. Included in exercisable options are 192,520 options that had an issue price lower than the closing price of \$10.20 at July 26, 2003, and consequently were "in the money" as of that date. Further details are provided in note 8 of the consolidated financial statements contained in the 2002 Annual Report.

During the quarter ended July 26, 2003, no stock options were granted (no options granted for the six month period ended July 26, 2003). The Company does not recognize compensation expense in earnings for options granted under the stock option plan. On a pro forma basis, if the Company had used the fair market value method of accounting for its option plan, the Company's net earnings and the basic and diluted earnings per share would be as indicated below:

	For the three months ended		For the six months ended	
	July 26, 2003	July 27, 2002	July 26, 2003	July 27, 2002
<b>Net income as reported</b>	\$ 2,543	\$ 2,422	\$ 2,924	\$ 2,765
Pro forma adjustment	(17)	(31)	(46)	(33)
<b>Pro forma net income</b>	<b>\$ 2,526</b>	<b>\$ 2,391</b>	<b>\$ 2,878</b>	<b>\$ 2,732</b>
<b>Pro forma earnings per share</b>				
Basic	\$ 0.49	\$ 0.48	\$ 0.57	\$ 0.55
Diluted	0.47	0.46	0.54	0.53

On July 9, 2003, the shareholders of the Company approved an amendment to increase the maximum number of subordinate voting shares issuable under the Company's stock option plan to 1,500,000.

4. Earnings per share

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

	For the three months ended		For the six months ended	
	July 26, 2003	July 27, 2002	July 26, 2003	July 27, 2002
Weighted average number of shares outstanding - basic	5,126,504	4,984,057	5,075,728	4,964,015
Dilutive effect of stock options	207,654	219,367	208,445	194,949
Weighted average number of shares outstanding - diluted	5,334,158	5,203,424	5,284,173	5,158,964

5. Segmented Information

<i>(Unaudited)</i> <i>(In thousands of dollars)</i>	For the three months ended		For the six months ended	
	July 26, 2003	July 27, 2002	July 26, 2003	July 27, 2002
<b>Sales</b>				
Canada	\$ 52,277	\$ 49,112	\$ 95,869	\$ 89,964
United States	1,903	2,485	3,581	4,593
	<b>\$ 54,180</b>	<b>\$ 51,597</b>	<b>\$ 99,450</b>	<b>\$ 94,557</b>
<b>Net earnings (loss)</b>				
Canada	\$ 2,828	\$ 2,364	\$ 3,714	\$ 2,964
United States	(285)	58	(790)	(199)
	<b>\$ 2,543</b>	<b>\$ 2,422</b>	<b>\$ 2,924</b>	<b>\$ 2,765</b>
<b>Identifiable assets</b>				
Canada	\$ 76,204	\$ 70,268	\$ 76,204	\$ 70,268
United States	4,180	5,212	4,180	5,212
	<b>\$ 80,384</b>	<b>\$ 75,480</b>	<b>\$ 80,384</b>	<b>\$ 75,480</b>