

**STERLING SHOES INCOME FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
MAY 9, 2008**

*The following management's discussion and analysis ("MD&A") should be read in conjunction with the unaudited interim consolidated financial statements and accompanying notes ("Interim Financial Statements") of Sterling Shoes Income Fund (the "Fund") for the three-month period ended March 31, 2008. Results have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP" and reported in Canadian dollars unless otherwise indicated). The fiscal year-end of the Fund is December 31.*

*This MD&A contains forward-looking statements. Please see "Forward-Looking Statements" and "Risks and Uncertainties" for a discussion of the risks, uncertainties and assumptions relating to these statements. This MD&A also makes reference to certain non-GAAP measures to assist in assessing our financial performance. Non-GAAP measures do not have any standard meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers. See "Non-GAAP Measures" and "Adjusted Distributable Cash".*

**OVERVIEW OF THE FUND**

The Fund is a Vancouver-based, leading footwear retailer offering a broad selection of private label and brand name shoes and accessories through six separate retail banners: Sterling, Joneve, Shoe Warehouse, Freedman Shoes, Gia and Sterling Outlet. These retail concepts were designed to serve identified market segments which we can effectively and profitably serve. Since 1987 the Sterling Shoes business (formerly carried on by Sterling Shoes Inc.) has grown from five locations to 146 stores as at May 9, 2008. These stores are located primarily in high-traffic, high-visibility locations within enclosed shopping malls, on high streets and in strip malls.

The Fund is an unincorporated, open-ended, limited-purpose trust established under the laws of the Province of British Columbia pursuant to the declaration of trust dated May 31, 2005. The Fund was established to acquire an 80% interest in Sterling Shoes Limited Partnership ("Sterling Shoes LP"), which had acquired the retail footwear business of SSI Investments Inc., previously named Sterling Shoes Inc. ("Inc"). Inc retained a 20% interest in Sterling Shoes LP.

As at May 9, 2008, there were 5,313,488 units ("Units") of the Fund issued and outstanding. In addition, to provide Inc with voting rights commensurate with Inc's retained interest in Sterling Shoes LP, Inc holds 1,328,372 special voting units of the Fund (equal to the number of Class D LP Units Inc holds in Sterling Shoes LP (the "Class D LP Units")), which entitle the holder to one vote per special voting unit at meetings of unitholders of the Fund ("Unitholders").

Distributions on the Class D LP Units and the Class D LP Units themselves were not exchangeable for Units of the Fund until the Subordination End Date. As a result of the Fund achieving a specified EBITDA target for the year ended December 31, 2007 and distribution target for each of the fiscal years ended December 31, 2007 and 2006, the Subordination End Date has occurred.

The Class D LP Units are now freely exchangeable for Units on a one-for-one basis. The Class D LP Units have been reclassified from non-controlling interest to unitholders' equity. Also, the distributions on the Class D LP Units are no longer subordinated and will be made monthly, instead of quarterly.

On October 3, 2007 the Fund closed an offering of \$25 million of convertible unsecured subordinated debentures (the "Debentures") at a price of \$1,000 per debenture. The Debentures bear

interest at an annual rate of 6.5% payable semi-annually in arrears on October 31 and April 30 in each year commencing April 30, 2008. The maturity date for the Debentures is October 31, 2012.

The Debentures are convertible at any time at the option of the holders into Units of the Fund at a conversion rate of approximately 47.281 Units per \$1,000 principal amount of Debentures, which is equal to a conversion price of \$21.15 per Unit (or 1,182,025 Units). After October 31, 2010 and on or before October 31, 2011, the Fund will have the right to redeem all or a portion of the Debentures equal to the principal amount plus accrued and unpaid interest, provided that the market price on the date on which the notice of redemption is given is not less than 125% of the conversion price. After October 31, 2011, the Fund will have the right to redeem all or a portion of the Debentures equal to the principal amount plus accrued and unpaid interest.

The Units trade on the Toronto Stock Exchange under the symbol SSI.UN and the Debentures trade under the symbol SSI.DB.

## RECENT EVENTS AND OUTLOOK

On March 26, 2008 the Board of Trustees of the Fund approved a \$0.06 per Unit supplementary special distribution to the \$0.36 per Unit special distribution declared in December 2007. Distributions declared for 2007 (including special distributions) were \$1.86 per Unit, which is 73% higher than the targeted annual distribution of \$1.075 per Unit at the time of the Fund's initial public offering on July 12, 2005 ("IPO"). We also increased our monthly distributions from \$0.12 per Unit to \$0.125 per Unit beginning in January 2008. The Fund's monthly payout is now 40% more than when we went public in July 2005.

Our 146 stores operate under six retail banners in British Columbia, Alberta, Saskatchewan, Manitoba and Ontario as follows:

Number of Stores Operating												
9-May-08								Dec 31, 2007	Dec 31, 2006	Dec 31, 2005	July 12, 2005	
Province	Shoe		Sterling			Sterling Outlet		Total	Total	Total	Total	Total
	Warehouse	Sterling	Joneve	Freedman	Gia							
British Columbia	35	18	5	6	2	-	66	65	63	60	59	
Alberta	14	8	2	-	-	1	25	25	25	24	24	
Saskatchewan	2	1	-	-	-	-	3	3	3	4	4	
Manitoba	9	3	-	-	-	-	12	12	11	11	11	
Ontario	10	27	2	1	-	-	40	36	25	5	2	
<b>Total</b>	<b>70</b>	<b>57</b>	<b>9</b>	<b>7</b>	<b>2</b>	<b>1</b>	<b>146</b>	<b>141</b>	<b>127</b>	<b>104</b>	<b>100</b>	

During 2006 we started a new banner, Gia, as a concept store on Robson Street in Vancouver. On October 3, 2007 we opened our second Gia store in the Metrotown Mall in Burnaby, British Columbia. Gia offers fashionable and athletic footwear for women, along with handbags and accessories. In June 2007 we launched another new concept with our first Sterling Outlet store in Calgary, Alberta. Sterling Outlet offers mid and higher-end women's fashion and comfort footwear at clearance prices. We continue to experiment and innovate with these concepts and may expand both to further locations in the future.

We are in the process of finalizing arrangements for additional stores for 2008 and have secured a number of locations for 2009 and 2010. The normal course of business also includes closing stores due to a number of factors such as the redevelopment of real estate in malls, high streets and strip malls, changes in market and lease terms. We will continue to execute our expansion

strategy with a focus on more balanced store openings between eastern and western Canada as well as on more store openings under the Shoe Warehouse banner than in the past few years.

The actual timing of and number of additional store openings could differ materially from what is described herein if Sterling Shoes LP is unable to reach timely and satisfactory agreements with the various landlords as to the final lease documentation, to secure adequate labour and materials to construct the stores, to deliver sufficient inventory, to adapt its operational systems, or hire, train and integrate employees.

While the retail environment across Canada has been very robust over the past several years, we believe that certain regions, particularly in Ontario, are entering a period of economic weakness.

## **FUTURE INCOME TAXES**

On October 31, 2006, the Minister of Finance announced proposed changes to the income tax treatment of “flow-through entities”, including income trusts. On June 22, 2007 the Government of Canada enacted new legislation imposing a tax on distributions paid by publicly traded income trusts in Canada, commencing in 2011. Unitholders will be treated as if they have received an eligible dividend from a Canadian public corporation equal to the taxable portion of their distributions and will be taxed accordingly.

Prior to June 22, 2007, the Fund calculated its future income tax on certain temporary differences between amounts recorded on its balance sheet for book and tax purposes at a nil tax rate. Under the newly enacted legislation, the tax rate on the post-2010 reversal of these temporary differences is estimated to be 27.5%. Temporary differences reversing prior to December 31, 2010 will still give rise to nil future income taxes. Based on its assets and liabilities as at December 31, 2007, the Fund has estimated the amount of its temporary differences which were previously not subject to tax and the period in which these differences will reverse.

As a result of this new legislation, Canadian accounting guidance requires that the Fund record a future tax liability and a corresponding, one-time, non-cash charge to net income. The Fund’s identifiable intangible assets, recorded on the balance sheet at \$49.0 million, (but which have nil basis for tax purposes), are treated as a temporary difference that will reverse after January 1, 2011.

The result of this treatment is the creation of a non-cash, future income tax liability of \$7.7 million created during the second quarter of 2007. This future income tax liability is based on the enacted tax rate of 27.5% and the assumption that the Fund will be a taxable entity in 2011. The Fund estimates that its current temporary differences, other than those relating to its identifiable intangible assets, will reverse to nil by December 31, 2010. For the three months ended March 31, 2008, the estimated future income tax liability was reduced by \$0.7 million based on the temporary differences between the accounting and tax basis of the Fund’s assets and liabilities as at March 31, 2008 expected to reverse after January 1, 2011.

In future periods, adjustments to this future tax liability may be required based on changes in the differences between the tax basis and financial statement basis of the Fund’s assets and liabilities. These adjustments could be material. Consistent with the initial recognition, any future adjustments will be non-cash in nature and will be either a charge or an addition to net income of the period.

Since this tax will not be in effect until 2011, any changes to the tax legislation, or to the legal structure of the Fund prior to that time could have a material effect on the level of the future income taxes recorded by the Fund.

## INTERNATIONAL FINANCIAL REPORTING STANDARDS (“IFRS”)

The Canadian Accounting Standards Board (AcSB) will require all public companies to adopt IFRS for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Fund will be required to prepare both current and comparative financial information using IFRS. The Fund expects the transition to IFRS to impact financial reporting, business processes, and information systems. The Fund will begin to assess the impact of adoption of IFRS in 2008. The financial impact of the transition to IFRS cannot be reasonably estimated at this time.

## SUMMARY FINANCIAL INFORMATION

<b>Statement of Income Items (\$000's)</b>	<b>Three months ended March 31</b>	
	<b>2008</b>	<b>2007</b>
Sales	\$ 24,948	\$ 23,950
Cost of Sales	(13,875)	(9,851)
Gross Margin	11,073	14,100
<i>As a percentage of sales</i>	44.4%	58.9%
Store and selling expenses	(10,522)	(9,276)
General and administrative expenses	(2,060)	(1,663)
EBITDA <sup>(1)</sup>	(1,509)	3,161
Adjusted EBITDA <sup>(1)</sup>	(1,598)	3,087
<i>As a percentage of sales</i>	-6.4%	12.9%
Interest expense	(463)	(109)
Gain / (Loss) on disposal	0	5
Amortization	(751)	(788)
(Loss) / Income before non-controlling interest and taxes <sup>(2) (3)</sup>	(2,723)	2,268
Future income taxes	724	0
(Loss) / Income before non-controlling interest <sup>(2) (3)</sup>	(1,999)	2,268
Non-controlling interest <sup>(2) (3)</sup>	0	(462)
Net (loss) / income	\$ (1,999)	\$ 1,806
Maintenance capital expenditures <sup>(4)</sup>	1,067	1,108
	<b>March 31,</b>	<b>December 31,</b>
<b>Balance Sheet Items (\$000's)</b>	<b>2008</b>	<b>2007</b>
Total assets	110,832	111,192
Long-term financial liabilities	21,377	21,243

Notes:

- (1) See definition of EBITDA and Adjusted EBITDA under "Non-GAAP Measures".
- (2) In any fiscal year Sterling Shoes LP and the Fund intend to make distributions of available cash to the maximum extent possible to the Unitholders and the non-controlling interest. Sterling Shoes LP and the Fund may make

additional distributions in excess of monthly distributions during the year, as the Boards determine. Distributions to Unitholders and the non-controlling interest will be determined by the Boards, to provide for the stability of distributions over a 12-month period.

- (3) Effective April 1, 2008, distributions to the non-controlling interest are made monthly and are no longer subordinated. These distributions were subject to subordination pending the Fund achieving explicit EBITDA targets, based on audited consolidated financial statements, and distribution targets. For further information see “End of Subordination”. On the Subordination End Date, the non-controlling interest held by Inc, which retained a 20% in the business of Sterling Shoes LP, has been reclassified to unitholders’ equity. As a result, (loss) / income before non-controlling interest and taxes is applicable to the quarters up to December 31, 2007 only.
- (4) “Maintenance Capital Expenditures” is not a recognized measure under GAAP. Maintenance Capital Expenditures include those required to upgrade existing stores and to maintain information systems and equipment and our warehouse.

The table below summarizes the distributions declared during the three-month periods ended March 31, 2008 and 2007 for Units of the Fund and to Inc on its units of Sterling Shoes LP:

<u>in (\$000's)</u>	<u>Three-months ended Mar 31</u>	
	<u>2008</u>	<u>2007</u>
Trust Units	\$ 1,993	\$ 1,913
Inc's ownership in Sterling Shoes LP	498	478
Total	\$ 2,491	\$ 2,391

## **OPERATING RESULTS**

### ***Sales***

Sales were \$24.9 million during the three-months ended March 31, 2008, representing an increase of 4.2% over the \$23.9 million in 2007. The growth in sales was a result of same-store sales growth, incremental growth from new stores not opened for the full quarter ended March 31, 2007, and sales from new stores opened since April 1, 2007.

The Fund achieved same-store sales growth of 1.4% in those stores that were open for the three months ended March 31, 2007. Same store growth was achieved through new and successful promotions in some of our divisions as well as continued improvement in product selection, timing, quantity and price. We had an increase of 14 stores, representing an increase of 11% in the number of stores operating as of January 1, 2008 as compared to January 1, 2007. Our ability to grow sales will depend on a number of factors including our ability to successfully identify and respond to changes in trends and customer tastes, our ability to hire, train, motivate, manage and retain qualified buyers, retail store management and personnel, as well as other factors further outlined in Risks and Uncertainties.

### ***Cost of sales, gross margin and change in inventory valuation methodology***

Cost of sales as a percentage of sales, for the three-months ended March 31, 2008 was 55.6%, compared to 41.1% for the same period during 2007.

In June 2007, the CICA issued CICA Handbook Section 3031 – “Inventories”, which replaced Section 3030 of the same title. The new standard has been developed based on International

Financial Reporting Standards (“IFRS”).

This Section applies to interim and annual financial statements for fiscal years beginning on or after January 1, 2008. The Fund has applied this section to the opening inventory for fiscal 2008. Opening retained earnings as at January 1, 2008 was also adjusted for the difference on adoption of the new standard (prior periods will not restated).

Margins obtained under the previous method of inventory valuation, (the “Retail Method”) and the new method of inventory valuation, (the “Cost Method”) are **NOT** comparable in finite periods.

Margins from season to season under the Cost Method will vary greatly. It was an unintended consequence of the Retail Method that gross margins were substantially ‘smoothed’ throughout the year. Over the course of a calendar year, if all else remains the same, margins under the Retail method and the Cost Method are expected to be largely the same. **The difference from season to season is expected to be related to timing.**

Under the Retail Method, the gross margin was reduced during the period markdowns were taken. Therefore, margin impairment were taken earlier and inventory valuation was reduced.

Under the Cost Method, the impact of price markdowns on inventory is only recognized at the point of sale. Therefore, margin impairments are taken later; inventory valuation is only impacted if the estimated net realizable value falls below cost.

During the first quarter a large proportion of inventory had been discounted to clear inventory as well as to drive traffic into the stores during our typically slowest retail period of the year. Under the Cost Method, with the impact of markdowns taken at the point of sale, margins were significantly depressed. Previously, under the Retail Method, the normal profit margin would have been maintained at sale, (impairments having already been taken in prior periods) leaving strong margins despite the fact that a large proportion of inventory was on sale.

#### *Store and selling expenses*

Store and selling expenses for the three months ended March 31, 2008 were 42.2% of sales, compared to 38.7% for the same period during 2007. Store and selling expenses have a fixed underlying core with a large variable component, primarily consisting of expenses relating to occupancy and employee costs.

The Fund opened 2 new stores during the first quarter of 2008, 5 up to May 9, 2008, for a total of 82 new leases since its IPO (51 new stores and 31 renewals). New stores have a higher rent profile than the average store base, which has resulted in higher occupancy charges compared to the first quarter of 2007. The Fund also employed additional resources in those stores to ensure that new staff were properly trained and that new stores opened smoothly. These start up costs coupled with pressure on labour costs, especially in Western Canada, contributed to higher store and selling expenses in the first three months of 2008.

#### *General and administrative expenses*

General and administrative (“G&A”) expenses for the three months ended March 31, 2008 were 8.3% of sales, compared to 6.9% during the same period in 2007.

On-going investments in the Fund’s growth initiatives and higher salary costs resulted in increased general and administration expenses during the first quarter of 2008. We have been taking steps to

build our infrastructure and position the business for sustainable long-term earnings growth by hiring key people into areas of need and investing in process and systems improvement initiatives.

**Adjusted EBITDA** (see “Non-GAAP Measures”)

Adjusted EBITDA for the three months ended March 31, 2008 was negative 6.4% of sales, compared to 12.9% for the same period during 2007.

The decrease in Adjusted EBITDA is largely attributable to the increase in cost of sales and expenses discussed above.

For the trailing twelve-month period ended March 31, 2008, the Return on Capital Invested (“ROIC”) was 40.6% (three months ended March 31, 2007 – 72.0%). The change from the same period in the previous year is due to the greater investment in working capital and leaseholds and equipment in the first quarter of 2008.

**Income before non-controlling interest and taxes**

As described above in “Overview of the Fund”, on the Subordination End Date, distributions on the Class D LP units were no longer subordinated and the Class D LP Units became freely exchangeable for Units on a one-for-one basis. As a result, the Class D LP Units have been reclassified from non-controlling interest to unitholders’ equity.

**SELECTED QUARTERLY FINANCIAL INFORMATION**

<b>in (\$000's) except per Unit amounts</b>	<b>Q1-2008</b>	<b>Q4-2007</b>	<b>Q3-2007</b>	<b>Q2-2007</b>	<b>Q1-2007</b>	<b>Q4-2006</b>	<b>Q3-2006</b>	<b>Q2-2006</b>
Sales	\$ 24,948	\$ 36,083	\$ 30,483	\$ 28,242	\$ 23,950	\$ 31,415	\$ 26,968	\$ 25,159
(Loss) / Income before non-controlling interest and taxes <sup>(1)</sup>	\$ (2,723)	\$ 5,228	\$ 4,049	\$ 2,915	\$ 2,268	\$ 3,529	\$ 4,497	\$ 2,429
Future income taxes	724	-	-	(7,724)	-	-	-	-
(Loss) / Income before non-controlling interest <sup>(1)</sup>	(1,999)	5,228	4,049	(4,809)	2,268	3,529	4,497	2,429
Net (loss) / income	\$ (1,999)	\$ 4,153	\$ 3,329	\$ (3,849)	\$ 1,807	\$ 2,822	\$ 3,594	\$ 1,940
Basic and fully diluted (loss) / income per Unit	\$ (0.371)	\$ 0.787	\$ 0.610	\$ (0.724)	\$ 0.340	\$ 0.531	\$ 0.676	\$ 0.365
Cash distributions per Unit	\$ 0.375	\$ 0.780	\$ 0.360	\$ 0.360	\$ 0.360	\$ 0.815	\$ 0.315	\$ 0.300
Number of stores open at end of period	143	141	138	135	127	127	124	113

Notes:

- (1) During the quarter ended March 31, 2008, the non-controlling interest held by Inc, which retained a 20% in the business of Sterling Shoes LP has been reclassified to unitholders’ equity. For further information see “End of Subordination”. As a result, (loss) / income before non-controlling interest and taxes is applicable to the quarters up to December 31, 2007 only.

Refer to the discussion on the change in inventory valuation under “Operating Results” above for a description of its impact on the loss for the period. Our sales are seasonal, primarily related to consumer spending patterns. Historically, sales have been the weakest during the first quarter as a result of the decrease in consumer spending after the Christmas season. April and May are typically peak months, as consumers are looking for new shoes for the spring and summer, August and September sales are typically strengthened by back-to-school demand for shoes, and December sales are usually strong. Our quarterly results also fluctuate as a result of a number of other factors. The footwear and accessories sector of the Canadian retail market has two primary selling seasons during which new merchandise is introduced – Spring and Fall. Gross margins fluctuate over the course of each of these selling seasons. Other factors include, but are not limited to, the timing of new store openings, merchandise mix and weather.

In any given period, weather can have a material impact on our business. As we become more geographically diversified, we expect weather-related effects to be less significant.

## CASH FLOW AND LIQUIDITY

The table below reconciles net income to cash flow from operations for the three-months ended March 31, 2008 and 2007.

in (\$000's)	Three-months ended Mar 31	
	2008	2007
<b>(Loss) / income before non-controlling interest <sup>(1)</sup></b>	\$ (1,999)	\$ 2,268
Add charges (deduct credits) to operations not requiring a cash payment:		
Revaluation of inventory per CICA Handbook Section 3031	3,306	-
Future income taxes	(724)	-
Amortization of leaseholds and equipment	751	788
Amortization of deferred financing costs	-	-
Accreted interest expense	134	-
Amortization of deferred leasehold inducements	(89)	(74)
Loss on disposal of leaseholds and equipment	-	-
	<u>1,379</u>	<u>2,982</u>
Net change in non-cash working capital balances related to operations:		
Accounts receivable	481	228
Inventory	(7,716)	(8,794)
Prepaid expenses and deposits	53	(106)
Accounts payable and accrued liabilities	<u>4,172</u>	<u>4,875</u>
<b>Cash used in operating activities</b>	<b>\$ <u>(1,631)</u></b>	<b>\$ <u>(814)</u></b>

Notes:

- (1) During the quarter ended March 31, 2008, the non-controlling interest held by Inc, which retained a 20% in the business of Sterling Shoes LP has been reclassified to unitholders' equity. For further information see "End of Subordination". As a result, (loss) / income before non-controlling interest and taxes is applicable to the quarters up to December 31, 2007 only.

The Fund invested in capital expenditures of \$1.6 million (net of leasehold inducements) during the three months ended March 31, 2008 (three months ended March 31, 2007 - \$1.6 million). Of this amount \$0.5 million was invested in leaseholds and equipment to furnish new stores (three months ended March 31, 2007 - \$0.5 million). The Fund incurred maintenance capital expenditures of \$1.1 million during the three months ended March 31, 2008 (three months ended March 31, 2007 - \$1.1 million), which were related to upgrades to information technology ("IT") infrastructure, store renovations and store relocations. New store capital expenditures and maintenance capital expenditures were funded by cash from operations and proceeds from the offering of Debentures.

## DISTRIBUTABLE CASH AND DISTRIBUTIONS

In any fiscal year Sterling Shoes LP and the Fund intend to make distributions of available cash to the maximum extent possible to the Unitholders and the non-controlling interest. This includes the distribution of all available cash from operations after cash required for maintenance capital expenditures, and after consideration of changes in non-cash working capital balances and other reserves considered advisable by the Fund's Board.

The Fund may make additional distributions in excess of monthly distributions. Distributions declared in respect of the month ended December 31 of each year will include such amounts as are necessary to ensure that the Fund will not be liable for income taxes under Part I of the Tax Act.

The Fund reviews its historic and expected results on a regular basis. This review includes consideration of economic conditions, including seasonality, and the competitive environment. Distributions made may not equal Adjusted Distributable Cash generated in any one period. The Fund's policy is to make stable monthly distributions to Unitholders based on estimated Adjusted Distributable Cash for the year.

## ADJUSTED DISTRIBUTABLE CASH

On July 6, 2007 the Canadian Securities Administrators ("CSA") amended National Policy 41-201 "Income Trusts and Other Indirect Offerings" (the "CSA Guidance"). The Fund has calculated Standardized Distributable Cash based on the CSA Guidance as cash flows from operating activities, including the effects of changes in non-cash working capital, less sustaining (maintenance) capital expenditures. The Fund has also retained the Fund's historical Non-GAAP measure of Adjusted Distributable Cash (formerly Distributable Cash) by further adjusting Standardized Distributable Cash to exclude the effect of changes in non-cash working capital. The table below is a summary of Standardized Distributable Cash and Adjusted Distributable Cash and per Unit and Ratio disclosures for the three month periods ended March 31, 2008 and 2007.

in \$000's except per unit amounts and payout ratios	Three-months ended Mar 31	
	2008	2007
<b>Standardized Distributable Cash</b>		
Cash provided by operating activities	\$ (1,631)	\$ (814)
Less: Maintenance Capital Expenditures	(1,067)	(1,108)
<b>Standardized distributable cash generated</b>	<u>\$ (2,698)</u>	<u>\$ (1,922)</u>
Less: Changes in non-cash working capital balances related to operation	(3,010)	(3,796)
<b>Adjusted distributable cash generated</b>	<u>\$ 312</u>	<u>\$ 1,874</u>
Adjusted Distributable Cash available for distribution to Unitholders	\$ 312	\$ 1,499
Adjusted Distributable Cash generated per Unit	\$ 0.04697	\$ 0.28215
Distributions declared per Unit	\$ 0.37500	\$ 0.36000
Adjusted Payout Ratio	798.3%	127.6%
Number of units outstanding:	6,641,860	5,313,488

Management believes that the Standardized Distributable Cash calculation introduces significant volatility to the Fund's quarter-to-quarter distributable cash and payout ratios, as our non-cash working capital fluctuates significantly as a result of the seasonality of our business, changes in the timing of the payment of payable transactions and the investment in working capital required to open new stores. As a result, management believes our historical measure of Adjusted Distributable Cash, which excludes the impact of changes in non-cash working capital, is a better measure for determining our operating performance.

For the three months ended March 31, 2008, using the Adjusted Distributable Cash calculation, the adjusted payout ratio indicates that we have generated significantly less cash from on-going operations than we have paid out to Unitholders. The Fund's Board looks beyond quarter-to-quarter fluctuations in working capital when making decisions regarding monthly distributions. As mentioned earlier, the Fund's policy has been to make distributions to its Unitholders necessary to pay out its taxable income. We believe that the low Adjusted Distributable Cash generated per unit

in the period is not indicative of the adjusted distributed cash generated per unit for the remainder of 2008 due to the reasons cited above under “Operating Results”. The adjusted payout ratio for the trailing twelve months ended March 31, 2008 was 98.2%, as compared to 86.7% for the twelve months ended December 31, 2007.

Management believes that our present level of distributions is sustainable.

Cash distributions have been made as follows:

Distribution History	Distributions	Distribution History	Distributions	Distribution History	Distributions	Distribution History	Distributions
Year / Month	per Unit	Year / Month	per Unit	Year / Month	per Unit	Year / Month	per Unit
<b>2005</b>		<b>2006</b>		<b>2007</b>		<b>2008</b>	
		January	\$ 0.08958	January	\$ 0.12000	January	\$ 0.12500
		February	0.08958	February	0.12000	February	0.12500
		March	0.08958	March	0.12000	March	0.12500
		April	0.08958	April	0.12000	<b>Q1-2008</b>	<b>\$ 0.37500</b>
		May <sup>(3)</sup>	0.10500	May	0.12000		
		June	0.10500	June	0.12000	April	\$ 0.12500
		July	0.10500	July	0.12000	<b>Total year-to-date \$ 0.50000</b>	
		August	0.10500	August	0.12000		
July / August <sup>(1)</sup>	\$ 0.14737	September	0.10500	September	0.12000		
September	0.08958	October	0.10500	October	0.12000		
October	0.08958	November <sup>(4)</sup>	0.12000	November	0.12000		
November	0.08958	December	0.12000	December	0.12000		
December	0.08958	December <sup>(5)</sup>	0.32000	December <sup>(7)</sup>	0.36000		
December <sup>(2)</sup>	0.16000	December <sup>(6)</sup>	0.15000	December <sup>(8)</sup>	0.06000		
<b>Total 2005</b>	<b>\$ 0.66569</b>	<b>Total 2006</b>	<b>\$ 1.69832</b>	<b>Total 2007</b>	<b>\$ 1.86000</b>		

Notes:

- (1) The Fund made its initial distribution of \$0.14737 per Unit for the 51-day period from July 12, 2005 to August 31, 2005.
- (2) On December 13, 2005 the Fund announced a special distribution of \$0.16 per Unit to Unitholders of record on December 30, 2005, representing the Fund’s estimate of the distribution required to ensure the Fund was not liable for income taxes under Part I of the Tax Act for fiscal 2005. \$0.16 per Unit, the Fund’s estimate of this amount, was paid on January 16, 2006 to Unitholders of record on December 30, 2005.
- (3) Effective May 1, 2006 the Fund raised its monthly distribution by 17.2% from \$0.08958 per Unit to \$0.105 per Unit.
- (4) Effective November 1, 2006 the Fund raised its monthly distribution by 14.3% from \$0.105 per Unit to \$0.12 per Unit.
- (5) On December 18, 2006 the Fund announced a special distribution of \$0.32 per Unit to Unitholders of record on December 29, 2006, representing the Fund’s estimate of the distribution required to ensure the Fund was not liable for income taxes under Part I of the Tax Act for fiscal 2006. This amount was paid on January 15, 2007 to Unitholders of record on December 29, 2006.
- (6) On March 22, 2007 the Fund announced a supplementary special distribution of \$0.15 per Unit to Unitholders of record on December 29, 2006, representing the Fund’s remaining distribution required to ensure the Fund was not liable for income taxes under Part I of the Tax Act for fiscal 2006. The \$0.15 per Unit supplementary special is in addition to the \$0.32 per Unit that was estimated at December 18, 2006 and paid on January 15, 2007. The \$0.15 per Unit was paid on March 30, 2007 to Unitholders of record on December 29, 2006.
- (7) On December 17, 2007 the Fund announced a special distribution of \$0.36 per Unit to Unitholders of record on December 31, 2007, representing the Fund’s estimate of the distribution required to ensure the Fund was not liable for income taxes under Part I of the Tax Act for fiscal 2007. This amount was paid on January 15, 2008 to Unitholders of record on December 31, 2007.

- (8) On March 26, 2008 the Fund announced a supplementary special distribution of \$0.06 per Unit to Unitholders of record on December 31, 2007, representing the Fund's remaining distribution required to ensure the Fund was not liable for income taxes under Part I of the Tax Act for fiscal 2007. The \$0.06 per Unit supplementary special is in addition to the \$0.36 per Unit that was estimated at December 17, 2007 and paid on January 15, 2008. The \$0.06 Unit was paid on March 31, 2008 to Unitholders of record on December 31, 2007.

Distributions are paid on the 15<sup>th</sup> of each month, or the next following business day, to Unitholders of record on the last business day of the preceding month. Unitholders who are non-residents of Canada are required to pay all withholding taxes payable on any distributions by the Fund. Effective April 1, 2008, distributions to the non-controlling interest are made monthly and are no longer subordinated. These distributions were subject to subordination until December 31, 2007 pending the Fund achieving specific EBITDA and distribution targets. For further information see "End of Subordination".

Effective January 1, 2008, the Fund raised its monthly distributions from \$0.12 per Unit to \$0.125 per Unit. The Fund declared distributions (excluding special distributions) to public Unitholders of \$2.0 million for the three-months ended March 31, 2008 (three-months ended March 31, 2007 - \$1.9 million). Furthermore, Sterling Shoes LP declared distributions (excluding special distributions) to Inc, the holder of the Class D LP Units, of \$0.5 million for the three-months ended March 31, 2008 (three-months ended March 31, 2007 - \$0.5 million)

## NON-GAAP MEASURES

References to "EBITDA" are to earnings before interest, income taxes, depreciation and amortization and references to "Adjusted EBITDA" are to EBITDA after adjusting for amortization of leasehold inducements. EBITDA is a measure used by many investors to compare issuers on the basis of ability to generate cash flow from operations. Adjusted EBITDA is a measure our management believes facilitates the comparability and analysis of our financial performance. EBITDA and Adjusted EBITDA are not earnings measures recognized by GAAP and do not have standardized meanings prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers. We intend to distribute substantially all of our cash on an on-going basis (after providing for certain amounts described elsewhere in this MD&A) and, accordingly, our management believes that EBITDA and Adjusted EBITDA are important supplemental measures in evaluating our performance and in determining whether to invest in Units.

You are cautioned that EBITDA and Adjusted EBITDA should not be construed as an alternative to net income or loss determined in accordance with GAAP as indicators of our performance or to cash flows from operating, investing and financing activities as measures of our liquidity and cash flows.

References in this MD&A to "Return on Invested Capital" are to the ratio calculated as follows:

$$\text{Return on Invested Capital} = \frac{\text{Free Cash Flow}}{\text{Average Invested Capital}}$$

where "Free Cash Flow" is calculated as:

$$\text{Free Cash Flow} = \text{EBITDA} - \text{Maintenance Capital Expenditures}$$

And where “Average Invested Capital” is calculated as:

$$\text{Average Invested Capital} = \frac{\text{Beginning (net working capital + net property, plant \& equipment)} + \text{Ending (net working capital + net property, plant \& equipment)}}{2}$$

Average Invested Capital, Free Cash Flow and Return on Invested Capital are not recognized measures under GAAP and do not have standardized meanings prescribed by GAAP. Retailers, such as the Fund, use these measures to provide insight into the businesses ability to generate strong returns on the capital employed in the business.

“Maintenance Capital Expenditures” is not a recognized measure under GAAP. Maintenance Capital Expenditures include those required to upgrade existing stores and to maintain information systems and equipment and our warehouse.

## **CAPITAL RESOURCES**

On October 3, 2007 the Fund closed the offering of Debentures. The offering was completed on a “bought deal” basis by a syndicate of underwriters led by CIBC World Markets Inc. that included BMO Nesbitt Burns Inc., Canaccord Capital Corporation and TD Securities Inc.

A portion of the net proceeds from the offering was used to repay existing bank indebtedness of approximately \$13 million. We expect to utilize the balance of the net proceeds for existing expansion and corporate commitments during 2008. Since our IPO, the Fund has opened 51 stores (46 net openings), renovated 20 stores and relocated 10 stores. Previously we used our credit facilities to finance capital expenditure associated with our store openings, renovations and relocations, as well as the growth in inventory required for our new and existing stores. The Fund anticipates renewing its credit facilities shortly to fund its growth once the net proceeds of the Debentures are fully utilized. The Fund may access the capital markets to assist in its growth, as appropriate. There can be no assurance that the Fund will be able to access new capital or new long term debt on acceptable terms.

We have a \$12.5 million operating facility, which is available for working capital requirements, capital expenditures and for general corporate purposes. We have an additional \$10 million term facility, which is available for general funding of new store facilities. As at March 31, 2008 we have not utilized any of the operating facility or any of the new store capital expenditure facility.

At March 31, 2008, the Fund was in compliance with all covenants of its credit facilities.

## **OFF-BALANCE SHEET FINANCING**

The Fund enters into standby letters of credit to facilitate the international purchase of merchandise and to secure certain of our obligations, including insurance programs and duties related to import purchases. As of March 31, 2008 letters of credit totaling \$265 thousand have been issued. The Fund has no other off balance sheet arrangements.

## CONTRACTUAL OBLIGATIONS

The Fund has the following inventory purchase, long-term debt and minimum rental commitments for premises, over the remainder of this year and the next four fiscal periods, in thousands of dollars:

<u>in \$000's</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Inventory purchase commitments	265				
Long-term debt					25,000
Minimum rental commitments <sup>(1)</sup>	10,320	13,108	11,803	10,861	10,431
	<u>10,585</u>	<u>13,108</u>	<u>11,803</u>	<u>10,861</u>	<u>35,431</u>

Note:

- (1) Excludes percentage rent adjustments and operating expense adjustments.

## TRANSACTIONS WITH RELATED PARTIES

- (a) The Fund paid rent to a company in which Jeremy Horwitz and Mannie Druker, trustees and officers of the Fund have an interest, amounting to \$71 thousand for the three month period ended March 31, 2008 (three month period ended March 31, 2007 – \$50 thousand).
- (b) The Fund purchased equipment from a company in which Mannie Druker, a trustee and officer of the Fund has an interest, for \$92 thousand during the three month period ended March 31, 2008 (three month period ended March 31, 2007 – \$139 thousand).

These transactions arose during the normal course of business and have been recorded at the exchange amount, which is the amount agreed upon by the parties.

## CRITICAL ACCOUNTING ESTIMATES

The preparation of our financial statements requires us to estimate the effect of several variables that are inherently uncertain. These estimates and assumptions can affect the reported amounts of assets, liabilities, sales and expenses. Management bases its estimates on historical experience and other assumptions, which it believes to be reasonable under the circumstances. Management also evaluates its estimates on an ongoing basis. Our significant accounting policies are described in Note 2 of the Fund's unaudited interim consolidated financial statements for the three-month period ended March 31, 2008. Management believes that the following items represent the Fund's critical accounting estimates.

### *Inventory Valuation*

Effective January 1, 2008, the Fund adopted CICA Handbook Section 3031, Inventories ("Section 3031"). Section 3031 requires inventories to be measured at the lower of cost and net realizable value. The Fund determines inventory cost based on a weighted average cost formula and values inventory at the lower of cost and net realizable value. The Fund previously valued its inventory at the lower of average cost and net realizable value less a normal profit margin, using the retail method. Under the previous method, the net realizable value included a reduction for a normal profit margin taking into consideration current and expected selling prices, historic sales patterns for the inventory, recent product introductions and the level of inventory on hand. Section 3031 excludes from the definition of net realizable value the ability to maintain a normal profit margin

and notes that the retail method is only acceptable technique for measuring inventories, if the results approximate cost. Upon adoption of the new standard, inventory was increased by a one-time adjustment of \$3.3 million on January 1, 2008, which was credited to opening retained earnings.

### ***Intangible assets***

Identifiable intangible assets, including store banners and private label brand names, are carried at cost. These assets have been determined by management to have indefinite lives and are therefore not being amortized. These assets are reviewed at least annually for impairment or whenever events or changes in circumstances indicate that the carrying amount of an asset may be impaired.

If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds fair value.

### ***Goodwill***

Goodwill is recorded at cost and is not amortized. Goodwill is reviewed for impairment at least annually, or whenever events or changes in circumstances indicate that the carrying amount may be impaired. If goodwill is considered to be impaired, the impairment to be recognized is measured as the estimated amount by which the carrying amount of the goodwill exceeds fair value.

### ***Future income taxes***

Future income tax assets and liabilities are determined based on the difference between the tax basis of the Fund's assets and liabilities and the amounts reported in the financial statements. Future tax assets or liabilities are calculated using the tax rates for the periods in which the differences are expected to be settled. Future tax assets are recognized to the extent that they are considered more likely than not to be realized.

### ***Convertible Debentures***

The Fund has allocated the proceeds of the Debentures between debt and equity based on the relative fair values of the debt and the conversion option, as determined by the residual valuation of the equity component. Under this approach, the liability component was valued first, and the difference between the proceeds of the Debentures and the fair value of the debt was assigned to the conversion option. The present value of the liability component was calculated using a discount rate of 9.2%, the market interest rate for similar debentures having no conversion rights.

## **NEW ACCOUNTING STANDARDS ADOPTED**

The Canadian Institute of Chartered Accountants ("CICA") issued four new accounting standards that became effective for the Fund on January 1, 2008: Handbook Section 3031, Inventories ("Section 3031") as described above, Handbook Section 3862, Financial Instruments – Disclosures ("Section 3862"), Handbook Section 3863 Financial Instruments – Presentation ("Section 3863"), and Handbook Section 1535, Capital Disclosures ("Section 1535").

### ***Section 3862, Financial Instruments – Disclosures and Section 3863 Financial Instruments – Presentation***

Section 3862 and Section 3863 applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. These sections replace Handbook Section 3861,

Financial Instruments – Disclosure and Presentation to revise and enhance the disclosure requirements and to carry forward its presentation requirements. These sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. The note disclosure on financial instruments in the unaudited interim financial statements has been expanded as a result of Section 3862 and 3863 for the three months ended March 31, 2008.

### ***Section 1535, Capital Disclosures***

Section 1535 applies to interim and annual financial statement relating to fiscal years beginning on or after October 1, 2007. Section 1535 specifies the disclosure of: (i) an entity’s objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and, (iv) if it has not complied, the consequences of such non-compliance. There is a new note disclosure on capital disclosures in the unaudited interim financial statements as a result of Section 1535 for three months ended March 31, 2008.

## **RISKS AND UNCERTAINTIES**

### ***Maintaining Profitability and Managing Growth***

Our future operating results will depend on a number of factors, including:

- our ability to maintain or realize increased sales and profitability;
- our ability to successfully identify and respond to changes in trends and customer tastes;
- our ability to maintain cost-effective delivery of our merchandise to our distribution centre and our stores;
- our ability to hire, train, motivate, manage and retain qualified buyers, retail store management and personnel;
- the level of competition in the retail footwear industry in the markets in which we operate;
- the efficiency and effectiveness of our marketing programs in building brand awareness and increasing sales; and
- general economic conditions and consumer confidence.

There can be no assurance that we will be able to successfully implement our strategic plan or that such plan will enable us to maintain or increase historical sales, profitability or growth rates. Failure to successfully execute any material part of our strategic plan could have a material adverse effect on our business, financial condition, liquidity and results of operations. There can be no assurance that we will be able to effectively manage our growth, and any failure to do so could have a material adverse effect on our business, financial condition, liquidity and results of operations.

### ***Competitive and Economic Environment***

Retail footwear is a highly competitive global business that is subject to rapidly changing consumer demands. In addition, several external factors over which we have no influence affect the economic climate and consumer confidence.

In this competitive environment, the importance of the following cannot be over-emphasized: implementing efficient and effective marketing programs to build brand awareness; identifying and responding to changes in trends and customer tastes; providing quality service; and continually exceeding customer expectations so that we deliver a total customer experience.

We believe that our strong financial position, targeted marketing, purchasing expertise, strong sourcing capabilities, cost-effective delivery of merchandise, experienced management, and dedicated personnel will facilitate our continued success; however, there is no guarantee that we will be successful.

### ***Risks Associated with Leasing and Expansion***

Our continued growth will depend to a significant degree on our ability to expand our operations through the opening of new stores and to operate these stores on a profitable basis. The success of our planned expansion will be significantly dependent upon our ability to locate suitable store sites and negotiate acceptable lease terms. In addition, several other factors could affect our ability to expand, including the adequacy of our capital resources, the ability to hire, train and integrate employees and the ability to adapt our operational systems.

There can be no assurance that we will achieve our planned expansion or that any such expansion will be profitable. In addition, there can be no assurance that our expansion within our existing markets will not adversely affect the financial performance of our existing stores or our overall operating results, or that new stores will achieve net sales and profitability levels consistent with existing stores. As part of our expansion planning, we regularly evaluate the adequacy of our existing systems and procedures, including our product distribution facility, store management, financial controls and management information systems. However, there can be no assurance that we will anticipate all of the changing demands that expanded operations may impose on such systems. Failure to adapt our internal systems or procedures as required could have a material adverse effect on our business, financial condition and results of operations.

### ***Foreign Exchange***

Our foreign exchange risk is primarily limited to currency fluctuations between the Canadian and U.S. dollar. From time to time we enter into foreign exchange forward contracts that oblige us to purchase specific amounts of foreign currencies at set future dates at predetermined exchange rates. The contracts are matched with anticipated foreign currency purchases in U.S. dollars from time to time. We enter into the foreign exchange forward contracts to provide a hedge against the risk of losses should the value of the Canadian dollar decline compared to the foreign currency. We do not enter into foreign exchange contracts for speculative or trading purposes. See further discussion under “Financial Instruments”.

### ***Seasonality and Fluctuations in Quarterly Results***

Our business is seasonal and generally we experience lower sales in the months of January and February. As the Fund's fiscal year is the calendar year, this seasonal decline in sales will likely occur in the first quarter of each fiscal year.

The footwear and accessories sector of the Canadian retail market has two primary selling seasons during which new merchandise is introduced – Spring and Fall. Gross margins fluctuate over the course of each of these selling seasons, declining as the season draws to a close as mark-downs are taken on sales and the inventory is discounted.

Our quarterly results of operations may also fluctuate based upon such factors as delays in the flow of merchandise, the number and timing of new store openings and related pre-opening expenses, the amount of sales contributed by new and existing stores, the mix of products sold, competitive factors, changes to shipping costs, general economic conditions, labour market fluctuations, changes in accounting rules and regulations and unseasonable weather conditions.

***Cash Distributions Are Not Guaranteed and May Fluctuate with Sterling Shoes LP's Performance***

Although the Fund intends to distribute the interest and distributions received by the Fund on the Units and notes of SS Holdings Trust (the "Trust") less expenses and amounts, if any, paid by the Fund in connection with the redemption of Units, there can be no assurance regarding the amounts of income to be generated by Sterling Shoes LP and paid, indirectly, to the Fund. The actual amount distributed in respect of the Units will depend upon numerous factors associated with Sterling Shoes LP, including its profitability, fluctuations in its working capital, the sustainability of its margins, interest expenses and its requirements for repayment of indebtedness and incurrence of capital expenditures.

The market value of the Units may deteriorate significantly if the Fund is unable to continue to distribute cash to Unitholders at current distribution levels.

***Nature of Units***

Unitholders own an equal undivided interest in the Fund. The Units do not and will not represent a direct investment in Sterling Shoes LP. As holders of Units, Unitholders do not have the statutory rights normally associated with ownership of shares of a corporation including, for example, the right to bring oppression or derivative actions. The Units represent a fractional interest in the Fund.

The Fund's primary assets are its 100% ownership interest in the notes and units of the Trust. The Trust, in turn, is a limited partner in Sterling Shoes LP. The price per Unit is, in part, a function of anticipated distributable income, distributions, as well as the consolidated indebtedness, net of cash and cash equivalents of the Fund including the net indebtedness of Sterling Shoes LP. The price per Unit may also be a function of interest rates or expected returns available, or perceived to be available, on alternative investments.

***Risks Associated with Convertible Debentures***

***Interest Payments***

Interest payments on the Debentures and cash distributions on the Units issuable upon conversion, redemption or repayment of the Debentures are not guaranteed and are entirely derived from the business operated by related entities of the Fund and from the ability of each such entity to make distributions on its securities. There can be no assurance that the Fund and the related entities of the Fund will be able to make interest payments as they become due pursuant to the terms of the Debentures.

***Prior Ranking Indebtedness***

The Debentures are subordinate to all Senior Indebtedness. The payment of the principal premium (if any) and interest on the Debentures is subordinated to Senior Indebtedness of the Fund. The Debentures are also effectively subordinate to claims of creditors of the Fund's

subsidiaries except to the extent the Fund is a creditor of such subsidiaries ranking at least *pari passu* with such other creditors.

#### *Inability to Fund Purchase of Debentures*

The Fund is required to offer to purchase all outstanding Debentures upon the occurrence of a change of Control. However, it is possible that following a Change of Control, the Fund will not have sufficient funds at that time to make the required purchase of outstanding Debentures or that restrictions contained in other indebtedness will restrict those purchases.

#### *Absence of Covenant Protection*

The Indenture does not restrict the Fund or any of its subsidiaries from incurring additional indebtedness or from mortgaging, pledging or charging its assets to secure any indebtedness. The Indenture does not contain any provisions specifically intended to protect holders of the Debentures in the event of a future leveraged transaction involving the Fund or any of its subsidiaries.

#### *Update for Tax Legislation*

On June 22, 2007, the Parliament of Canada passed into law Bill C-52, an Act to implement certain provisions of the federal budget tabled in Parliament on March 19, 2007, which included legislation to implement the proposal announced by the Minister of Finance on October 31, 2006 to tax certain publicly traded trusts and partnerships on the taxable portion of their distributions. As a result of the enactment of Bill C-52 commencing January 1, 2011 (subject to the qualification below regarding the possible loss of the four year grandfathering period in the case of “undue expansion”), the Fund will not be entitled to deduct certain of its distributed income (referred to as specified income) and the Fund will be subject to a distribution tax on the specified income at a special rate estimated to be 27.5%.

The Fund may be subject to this distribution tax in respect of a taxation year of the Fund commencing earlier than January 1, 2011 if, prior to such date, the Fund engages in “undue expansion” as set out in the guidelines released by the Department of Finance on December 15, 2006 and which was incorporated by reference in Bill C-52.

The implementation of the legislation could have an adverse effect on the Fund, its ability to pay distributions and the market value of its units.

## **FINANCIAL INSTRUMENTS**

Our business is exposed to financial risks that arise from fluctuations in interest rates (in terms of our credit facilities) and foreign exchange rates (in terms of our U.S. dollar-denominated purchases) and the degree of volatility of these rates.

Risk from foreign exchange arises as a result of variations in exchange rates between the Canadian and the U.S. dollar. Historically, approximately 30% to 40% of the Fund’s product purchases are denominated in U.S. dollars. During the three month period ended March 31, 2008 approximately 33.5% of the Fund’s product purchases were denominated in U.S. Dollars. The Fund does not hold or issue financial instruments for trading or speculative purposes. As at March 31, 2008 there are no foreign exchange contracts outstanding.

We are subject to risks associated with fluctuating interest rates on our credit facilities, which contain interest terms which float with movements in prevailing interest rates.

## **DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING**

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the President and Chief Executive Officer (“CEO”) and the Chief Financial Officer (“CFO”), on a timely basis so that appropriate decisions can be made regarding public disclosure.

Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian generally accepted accounting principles. Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Fund.

The Fund’s Chief Executive Officer and Chief Financial Officer certified the appropriateness of the financial disclosures in the MD&A and unaudited interim consolidated financial statements for the three-months ended March 31, 2008. These executives also certified that they are responsible for the design of disclosure controls and procedures and internal control over financial reporting. The Audit Committee reviewed this MD&A and the attached unaudited interim consolidated financial statements and the Board of Trustees approved the documents prior to their release.

There have been no changes in internal control over financial reporting during the quarter ended March 31, 2008 that have materially affected, or are reasonably likely to materially affect, the Fund’s internal control over financial reporting.

## **END OF SUBORDINATION**

As indicated in Note 6 to the financial statements, distributions on the Class D LP Units held by Inc are subordinated and were not exchangeable for Units of the Fund until the Subordination End Date. As a result of the Fund achieving a specified EBITDA target for the year ended December 31, 2007 and a distribution target for each of the fiscal years ended December 31, 2007 and 2006, the Subordination End Date occurred during the quarter ended March 31, 2008. As a result, effective April 1, 2008, distributions to Inc. on the Class D LP Units are made monthly and are no longer subordinated.

## **FORWARD-LOOKING STATEMENTS**

This MD&A includes forward-looking statements. Forward-looking statements relate to, among other things, anticipated financial performance, business prospects, strategies, market forces, and commitments. Many of these statements can be identified by words such as “believe”, “expects”, “expected”, “will”, “intends”, “projects”, “anticipates”, “estimates”, “continues” or similar words. The Fund believes the expectations reflecting in such statements are reasonable but no assurance is given that such expectations will be correct. All forward-looking statements are based on the Fund’s beliefs and assumptions based on information available at the time the assumption was made and on management’s experience and perception of historical trends, current conditions and expected further developments as well as other factors deemed appropriate in the circumstances. In addition to other assumptions made in this MD&A, assumptions have been made in respect of factors such as, but not limited to, the following:

- industry activity levels;
- competitive conditions;
- consumer demand;
- access to capital;
- capital expenditure estimates, plans, schedules and activities;
- income tax considerations;
- operating risks; and
- cash distributions

By its nature, such forward-looking information is subject to various risks and uncertainties that are known and unknown, including those material risks discussed in the Fund's most recent annual information form and in this management's discussion and analysis of the Fund which could cause actual results and experience to differ materially from the anticipated results or other expectations expressed. Readers are cautioned not to place undue reliance on this forward-looking information, which is given as of the date it is expressed in this annual information form or otherwise, and the Fund undertakes no obligation to update publicly or revise any forward-looking information to reflect new events or circumstances, except as explicitly required by securities laws.

#### **ADDITIONAL INFORMATION**

Additional information relating to the Fund, including the Fund's Annual Information Form and other public filings, are available on SEDAR ([www.sedar.com](http://www.sedar.com)) and on the Fund's website at [www.SterlingShoesIncomeFund.com](http://www.SterlingShoesIncomeFund.com).

#### **INVESTOR RELATIONS**

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