Interim Consolidated Financial Statements of

STERLING SHOES INCOME FUND

March 31, 2010
(Unaudited – Expressed in thousands of dollars)

STERLING SHOES INCOME FUND
Consolidated Balance Sheets
(Unaudited - expressed in thousands of dollars, except per unit and number of unit figures.)

		As at March 31, 2010		As at December 31, 2009
ASSETS				
CURRENT				
Cash	$	**308**		**4,119**
Accounts receivable		**443**		**195**
Inventory		**41,164**		**36,446**
Prepaid expenses and deposits		**234**		**187**
		42,149		**40,947**
LEASEHOLDS AND EQUIPMENT [note 3]		**18,867**		**19,595**
INTANGIBLE ASSETS [note 4]		**16,623**		**16,623**
	$	**77,639**	$	**77,165**
LIABILITIES AND UNITHOLDERS' EQUITY				
CURRENT				
Accounts payable and accrued liabilities	$	**16,358**	$	**15,006**
Term Loan [note 5]		**5,000**		**5,000**
		21,358		**20,006**
FUTURE INCOME TAXES [note 11]		**2,364**		**2,364**
CONVERTIBLE DEBENTURES [note 6]		**22,699**		**22,520**
DEFERRED LEASE INDUCEMENTS		**1,961**		**2,057**
UNITHOLDERS' EQUITY		**29,257**		**30,218**
	$	**77,639**	$	**77,165**

COMMITMENTS [note 8]

On behalf of the Board of Trustees

(signed) Rick Mahler
Trustee

(signed) Jeremy Horwitz
Trustee

See accompanying notes

STERLING SHOES INCOME FUND

Consolidated Statements of Loss and Comprehensive Loss

(Unaudited - expressed in thousands of dollars, except per unit and number of unit figures.)

	Three-month period ended	
	Mar 31, 2010	**Mar 31, 2009**
SALES	$ **26,855**	$ **27,672**
COST OF SALES	**13,337**	**15,675**
GROSS MARGIN	**13,518**	**11,997**
EXPENSES		
Store and selling	**11,146**	**11,256**
General and administrative	**1,743**	**1,687**
	12,889	**12,943**
Loss before interest, amortization, and taxes	**629**	**(946)**
Interest expense	**644**	**652**
Loss on disposal of leaseholds and equipment	**-**	**66**
Amortization of leaseholds and equipment	**946**	**764**
LOSS BEFORE TAXES	**(961)**	**(2,428)**
Future income taxes [note 11]	**-**	**-**
NET LOSS AND COMPREHENSIVE LOSS	**(961)**	**(2,428)**
Basic and diluted net loss per unit	$ **(0.14)**	$ **(0.37)**
Basic weighted average number of units outstanding	**6,641,860**	**6,641,860**
Diluted weighted average number of units outstanding	**7,823,885**	**7,823,885**

See accompanying notes

STERLING SHOES INCOME FUND

Consolidated Statements of Unitholders' Equity

For the three-month period ended March 31, 2010

(Unaudited - expressed in thousands of dollars, except per unit and number of unit figures.)

	Unitholders' capital [note 7]	**Equity component of Debentures [note 6]**	**Cumulative earnings**	**Cumulative distributions**	**Cumulative deficit**	**Unitholders' equity**
BALANCE, December 31, 2008	59,809	2,657	33,740	(36,800)	$ (3,060)	$ **59,406**
Net loss			(2,428)		(2,428)	**(2,428)**
Distributions declared				(566)	(566)	**(566)**
BALANCE, March 31, 2009	$ 59,809	2,657	31,312	(37,366)	$ (6,054)	$ **56,412**
Net loss			(25,205)		(25,205)	**(25,205)**
Distributions declared				(989)	(989)	**(989)**
BALANCE, December 31, 2009	$ 59,809	2,657	6,107	(38,355)	(32,248)	$ **30,218**
Net loss			(961)		(961)	**(961)**
Distributions declared				0	0	**0**
BALANCE, March 31, 2010	$ 59,809	2,657	5,146	(38,355)	(33,209)	$ **29,257**

See accompanying notes

STERLING SHOES INCOME FUND
Consolidated Statement of Cash Flows
(Unaudited - expressed in thousands of dollars, except per unit and number of unit figures.)

	Three-month period ended	
	Mar 31, 2010	**Mar 31, 2009**
OPERATING ACTIVITIES		
Net loss	$ **(961)**	$ **(2,428)**
Items not involving cash		
Amortization of leaseholds and equipment	**946**	**764**
Loss on disposal of leaseholds and equipment	**-**	**66**
Amortization of deferred lease inducements	**(96)**	**(188)**
Accreted interest expense	**179**	**161**
	68	**(1,625)**
Change in non-cash working capital balances related to operations		
Accounts receivable	**(248)**	**419**
Inventory	**(4,718)**	**(4,380)**
Prepaid expenses and deposits	**(47)**	**(122)**
Accounts payable and accrued liabilities	**1,352**	**5,091**
	(3,661)	**1,008**
Cash used in operating activities	**(3,593)**	**(617)**
INVESTING ACTIVITIES		
Acquisition of leaseholds and equipment	**(218)**	**(1,202)**
Lease inducements received	**-**	**32**
Cash used in investing activities	**(218)**	**(1,170)**
FINANCING ACTIVITIES		
Operating loan [note 5]	**-**	**2,451**
Payment of distributions	**-**	**(664)**
Cash provided by financing activities	**-**	**1,787**
CASH OUTFLOW DURING THE PERIOD	**(3,811)**	**-**
CASH, BEGINNING OF PERIOD	**4,119**	**-**
CASH, END OF PERIOD	$ **308**	$ **-**
Supplemental cash flow information		
Interest paid	$ **59**	$ **85**

See accompanying notes

1. ORGANIZATION AND NATURE OF OPERATIONS

Sterling Shoes Income Fund (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 “Declaration of Trust”).

The Fund operates retail stores in five provinces in shopping malls, high-streets and strip malls, principally in Western Canada. The Fund is a leading retailer offering a broad selection of private label and national brand name shoes and accessories through six separate retail banners: Sterling, Joneve, Shoe Warehouse, Freedman Shoes, Gia and Sterling Outlet. The Fund holds, indirectly, a 100% interest in Sterling Shoes Limited Partnership (“Sterling Shoes LP”), a partnership established under the laws of the Province of Manitoba.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of presentation

These unaudited interim consolidated financial statements and accompanying notes have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). These unaudited interim consolidated financial statements do not include all of the disclosures required by Canadian generally accepted accounting principles for annual financial statements and, accordingly, should be read in conjunction with the audited annual consolidated financial statements and notes for the year-ended December 31, 2009. These unaudited interim consolidated financial statements follow the same accounting policies and methods of computation as used in the annual audited consolidated financial statements for the period ended December 31, 2009, except as noted below.

These unaudited interim consolidated financial statements include the accounts of the Fund, and its indirect 100% interest in Sterling Shoes LP. All material intercompany transactions have been eliminated upon consolidation.

(b) Inventory

The Fund determines inventory cost based on a weighted average cost formula and values inventory at the lower of cost and net realizable value.

Incentives received from suppliers are treated as a reduction in the prices of the suppliers’ products and are accounted for as a reduction in the related inventory.

Cost of sales is comprised of inventory and inventory-related costs only.

(c) Financial Instruments

Under CICA Handbook Section 3855 - “Financial Instruments – Recognition and Measurement”, financial assets and financial liabilities are initially recognized at fair value and their subsequent measurement is dependent on their classification as described below. Their classification depends on the purpose for which the financial instruments were acquired or issued, their characteristics and the Fund's designation of such instruments. The standards require that all financial assets be classified either as held-for-trading ("HFT"), available-for-sale ("AFS"), held-to-maturity ("HTM"), or loans and receivables. The standards require that all financial assets, including all derivatives, be measured at fair value with the exception of loans and receivables, debt securities classified as HTM, and AFS financial assets that do not have quoted market prices in an active market. Settlement date accounting continues to be used for all financial assets, except changes in fair value between the trade date and settlement date are reflected in interest and other expenses, net for HFT financial assets, while changes in fair value between trade date and settlement date are reflected in other comprehensive income ("OCI") for AFS financial assets.

The following is a summary of the accounting model the Fund has elected to apply to each of its significant categories of financial instruments outstanding.

Cash	Designated as held-for-trading
Accounts receivable	Loans and receivables
Accounts payable	Other liabilities
Bank indebtedness	Other liabilities
Long-term debt	Other liabilities

Held-for-trading – HFT financial assets are financial assets typically acquired for resale prior to maturity. They are measured at fair value at the balance sheet date. Interest earned, interest accrued, gains and losses realized on disposal and unrealized gains and losses from market fluctuations are included in interest and other expenses, net.

Financial liabilities designated at fair value ("FVO") are those non-derivative financial liabilities that the Fund elects to designate on initial recognition as instruments that it will measure at fair value through interest and other expenses, net. These are accounted for in the same manner as HFT financial assets. The Fund has not designated any non-derivative financial liabilities as FVO.

Held-to-maturity – HTM financial assets are non-derivative financial assets with fixed or determinable payments and a fixed maturity, other than loans and receivables that an entity has the positive intention and ability to hold to maturity. These financial assets are measured at amortized cost.

Available-for-sale – AFS financial assets are those non-derivative financial assets that are designated as AFS, or that are not classified as loans and receivables, HTM investments or HFT. AFS financial assets are carried at fair value with unrealized gains and losses included in OCI until realized when the cumulative gain or loss is transferred to the Statement of Income (Loss). The Fund has not designated any financial assets as AFS.

Loans and receivables – Loans and receivables are accounted for at amortized cost.

Other liabilities – Other liabilities ("OL"), are recorded at amortized cost and include all liabilities, other than derivatives or liabilities to which the FVO has been applied.

In June 2009, the CICA amended Section 3862 to improve fair value and liquidity risk disclosures. Section 3862 – "Financial Instruments – Disclosures" now requires that all financial instruments measured at fair value be categorized into one of three hierarchy levels, to reflect the significance of the inputs used to measure the fair values of assets and liabilities:

- Level 1 – inputs are unadjusted quoted prices of identical instruments in active markets.
- Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 – inputs used in a valuation technique are not based on observable market data in determining fair values of the instruments.

Section 3862 requires that the classification of a financial instrument in the hierarchy be based on the lowest level of input that is significant to the measurement of fair value. Adoption of these new disclosures has no impact on the financial statements.

(d) *Income taxes and future income taxes*

As the Fund intends to allocate all of its taxable income and taxable capital gains to Unitholders (the "Unitholders"), the Fund itself will not be subject to income taxes.

In June 2007 the Government of Canada substantively enacted legislation to tax distributions of publicly traded income trusts, commencing in 2011. As a result, the Fund is now required to recognize the future income tax assets and liabilities expected to arise when the tax on distributions becomes applicable.

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.

(e) *Future changes in accounting standards*

(i) *International Financial Reporting Standards ["IFRS"]*

The Canadian Accounting Standards Board (AcSB) will require all publicly accountable entities 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.

(ii) Handbook Section 1582, Business Combinations ("Section 1582")

Section 1582 replaces Handbook Section 1581 of the same title. It provides the Canadian equivalent to corresponding sections of IFRS.

Section 1582 applies prospectively to business combinations for which the acquisition date is on or after January 1, 2011 with early adoption permitted. This section improves the relevance, reliability, and comparability of the information that a reporting entity provides in its financial statements about a business combination. Adoption of this standard is not expected until January 1, 2011.

(iii) Handbook Section 1601, Consolidated Financial Statements (“Section 1601”) and Handbook Section 1602, Non-controlling Interests (“Section 1602”)

Sections 1601 and 1602 replace Handbook Section 1600, Consolidated Financial Statements and apply to fiscal years beginning on or after January 1, 2011, with early adoption permitted. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. An entity which adopts Section 1582, 1601, or 1602 early also adopts the other two sections at the same time. Adoption of this standard is not expected until January 1, 2011. The Fund has not yet determined the impact of the adoption of this new Section on the consolidated financial statements.

(f) *Measurement uncertainty*

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingencies at the date of the financial statements and the reported amount of revenues and expenses during the period. Areas requiring significant management estimates include the valuation of inventory, the valuation of intangible assets, the valuation of the liability and equity components of the convertible unsecured subordinated debentures, the recorded amounts of accrued liabilities, the estimation of future income taxes, and the useful life of leaseholds and equipment. Actual results could differ from these estimates.

(g) *Cash*

Cash consists of cash on hand and bank balances.

(h) *Leaseholds and equipment*

Leaseholds and equipment are recorded at cost. Amortization is provided on a straight-line basis over the following estimated useful lives of the assets:

Furniture and equipment ……………….……………………10 years
Computer equipment and software…….……………………….. 5 years
Leasehold improvements ……………….………initial term of the lease or useful life if that is shorter

Amortization is pro-rated in the year of acquisition.

Computer equipment and software acquired for use by the Fund comprises its purchase price and any directly attributable costs to prepare the asset for its intended use. These costs will be amortized over the asset's expected useful life with amortization to commence when the asset is available for use.

Leaseholds and equipment are reviewed for impairment whenever changes in circumstances indicate that the carrying amount of an asset may not be recoverable from expected undiscounted future cash flows from their expected use and eventual disposition. If such assets are considered impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds their fair value.

(i) *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 not be recoverable from its expected use and eventual disposition.

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.

(j) *Deferred lease inducements*

Deferred lease inducements consist of lease incentive amounts received from landlords and rent-free lease periods. These lease inducements are amortized over the life of the initial lease term as a reduction of store and selling expenses.

(k) *Financing fees*

Transaction costs attributable to financial instruments classified as other than held-for-trading are included in the recognized amount of the related financial instrument and recognized over the life of the instrument using the effective interest rate method, in the case of convertible debentures at an effective interest rate of 10.7%.

(l) *Revenue recognition*

Revenue is recognized at the point of sale, net of a provision for sales returns.

(m) *Foreign currency translation*

Monetary assets and liabilities denominated in foreign currencies are translated to the Canadian dollar equivalent at the rate of exchange at the balance sheet date. Transactions in foreign currencies are translated to the Canadian dollar equivalent at the rate of exchange in effect at the time of the transaction. Foreign currency gains and losses are included in the results of operations in the period in which they occur.

(n) *Net loss per Unit*

Basic net loss per Unit of the Fund (a "Unit") is calculated by dividing the net loss by the weighted average number of Units outstanding during the reporting period. Diluted net loss per Unit is calculated by dividing the net loss, adjusted for the interest expense on the Convertible Debentures (note 6), by the sum of the weighted average number of Units outstanding used in the basic net loss per Unit calculation and the number of Units that would be issued assuming conversion of all Convertible Debentures. As at March 31, 2010, the Convertible Debentures were not included in the computation of diluted net income per Unit for the three month period ended March 31, 2010 because to do so would have been anti-dilutive.

(o) *Long-term incentive plan*

Under the terms of a long-term incentive plan ("LTIP") 10% to 25% of distributable cash in excess of an established threshold is allocated as between: (i) cash awards to participants who already hold significant ownership positions; and (ii) monies to be used by the plan trustee to purchase units of the Fund for other participants. The cost is accrued in the period when distributable cash exceeds the thresholds established by the LTIP and amortized to compensation expense over the vesting period of the applicable employee award.

As at March 31, 2010, the Fund did not accrue any additional liability in respect of the LTIP (March 31, 2009 - $nil). During the three month period-ended March 31, 2010 the Fund did not record any compensation expense (2009 - $96).

(p) *Derivative financial instruments*

Derivative financial instruments are utilized by the Fund from time to time in the management of its foreign currency exposures. The Fund's policy is not to utilize derivative financial instruments for trading or speculative purposes.

The Fund formally documents all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategies for undertaking various hedge transactions. This process includes linking all derivatives to forecasted transactions. The Fund also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items.

When the Fund discontinues its designation of a hedging relationship, or when a hedging relationship is no longer effective, hedge accounting is discontinued. When the Fund discontinues hedge accounting, the derivative financial instrument is recorded on the consolidated balance sheet at fair value. Gains and losses that had previously been deferred are carried forward for recognition in the statement of income and statement of other comprehensive income in the same period that the hedged items are recognized. The Fund has decided not to use hedge accounting.

(Unaudited – Expressed in thousands of dollars, unless otherwise specified and except for per unit amounts.)

(q) *Cash Flow Statements*

Amendments to CICA 1540, Cash Flow Statements, require entities to disclose total cash distributions on financial instruments classified as equity in accordance with a contractual agreement and the extent to which total cash distributions are non-discretionary. The determination to declare and make payable distributions from the Fund is at the discretion of the Board of Trustees of the Fund and, until declared payable by the Board of Trustees of the Fund, the Fund has no contractual requirement to pay cash distributions to Unitholders' of the Fund. During the three month period-ended March 31, 2010, no cash distributions (2009 - $566) were declared payable by the Board of Trustees of the Fund respectively to the Class C and Class D Unitholders.

3. LEASEHOLDS AND EQUIPMENT

	March 31, 2010			December 31, 2009		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Leasehold improvements	$ 15,020	$ (5,980)	$ 9,040	$ 14,981	$ (5,576)	$ 9,405
Furniture and equipment	11,710	(4,764)	6,946	11,704	(4,348)	7,356
Computer equipment and software	4,643	(1,762)	2,881	4,470	(1,636)	2,834
	$ 31,373	$ (12,506)	$ 18,867	$ 31,155	$ (11,560)	$ 19,595

During the quarter ended March 31, 2010, the Fund invested $156 thousand in the development of a new enterprise resource planning (ERP) system. Amortization of the ERP system will take place when it is substantially complete and ready for productive use.

4. INTANGIBLE ASSETS

	March 31, 2010	December 31, 2009
Store banners	$ 10,005	$ 10,005
Private label brand names	6,618	6,618
	$ 16,623	$ 16,623

These intangible assets have no basis for tax purposes.

(Unaudited – Expressed in thousands of dollars, unless otherwise specified and except for per unit amounts.)

5. BANK INDEBTEDNESS

	March 31, 2010	December 31, 2009
Term loan	$ 5,000	$ 5,000

The Fund has available a $15,000, 3-year committed revolving loan (the "Operating Loan") due on October 31, 2010. The Operating Loan is available for working capital requirements, capital expenditures and for general corporate purposes. Advances bear interest at the lender's prime rate plus 2.50% to 2.75% or at the banker's acceptance rate plus 4.00% to 4.25%, based on the ratio of debt to earnings before interest, taxes, depreciation and amortization, calculated on a quarterly basis. This loan is secured by a general security agreement covering all assets of Sterling Shoes LP.

The Fund utilized $5,000 of an available $5,000 revolving term facility (the "Term Loan"). Interest, term, and security are the same as for the Operating Loan.

6. CONVERTIBLE DEBENTURES

	March 31, 2010	December 31, 2009
Principal amount	$ 25,000	$ 25,000
Equity component	(2,657)	(2,657)
Accretion	1,037	920
Deferred financing fees, net of amortization	(681)	(743)
Convertible unsecured subordinated debentures	$ 22,699	$ 22,520

The convertible unsecured subordinated debentures (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. The maturity date for the Debentures is October 31, 2012.

The Debentures are convertible at any time at the option of the holders into trust units ("Trust Units") of the Fund at a conversion rate of approximately 47.281 Trust Units per $1 thousand principal amount of Debentures, which is equal to a conversion price of $21.15 per Trust Unit. 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 Fund 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 estimated market interest rate for similar debentures having no conversion rights.

The conversion option was valued at $2,657 at the date of issuance. The liability portion of the Debentures is being accreted to its face value over the term of the debt using the effective interest method, at an effective interest rate of 10.7%. Transaction costs consisting of commissions and professional fees related to the issuance of the Debentures amounted to $1,231.

7. UNITHOLDERS' CAPITAL

(in thousands of dollars)	**Fund Units**	**Class D LP Units**	**Unitholders' Capital**
Balance, December 31, 2009	**47,847**	**11,962**	**59,809**
			-
Balance, March 31, 2010	**47,847**	**11,962**	**59,809**

(in number of units)	**Fund Units**	**Class D LP Units**	**Total Units**
Balance, December 31, 2009	**5,313,488**	**1,328,372**	**6,641,860**
			-
Balance, March 31, 2010	**5,313,488**	**1,328,372**	**6,641,860**

An unlimited number of Units may be created and issued pursuant to the Declaration of Trust. Each Unit is transferable and represents an equal undivided beneficial interest in any distributions from the Fund, whether of net income, net realized capital gains or other amounts and in the net assets of the Fund in the event of a termination or winding up of the Fund. Each Unit entitles the holder thereof to one vote at all meetings of voting Unitholders.

The Units are redeemable at any time on demand by the holders thereof, subject to the terms and conditions as outlined in the prospectus of the Fund dated June 30, 2005. The total amount payable by the Fund in respect of those Units and all other Units tendered for redemption in the same calendar month shall not exceed $50, provided that the Trustees of the Fund may, in their sole discretion, waive this limitation in respect of all Units tendered for redemption in any calendar month.

(Unaudited – Expressed in thousands of dollars, unless otherwise specified and except for per unit amounts.)

8. COMMITMENTS

(a) Minimum rental commitments

The Fund has the following minimum rental commitments for premises, excluding percentage rent adjustments and operating expense assessments, for the remainder of the current fiscal year and over the next four fiscal years:

2010	$	11,898
2011		14,402
2012		13,801
2013		12,626
2014		10,666
Thereafter		27,577
	$	90,970

Certain of the operating leases provide for additional annual rentals based on store sales.

(b) Letters of credit

The Fund had letters of credit outstanding on March 31, 2010 securing inventory purchase commitments totaling $1.47 million. The last of these letters of credit expires on July 31, 2010 for $1.0 million.

9. FINANCIAL INSTRUMENTS

(a) Fair value

Financial instruments consist of cash at fair value (which is a Level 1 input), accounts receivable, term loans, accounts payable, foreign exchange contracts, and the debentures. The fair values of all financial instruments, other than cash, the Debentures (Note 6), and the foreign exchange contracts, approximate their carrying values due to their short term or floating rate nature.

Cash is stated at fair value. The fair value of the Debentures is determined by calculating its present value using the estimated market interest rate for loans with similar terms, conditions, and maturities. By using this valuation method, the estimated fair value of the Debentures at March 31, 2010 was $22,344 (2009 - $21,566) compared to its carrying value of $22,699 (2009 – $22,008). As the Debentures are other financial liabilities and are measured at amortized cost, no gain or loss has been recognized in net income relating to the difference between the Debentures' estimated fair value and carrying value.

(b) *Liquidity risk*

Liquidity risk is the risk that the Fund will not be able to meet its obligations associated with financial liabilities and commitments as they become due. Liquidity risk also includes the risk of not being able to liquidate assets in a timely manner at a reasonable price. The following table shows the maturity dates for the Fund's liabilities:

in $000's	2010	2011	2012	2013	2014
Accounts payable and accrued liabilities	16,358				
Convertible Debentures			25,000		
Operating and Term Loans	5,000				
	21,358	-	25,000	-	-

The Fund's future income tax obligation is discussed in Note 11, while its future obligations under operating leases are discussed in Note 8. Deferred lease inducements will not result in cash outflow for the Fund.

The Fund manages liquidity risk by managing its capital and debt structure, its cash flows, and its inventory flow. The Fund monitors the cash flows generated from operations and evaluates on a regular basis whether it needs to access the capital and banking markets to meet its financial obligations.

(c) *Interest rate risk*

Interest rate risk is the risk that the Fund's financial instruments or cash flows associated with the instrument will fluctuate due to changes in market interest rates. The Fund's interest rate risk arises primarily from the Debentures, the Operating Loan, and the Term Loan. The interest rate on the Debentures is at a fixed rate (Note 6). The loans under the Operating Loan and Term Loan bear interest at a floating rate based on the Canadian dollar prime rate or on the bankers' acceptance rates plus, in each case, an applicable margin to those rates. Based on the average carrying value of these facilities, a fluctuation in interest rate of 1% would represent a $12.5 change to the net loss for the three months ended March 31, 2010 (2009 - $6). The interest rate risk would be mitigated by income received on cash balances.

(d) *Foreign exchange risk*

Foreign exchange risk is the risk that the value of a financial asset or liability or commitment will fluctuate due to changes in foreign exchange rates. The Fund's foreign exchange risk arises primarily from its inventory purchases. Substantially all footwear sold in Canada is manufactured outside of Canada. The cost of substantially all inventory purchases is exposed to currency fluctuations. During the three months ended March 31, 2010, approximately 43% (2009- 39%) of product purchases were denominated in US dollars respectively.

(Unaudited – Expressed in thousands of dollars, unless otherwise specified and except for per unit amounts.)

From time to time, the Fund enters into contracts to manage the foreign exchange risk associated with anticipated purchases in US dollars. At March 31, 2010, the Fund had forward foreign exchange contracts as follows;

Settlement dates	Face Value $US	Average rate $Cdn
April 2010	1,000	1.041
May 2010	950	1.025
June 2010	1,300	1.014
July 2010	2,150	1.012
August 2010	2,350	1.010
September 2010	2,625	1.010
October 2010	2,250	1.013

As at March 31, 2010, the recorded aggregate unrealized loss on these contracts was $20 (2009 - $nil).

(e) *Credit risk*

Credit risk is the risk that customers on account are not able to discharge their obligations in due time. The Fund is not exposed to material credit risk because it factors all of its receivables to a third party. The risk of loss is transferred entirely to this third party.

(f) *Secured loan*

A loan of $38,597 has been made to Inc by SS Holdings Trust (the "Trust") (all the trust units of which are owned by the Fund), secured, in turn, by Class A LP units (with a par value of $38,597) issued by Sterling Shoes LP to Inc.

The secured loan and the Class A LP units, which have the attributes of a liability, are presented net in the consolidated balance sheet of the Fund as this reflects the entities' cash flows and the intention for settlement of the financial instruments, as well as the associated risks related to the cash flows.

10. RELATED PARTY TRANSACTIONS

(a) The Fund leases its head office location from a company in which two trustees and officers of the Fund have an interest. Rent expense recognized on this lease was $74 for the three months ended March 31, 2010 (2009 - $74) and is included in general and administrative expenses in the statement of income.

(b) The Fund purchased equipment from a company in which a trustee and officer of the Fund has an interest, for $6 during the three months ended March 31, 2010 (2009 - $58).

(Unaudited – Expressed in thousands of dollars, unless otherwise specified and except for per unit amounts.)

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 related parties.

11. FUTURE INCOME TAXES

The tax effected temporary differences comprising the future income tax liability are estimated as follows:

	March 31, 2010	December 31, 2009
Future income tax liability:		
Intangible Asset - store banners	$ 1,426	$ 1,426
Intangible asset - private label brand names	943	943
Other temporary differences	(5)	(5)
	$ 2,364	$ 2,364

Based on an estimate of the income tax liability at the beginning of 2011, the Fund recognized a future income tax liability and corresponding non-cash future tax charge to net income in 2007. This non-cash charge relates to the Fund's intangible assets and is based on temporary differences between the accounting and tax basis of the Fund's assets and liabilities expected to reverse after January 1, 2011.

For the three months ended March 31, 2010, there was no change to the estimated future income tax liability based on the temporary differences between the accounting and tax basis of the Fund's assets and liabilities as at March 31, 2010 expected to reverse after January 1, 2011.

12. SEGMENTED INFORMATION

The Fund operates in one industry segment; that being the retail footwear business, offering a broad selection of private label and brand name shoes and accessories.

13. CAPITAL DISCLOSURES

The Fund's capital structure consisted of the following components at March 31, 2010: Unitholders' equity of $29,257 (December 31, 2009 - $30,218) and the Debentures of $22,699 (December 31, 2009 - $22,520). The Fund's objectives when managing its capital are to make stable monthly distributions to Unitholders and maintain compliance with its bank covenants. The covenants include non-GAAP measures such as adjusted EBITDA. The Fund was in compliance with its bank covenants at March 31, 2010.

The Fund reviews its historical and expected operating results on a regular basis. This review includes consideration of economic conditions, including seasonality, and the competitive environment. In order to maintain or adjust the capital structure, the Fund may adjust the amount of distributions paid to its Unitholders, return capital to its Unitholders, issue new Units, or issue or reduce debt. There were no Unitholders' distributions during the first quarter of 2010.

14. SUBSEQUENT EVENTS

On April 22, 2010 Sterling issued a press release announcing Jeremy Horwitz's resignation as President and Chief Executive Officer of Sterling Shoes effective June 22, 2010 for personal reasons. Mr. Horwitz will also step down as a trustee of the Fund on that date. The Board of Trustees and Mr. Horwitz will be working closely with the senior management team, continuing to oversee the strategic management of the business. The Board is conducting a search for a new President and Chief Executive Officer.

Also on April 22, 2010 Sterling Shoes Income Fund announced that it will be asking its unitholders to approve the conversion of the Fund to a corporation at its annual and special meeting of unitholders to be held on June 24, 2010.

The conversion is to take place as a "plan of arrangement" and is expected to be effective July 1, 2010. Under the arrangement, unitholders of the Fund are to receive common shares of a newly formed corporation, "Sterling Shoes Inc.", on a one-for-one basis. Unitholders resident in Canada will generally receive their shares of Sterling Shoes Inc. on a tax deferred basis. SSI Investments Inc., the current holder of a 20% interest in Sterling Shoes Limited Partnership, the Fund's operating unit, will also exchange its exchangeable units for common shares of Sterling Shoes Inc., also on a one-for-one and tax deferred basis and its remaining units in the partnership for the debt owing to SS Holdings Trust by SSI Investments Inc. When the conversion is effective, SSI Investments Inc. will hold 20%, and the existing unitholders will hold 80%, of the issued common shares of Sterling Shoes Inc. The business of Sterling Shoes will continue to be conducted by Sterling Shoes Limited Partnership, all of the interests in which will be owned, directly or indirectly, by Sterling Shoes Inc.