STERLING SHOES INCOME FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS
MARCH 26, 2008

The following management's discussion and analysis ("MD&A") should be read in conjunction with the consolidated financial statements and accompanying notes ("Financial Statements") of Sterling Shoes Income Fund (the "Fund") for the year ended December 31, 2007. 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 143 stores as at March 26, 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 March 26, 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 Subordinated Exchangeable Class D LP Units Inc holds in Sterling Shoes LP (the "Subordinated Exchangeable LP Units")), which entitle the holder to one vote per special voting unit at meetings of unitholders of the Fund ("Unitholders").

Distributions on the Subordinated Exchangeable LP Units and the Subordinated Exchangeable LP Units themselves are not exchangeable for Units of the Fund until the Subordination End Date. As a result of the Fund achieving the EBITDA Target for the year ended December 31, 2007 and the Distribution Target for each of the fiscal years ended December 31, 2007 and 2006, the Subordination End Date occurred on March 26, 2008.

The Class D LP Units are now freely exchangeable for Units on a one-for-one basis. In future periods the Class D LP Units will be reclassified from non-controlling interest to unitholders' equity. Also, in future periods distributions on the Class D LP Units will no longer be 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. See further discussion below in "Recent Events and Outlook".

The Debentures are convertible at any time at the option of the holders into trust units ("Trust Units") of Sterling Shoes at a conversion rate of approximately 47.281 Trust Units per $1,000 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, Sterling Shoes 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, Sterling Shoes 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 supplement to the $0.36 per unit special distribution declared in December 2007. The Fund's December 17, 2007 announcement of the $0.36 per unit special distribution contemplated a supplementary special distribution, if necessary, to allow the Fund to distribute all of its taxable income for 2007. The $0.06 per unit supplement will be paid on March 31, 2008 to Unitholders of record on December 31, 2007.

The announcement of these special distributions caps a year of significant achievement for the Fund. In addition to $0.42 of special distributions (2006 - $0.47, 2005 - $0.16), we were able to reward our unitholders by increasing 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. Distributions declared for 2007 (including special distributions) were $1.86 per trust unit, which is 73% higher than the targeted annual distribution of $1.075 per trust unit at the time of the Fund's initial public offering on July 12, 2005 ("IPO").

Driving the increase in the Fund's distributions was strong growth in our business. The Fund reported substantial increases in sales, gross margins, EBITDA[1], net income and distributions to unitholders for the year ended December 31, 2007.

We increased sales by 15.8% during 2007 compared to the year-ended December 31, 2006, which included same-store sales growth of 5.9%. This top-line growth was achieved in an environment of increasing margins and profitability. Gross margins as a percentage of sales increased from 54.3% in 2006 to 56.9% in 2007 (49.9% in 2005). Sterling Shoes has been successful in achieving positive same-store sales growth over each of the past seven years. Over that period, same-store sales growth has averaged 5.9% and has ranged from 0.7% to 11.9%. We believe that the year-over-year growth in same-store sales is attributable to continued success in the execution of our strategy (See further discussion in "Operating Results"). The retail environment across Canada has been very robust over the past several years. It continued to be strong during 2007; however, we are concerned that certain regions, particularly in Ontario, are entering a period of economic weakness.

EBITDA[1] grew by 18.7% during 2007 compared to the year-ended December 31, 2006, from $15.5 million to $18.4 million. During 2007, the Fund achieved a Return on Invested Capital ("ROIC")[1] of 37.5%.

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(1) For further discussion of this item, see "Non-GAAP Measures"

We opened 17 stores during 2007; 11 stores in the Ontario market, one store in Manitoba, one store in Alberta and four stores in British Columbia. We believe that there is potential for continued growth across Canada using the formats that have proven successful for us and we continue to evaluate and identify opportunities to add new stores. We expect our store openings to be more geographically balanced between West and East in 2008.

Our 143 stores operate under six retail banners in British Columbia, Alberta, Saskatchewan, Manitoba and Ontario as follows:

Number of Stores Operating											
March 26, 2008								**Dec 31, 2007**	**Dec 31, 2006**	**Dec 31, 2005**	**July 12, 2005**
Province	**Shoe Warehouse**	**Sterling**	**Joneve**	**Freedman**	**Gia**	**Sterling Outlet**	**Total**	**Total**	**Total**	**Total**	**Total**
British Columbia	34	18	5	6	2	-	65	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	9	26	2	1	-	-	38	36	25	5	2
Total	68	56	9	7	2	1	143	141	127	104	100

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. We have also 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 closed three stores due to the redevelopment of the properties by the landlord. We are considering opening stores to replace these three closures in similar locations if and when suitable real-estate becomes available.

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.

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 indebtedness of approximately $13 million. The balance is being used to fund Sterling Shoes' new store expansion projects and for general corporate purposes. Since our IPO, the Fund has opened 48 stores (43 net openings), renovated 16 stores and relocated 9 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.

We expect to utilize the balance of the net proceeds for existing expansion and corporate commitments by the end of 2008. 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.

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. In future periods, adjustments to this future tax liability will 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.

SUMMARY FINANCIAL INFORMATION

	Twelve months ended December 31			Three months ended December 31		
Statement of Income Items ($000's)	**2007**	**2006**	**2005[(1)]**	**2007**	**2006**	**2005**
Sales	$ 118,759	$ 102,588	$ 81,946	36,083	$ 31,415	$ 24,127
Cost of Sales[(1)]	(51,210)	(46,846)	(41,045)	(15,340)	(15,306)	(12,753)
Gross Margin[(1)]	67,549	55,742	40,902	20,743	16,109	11,375
As a percentage of sales	*56.9%*	*54.3%*	*49.9%*	*57.5%*	*51.3%*	*47.1%*
Store and selling expenses	(41,273)	(34,292)	(27,023)	(11,499)	(10,001)	(7,631)
General and administrative expenses	(7,923)	(5,913)	(11,618)	(2,729)	(1,767)	(1,630)
EBITDA [(2)]	18,353	15,537	2,261	6,515	4,341	2,113
Adjusted EBITDA [(2)]	18,024	15,217	9,641	6,423	4,286	2,023
As a percentage of sales	*15.2%*	*14.8%*	*11.8%*	*17.8%*	*13.6%*	*8.4%*
Interest expense	(984)	(326)	(595)	(496)	(94)	(31)
Gain / (Loss) on disposal	5	(118)	(111)	0	(75)	(111)
Amortization	(2,911)	(2,558)	(1,849)	(791)	(643)	(567)
Income (loss) before non-controlling interest and taxes [(3)]	14,463	12,535	(295)	5,228	3,529	1,404
Future income taxes	(7,724)	0	0	0	0	0
Income before non-controlling interest [(3)]	6,739	12,535	(295)	5,228	3,529	1,404
Non-controlling interest [(3) (4)]	1,393	2,521	(887)	1,075	707	(281)
Net income (loss)	$ 5,346	$ 10,014	$ (1,182)	4,153	$ 2,822	$ 1,124
Maintenance capital expenditures [(5)]	2,929	2,553	N/A	382	782	320

	As at December 31	
Balance Sheet Items ($000's) at December 31,	**2007**	**2006**
Total assets	111,192	85,727
Long-term financial liabilities	25,000	5,000

Notes:

(1) Results for the twelve-month period ended December 31, 2005 are not strictly comparable as Inc was privately held, had a January 31st year end, and did not prepare quarterly reports for its shareholders. Results shown for the twelve-month period ended December 31, 2005 combine the unaudited results of Inc for the period January 1, 2005 to July 11, 2005 and those of the Fund for the 173-day period ended December 31, 2005.

Also, Inc calculated its obsolescence provision with respect to inventory on an annual basis only, at its year-end (January 31st), whereas the Fund reflects management's estimate for obsolescence on a quarterly basis. As a result, the Fund's cost of sales for the years ended ended December 31, 2007 and 2006 are not comparable to the cost of sales of Inc for the twelve-month period ended December 31, 2005 without adjustment for the effects of the inventory obsolescence provision. Inc also paid management fees based on the twelve-month results ending January 31, 2005. Also, certain figures have been reclassified to conform with the current period's presentation.

(2) See definition of EBITDA and Adjusted EBITDA under "Non-GAAP Measures".

(3) 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.

(4) Effective April 1, 2008, distributions to the non-controlling interest will be made monthly and will no longer be subordinated. These distributions were subject to subordination until December 31, 2007 pending the Fund achieving explicit EBITDA targets, based on audited consolidated financial statements, and distribution targets. For further information see "End of Subordination". The non-controlling interest is held by Inc, which retained

a 20% interest in the business of Sterling Shoes LP. For further discussion on Distributable Cash, see "Non-GAAP Measures".

(5) "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 and twelve-month periods ended December 31, 2007 for Units of the Fund and to Inc on its units of Sterling Shoes LP:

	Three-months ended Dec 31		Twelve-months ended Dec 31	
	2007	**2006**	**2007**	**2006**
Trust Units	$ 4,145	$ 4,330	$ 9,883	$ 9,024
Inc's ownership in Sterling Shoes LP	1,036	1,043	2,472	2,256
Total	$ 5,181	$ 5,374	$ 12,355	$ 11,280

OPERATING RESULTS

Sales

Sales were $118.8 million during 2007 an increase of 15.8% over the $102.6 million achieved in 2006. The growth in sales was a result of same-store sales growth, incremental growth from new stores not opened for the full year-ended December 31, 2006, and sales from new stores opened since January 1, 2007. During this time, the Fund achieved same-store sales growth of 5.9% in those stores that were open for at least 12 months leading up to January 1, 2007**.** Same-store sales growth of 5.9% was achieved through a number of factors; most significantly, we continue to successfully execute on our business strategy of the right shoe, at the right time, in the right quantity, at the right price. Continued improvement in product selection, timing, quantity and price were critical components in driving profitable same-store sales growth. The retail environment across Canada has been very robust over the past several years. It continued to be strong during 2007. As noted earlier, we are concerned that certain regions, particularly in Ontario, are entering a period of economic weakness.

During the three-months ended December 31, 2007, sales increased to $36.1 million 14.9% over the $31.4 million recorded in the same period in 2006, primarily due to the reasons cited above for the full year. Same-store sales growth during this period was 7.2% over 2006.

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 and gross margin

Cost of sales as a percentage of sales, for the three and twelve-months ended December 31, 2007 were 42.5% and 43.1%, respectively, compared to 48.7% and 45.7% for the same periods during 2006.

Gross margins are a function of a wide range of factors. In addition to the factors noted in the "Sales" section above, gross margins during the three and twelve-months ended December 31, 2007 were impacted by the following factors:

- The timing, severity, and seasonality of the weather;
- Better terms on branded merchandise;
- The impact of permanent markdowns, relative to comparative periods;
- Strengthening of the Canadian dollar relative to the US dollar which has a positive impact on margins;
- Increases in fuel and freight costs impacting international, national and local transportation charges;
- Increasing cost pressures (labour, material and regulatory) in Asian countries (particularly China);
- Changing product mix in some regions in order to build market awareness for our banners and our private label brands;
- Favourable economies of scale enjoyed with our private label and branded suppliers;

During parts of the second and third quarters of 2007, we experienced a slow-down of sales growth due to unsettled weather conditions in most of our markets. Higher than expected markdowns were taken during these periods to clear inventory as the selling-season progressed and to recognize impairment in the net realizable value of inventory. The impact of these mark-downs was mitigated by the utilization of inventory obsolescence reserves. Strong sales performance during the last six weeks of 2007 helped to reduce the markdowns on year-end inventory.

Under our current inventory valuation methodology the Fund recognizes those markdowns in cost of sales in the period that the mark-down is made, rather than during the period the inventory is sold. Higher markdowns were off-set by the strength of the Canadian dollar which contributed towards reducing our cost of sales, as approximately one-third of our purchases are denominated in U.S. dollars, and utilization of inventory obsolescence reserves. Effective January 1, 2008 the Fund will adopt the Canadian Institute of Chartered Accountant's new policy on inventory valuation, which will result in markdowns impacting cost of sales during the period of sale. For further explanation of the impact of this standard, see "New Accounting Standards Issued".

Store and selling expenses

Store and selling expenses for the three and twelve-months ended December 31, 2007 were 31.9% and 34.8% of sales, compared to 31.8% and 33.4% respectively for the same periods during 2006. Store and selling expenses have a fixed underlying core with a large variable component.

The Fund has entered into 75 new leases since its IPO (48 new stores and 27 renewals). The Fund's new stores have a higher rent profile than the average store base, which has resulted in higher occupancy charges. The Fund has also taken a proactive approach to renewing and renovating its existing store base. Renewals typically come at higher rates; however, the Fund has achieved the security of long-term cost certainty in its established markets. Nearly all of these leases have ten-year terms. As the new stores mature and the existing, renewed stores continue to build sales, the Fund expects occupancy costs as a percentage of sales to fall.

Employee costs were higher as a percentage of sales during the three and twelve-months ended December 31, 2007. Staff training and other staffing related store opening costs were higher due to the number of store openings. We also experienced pressure on labour costs due to tight employment markets, especially in Western Canada.

General and administrative expenses

General and administrative ("G&A") expenses for the three and twelve-months ended December 31, 2007 were 7.6% and 6.7% sales, respectively, compared to 5.6% and 5.8% during the same periods in 2006. G&A costs were higher in the three and twelve-month periods than the same periods in the prior year, due to increased obligations under the Fund's long-term incentive plan ("LTIP"), higher G&A salaries and an increase of general overhead and infrastructure expenditures to keep pace with the overall growth of the business.

The LTIP pool is based on the amount by which cash available for distribution per annum exceeds a base threshold of $1.075 per Unit per annum, as determined in the sole discretion of the Trustees of the Fund for each fiscal period. A percentage of that excess is determined in accordance with a formula, outlined in the Fund's Management Information Circular, and forms the LTIP pool. For the year ended December 31, 2007, $1,985 (2006 - $1,357) has been allocated to the LTIP pool.

Adjusted EBITDA (see "Non-GAAP Measures")

Adjusted EBITDA for the three and twelve-months ended December 31, 2007 was 17.8% and 15.2% of sales, respectively, compared to 13.6% and 14.8% for the same periods during 2006.

The increase in Adjusted EBITDA during these comparative periods is largely attributable to the improvements in gross margins achieved, partially offset by increases in store and selling expenses and G&A, each of which are discussed above.

During the twelve months ended December 31, 2007, the Fund achieved a Return on Invested Capital ("ROIC")[1] of 37.5%.

Income before non-controlling interest and taxes

Income before non-controlling interest and taxes for the three and twelve-month periods ended December 31, 2007 was 14.5% and 12.2% of sales, respectively compared to income before non-controlling interest of 11.2% and 12.2% for the same periods during 2006.

SELECTED QUARTERLY FINANCIAL INFORMATION

in ($000's) except per Unit amounts	Q4-2007	Q3-2007	Q2-2007	Q1-2007	Q4-2006	Q3-2006	Q2-2006	Q1-2006
Sales	$ 36,083	$ 30,483	$ 28,242	$ 23,950	$ 31,415	$ 26,968	$ 25,159	$ 19,046
Income before non-controlling interest and taxes	$ 5,228	$ 4,049	$ 2,915	$ 2,268	$ 3,529	$ 4,497	$ 2,429	$ 2,078
Future income taxes	-	-	(7,724)	-	-	-	-	-
Income before non-controlling interest	5,228	4,049	(4,809)	2,268	3,529	4,497	2,429	2,078
Net income	$ 4,153	$ 3,329	$ (3,849)	$ 1,807	$ 2,822	$ 3,594	$ 1,940	$ 1,663
Basic and fully diluted income per Unit	$ 0.787	$ 0.610	$ (0.724)	$ 0.340	$ 0.531	$ 0.676	$ 0.365	$ 0.313
Cash distributions per Unit	$ 0.780	$ 0.360	$ 0.360	$ 0.360	$ 0.815	$ 0.315	$ 0.300	$ 0.269
Number of stores open at end of period	141	138	135	127	127	124	113	111

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 year ended December 31, 2007.

in ($000's)	Three-months ended Dec 31 2007	Three-months ended Dec 31 2006	Year-ended Dec 31 2007	Year-ended Dec 31 2006
Income before non-controlling interest	$ 5,228	$ 3,529	$ 6,739	$ 12,535
Add charges (deduct credits) to operations not requiring a cash payment:				
Future income taxes	-	-	7,724	-
Amortization of leaseholds and equipment	791	579	2,911	2,467
Amortization of deferred financing costs	-	64	-	91
Accreted interest expense	131	-	131	-
Amortization of deferred leasehold inducements	(92)	(55)	(330)	(320)
Loss on disposal of leaseholds and equipment	-	75	-	118
	6,058	4,192	17,175	14,891
Net change in non-cash working capital balances related to operations:				
Accounts receivable	53	30	(308)	(368)
Inventory	3,529	5,189	(10,394)	(3,302)
Prepaid expenses and deposits	(46)	152	(383)	(382)
Accounts payable and accrued liabilities	(3,404)	(2,291)	4,520	2,921
Cash provided by operations	$ 6,190	$ 7,272	$ 10,610	$ 13,760

The Fund invested in capital expenditures of $0.9 million and $5.6 million (net of leasehold inducements) during the quarter and year-ended December 31, 2007, respectively. Of these amounts $0.5 million and $2.7 million were invested in leaseholds and equipment to furnish new stores, respectively. The Fund incurred maintenance capital expenditures of $0.4 million and $2.9 million during the quarter and year-ended December 31, 2007, 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 Debenture.

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.

In accordance with this policy and based on the strong performance of the Sterling Shoes LP, the Fund has increased its monthly distributions by 40% since our IPO, and paid special distributions of $0.42 per unit, $0.47 per unit and $0.16 per unit for each of the past three fiscal years.

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 Standardized Distributable Cash generated in any one period. The Fund's policy is to make stable monthly distributions to Unitholders based on estimated 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 and twelve-month periods ended December 31, 2006 and 2007, as well as since the Fund's inception.

in $000's except per unit amounts and payout ratios	Three-months ended Dec 31 2007	Three-months ended Dec 31 2006	Twelve-months ended Dec 31 2007	Twelve-months ended Dec 31 2006	From inception of the Fund to Dec 31, 2007
Standardized Distributable Cash					
Cash provided by operating activities	$ 6,190	$ 7,272	$ 10,610	$ 13,760	$ 31,976
Less: Maintenance Capital Expenditures	(382)	(782)	(2,929)	(2,553)	(6,225)
Standardized distributable cash generated	$ 5,808	$ 6,490	$ 7,681	$ 11,207	$ 25,751
Less: Changes in non-cash working capital balances related to operation	132	3,080	(6,565)	(1,131)	(5,404)
Adjusted distributable cash generated	$ 5,676	$ 3,410	$ 14,246	$ 12,338	$ 31,155
Adjusted Distributable Cash available for distribution to Unitholders	$ 4,541	$ 2,728	$ 11,397	$ 9,870	$ 24,924
Adjusted Distributable Cash generated per Unit	$ 0.85458	$ 0.51341	$ 2.14488	$ 1.85761	$ 4.69068
Distributions declared per Unit	$ 0.78000	$ 0.81500	$ 1.86000	$ 1.69832	$ 4.22401
Adjusted Payout Ratio	91.27%	158.74%	86.72%	91.42%	90.05%
Number of units outstanding:	5,313,488	5,313,488	5,313,488	5,313,488	5,313,488

During the three and twelve-month periods ended December 31, 2007 cash provided by operations and Standardized Distributable Cash were lower than during the same period in 2006. The decrease compared to the prior year is due to timing of payments and investments in working capital to fund growth in existing and new store inventories.

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. The Fund's Board looks beyond quarter-to-quarter fluctuations in working capital when making decisions regarding monthly distributions. 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.

Since the inception of the Fund, on July 12, 2005 through December 31, 2007, using the Adjusted Distributable Cash calculation, our adjusted payout ratio of 90.05% indicates that we have generated more cash from on-going operations than we have paid out to Unitholders. As mentioned earlier, the Fund's policy has been to make distributions to its Unitholders necessary to pay out its taxable income.

Management believes that our present level of distributions is sustainable.

Cash distributions have been made as follows:

Distribution History Year / Month	Distributions per Unit	Distribution History Year / Month	Distributions per Unit	Distribution History Year / Month	Distributions per Unit
2005		**2006**		**2007**	
		January	$ 0.08958	January	$ 0.12000
		February	0.08958	February	0.12000
		March	0.08958	March	0.12000
		April	0.08958	April	0.12000
		May [3]	0.10500	May	0.12000
		June	0.10500	June	0.12000
		July	0.10500	July	0.12000
		August	0.10500	August	0.12000
July / August [1]	$ 0.14737	September	0.10500	September	0.12000
September	0.08958	October	0.10500	October	0.12000
October	0.08958	November [4]	0.12000	November	0.12000
November	0.08958	December	0.12000	December	0.12000
December	0.08958	December [5]	0.32000	December [7]	0.36000
December [2]	0.16000	December [6]	0.15000	December [8]	0.06000
Total 2005	$ **0.66569**	**Total 2006**	$ **1.69832**	**Total 2007**	**$ 1.86**

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. $0.32 per Unit. 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 is to be paid on March 31, 2008 to Unitholders of record on December 31, 2007.

Distributions are paid on the 15th 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 will be made monthly and will no longer be 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".

The Fund declared distributions (excluding special distributions) to public Unitholders of $1.9 million and $7.7 million for the three and twelve-month periods ended December 31, 2007 (the three and twelve-month periods ended December 31, 2006 of $1.8 million and $6.5 million), respectively. Furthermore, Sterling Shoes LP declared distributions (excluding special distributions) to Inc, the holder of the Class D LP Units, of $0.5 million and $1.9 million for the three and twelve-month periods ended December 31, 2007 (the three and twelve-month periods ended December 31, 2007 of $0.5 million and $1.6 million), respectively.

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:

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

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 by the end of 2008. Since our IPO, the Fund has opened 48 stores (43 net openings), renovated 16 stores and relocated 9 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 December 31, 2007 we have not utilized any of the operating facility or any of the new store capital expenditure facility.

At December 31, 2007, 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 December 31, 2007 letters of credit totaling $1.3 million 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 next five fiscal periods, in thousands of dollars:

in $000's	2008	2009	2010	2011	2012
Inventory purchase commitments	1,319				
Long-term debt					25,000
Minimum rental commitments [1]	12,969	12,621	11,056	9,498	8,858
	14,288	12,621	11,056	9,498	33,858

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 $93 thousand and $250 thousand for the three and twelve-month periods ended December 31, 2007 (three and twelve month periods ended December 31, 2006 – $50 thousand and $198 thousand), respectively.

(b) The Fund purchased equipment from a company in which Mannie Druker, a trustee and officer of the Fund has an interest, for $55 thousand and $519 thousand during the three and twelve-month periods ended December 31, 2007 (three and twelve-month periods ended December 31, 2006 – $68 thousand and $612 thousand), respectively.

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 consolidated financial statements for the year-ended December 31, 2007. Management believes that the following items represent the Fund's only critical accounting estimates.

Inventory Valuation

Inventory is valued at the lower of average cost and net realizable value less a normal profit margin, using the retail method. The Fund records a provision to reflect management's best estimate of the net realizable value less a normal profit margin, of inventory based on current and expected selling prices, sales patterns for the inventory, recent product introductions and the level of inventory on hand.

The estimation method has been consistently applied to the Sterling Shoes business for over ten years. Should actual inventory provisions vary from amounts estimated, this would result in an increase or decrease to cost of sales on the statement of income and a corresponding decrease or increase in gross margins. See further discussion in “New Accounting Standards Issued”.

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 ISSUED

Inventories

In June 2007, the CICA issued CICA Handbook Section 3031 – "Inventories", which replaces Section 3030 of the same title. The new standard has been developed based on International Financial Reporting Standards ("IFRS"). The standard was revised to provide more extensive guidance than Section 3030, to facilitate the CICA's move towards IFRS, and to reduce the number of alternatives for the measurement of inventories.

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

As noted above, under "Critical Accounting Estimates", the Fund currently values its inventory at the lower of average cost and net realizable value less a normal profit margin, using the retail method. Management estimates the net realizable value less a normal profit margin, taking into

consideration current and expected selling prices, sales patterns for the inventory, recent product introductions and the level of inventory on hand.

Section 3031 allows for the measurement of inventories at the lower of cost and net realizable value, however, it excludes from the definition of net realizable value the ability to maintain a normal profit margin and notes that the retail method is only an acceptable technique for measuring the cost of inventories, if the results approximate cost.

Setting 'cost' as the floor for valuing inventory shifts the financial impact on gross margin primarily from poor buying decisions and the corresponding slow-moving inventory from the periods in which the poor buying decision was made into the period into which the sale is made.

The Fund believes that the ultimate adoption of the new standard will have a material impact on the Fund's valuation of its inventory, which will increase by a one-time adjustment to January 1, 2008 inventory and retained earnings. Based on our analysis of the December 31, 2007 inventory, the impact of the change in valuation method was an increase of approximately 12% to the consolidated inventory value.

NEW ACCOUNTING STANDARDS ADOPTED

On January 1, 2007, the Fund adopted the CICA Handbook Section 3855 "Financial Instruments – Recognition and Measurement" and Handbook Section 1540 "Cash Flow Statements". The adoption of these standards has had no material impact on the Fund's net income or cash flows. The other effects of the implementation of the new standards are discussed below.

Financial Instruments

The financial instruments standard establishes the recognition and measurement criteria for financial assets, financial liabilities and derivatives. All financial instruments are required to be measured at fair value on initial recognition of the instrument, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as "held-for-trading", "available-for-sale", "held-to-maturity", "loans and receivables", or "other financial liabilities" as defined by the standard.

Financial assets and financial liabilities designated as "held-for-trading" are measured at fair value with changes in those fair values recognized in net earnings. Financial assets designated as "available-for-sale" are measured at fair value, with changes in those fair values recognized in other comprehensive income ("OCI"). Financial assets designated as "held-to-maturity", "loans and receivables" and "other financial liabilities" are measured at amortized cost using the effective interest method of amortization. The methods used by the Fund in determining fair value of financial instruments are unchanged as a result of implementing the new standard.

Cash and cash equivalents are designated as "held-for-trading" and are measured at fair value, which approximates cost due to the short-term nature of these instruments. Accounts receivable are designated as "loans and receivables". Accounts payable and accrued liabilities, and long-term debt are designated as "other liabilities".

Risk management assets and liabilities are derivative financial instruments classified as "held-for-trading". For further disclosure, see note 2 in the audited consolidated financial statements.

Cash Flow Statement

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. This disclosure requirement is effective for interim and annual financial statements for fiscal periods ending on or after March 31, 2007. The determination to declare and make payable distributions from the Fund are 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 and twelve-month periods ended December 31, 2007, $4.1 million and $9.9 million (three and twelve-month periods ended December 31, 2006 - $4.3 million and $9.0 million), respectively, in cash distributions were declared payable by the Board of Trustees of the Fund and paid to unitholders.

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.

Risks Associated with Convertible Debentures

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.

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.

Redemption Prior to Maturity

The Debentures may be redeemed, at the option of the Fund, after October 31, 2010 and prior to the Maturity Date at any time and from time to time, at the Redemption Price , together with any accrued and unpaid interest. Holders of Debentures should assume that this redemption option will be exercised if the Fund is able to refinance at a lower interest rate or it is otherwise in the interest of the Fund to redeem the Debentures.

Conversion Following Certain Transactions

In the case of certain transactions, each Debenture will become convertible into securities, cash or property receivable by a holder of Units in the kind and amount of securities, cash or property into which the Debenture was convertible immediately prior to the transaction. This change could substantially lessen or eliminate the value of the conversion privilege associated with the Debentures in the future.

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 31.5%.

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 and twelve-month periods ended December 31, 2007 approximately 38% and 39%, respectively 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 December 31, 2007 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.

An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures was conducted as of December 31, 2007, by and under the supervision of management, including the CEO and the CFO. Based on this evaluation, the CEO and the CFO have concluded that our disclosure controls and procedures, as defined by Multilateral Instrument 52-109, *Certification of Disclosure in Issuers' Annual and Interim Filings*, are effective to ensure that information required to be disclosed in reports filed or submitted under Canadian securities legislation is recorded, processed, summarized and reported within the time period specified in those rules and forms.

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 audited consolidated financial statements for the year ended December 31, 2007. 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 audited consolidated financial statements and the Board of Trustees approved the documents prior to their release.

Although the Fund has implemented a number of changes in internal control over financial reporting during the year ended December 31, 2007 substantially improving the Fund's internal control over financial reporting, there have been no changes in internal control over financial reporting during the quarter ended December 31, 2007 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 7 to the financial statements, distributions on the Subordinated Exchangeable LP Units held by Inc are subordinated and are not exchangeable for Units of the Fund until the Subordination End Date. As a result of the Fund achieving the 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 occurred on March 26, 2008. As a result, effective April 1, 2008, distributions to Inc. on the Subordinated Exchangeable LP Units will be made monthly and will no longer be 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 2007 annual information form and in the management’s discussion and analysis of the Fund for the year ended December 31, 2007 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) and on the Fund’s website at www.SterlingShoesIncomeFund.com .

INVESTOR RELATIONS

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