

# Sterling

STERLING SHOES LIMITED PARTNERSHIP

FOR IMMEDIATE RELEASE

November 14, 2005

## STERLING SHOES INCOME FUND REPORTS RESULTS FOR ITS INITIAL PERIOD ENDED SEPTEMBER 30, 2005

VANCOUVER, BC, November 14, 2005 – Sterling Shoes Income Fund (“Sterling Shoes”) (TSX: SSI.UN), today reported its financial results for its initial 81-day period from July 12, 2005 to September 30, 2005. The financial results include the results of operations of Sterling Shoes Limited Partnership (“Sterling Shoes LP”) from acquisition on July 12, 2005.

### Results for the Initial Period Ended September 30, 2005

For the 81-day period ended September 30, 2005, Sterling Shoes reported sales of \$19.5 million and earnings before interest, taxes, depreciation and amortization and non-controlling interest (“Adjusted EBITDA”) of \$3.5 million.

During the period, Sterling Shoes LP generated distributable cash of \$0.45326 per unit and distributions of \$0.23695 per unit were declared on both the Fund Units and Subordinated Exchangeable LP Units held by the holder of the 20% retained interest.

Distributions were made on September 15, 2005 and October 15, 2005 to unitholders of record on August 31, 2005 and September 30, 2005, respectively. Per unit distributions were in accordance with Sterling Shoes’ targeted monthly distributions.

“This is our first quarterly report as a public entity; we are very pleased with our results. We are particularly encouraged with our same-store sales growth of 6.6% during this initial 81-day period, as compared to the period of July 12 to September 30, 2004”, said Jeremy Horwitz, President and CEO of Sterling Shoes.

“Our recent expansion into Ontario is showing early signs of success, with our new Ontario stores performing at or above plan. Our plans for 2005 remain on target due to solid same-store sales growth and overall sales growth of 16.2% compared to the same period last year.”

### New Store Openings Since July 12, 2005

Sterling Shoes became a publicly traded entity on July 12, 2005 with 100 stores; since that time Sterling Shoes has opened four stores, a Freedman’s in Richmond Centre Mall in Richmond, British Columbia, a Shoe Warehouse in Red Deer Centre Mall in Red Deer, Alberta, a Sterling in Midtown Plaza in Saskatoon, Saskatchewan and a Sterling in Toronto’s Eaton Centre Mall.



# Sterling

STERLING SHOES LIMITED PARTNERSHIP

## Major Expansion in Ontario

In addition to its existing three stores operating in the Ontario market, Sterling Shoes recently (October 24, 2005) announced its plans for eight more stores in southern Ontario, where it expects to have at least 11 stores operating by the end of March 2006. Sterling Shoes' existing and expected southern Ontario stores include:

Store Location	Store Banner	Existing / Expected Opening Date
Upper Canada Mall in Newmarket	Sterling	May 2005
Dixie Outlet Mall in Mississagua	Shoe Warehouse	May 2005
Eaton Centre Mall in Toronto	Sterling	August 2005
Cambridge Centre Mall in Cambridge	Shoe Warehouse	December 2005
Eastgate Mall in Stoney Creek (Hamilton)	Shoe Warehouse	December 2005
Masonville Place Shopping Centre in London,	Sterling	March 2006
Fairview Park Mall in Kitchener	Sterling	March 2006
Lime Ridge Mall in Hamilton,	Sterling	March 2006
Erin Mills Town Centre Mall in Mississauga	Sterling	March 2006
Markville Shopping Centre in Markham	Sterling	March 2006
The Georgian Mall in Barrie	Sterling	March 2006

These steps are consistent with the expansion plans outlined in Sterling Shoes' initial public offering prospectus. Sterling Shoes continues to expand its market presence under the Sterling banner in some of Ontario's high profile malls, and to add Shoe Warehouse outlets in Ontario where suitable locations become available.

"We believe that there is significant potential for growth in eastern Canada using the formats that have proven successful for us in the past and we continuously evaluate and identify opportunities to add new stores in regions already served by us."

## Sterling Shoes Income Fund Website Launched Today – November 14, 2005

We are also pleased to announce the launch of our 'corporate' website today. This website can be found at [www.SterlingShoesIncomeFund.com](http://www.SterlingShoesIncomeFund.com) and will provide current corporate and financial information regarding the Fund. The site will be regularly updated to provide the most up-to-date information to our unitholders, employees, customers and other interested parties.



# Sterling

STERLING SHOES LIMITED PARTNERSHIP

## Conference Call 8am PST, (11am EST) November 15, 2005

Mr. Jeremy Horwitz, President and CEO and Mr. Daniel Gumprich, CFO of Sterling Shoes will be hosting a conference call to review the financial results and corporate developments for the initial 81-day period ended September 30, 2005 at 8:00am PST, (11:00am EST) on Tuesday, November 15, 2005. To participate in this conference call, please dial one of the following numbers approximately 10 minutes prior to the commencement of the call:

Toll-free: 1.877.667.7774

GTA local and international: 1.416.695.6622

## About Sterling Shoes Income Fund

Sterling Shoes Income Fund was established under the laws of the Province of British Columbia on May 31, 2005 to acquire, indirectly, 80% of the partnership units of Sterling Shoes LP, which had acquired the retail footwear business of Sterling Shoes Inc. (“Inc”). Inc was a leading independent shoe retailer offering a broad selection of private label and national brand name shoes and accessories through four separate retail banners: Sterling, Joneve, Shoe Warehouse and Freedman’s. Inc retained a 20% interest as partial consideration for the acquisition of the retail footwear business carried on by Sterling Shoes Inc. Sterling Shoes Income Fund was inactive until its acquisition of Sterling Shoes LP.

Note: “EBITDA” and “Adjusted EBITDA” are not recognized financial measures recognized by Canadian generally accepted accounting principals (“GAAP”) and do not have standardized meanings prescribed by GAAP. Management cautions investors that EBITDA and Adjusted EBITDA should not replace net income or loss as an indicator of performance, or cash flows from operating, investing, and financing activities as a measure of the Sterling Shoes’ liquidity and cash flows. Sterling Shoes’ method of calculating EBITDA and Adjusted EBITDA may differ from the methods used by other issuers. See “Reconciliation of Net Income to EBITDA and Adjusted EBITDA” for reconciliation of EBITDA and Adjusted EBITDA to the most directly comparable measure calculated in accordance with GAAP. See also “Non-GAAP Measures” in the attached Management’s Discussion and Analysis.

Distributable cash is a non-GAAP measure generally used by Canadian income funds as an indicator of financial performance. Sterling Shoes defines distributable cash as Adjusted EBITDA less interest expense and less maintenance capital expenditures. The method of calculating the Sterling Shoes’ distributable cash may differ from similar computations as reported by similar entities and, accordingly, may not be comparable to distributable cash as reported by such entities.

freedman  
shoes

Sterling

Joneve

SHOE  
WAREHOUSE

*Interim Consolidated Financial Statements of*

**STERLING SHOES INCOME FUND**

*For the period from July 12, 2005 to September 30, 2005*  
(Unaudited)

**Sterling Shoes Income Fund**  
**Interim Consolidated Balance Sheet**  
**As at September 30, 2005**  
**(unaudited)**

---

**ASSETS**

CURRENT

Cash	\$	2,907,458
Accounts receivable		5,229
Inventory		18,994,682
Prepaid expenses and deposits		328,542

---

LEASEHOLDS AND EQUIPMENT [note 3]		9,416,918
GOODWILL [note 1]		4,325,809
INTANGIBLE ASSETS [notes 1 and 5]		45,543,000
DEFERRED FINANCING COSTS [note 4]		99,594
	\$	81,621,232

---

**LIABILITIES AND UNITHOLDERS' EQUITY**

CURRENT

Accounts payable and accrued liabilities	\$	10,779,169
Distributions payable		790,742
Due to Sterling Shoes Inc. [note 13]		2,434,439

---

TERM LOAN [note 6]		5,000,000
DEFERRED LEASE INDUCEMENTS		1,350,560
NON-CONTROLLING INTEREST [note 7]		12,253,263

UNITHOLDERS' EQUITY		49,013,058
	\$	81,621,232

---

COMMITMENTS [notes 10 and 11]

On behalf of the Board of Trustees

\_\_\_\_\_  
(\_\_\_\_\_) Rick Mahler  
Trustee

\_\_\_\_\_  
(\_\_\_\_\_) Jeremy Horwitz  
Trustee

*See accompanying notes*

**Sterling Shoes Income Fund**  
**Interim Consolidated Statement of Income**  
**For the period from July 12, 2005 to September 30, 2005**  
**(unaudited)**

SALES	\$ 19,544,356
COST OF SALES	9,014,457
<b>GROSS MARGIN</b>	<b>10,529,899</b>
EXPENSES	
Store and selling	6,192,472
General and administrative	767,695
	<b>6,960,167</b>
Income before interest, depreciation, amortization and non-controlling interest	3,569,732
Interest expense	80,623
Depreciation on leaseholds and equipment	449,522
Amortization of deferred financing costs	7,956
<b>INCOME BEFORE NON-CONTROLLING INTEREST</b>	<b>3,031,631</b>
NON-CONTROLLING INTEREST [note 7]	606,326
<b>NET INCOME</b>	<b>\$ 2,425,305</b>
Basic and diluted net income per unit	\$ 0.46
Basic weighted average number of units outstanding	5,313,488
Diluted weighted average number of units outstanding	6,641,860

*See accompanying notes*

**Sterling Shoes Income Fund**

**Interim Consolidated Statement of Unitholders' Equity**

**For the period from July 12, 2005 to September 30, 2005**

**(unaudited)**

	<b>Fund Units</b>	<b>Accumulated</b>	<b>Accumulated</b>	
	<b>[note 9]</b>	<b>earnings</b>	<b>distributions</b>	<b>Total</b>
Issuance of Class C LP units on initial public offering [n	\$ 53,134,880			\$ 53,134,880
Issuance costs [note 1]	(5,288,093)			(5,288,093)
Net income for the period		2,425,305		2,425,305
Distributions declared			(1,259,034)	(1,259,034)
<b>BALANCE, END OF PERIOD</b>	\$ 47,846,787	2,425,305	(1,259,034)	\$ 49,013,058

*See accompanying notes*

**Sterling Shoes Income Fund**  
**Interim Consolidated Statement of Cash Flows**  
**For the period from July 12, 2005 to September 30, 2005**  
**(unaudited)**

<b>OPERATING ACTIVITIES</b>	
Net Income	\$ 2,425,305
Items not involving cash	
Depreciation on leaseholds and equipment	449,522
Amortization of deferred financing costs	7,956
Amortization of deferred lease inducements	(56,077)
Non-controlling interest	606,326
	<u>3,433,032</u>
Change in non-cash working capital	885,156
	<u>4,318,188</u>
<b>INVESTING ACTIVITIES</b>	
Acquisition of leaseholds and equipment	(685,881)
Lease inducements received	58,200
Acquisition of Sterling Shoes Inc. [note 1]	(52,739,237)
	<u>(53,366,918)</u>
<b>FINANCING ACTIVITIES</b>	
Proceeds from credit facility [note 6]	5,000,000
Financing costs incurred [note 4]	(107,550)
Initial public offering of Fund Units, net of expenses [note 1]	47,846,787
Payment of distributions	(783,049)
	<u>51,956,188</u>
<b>NET INCREASE IN CASH DURING THE PERIOD</b>	<b>2,907,459</b>
<b>CASH, BEGINNING OF PERIOD</b>	<b>0</b>
<b>CASH, END OF PERIOD</b>	<b>\$ 2,907,459</b>
<b>Supplemental cash flow information</b>	
Interest paid	\$ 82,923

*See accompanying notes*

# STERLING SHOES INCOME FUND

## Notes to Consolidated Financial Statements

For the period from July 12, 2005 to September 30, 2005

(Unaudited)

---

### 1. ORGANIZATION, NATURE OF OPERATIONS AND ACQUISITION

#### (a) *Organization, 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 was created to acquire, indirectly, an interest in the retail footwear business of Sterling Shoes Inc. (“Inc”), a leading independent retailer offering a broad selection of private label and national brand name shoes and accessories through four separate retail banners: Sterling, Joneve, Shoe Warehouse and Freedman’s. The Fund commenced operations on July 12, 2005, when it completed an initial public offering and acquisition (see note 1(b)). When it commenced operations, the Fund operated 100 retail stores in five provinces in shopping malls, high-streets and strip malls, principally in western Canada.

The Fund holds, indirectly, an 80% interest in the units of Sterling Shoes Limited Partnership (“Sterling Shoes LP”), a partnership established under the laws of the Province of Manitoba.

#### (b) *Acquisition*

On July 12, 2005, the Fund completed an initial public offering of 5,313,488 units of the Fund (“Units”) at \$10 per Unit (the “Offering”) for net proceeds of \$47,846,787 after deducting expenses of the Offering of \$5,288,093. The Fund used the net proceeds of the Offering, together with funds from new credit facilities, to acquire an 80% indirect interest in Sterling Shoes LP for \$52,739,237.

The purchase was subject to a working capital adjustment which required the difference between the working capital delivered on the initial acquisition and \$7,000,000 to be settled through a cash payment. The working capital excess delivered on initial acquisition of \$1,308,421 has been reflected as due to Sterling Shoes Inc. in the purchase equation.

---

# STERLING SHOES INCOME FUND

## Notes to Consolidated Financial Statements

For the period from July 12, 2005 to September 30, 2005

(Unaudited)

---

### 1. ORGANIZATION, NATURE OF OPERATIONS AND ACQUISITION (Continued)

#### (b) Acquisition (continued)

The acquisition of Sterling Shoes LP has been accounted for using the purchase method, and the Fund has recorded the results of operations of Sterling Shoes LP from the date of acquisition.

A preliminary allocation of the purchase price to the fair value of the net assets acquired is as follows:

Net working capital	\$ 8,308,421
Due to Sterling Shoes Inc.	(1,308,421)
Leaseholds and equipment	9,180,559
Goodwill	4,325,809
Other intangible assets	45,543,000
Deferred lease inducements	(1,348,437)
Non-controlling interest	(11,961,694)
	<hr/>
	\$ 52,739,237

The purchase was funded by:

Cash (net proceeds from Offering)	47,846,787
New credit facility, net of financing costs	4,892,450
	<hr/>
	\$ 52,739,237

---

# STERLING SHOES INCOME FUND

## Notes to Consolidated Financial Statements

For the period from July 12, 2005 to September 30, 2005

(Unaudited)

---

### 2. SIGNIFICANT ACCOUNTING POLICIES

These unaudited consolidated interim financial statements and accompanying notes (“Interim Financial Statements”) have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) for interim financial statements and may not include all disclosures required by GAAP for annual financial statements. It is impracticable to present prior period information for the interim period in the immediately preceding financial year as Inc was privately held, had a January 31st year end, and did not prepare quarterly reports for its shareholders. These Interim Financial Statements should be read in conjunction with the financial statements included in the prospectus of the Fund dated June 30, 2005 (the “Prospectus”).

(a) *Basis of presentation*

These Interim Financial Statements include the accounts of the Fund, and its 80% interest in Sterling Shoes LP. All material intercompany transactions have been eliminated upon consolidation.

(b) *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 Interim 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 goodwill and other intangible assets, and amounts of accrued liabilities. Actual results could differ from these estimates.

(c) *Cash and cash equivalents*

Cash and cash equivalents consist of cash on hand and bank balances.

(d) *Inventory*

Inventory, all of which is finished goods, is valued using the retail method at the lower of average cost and net realizable value, less a normal profit margin. Inventory write-downs are included in cost of sales.

Incentives received from suppliers are presumed to be a reduction in the prices of the suppliers’ products and are accounted for as a reduction in the related inventory and cost of sales.

---

# STERLING SHOES INCOME FUND

## Notes to Consolidated Financial Statements

For the period from July 12, 2005 to September 30, 2005

(Unaudited)

---

### 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) *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

Amortization is reduced to one-half the normal rate in the year of acquisition.

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. 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.

(f) *Deferred financing costs*

Financing costs incurred to obtain new credit facilities are deferred on the balance sheet and amortized on a straight line basis, over the life of the related debt.

(g) *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.

Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. 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.

---

# STERLING SHOES INCOME FUND

## Notes to Consolidated Financial Statements

For the period from July 12, 2005 to September 30, 2005

(Unaudited)

---

### 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(h) *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.

(i) *Revenue recognition*

Revenue is recognized at the point of sale when the price is fixed or determined upon delivery to the customer, net of a provision for sales returns and allowances in net sales.

(j) *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. Purchases transacted 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.

(k) *Deferred lease inducements*

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

(l) *Hedging relationships*

Accounting Guideline-13 (“AcG-13”) establishes the criteria for identification, designation, documentation and effectiveness of hedging relationships for the purpose of applying hedge accounting. Emerging issue committee pronouncement (“EIC”) #128 establishes that a freestanding derivative financial instrument that gives rise to a financial asset or financial liability and is entered into for trading or speculative purposes, or that does not qualify for hedge accounting under AcG-13, should be recognized on the balance sheet and measured at fair value, with changes in fair value recognized in income of the period. The Fund adopted AcG-13 and EIC-128 upon commencement of operations. The adoption of this guideline has not affected the Fund’s financial statements.

---

# STERLING SHOES INCOME FUND

## Notes to Consolidated Financial Statements

For the period from July 12, 2005 to September 30, 2005

(Unaudited)

---

### 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(m) *Income taxes*

As the Fund allocates all of its taxable income and taxable capital gains to unitholders, the Fund itself will not be subject to income taxes.

(n) *Earnings per Unit*

Basic earnings per Unit is calculated by dividing net income by the weighted average number of units outstanding during the reporting period. Diluted earnings per Unit is calculated by dividing the income before non-controlling interest by the sum of the weighted average number of Units outstanding used in the basic earnings per Unit calculation and the number of units that would be issued assuming conversion of all Subordinated Exchangeable Class D LP Units, being the only dilutive securities.

### 3. LEASEHOLDS AND EQUIPMENT

	September 30, 2005		
	Cost	Accumulated Amortization	Net Book Value
Leasehold improvements	\$ 4,559,915	\$ 226,931	\$ 4,332,984
Furniture and equipment	4,467,796	162,740	4,305,056
Computer equipment and software	838,729	59,851	778,878
	\$ 9,866,440	\$ 449,522	\$ 9,416,918

### 4. DEFERRED FINANCING COSTS

Costs associated with obtaining the Credit Facilities (Note 6) are amortized on a straight-line basis over three years.

	September 30, 2005		
	Cost	Accumulated Amortization	Net Book Value
Deferred financing costs	\$ 107,550	\$ 7,956	\$ 99,594

---

# STERLING SHOES INCOME FUND

## Notes to Consolidated Financial Statements

For the period from July 12, 2005 to September 30, 2005

(Unaudited)

---

### 5. INTANGIBLE ASSETS

	<u>September 30, 2005</u>
Store banners	25,960,000
Private label brands	19,583,000
	<u>\$ 45,543,000</u>

### 6. CREDIT FACILITIES

	<u>September 30, 2005</u>
(a) <i>Term loan #1</i>	
<p>Sterling Shoes LP has utilized a \$5,000,000, 3-year committed non-revolving loan (the "Term Loan #1"). Term Loan #1 was made available to fund the purchase of assets from Sterling Shoes Inc. Advances bear interest at the lender's prime rate plus 0.25% to 0.75% or at the banker's acceptance rate plus 1.50% to 2.00%, based on the ratio of senior debt to earnings before interest, taxes, depreciation and amortization, calculated on a quarterly basis. Term Loan #1 is secured by a general security agreement covering all assets of Sterling Shoes LP.</p>	\$5,000,000
(b) <i>Operating loan</i>	
<p>Sterling Shoes LP has available a \$10,000,000 3-year committed revolving loan (the "Operating Loan"). The Operating Loan is available for working capital requirements, capital expenditures and for general corporate purposes. Interest, terms and security are the same as Term loan #1.</p>	-
(c) <i>Term loan #2</i>	
<p>Sterling Shoes LP has available a \$7,500,000, 3-year committed non-revolving loan ("Term Loan #2"). Term Loan #2 is available for general future funding of new store facilities. Interest, terms and security are the same as Term loan #1.</p>	-
	<u>\$5,000,000</u>

---

# STERLING SHOES INCOME FUND

## Notes to Consolidated Financial Statements

For the period from July 12, 2005 to September 30, 2005

(Unaudited)

---

### 7. NON-CONTROLLING INTEREST

	September 30, 2005
Retained interest of Sterling Shoes Inc. in Sterling Shoes LP (note 1)	11,961,694
Non-controlling interest in income of Sterling Shoes LP for the period	606,326
Distributions declared in respect of the non-controlling interest	(314,757)
	\$ 12,253,263

---

The shareholders of Inc have retained a 20% interest in Sterling Shoes LP through ownership of 100% of the issued and outstanding Subordinated Exchangeable Class D LP units (“Class D units”).

The Class C LP units (all of which are owned indirectly by the Fund) and the Class D LP units (collectively, the “LP Units”) have economic and voting rights that are equivalent in all material respects, except that distributions on the Class D LP units are subordinated to distributions on the Class A LP units and Class C LP units, such that distributions will only be paid on the Class D LP units at the end of a fiscal quarter to the extent that Sterling Shoes LP has paid average monthly distributions on the Class C LP units to enable the Fund to make distributions of at least \$0.0896 per Unit to holders of Units during that quarter, along with priority Class A LP unit distributions, and any deficiency in such distributions during the preceding 12 months has been satisfied.

Subject to subordination, distributions are to be made monthly on the outstanding limited partnership units of Sterling Shoes LP. Generally, distributions on the Class D LP units will be made quarterly on a prorated basis to the amount distributed on the outstanding limited partnership units during such fiscal quarter, only after the distributions have been made on the outstanding limited partnership units and to the extent that cash is available to make such distributions.

---

# STERLING SHOES INCOME FUND

## Notes to Consolidated Financial Statements

For the period from July 12, 2005 to September 30, 2005

(Unaudited)

---

### 7. NON-CONTROLLING INTEREST (Continued)

Class D LP units will automatically become freely exchangeable for Units on a one-for-one basis on (and the distribution subordination provisions will only apply until) the date (the “Subordination End Date”) that is the earlier of:

1. December 31, 2007, if the Fund’s consolidated earnings before interest, depreciation and amortization (“EBITDA”) for the fiscal year then ended is at least \$9.545 million (the “EBITDA Target”) (based on our audited consolidated financial statements), and cash distributions of at least \$5.712 million (\$1.075 per Unit) have been paid on the Units, and cash advances or distributions of at least \$1.428 million (effectively \$1.075 per unit) have been paid to Inc, as the holder of the Subordinated Exchangeable LP Units (the “Distribution Target”) for each of the fiscal years ended December 31, 2007 and 2006, and
2. the last day of any fiscal year of the Fund following December 31, 2007 in respect of which the Fund’s consolidated EBITDA (based on our audited consolidated financial statements) is at least the EBITDA Target and cash distributions at least equal to the Distribution Target have been made for such fiscal year.

As noted above, the distributions on Class D LP units are not economically equivalent to distributions received by Units of the Fund, as a result of the subordination of distributions on Class D LP units. As a result, the Class D LP units have been classified as non-controlling interests.

### 8. SECURED LOAN AND CLASS A UNITS

As outlined in the Prospectus, a loan of \$38,596,780 has been made by the Trust to Inc, secured, in turn, by Class A LP units (with a par value of \$38,596,780) issued by Sterling Shoes LP to Inc. The Class A LP units have the attributes of a liability and have been reflected as such in the Interim Financial Statements.

These financial instruments continue to exist in the non-consolidated accounts of the Fund. However, Inc can only use the Class A LP units to set off against the secured loan, or can only redeem the Class A LP units if it has first paid down the secured loan. In addition, the instruments carry the same interest rate whereby the interest payable on the secured loan is funded by the distributions Inc receives on the Class A LP units issued by Sterling Shoes LP.

As a result, the secured loan and the Class A LP units 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.

---

# STERLING SHOES INCOME FUND

## Notes to Consolidated Financial Statements

For the period from July 12, 2005 to September 30, 2005

(Unaudited)

---

### 9. FUND UNITS

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. 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 \$50,000, 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.

### 10. LONG-TERM INCENTIVE PLAN

Officers and key employees of Sterling Shoes LP are eligible to participate in Sterling Shoes LP's Long-term Incentive Plan (the "LTIP"). The purpose of the LTIP is to provide eligible participants with compensation opportunities that will enhance our ability to attract, retain and motivate key personnel and reward officers and key employees for significant performance and associated growth in distributions. Pursuant to the LTIP, Sterling Shoes LP sets aside a pool of funds based upon the amount, if any, by which Sterling Shoes LP's distributable cash exceeds cash distribution thresholds (as defined in the LTIP plan documents). A trustee then purchases units of the Fund in the market with this pool of funds and holds these units until such time as ownership vests to each participant. The LTIP is administered by the Compensation Committee of the Board.

The Board, or the Compensation Committee has the power to, among other things, determine those individuals who participate in the LTIP, determine the level of participation of each participant, and determine the time or times when LTIP awards will vest or be paid to each participant.

As at the balance sheet date, there is no amount to be accrued.

---

# STERLING SHOES INCOME FUND

## Notes to Consolidated Financial Statements

For the period from July 12, 2005 to September 30, 2005

(Unaudited)

---

### 11. COMMITMENTS

Sterling Shoes LP has the following minimum rental commitments for premises, excluding percentage rent adjustments and operating expense assessments, in the next five year period and thereafter:

Year ending December 31:	
2005	\$ 2,072,507
2006	7,428,431
2007	6,346,299
2008	5,446,288
2009	4,091,121
2010	2,740,544
Thereafter	4,175,817
	<u>\$ 32,301,007</u>

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

### 12. FINANCIAL INSTRUMENTS

(a) *Fair value*

Financial instruments consist of cash, accounts receivable, accounts payable and accrued liabilities, distributions payable, due to Sterling Shoes Inc., and term loan. The fair values of all financial instruments, except the term loan, are considered to approximate their carrying values due to their ability of prompt liquidation. The fair value of the term loan is considered to approximate the carrying value as the instrument bears interest at floating rates.

(b) *Interest rate risk*

The Fund is subject to the risks associated with fluctuating interest rates on its credit facilities.

(c) *Foreign exchange risk*

As at September 30, 2005, approximately 40% of product purchases were denominated in US dollars. From time to time, the SSLP enters into contracts to manage the foreign exchange risk associated with anticipated purchases in US dollars. The Fund does not hold or issue financial instruments for trading or speculative purposes. As at September 30, 2005 there are no foreign exchange contracts outstanding.

---

# STERLING SHOES INCOME FUND

## Notes to Consolidated Financial Statements

For the period from July 12, 2005 to September 30, 2005

(Unaudited)

---

### 13. RELATED PARTY TRANSACTIONS

(a) *Leases*

Sterling Shoes LP leases its head office location from a company affiliated with the principal shareholders of Inc, who have a non-controlling interest in the Fund (see Note 7). Rent expense recognized on this lease was \$43,053 for the period ended September 30, 2005, which is included in general and administrative expenses in the statement of income.

(b) *Due to Sterling Shoes Inc.*

The amount due to Inc relates to the working capital adjustment as outlined in the Prospectus and reimbursement of Offering costs and operational items paid on behalf of Sterling Shoes LP by Inc. This entity is related to the Fund as it has a significant common investment, being Sterling Shoes LP. The balance is due on demand, is unsecured and does not bear interest.

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.

### 14. SEGMENTED INFORMATION

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

---

**STERLING SHOES INCOME FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
NOVEMBER 14, 2005**

*The following management's discussion and analysis ("MD&A") should be read in conjunction with the unaudited consolidated interim financial statements and accompanying notes ("Interim Financial Statements") of Sterling Shoes Income Fund (the "Fund") for the initial period from July 12, 2005 to September 30, 2005. Results have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") for interim financial statements. The fiscal year-end of the Fund is December 31.*

*This MD&A contains forward-looking statements. Please see "Forward-Looking Statements" 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 earnings 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 "Reconciliation of Net Income to EBITDA and Adjusted EBITDA".*

**OVERVIEW OF THE FUND**

The Fund owns, indirectly, an 80% interest in Sterling Shoes Limited Partnership ("SSLP"), a Vancouver-based, leading independent footwear retailer offering a broad selection of private label and brand name shoes and accessories through four separate retail banners: Sterling, Joneve, Shoe Warehouse and Freedman's. These retail concepts were designed to serve identified market segments in which we believe we can compete. Each of the banners in our portfolio provides us with compelling growth opportunities, attractive margins and high returns on capital. Since 1987 the Sterling Shoes business (formerly carried on by Sterling Shoes Inc.) has grown from five shopping mall locations to over 100 stores. These stores are located primarily in western Canada 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% indirect interest in the partnership units of SSLP, which had acquired the retail footwear business of Sterling Shoes Inc. ("Inc"). Inc retained a 20% interest in SSLP through ownership of 1,328,372 Subordinated Exchangeable LP Units.

As at November 14, 2005, there were 5,313,488 Units of the Fund issued and outstanding. In addition, to provide Inc with voting rights commensurate with Inc's retained interest in SSLP, Inc also holds 1,328,372 special voting units of the Fund (equal to the number of Subordinated Exchangeable LP Units Inc holds), which entitle the holder to one vote per special voting unit at Unitholder meetings.

Once certain EBITDA and distribution targets are met, and in certain other limited circumstances, the Subordinated Exchangeable LP Units become exchangeable, on a one for one basis, into Fund Units. See Note 7 of the Fund's financial statements for the period ended September 30, 2005 and the Fund's initial public offering prospectus for further details.

Sterling Shoes Income Fund Units trade on the Toronto Stock Exchange under the symbol SSI.UN.

## **BASIS OF MANAGEMENT'S DISCUSSION AND ANALYSIS**

The Fund was inactive until its indirect acquisition of an 80% interest in SSLP on July 12, 2005. The Fund's results of operations therefore reflect the Fund's operations for the 81-day period from the date of acquisition, July 12, 2005 until September 30, 2005.

This represents the Fund's first reporting period, and consequently, no comparative information is provided in the Interim Financial Statements. However, in order to enhance the usefulness of this MD&A, certain financial and operating results of the Fund for the 81-day period from July 12, 2005 to September 30, 2005 are compared to the unaudited results of Inc for the three-month period ended September 30, 2004. Such information is for reference purposes only and is not intended to represent a comprehensive comparison of the consolidated financial results.

## **OPERATING RESULTS**

The table below provides the operating results reported by the Fund for the 81-day period ended September 30, 2005. Other than incremental transactions and costs related to becoming a public entity, there are no unusual items in the Fund's results for the 81-day period ended September 30, 2005.

<b>Statement of Income Items (\$000's)</b>	<b>The Fund <sup>(3)</sup></b>	<b>Sterling Shoes Inc.</b>
	<b>For the period</b>	<b>(Pre Fund <sup>(4)</sup>)</b>
	<b>July 12 to</b>	<b>For the three</b>
	<b>Sept 30, 2005</b>	<b>months ended</b>
	<b>Sept 30, 2005</b>	<b>Sept 30, 2004</b>
Sales	\$ 19,544	\$ 18,834
Cost of Sales	(9,014)	(8,813)
Gross Margin	10,530	10,021
<i>As a percentage of sales</i>	53.9%	53.2%
Store and selling expenses	(6,192)	(6,165)
General and administrative expenses	(768)	(619)
EBITDA <sup>(1)</sup>	3,570	3,237
Adjusted EBITDA <sup>(1)</sup>	3,514	3,191
<i>As a percentage of sales</i>	18.0%	16.9%
Interest expense	(81)	(142)
Amortization	(457)	(440)
Income before non-controlling interest <sup>(6)</sup>	3,032	2,655
Non-controlling interest <sup>(5)(6)</sup>	(606)	0
Net income to the Fund	\$ 2,426	\$ 2,655
Maintenance Capital Expenditures <sup>(2)</sup>	423	N/A

---

Notes:

- (1) "EBITDA" and "Adjusted EBITDA" are not recognized measures under GAAP and do not have a standardized meaning prescribed under GAAP. As a result, our EBITDA and Adjusted EBITDA may not be comparable to similar measures used by other issuers. See "Reconciliation of Net Income to EBITDA and Adjusted EBITDA" for reconciliation of EBITDA to the most directly comparable measure calculated in accordance with GAAP. See also "Non-GAAP Measures".
- (2) "Maintenance Capital Expenditures" is not a recognized measure under GAAP. Maintenance capital expenditures have not been calculated for the three-month period ended September 30, 2004.
- (3) The Fund was inactive until its indirect acquisition of an 80% interest in SSLP on July 12, 2005. Included in the Fund's results of operations are the results of SSLP's operations for the 81-day period from July 12, 2005 to September 30, 2005.
- (4) Results for the three-month period ended September 30, 2004 are not strictly comparable as Sterling Shoes Inc. was privately held, had a January 31st year end, and did not prepare quarterly reports for its shareholders.
- (5) The non-controlling interest will be distributed, on a subordinated basis until certain targets have been met, to Sterling Shoes Inc., which retained a 20% interest in the business of SSLP.
- (6) In any fiscal year SSLP and the Fund intend to make distributions of its available cash to the maximum extent possible to the Unitholders and the non-controlling interest. SSLP and the Fund may make additional distributions in excess of monthly distributions during the year, as the Boards determine. Distributions to the Fund's Unitholder's and the non-controlling interest will be determined by the Boards, to provide for the stability of distributions over a 12-month period. At the present time, the Board has not yet felt it prudent to make an extraordinary distribution; however the Board and management monitor SSLP's cash from operations on a monthly basis. Before the end of the year, the Board will be reviewing projected net income of SSLP for the fiscal year, evaluating any cash reserves against available tax shelter and likely slowdowns in cash generation that typically occur in Sterling Shoes' business in January and February, and determining whether a special year end distribution is appropriate. Consequently, distributions made may not equal distributable cash generated in any one period.

## **RECENT EVENTS**

The Fund became a publicly traded entity on July 12, 2005. At this point SSLP had 100 stores — 60 Shoe Warehouses, 35 Sterling/Joneves and five Freedman's; Since that time we have opened four stores: A Freedman's in Richmond Centre Mall in Richmond, British Columbia, a Shoe Warehouse in Red Deer Centre Mall in Red Deer, Alberta, a Sterling in Midtown Plaza in Saskatoon, Saskatchewan and a Sterling in Toronto's Eaton Centre Mall.

Management's plan for the 12 month period from February 1, 2005 to January 31, 2006 (the previous fiscal period of Sterling Shoes Inc.) was to open ten new stores, all of which were opened by November 14, 2005.

On October 24, 2005, the Fund announced that it reached agreement to open six Sterling stores in Southern Ontario in major malls owned and operated by Cadillac Fairview Corporation, on or before March 15, 2006.

These stores will be in the following locations:

- Masonville Place Shopping Centre in London,
- Fairview Park Mall in Kitchener,
- Lime Ridge Mall in Hamilton,
- Erin Mills Town Centre Mall in Mississauga,
- Markville Shopping Centre in Markham, and
- The Georgian Mall in Barrie.

In addition, two Shoe Warehouse stores are expected to open in Southern Ontario in December 2005, located in the Cambridge Centre Mall in Cambridge and in the Eastgate Mall in Stoney Creek (Hamilton).

As a result of these recent events, we anticipate having at least 11 stores operating in the Ontario market by the end of March 2006.

Consistent with the expansion plans outlined in our initial public offering prospectus, we continue to expand our market presence under the Sterling banner in some of Ontario's high profile malls, and to add Shoe Warehouse outlets in Ontario where suitable locations become available.

We believe that there is significant potential for growth in eastern Canada using the formats that have proven successful for us in the past and we continuously evaluate and identify opportunities to add new stores in regions already served by us.

### ***Sales***

For the 81-day period ended September 30, 2005, total sales were \$19.5 million versus \$18.8 million for the three-months ended September 30, 2004. The growth in sales was a result of same-store sales growth, incremental growth from new stores not opened for the full three-month period ended September 30, 2004, and sales from new stores opened since October 1, 2004.

Management believes same-store sales increased over the three-month period ended September 30, 2004 through a combination of merchandising, product selection, advertising, co-marketing, brand awareness, rapid trend response times, and appropriate renovations. Sterling Shoes has been successful in achieving positive same-store sales growth over the past five years. Based on historical performance, we believe that our existing stores will grow at least as fast as the industry in the future.

### ***Cost of sales and gross margin***

Cost of sales as a percentage of sales fell from 46.8% for the three-month period ended September 30, 2004 to 46.1% for the 81-day period ended September 30, 2005.

Decreases in cost of sales were achieved through a number of areas: Lower product costs resulting from better pricing on first-cost purchasing, purchasing economies of scale, better terms on branded merchandise and pricing stability in most markets. Also, the strength of the Canadian dollar contributed towards reducing our cost of sales, as some purchases are denominated in U.S. dollars.

These improvements were slightly offset by higher in-bound freight costs during the period, which resulted from the 6-week truckers' strike, which closed down the container operations at the Port of Vancouver, B.C during that period.

***Store and selling expenses***

Store and selling expenses fell as a percentage of sales from 32.7% for the three-month period ended September 30, 2004 to 31.7% for the 81-day period ended September 30, 2005. Increased warehousing costs (incurred to clear the backlog of shipments at the end of the truckers' strike mentioned above), were offset by efficiency gains on occupancy costs and advertising costs as a percentage of sales.

***General and administrative expenses***

General and administrative ("G&A") expenses rose as a percentage of sales from 3.3% for the three-month period ended September 30, 2004 to 3.9% for the 81-day period ended September 30, 2005. The increased costs relate to structural changes resulting from the change from a private to a public entity.

***Adjusted EBITDA***

Adjusted EBITDA as a percentage of sales grew from 16.9% for the three-month period ended September 30, 2004 to 18.0% for the 81-day period ended September 30, 2005. The increase in Adjusted EBITDA was largely attributable to the increase in gross margin and the reduction in store and selling expenses, offset by the increase in G&A, each of which are discussed above.

***Net income***

Net income before non-controlling interest increased from 14.8% of sales during the three-month period ended September 30, 2004 to 15.5% for the 81-day period ended September 30, 2005.

## SELECTED QUARTERLY FINANCIAL INFORMATION

The table below provides selected quarterly financial information for the 81-day period ended September 30, 2005 and the three-month period ended September 30, 2004. Additional quarterly financial information is not available. As a private company, Sterling Shoes Inc. did not prepare quarterly reports for its shareholders and had a January 31 year-end. As such, results for the three-month period ended September 30, 2004 are not strictly comparable.

Quarter-to-quarter comparisons of our financial results are not necessarily meaningful and should not be relied upon as indication of future performance.

in (\$000's) except per unit amounts	The Fund		(Pre Fund)	
	For the period July 12 to Sept 30, 2005		For the three months ended Sept 30, 2004	
Total sales	\$	19,544	\$	18,834
Income before non-controlling interest	\$	3,032	\$	2,655
Net income to the Fund	\$	2,426	\$	2,655
Basic and fully diluted earnings per Unit	\$	0.457		N/A
Distributable cash available per Unit	\$	0.453		N/A
Cash distributions per Unit	\$	0.237		N/A

## LIQUIDITY

### *Cash Flow*

On July 12, 2005, the Fund completed an initial public offering of 5,313,488 units of the Fund at the price of \$10 per unit (the "Offering") for net proceeds of \$47,846,787 after deducting expenses of the Offering of \$5,288,093. The Fund used the net proceeds of the Offering, together with funds from the new credit facilities, to acquire an 80% indirect interest of the partnership units of SSLP which, had acquired the retail footwear business of Inc. Inc was a Vancouver-based, leading independent footwear retailer offering a broad selection of private label and brand name shoes and accessories through four separate retail banners.

During the period July 12, 2005 to September 30, 2005, SSLP generated \$4.3 million in cash flow from operating activities. Consistent with management expectations, inventory increased during this period in order to ensure adequate supply for the growing number of stores and to provide inventory for the fourth quarter. Increases in inventory were offset by a build-up in accounts payable and a reduction in prepaid expenses and deposits. SSLP had capital expenditures (other than those

mentioned in relation to the acquisition of the Sterling Shoes business from Inc and the Offering) of \$0.7 million related to on-going maintenance capital expenditures and capital expenditures related to the build-out of new stores.

### ***Distributable Cash and Distributions***

In any fiscal year SSLP and the Fund intend to make distributions of its available cash to the maximum extent possible to the Unitholders and the non-controlling interest. SSLP and the Fund may make additional distributions in excess of monthly distributions during the year, as the Boards determine. Distributions to the Fund's Unitholder's and the non-controlling interest will be determined by the Boards, to provide for the stability of distributions over a 12-month period.

At the present time, the Board has not yet felt it prudent to make an extraordinary distribution; however the Board and management monitor SSLP's cash from operations on a monthly basis. Before the end of the year, the Board will be reviewing projected net income of SSLP for the fiscal year, evaluating any cash reserves against available tax shelter and likely slowdowns in cash generation that typically occur in Sterling Shoes' business in January and February, and determining whether a special year end distribution is appropriate. Consequently, distributions made may not equal distributable cash generated in any one period.

Distributions are paid on the 15th of the month that follows the month when the cash was earned. During the period, the Fund declared its first distribution of \$0.14737 per unit (for the 50 day period ended August 31, 2005), which was paid on September 15, 2005, consistent with the distribution amount anticipated in the Fund's initial prospectus. Furthermore, the Fund declared its second distribution of \$0.08958 per unit (for the month ended September 30, 2005), which was paid on October 15, 2005, consistent with the distribution amount anticipated in the Fund's initial prospectus.

In addition, a distribution in an amount equal to \$0.23695 per Subordinated Exchangeable LP Unit was made to Inc as the holder of a 20% retained interest in SSLP for the period from the closing of the Fund's initial public offering on July 12, 2005 to September 30, 2005. This distribution was also in an amount consistent with the Fund's initial prospectus and was paid on October 15, 2005. Distributable cash for the period is calculated in the section below.

### **RECONCILIATION OF NET INCOME TO EBITDA AND ADJUSTED EBITDA**

It is the policy of the Fund to distribute substantially all of its cash in any fiscal year and, accordingly, our management believes that EBITDA and Adjusted EBITDA are important supplemental measures in evaluating the performance of our business and in determining whether to invest in the Units. However, EBITDA and Adjusted EBITDA are not recognized earnings measures under GAAP and do not have a standardized meaning prescribed by GAAP. Therefore, EBITDA and Adjusted EBITDA may not be comparable to similar measures presented by other issuers. Investors are cautioned that EBITDA and Adjusted EBITDA should not be construed as alternatives to net income or loss determined in accordance with GAAP as an indicator of our performance to cash flows from operating, investing and financing activities or as a measure of our liquidity and cash flows. We define and have computed EBITDA and Adjusted EBITDA as described under "Non-GAAP Measures". The following table reconciles net income to EBITDA

and Adjusted EBITDA based on the financial statements of the Fund for the 81-day period ended September 30, 2005.

We have used net income as the starting point for our determination of distributable cash as opposed to cash flows from operating activities as it is the underlying performance of our business that must be maintained in order to continue to fund monthly distributions – as such, our management consider net income, a performance measure under GAAP, to be more relevant to a potential investor than cash flows from operations, which is a liquidity measure.

in \$000's except per unit amounts	<b>July 12 to Sept 30, 2005</b>
<b>Net income to the Fund</b>	\$ 2,425
Add: Non-controlling interest	606
Add: Depreciation and amortization on leaseholds and equipment	450
Add: Amortization on deferred financing costs	8
Add: Interest expense	81
<b>EBITDA</b> <sup>(1)</sup>	3,570
Less: Amortization of deferred lease inducements <sup>(2)</sup>	(56)
<b>Adjusted EBITDA</b> <sup>(1)</sup>	3,514
<i>As a percentage of sales</i>	18.0%
Less: Interest expense	(81)
Less: Net maintenance capital expenditures	(423)
Distributable cash generated <sup>(3) (4)</sup>	\$ 3,011
Distributable cash available for distribution to Fund Unitholders <sup>(3) (4)</sup>	\$ 2,408
Distributable cash available for distribution to non-controlling interest <sup>(3) (4)</sup>	\$ 602
Distributable cash generated per Fund unit <sup>(3) (4)</sup> - (5,313,488 units)	\$ 0.45326
Distributions declared per unit	\$ 0.23695
Payout ratio	52.28%

Notes:

- (1) "EBITDA" and "Adjusted EBITDA" are not recognized measures under GAAP and do not have a standardized meaning prescribed under GAAP. As a result, our EBITDA and Adjusted EBITDA may not be comparable to similar measures used by other issuers. See "Non-GAAP Measures".
- (2) Lease inducements are incentive funds received from landlords and rent-free periods. The non-cash amortization of these amounts is recognized over the life of the lease term as a reduction of rent expense.
- (3) The non-controlling interest will be distributed, on a subordinated basis until certain targets have been met, to Sterling Shoes Inc., which retained a 20% interest in the business of SSLP.
- (4) In any fiscal year SSLP and the Fund intend to make distributions of its available cash to the maximum extent possible to the Unitholders and the non-controlling interest. SSLP and the Fund may make additional

distributions in excess of monthly distributions during the year, as the Boards determine. Distributions to the Fund's Unitholder's and the non-controlling interest will be determined by the Boards, to provide for the stability of distributions over a 12-month period. At the present time, the Board has not yet felt it prudent to make an extraordinary distribution; however the Board and management monitor SSLP's cash from operations on a monthly basis. Before the end of the year, the Board will be reviewing projected net income of SSLP for the fiscal year, evaluating any cash reserves against available tax shelter and likely slowdowns in cash generation that typically occur in Sterling Shoes' business in January and February, and determining whether a special year end distribution is appropriate. Consequently, distributions made may not equal distributable cash generated in any one period.

## SEASONALITY

The Sterling Shoes business has historically followed a seasonal pattern, with first quarter sales being lower, due to post December spending habits affecting retail sales through January and February. Sales have historically been relatively consistent for the remaining quarters of the year.

## CAPITAL RESOURCES

We have utilized a \$5,000,000, three-year committed non-revolving loan with a single lender. We have a \$10,000,000 operating facility, which is available for working capital requirements, capital expenditures and for general corporate purposes. We have an additional \$7,500,000 term facility, which is available for general future funding of new store facilities. Only the \$5,000,000 non-revolving loan has been drawn upon as at September 30, 2005.

## OFF-BALANCE SHEET FINANCING

We have no off balance sheet arrangements.

## CONTRACTUAL OBLIGATIONS

The following table outlines our minimum rental commitments for premises and debt obligations as at September 30, 2005 over the periods noted, in thousands of dollars:

	<u>&lt; 1 year</u>	<u>1-3 years</u>	<u>4-5 years</u>	<u>5+ years</u>
Minimum rental commitments <sup>(1)</sup>	7,717	12,768	7,135	4,682
Long-term debt		5,000		
	<u>7,717</u>	<u>17,768</u>	<u>7,135</u>	<u>4,682</u>

Note:

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

## LONG-TERM INCENTIVE PLAN

Officers and key employees of Sterling Shoes LP are eligible to participate in Sterling Shoes LP's Long-term Incentive Plan (the "LTIP"). The purpose of the LTIP is to provide eligible participants

with compensation opportunities that will enhance our ability to attract, retain and motivate key personnel and reward officers and key employees for significant performance and associated growth in distributions. Pursuant to the LTIP, Sterling Shoes LP sets aside a pool of funds based upon the amount, if any, by which Sterling Shoes LP's distributable cash exceeds cash distribution thresholds (as defined in the LTIP plan documents). A trustee then purchases units of the Fund in the market with this pool of funds and holds these units until such time as ownership vests to each participant. The LTIP is administered by the Compensation Committee of the Board. .

The Board, or the Compensation Committee has the power to, among other things, determine those individuals who participate in the LTIP, determine the level of participation of each participant, and determine the time or times when LTIP awards will vest or be paid to each participant.

As at the balance sheet date, there is no amount to be accrued.

### **TRANSACTIONS WITH RELATED PARTIES**

- (a) SSLP paid rent to a company in which certain Board members have an interest amounting to \$43,053 for the 81-day period ended September 30, 2005 (three-month period ended September 30, 2004 — \$48,500).
- (b) SSLP purchased equipment from a company in which a Board member has an interest, for \$11,288 during the 81-day period ended September 30, 2005 (three-month period ended September 30, 2004 — \$57,753).
- (c) As outlined in the Prospectus, the Acquisition and Investment Agreement between the Fund, SSLP and Inc provided for a working capital adjustment and the reimbursement of Offering costs and operational items paid on behalf of SSLP by Inc. This entity is related to the Fund as it has a significant common investment, being SSLP. The balance is due on demand, is unsecured and does not bear interest.

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

### **CRITICAL ACCOUNTING ESTIMATES**

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

### ***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 over the past two 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 increase or decrease in gross margins.

### ***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.

Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. 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.

## **RISKS AND UNCERTAINTIES**

### ***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 an 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.

### ***Department of Finance (Canada) Consultation Paper***

On September 8, 2005, the Department of Finance (Canada) released a consultation paper on tax and other issues related to publicly listed flow-through entities such as income trusts and limited partnerships (“FTEs”) and invited interested parties to make submissions prior to December 31, 2005.

The stated focus of the consultation paper is to assess the tax and economic efficiency implications of FTEs to determine if the current tax system is appropriate or should be modified. Although the consultation paper does not propose any particular legislative or administrative changes, it identifies possible policy approaches, including limiting the deduction of interest expenses by operating entities, taxing FTEs in a manner similar to corporations or better integrating the personal and corporate income tax systems to make the tax system more neutral between forms of business organizations.

On September 19, 2005, the Minister of Finance (Canada) announced that he had requested that CRA postpone providing advance income tax rulings respecting FTE structures pending these consultations, that the Department of Finance (Canada) is closely monitoring developments in the FTE market with a view to proposing measures in response to the consultations and that consideration would be given to what, if any, transitional measures were appropriate. Further initiatives in this area, if any, including the possible initiatives referred to in the consultation paper, may be taken following the completion of such consultations.

It is not possible at this time for the Fund to determine what impact, if any, this process will have on the Fund or its Unitholders.

### ***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. We do not have any foreign exchange forward contracts outstanding at September 30, 2005.

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

Our business is seasonal and generally we experience a decline in sales and operating income generated in the months of January and February. As the Fund's fiscal year is the calendar year, this

seasonal decline in sales and operating income will all occur in one quarter, namely the first quarter of each fiscal year.

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 net 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.

## **FINANCIAL INSTRUMENTS AND OTHER 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.

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.

## **OUTLOOK**

Management believes that operations will continue to improve in the coming year through:

- Same-store sales growth,
- Increased contribution from new stores opened in the past 12 months, which will generate store income for a full-year period, and
- Contributions from new stores to be opened over the next 12 months.

## **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 various other items which are detailed under "Reconciliation of Net Income to EBITDA and Adjusted EBITDA". EBITDA is a measure used by many investors to compare issues on the basis of ability to generate cash flows from operations. Adjusted EBITDA is a measure our management believes facilitates the comparability the analysis of our financial performance. EBITDA and Adjusted EBITDA are not earnings measures recognized by generally accepted accounting principles in Canada ("GAAP") and do not have standardized meanings prescribed by GAAP. Our management believes that EBITDA and Adjusted EBITDA are the appropriate measures from which to make adjustments to determine our Distributable Cash. We intend to distribute substantially all of our cash on an ongoing 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. Our methods of calculating EBITDA and Adjusted EBITDA may differ from methods used by other issuers and, accordingly, our EBITDA and Adjusted EBITDA may not be comparable to similar measures presented by other issuers. For a reconciliation of EBITDA and Adjusted EBITDA to net income, based on the historical financial statements contained elsewhere in this MD&A presented in accordance with GAAP, see "Reconciliation of Net Income to EBITDA and Adjusted EBITDA".

References in this MD&A to "Distributable Cash" are to cash available for distribution to the Unitholders by the Fund. Distributable Cash is not a recognized measure under GAAP. Canadian open-ended income trusts, such as the Fund, use distributable cash as an indicator of financial performance. Our Distributable Cash may differ from similar computations as reported by other entities and, accordingly, may not be comparable to distributable cash as reported by such entities. Our management believes that in addition to net income, Distributable Cash is a useful supplemental measure that may assist investors in assessing the return on their investment in Units. See "Reconciliation of Net Income to EBITDA and Adjusted EBITDA".

## **FORWARD-LOOKING STATEMENTS**

Certain statements in this Management's Discussion and Analysis may constitute "forward-looking" statements that involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. When used in this MD&A, such statements often use such words as "may", "will", "expect", "should", "believe", "intend", "plan", "anticipate", "potential", and other similar terminology. These statements reflect current expectations of management regarding future events and operating performance and speak only as of the date of this MD&A. Forward-looking statements involve significant risks and uncertainties, should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not such results will be achieved. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements, including, but not limited to, the factors discussed under "Risks and Uncertainties ". Although the forward-looking statements contained in this MD&A are based upon what our management believes to be reasonable assumptions, we cannot assure investors that actual results will be consistent with these forward-looking statements. These forward-looking statements are made as of the date of this MD&A and we assume no obligation to update or revise them to reflect new events or circumstances.

## **ADDITIONAL INFORMATION**

Additional information relating to the Fund, including all public filings, is available on SEDAR ([www.sedar.com](http://www.sedar.com)).

## **INVESTOR RELATIONS**

Daniel S. Gumprich  
Chief Financial Officer  
2580 Viscount Way  
Richmond, BC V6V 1N1  
Phone: (640) 270-6114  
E-mail: [dgumprich@sterlingshoes.com](mailto:dgumprich@sterlingshoes.com)

# Sterling

STERLING SHOES LIMITED PARTNERSHIP

For further information, please contact:

Jeremy Horwitz  
President and Chief Executive Officer  
(604) 270-6114

Daniel S. Gumprich  
Chief Financial Officer  
(604) 270-6114

*Additional information about Sterling Shoes Income Fund can be found in the disclosure documents filed by Sterling Shoes Income Fund with the securities regulatory authorities, available at [www.sedar.com](http://www.sedar.com).*

**freedman**  
shoes

**Sterling**

*Joneve*

**SHOE**  
**WAREHOUSE**