

STERLING SHOES INCOME FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS
August 7, 2008

The following management's discussion and analysis ("MD&A") should be read in conjunction with the unaudited interim consolidated financial statements and accompanying notes ("Interim Financial Statements") of Sterling Shoes Income Fund (the "Fund") for the three and six-month periods ended June 30, 2008. Results have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP" and reported in Canadian dollars unless otherwise indicated). The fiscal year-end of the Fund is December 31.

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

OVERVIEW OF THE FUND

The Fund is a Vancouver-based, leading footwear retailer offering a broad selection of private label and brand name shoes and accessories through six separate retail banners: Sterling, Joneve, Shoe Warehouse, Freedman Shoes, Gia and Sterling Outlet. These retail concepts were designed to serve identified market segments which we can effectively and profitably serve. Since 1987 the Sterling Shoes business (formerly carried on by Sterling Shoes Inc.) has grown from five locations to 149 stores as at August 7, 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 August 7, 2008, there were 5,313,488 units ("Units") of the Fund issued and outstanding. In addition, to provide Inc with voting rights commensurate with Inc's retained interest in Sterling Shoes LP, Inc holds 1,328,372 special voting units of the Fund (equal to the number of Class D LP Units Inc holds in Sterling Shoes LP (the "Class D LP Units")), which entitle the holder to one vote per special voting unit at meetings of unitholders of the Fund ("Unitholders").

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

Consequently, the Class D LP Units became freely exchangeable for Units on a one-for-one basis and were reclassified from non-controlling interest to unitholders' equity in 2008. Also, the distributions on the Class D LP Units are no longer subordinated and are made monthly, instead of quarterly.

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

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

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

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

RECENT EVENTS AND OUTLOOK

We believe that unfavourable weather conditions and declining consumer confidence led to slower sales growth in the second quarter of 2008. British Columbia experienced the coldest April on record, while Ontario is experiencing the wettest summer since records have been kept. In addition, while the retail environment across Canada has been very robust over the past several years, certain regions, particularly in Ontario, are experiencing a period of economic weakness. Margins have been affected by a change in accounting for inventory valuation, as discussed later in this document.

During the second quarter of 2008, we continued to expand with a focus on balancing store openings between eastern and western Canada as well as opening more stores under the Shoe Warehouse banner than in the past few years. Since January 1, 2008, the Fund has opened 8 stores, renovated 5 stores and relocated 2 stores. We are in the process of completing construction on 11 additional stores for 2008. Most of these stores will be open for the busy back-to-school season. 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.

Our 149 stores operate under six retail banners in British Columbia, Alberta, Saskatchewan, Manitoba and Ontario as follows:

Number of Stores Operating											
August 7 th , 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	35	18	5	6	2	-	66	65	63	60	59
Alberta	14	8	2	-	-	1	25	25	25	24	24
Saskatchewan	2	1	-	-	-	-	3	3	3	4	4
Manitoba	9	3	-	-	-	-	12	12	11	11	11
Ontario	12	27	3	1	-	-	43	36	25	5	2
Total	72	57	10	7	2	1	149	141	127	104	100

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 to hire, train and integrate employees.

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 was a future income tax liability of \$7.7 million created during the second quarter of 2007. This future income tax liability was based on the expected tax rate of 31.5% and the assumption that the Fund will be a taxable entity in 2011. Based on the currently enacted tax rate of 27.5%, and the same assumptions, the Fund revised this future income tax liability during the first quarter of 2008 to \$7.0 million. For the three and six-month periods ended June 30, 2008, the estimated future income tax liability was reduced by \$nil and \$0.7 million, respectively, based on the temporary differences between the accounting and tax basis of the Fund’s assets and liabilities as at June 30, 2008 expected to reverse after January 1, 2011.

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

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

INTERNATIONAL FINANCIAL REPORTING STANDARDS (“IFRS”)

The Canadian Accounting Standards Board (AcSB) will require all public companies to adopt IFRS, replacing Canadian GAAP, for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Fund will be required to prepare comparative financial information using IFRS for the year ended December 31, 2010. The Fund expects the transition to IFRS to impact financial reporting, business processes, and information systems. The Fund is beginning to assess the impact of adoption of IFRS and develop a plan for convergence. Training and additional resources will be utilized to ensure timely conversion to IFRS. The financial impact of the transition to IFRS cannot be reasonably estimated at this time.

SUMMARY FINANCIAL INFORMATION

Statement of Income Items (\$000's)	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Sales	\$ 29,405	28,242	54,353	52,193
Cost of Sales	(14,395)	(12,706)	(28,270)	(22,557)
Gross Margin	15,010	15,536	26,083	29,636
<i>As a percentage of sales</i>	51.0%	55.0%	48.0%	56.8%
Store and selling expenses	(10,768)	(9,933)	(21,289)	(19,208)
General and administrative expenses	(1,574)	(1,887)	(3,634)	(3,551)
EBITDA ⁽¹⁾	2,668	3,716	1,160	6,877
Adjusted EBITDA ⁽¹⁾	2,573	3,638	1,071	6,724
<i>As a percentage of sales</i>	8.8%	12.9%	2.0%	12.9%
Interest expense	(690)	(185)	(1,152)	(294)
(Loss) / Gain on disposal	(333)	0	(333)	5
Amortization	(779)	(616)	(1,530)	(1,404)
Income / (Loss) before non-controlling interest and taxes ⁽²⁾⁽³⁾	866	2,915	(1,855)	5,184
Future income taxes	0	(7,724)	724	(7,724)
Income / (Loss) before non-controlling interest ⁽²⁾⁽³⁾	866	(4,809)	(1,131)	(2,540)
Non-controlling interest ⁽²⁾⁽³⁾	-	(960)	-	(498)
Net income / (loss)	\$ 866	(3,849)	(1,131)	(2,042)
Maintenance capital expenditures ⁽⁴⁾	942	830	2,009	1,938
	June 30,	December 31,		
Balance Sheet Items (\$000's)	2008	2007		
Total assets	106,355	111,192		
Long-term financial liabilities	21,672	21,243		

Notes:

- (1) See definition of EBITDA and Adjusted EBITDA under "Non-GAAP Measures".
- (2) In any fiscal year Sterling Shoes LP and the Fund intend to make distributions of available cash to the maximum extent possible to the Unitholders and the non-controlling interest. Sterling Shoes LP and the Fund may make additional distributions in excess of monthly distributions during the year, as the Boards determine. Distributions to Unitholders and the non-controlling interest will be determined by the Boards, to provide for the stability of distributions over a 12-month period.
- (3) Effective April 1, 2008, distributions to the non-controlling interest are made monthly and are no longer subordinated. These distributions were subject to subordination pending the Fund achieving explicit EBITDA targets, based on audited consolidated financial statements, and distribution targets. For further information see "End of Subordination". On the Subordination End Date, the non-controlling interest held by Inc, which retained a 20% in the business of Sterling Shoes LP, has been reclassified to unitholders' equity. As a result,

(loss) / income before non-controlling interest and taxes is applicable to the quarters up to December 31, 2007 only.

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

The table below summarizes the distributions declared during the three and six-month periods ended June 30, 2008 and 2007 for Units of the Fund and to Inc on its units of Sterling Shoes LP:

	<u>Three-months ended June 30</u>		<u>Six-months ended June 30</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Trust Units	\$ 1,993	\$ 1,913	3,985	3,826
Inc's ownership in Sterling Shoes LP	498	478	996	956
Total	\$ 2,491	\$ 2,391	4,981	\$ 4,782

OPERATING RESULTS

Sales

Sales were \$29.4 million during the three-month period ended June 30, 2008, representing an increase of 4.1% over the \$28.2 million in 2007. The growth in sales was a result of incremental growth from new stores not opened for the full quarter ended June 30, 2007 and sales from new stores opened since July 1, 2007. On April 1, 2008 we had 143 stores operating, representing an 8% increase as compared to the number of stores operating as April 1, 2007.

The Fund experienced a decline in same-store sales growth of 2.0% in those stores that were open for the at least three months leading up to July 1, 2007. Management believes that the decline in same store growth reflected slower general economic conditions and unusual weather patterns experienced in the quarter.

For the six-month period ended June 30, 2008, sales increased to \$54.4 million or 4.1% over the same period in 2007. During the six-month period ended June 30, 2008 same store sales declined by 0.9% in those stores that were open at least six-months leading up to July 1, 2007 for the reasons discussed above.

Our ability to grow sales will depend on a number of factors including our ability to successfully identify and respond to changes in trends and customer tastes, our ability to hire, train, motivate, manage and retain qualified buyers, retail store management and personnel, as well as other factors further outlined in Risks and Uncertainties.

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

Cost of sales as a percentage of sales, for the three and six-month periods ended June 30, 2008 was 49.0% and 52.0%, compared to 45.0% and 43.2% respectively for the same periods during 2007.

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

This Section applies to interim and annual financial statements for fiscal years beginning on or after January 1, 2008. The Fund has applied this section to the opening inventory for fiscal 2008 resulting in a one-time, \$3.3 million increase. Opening retained earnings as at January 1, 2008 was also adjusted for the difference on adoption of the new standard (prior periods will not be restated).

Tax treatment usually follows accounting principles; however, the income tax act requires this write-up to be included into income for income tax purposes. Therefore, during 2008 taxable income will be \$3.3 million greater than accounting income.

Margins from season to season under the Cost Method will vary greatly, and will be impacted by the above noted \$3.3 million write-up in inventory values until the January 1, 2008 opening inventory is completely sold. Apart from the one-time effect of this change, management believes that over the course of a calendar year, if all else remains the same, margins under the Retail method and the Cost Method are expected to be largely the same. The difference from season to season is expected to be related to timing. Margins calculated under the Retail Method and the Cost Method are not comparable in finite periods.

Store and selling expenses

Store and selling expenses for the three and six-months ended June 30, 2008 were 36.6% and 39.2% of sales, compared to 35.1% and 36.8% for the same periods during 2007, respectively. Store and selling expenses have a fixed underlying core with a large variable component, primarily consisting of expenses relating to occupancy and employee costs.

The Fund opened 5 new stores during the second quarter of 2008, and an additional 1 up to August 7, 2008, for a total of 87 new leases since its IPO (54 new stores and 33 renewals). New stores have a higher rent profile than the average store base, which has resulted in higher occupancy charges compared to the second quarter of 2007. Higher lease rates on renewals further reflect the increasingly expensive real estate environment, especially in Western Canada.

The Fund also employed additional resources in those stores to ensure that new staff were properly trained and that new stores opened smoothly. These start up costs coupled with pressure on labour costs, especially in Western Canada, contributed to higher store and selling expenses in the first and second quarters of 2008.

General and administrative expenses

General and administrative (“G&A”) expenses for the three and six-months ended June 30, 2008 were 5.4% and 6.7% of sales, compared to 6.7% and 6.8% during the same periods in 2007, respectively.

Lower G&A expenses in the second quarter of 2008 as compared to 2007 were the result of lower professional fees, travel expenses, LTIP and management bonuses accrued.

On-going investments in the Fund’s growth initiatives and higher salary costs, offset in part by the reductions discussed above resulted in similar general and administration expenses as a percentage of sales during the six-month period of 2008. We have been taking steps to build our infrastructure and position the business for sustainable long-term earnings growth by hiring key people into areas of need and investing in process and systems improvement initiatives.

Adjusted EBITDA (see “Non-GAAP Measures”)

Adjusted EBITDA for the three and six-months ended June 30, 2008 was 8.8% and 2.0% of sales, respectively, compared to 12.9% and 12.9% for the same periods during 2007.

The decrease in Adjusted EBITDA is largely attributable to the increase in cost of sales and expenses discussed above. Furthermore, there was a loss of \$333 thousand for the three and six-months ended June 30, 2008 resulting from the write off of computer software assets.

For the trailing twelve-month period ended June 30, 2008, the Return on Capital Invested (“ROIC”) was 32.8% (June 30, 2007 – 69.0%). The change from the same period in the previous year is due to the decline in profitability discussed above and greater investment in working capital and leaseholds and equipment.

Income before non-controlling interest and taxes

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

SELECTED QUARTERLY FINANCIAL INFORMATION

<u>in (\$000's) except per Unit amounts</u>	<u>Q2-2008</u>	<u>Q1-2008</u>	<u>Q4-2007</u>	<u>Q3-2007</u>	<u>Q2-2007</u>	<u>Q1-2007</u>	<u>Q4-2006</u>	<u>Q3-2006</u>
Sales	\$ 29,405	\$ 24,948	\$ 36,083	\$ 30,483	\$ 28,242	\$ 23,950	\$ 31,415	\$ 26,968
Income / (Loss) before non-controlling interest and taxes ⁽¹⁾	\$ 866	\$ (2,723)	\$ 5,228	\$ 4,049	\$ 2,915	\$ 2,268	\$ 3,529	\$ 4,497
Future income taxes	-	724	-	-	(7,724)	-	-	-
Income / (Loss) before non-controlling interest ⁽¹⁾	\$ 866	\$ (1,999)	\$ 5,228	\$ 4,049	\$ (4,809)	\$ 2,268	\$ 3,529	\$ 4,497
Net income / (loss)	\$ 866	\$ (1,999)	\$ 4,153	\$ 3,329	\$ (3,849)	\$ 1,807	\$ 2,822	\$ 3,594
Basic and fully diluted income / (loss) per Unit	\$ 0.130	\$ (0.371)	\$ 0.787	\$ 0.610	\$ (0.724)	\$ 0.340	\$ 0.531	\$ 0.676
Cash distributions per Unit	\$ 0.375	\$ 0.375	\$ 0.780	\$ 0.360	\$ 0.360	\$ 0.360	\$ 0.815	\$ 0.315
Number of stores open at end of period	148	143	141	138	135	127	127	124

Notes:

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

Refer to the discussion on the change in inventory valuation under “Operating Results” above for a description of its impact on the loss for the period. Our sales are seasonal, primarily related to consumer spending patterns. The footwear and accessories sector of the Canadian retail market has two primary selling seasons during which new merchandise is introduced – Spring and Fall. Management believes that due to unseasonably poor weather during the second quarter of 2008, coupled with economic uncertainty in our key regions, sales were negatively affected. Gross margins fluctuate over the course of these two primary selling seasons. Other factors include, and are not limited to, the timing of new store openings, merchandise mix and weather.

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

CASH FLOW AND LIQUIDITY

The table below reconciles net income to cash flow from operations for the three and six-months ended June 30, 2008 and 2007.

in (\$000's)	Three-months ended Jun 30		Six-months ended Jun 30	
	2008	2007	2008	2007
Income / (loss) before non-controlling interest⁽¹⁾	\$ 866	(4,809)	(1,131)	(2,542)
Add charges (deduct credits) to operations not requiring a cash payment:				
Revaluation of inventory per CICA Handbook Section 3031	-	-	3,306	-
Future income taxes	-	7,724	(724)	7,724
Amortization of leaseholds and equipment	779	616	1,530	1,404
Accreted interest expense	295	-	429	-
Amortization of deferred leasehold inducements	(95)	(78)	(184)	(153)
Loss on disposal of leaseholds and equipment	333	-	333	-
	2,178	3,453	3,559	6,433
Net change in non-cash working capital balances related to operations:				
Accounts receivable	75	304	556	(422)
Inventory	(14)	1,131	(7,730)	(7,663)
Prepaid expenses and deposits	(76)	(146)	(23)	(252)
Accounts payable and accrued liabilities	(4,763)	(3,867)	(594)	1,965
Cash (used in) / provided by operating activities	\$ (2,600)	875	(4,232)	61

Notes:

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

The Fund invested in capital expenditures of \$2.1 million and \$3.7 million during the three and six-months ended June 30, 2008 (2007 - \$2.0 million and \$3.6 million), respectively. Of this amount \$0.6 million and \$1.1 million were invested in leaseholds and equipment to furnish new stores during the three and six-months ended June 30, 2008 (2007 - \$1.2 million and \$1.7 million), respectively. The Fund incurred maintenance capital expenditures of \$0.9 million and \$2.0 million during the three and six-months ended June 30, 2008 (2007 - \$0.8 million and \$1.9 million), which were related to upgrades to information technology ("IT") infrastructure, store renovations and store relocations. New store capital expenditures and maintenance capital expenditures were funded by cash from operations and the Fund's available credit facilities.

DISTRIBUTABLE CASH AND DISTRIBUTIONS

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

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

The Fund reviews its historic and expected results on a regular basis. This review includes consideration of economic conditions, including seasonality, and the competitive environment. Distributions made may not equal Adjusted Distributable Cash generated in any one period. The

Fund's policy is to make stable monthly distributions to Unitholders based on estimated Adjusted Distributable Cash for the year.

ADJUSTED DISTRIBUTABLE CASH

On July 6, 2007 the Canadian Securities Administrators ("CSA") amended National Policy 41-201 "Income Trusts and Other Indirect Offerings" (the "CSA Guidance"). The Fund has calculated Standardized Distributable Cash based on the CSA Guidance as cash flows from operating activities, including the effects of changes in non-cash working capital, less sustaining (maintenance) capital expenditures. The Fund has also retained the Fund's historical Non-GAAP measure of Adjusted Distributable Cash (formerly Distributable Cash) by further adjusting Standardized Distributable Cash to exclude the effect of changes in non-cash working capital. The table below is a summary of Standardized Distributable Cash and Adjusted Distributable Cash and per Unit and Ratio disclosures for the three and six-month periods ended June 30, 2008 and 2007.

in \$000's except per unit amounts and payout ratios	Three-months ended Jun 30		Six-months ended Jun 30	
	2008	2007	2008	2007
Standardized Distributable Cash				
Cash (used in) / provided by operating activities	\$ (2,600)	875	(4,232)	61
Less: Maintenance Capital Expenditures	(942)	(830)	(2,009)	(1,938)
Standardized distributable cash generated	\$ (3,542)	45	(6,241)	(1,877)
Less: Changes in non-cash working capital balances related to operation	(4,778)	2,578	(7,791)	6,372
Adjusted distributable cash generated	\$ 1,236	2,623	1,550	4,495
Adjusted Distributable Cash available for distribution to Unitholders	\$ 1,236	2,098	1,550	3,596
Adjusted Distributable Cash generated per Unit	\$ 0.186	0.395	0.233	0.677
Distributions declared per Unit	\$ 0.375	0.360	0.750	0.720
Adjusted Payout Ratio	201.5%	91.2%	321.4%	106.4%
Number of units outstanding:	6,641,860	5,313,488	6,641,860	5,313,488

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

For the three and six-months ended June 30, 2008, using the Adjusted Distributable Cash calculation, the adjusted payout ratio indicates that we have generated significantly less cash from on-going operations than we have paid out to Unitholders. The Fund's Board looks beyond quarter-to-quarter fluctuations in working capital when making decisions regarding monthly distributions. As mentioned earlier, the Fund's policy has been to make distributions to its Unitholders necessary to pay out its taxable income. We believe that the low Adjusted Distributable Cash generated per unit in the period is not indicative of the adjusted distributed cash generated per unit for the remainder of 2008 due to the reasons cited above under "Operating Results". The adjusted payout ratio for the trailing twelve months ended June 30, 2008 was 127.0%, as compared to 86.7% for the twelve months ended December 31, 2007.

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	Distribution History Year / Month	Distributions per Unit
2005		2006		2007		2008	
		January	\$ 0.08958	January	\$ 0.12000	January	\$ 0.12500
		February	0.08958	February	0.12000	February	0.12500
		March	0.08958	March	0.12000	March	0.12500
		April	0.08958	April	0.12000	Q1-2008	\$ 0.37500
		May ⁽³⁾	0.10500	May	0.12000		
		June	0.10500	June	0.12000	April	\$ 0.12500
		July	0.10500	July	0.12000	May	0.12500
		August	0.10500	August	0.12000	June	0.12500
July / August ⁽¹⁾	\$ 0.14737	September	0.10500	September	0.12000	Q2-2008	\$ 0.37500
September	0.08958	October	0.10500	October	0.12000		
October	0.08958	November ⁽⁴⁾	0.12000	November	0.12000	July	\$ 0.12500
November	0.08958	December	0.12000	December	0.12000	Total year-to-date 2008	\$ 0.8750
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	\$ 1.8600		

Notes:

- (1) The Fund made its initial distribution of \$0.14737 per Unit for the 51-day period from July 12, 2005 to August 31, 2005.
- (2) On December 13, 2005 the Fund announced a special distribution of \$0.16 per Unit to Unitholders of record on December 30, 2005, representing the Fund's estimate of the distribution required to ensure the Fund was not liable for income taxes under Part I of the Tax Act for fiscal 2005. \$0.16 per Unit, the Fund's estimate of this amount, was paid on January 16, 2006 to Unitholders of record on December 30, 2005.
- (3) Effective May 1, 2006 the Fund raised its monthly distribution by 17.2% from \$0.08958 per Unit to \$0.105 per Unit.
- (4) Effective November 1, 2006 the Fund raised its monthly distribution by 14.3% from \$0.105 per Unit to \$0.12 per Unit.
- (5) On December 18, 2006 the Fund announced a special distribution of \$0.32 per Unit to Unitholders of record on December 29, 2006, representing the Fund's estimate of the distribution required to ensure the Fund was not liable for income taxes under Part I of the Tax Act for fiscal 2006. This amount was paid on January 15, 2007 to Unitholders of record on December 29, 2006.
- (6) On March 22, 2007 the Fund announced a supplementary special distribution of \$0.15 per Unit to Unitholders of record on December 29, 2006, representing the Fund's remaining distribution required to ensure the Fund was not liable for income taxes under Part I of the Tax Act for fiscal 2006. The \$0.15 per Unit supplementary special is in addition to the \$0.32 per Unit that was estimated at December 18, 2006 and paid on January 15, 2007. The \$0.15 per Unit was paid on March 30, 2007 to Unitholders of record on December 29, 2006.
- (7) On December 17, 2007 the Fund announced a special distribution of \$0.36 per Unit to Unitholders of record on December 31, 2007, representing the Fund's estimate of the distribution required to ensure the Fund was not liable for income taxes under Part I of the Tax Act for fiscal 2007. This amount was paid on January 15, 2008 to Unitholders of record on December 31, 2007.
- (8) On March 26, 2008 the Fund announced a supplementary special distribution of \$0.06 per Unit to Unitholders of record on December 31, 2007, representing the Fund's remaining distribution required to ensure the Fund was not liable for income taxes under Part I of the Tax Act for fiscal 2007. The \$0.06 per Unit supplementary special is in addition to the \$0.36 per Unit that was estimated at December 17, 2007 and paid on January 15, 2008. The \$0.06 Unit was paid on March 31, 2008 to Unitholders of record on December 31, 2007.

Distributions are paid on the 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 are made monthly and are no longer subordinated. These distributions were subject to subordination until December 31, 2007 pending the Fund achieving specific EBITDA and distribution targets. For further information see "End of Subordination".

Effective January 1, 2008, the Fund raised its monthly distributions from \$0.12 per Unit to \$0.125 per Unit. The Fund declared distributions (excluding special distributions) to public Unitholders of \$2.0 million and \$4.0 million for the three and six-months ended June 30, 2008 (2007 - \$1.9 million and \$3.8 million). Furthermore, Sterling Shoes LP declared distributions (excluding special distributions) to Inc, the holder of the Class D LP Units, of \$0.5 million and \$1.0 million for the three and six-months ended June 30, 2008 (2007 - \$0.5 million and \$1.0 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:

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

And where "Average Invested Capital" is calculated as:

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

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

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

CAPITAL RESOURCES

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

A portion of the net proceeds from the offering was used to repay existing bank indebtedness of approximately \$13 million. The balance of the net proceeds was used for existing expansion and corporate commitments during 2008. Since our IPO, the Fund has opened 54 stores (49 net openings), renovated 21 stores and relocated 11 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 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. As at June 30, 2008, we have utilized \$2.0 million of the operating facility. Subsequent to June 30, 2008, the Fund, with approval from its Board of Trustees, increased the amount available from its operating facility to \$15.0 million.

We have an additional \$10 million term facility, which is available for general funding of new store facilities. As at June 30, 2008 we have not utilized any of the new store capital expenditure facility.

At June 30, 2008, the Fund was in compliance with all covenants of its credit facilities.

OFF-BALANCE SHEET FINANCING

The Fund enters into standby letters of credit to facilitate the international purchase of merchandise and to secure certain of our obligations, including insurance programs and duties related to import purchases. As of June 30, 2008 letters of credit totaling \$2,702 thousand have been issued. The Fund has no other off balance sheet arrangements.

CONTRACTUAL OBLIGATIONS

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

in \$000's	2008	2009	2010	2011	2012
Inventory purchase commitments	2,702				
Long-term debt					25,000
Minimum rental commitments ⁽¹⁾	7,570	14,804	13,715	12,459	11,848
	<u>10,272</u>	<u>14,804</u>	<u>13,715</u>	<u>12,459</u>	<u>36,848</u>

Note:

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

TRANSACTIONS WITH RELATED PARTIES

- (a) The Fund paid rent to a company in which Jeremy Horwitz and Mannie Druker, trustees and officers of the Fund have an interest, amounting to \$71 thousand and \$142 thousand for the three and six-month periods ended June 30, 2008 (2007 – \$50 thousand and \$100 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 \$131 thousand and \$223 thousand during the three and six-month periods ended June 30, 2008 (2007 – \$187 thousand and \$327 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 unaudited interim consolidated financial statements for the three and six-month periods ended June 30, 2008. Management believes that the following items represent the Fund's critical accounting estimates.

Inventory Valuation

Effective January 1, 2008, the Fund adopted CICA Handbook Section 3031, Inventories ("Section 3031"). Section 3031 requires inventories to be measured at the lower of cost and net realizable value. The Fund determines inventory cost based on a weighted average cost formula and values inventory at the lower of cost and net realizable value. The Fund previously valued its inventory at the lower of average cost and net realizable value less a normal profit margin, using the retail method. Under the previous method, the net realizable value included a reduction for a normal profit margin taking into consideration current and expected selling prices, historic sales patterns for the inventory, recent product introductions and the level of inventory on hand. Section 3031 excludes from the definition of net realizable value the ability to maintain a normal profit margin and notes that the retail method is only acceptable technique for measuring inventories, if the results approximate cost. Upon adoption of the new standard, inventory was increased by a one-time adjustment of \$3.3 million on January 1, 2008, which was credited to opening retained earnings.

Intangible assets

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

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

Goodwill

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

Future income taxes

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

Convertible Debentures

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

NEW ACCOUNTING STANDARDS ADOPTED

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

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

Section 3862 and Section 3863 applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. These sections replace Handbook Section 3861, Financial Instruments – Disclosure and Presentation to revise and enhance the disclosure requirements and to carry forward its presentation requirements. These sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. The note disclosure on financial instruments in the unaudited

interim financial statements has been expanded as a result of Section 3862 and 3863 for the three and six-month periods ended June 30, 2008.

Section 1535, Capital Disclosures

Section 1535 applies to interim and annual financial statement relating to fiscal years beginning on or after October 1, 2007. Section 1535 specifies the disclosure of: (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and, (iv) if it has not complied, the consequences of such non-compliance. There is a note disclosure on capital disclosures in the unaudited interim financial statements as a result of Section 1535 for three and six-month periods ended June 30, 2008.

RISKS AND UNCERTAINTIES

Maintaining Profitability and Managing Growth

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

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

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

Competitive and Economic Environment

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

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

We believe that our strong financial position, targeted marketing, purchasing expertise, strong sourcing capabilities, cost-effective delivery of merchandise, experienced management, and

dedicated personnel will facilitate our continued success; however, there is no guarantee that we will be successful.

Risks Associated with Leasing and Expansion

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

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

Foreign Exchange

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

Seasonality and Fluctuations in Quarterly Results

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

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

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

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

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

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

Nature of Units

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

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

Risks Associated with Convertible Debentures

Interest Payments

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

Prior Ranking Indebtedness

The Debentures are subordinate to all Senior Indebtedness. The payment of the principal premium (if any) and interest on the Debentures is subordinated to Senior Indebtedness of the Fund. The Debentures are also effectively subordinate to claims of creditors of the Fund's subsidiaries except to the extent the Fund is a creditor of such subsidiaries ranking at least *pari passu* with such other creditors.

Inability to Fund Purchase of Debentures

The Fund is required to offer to purchase all outstanding Debentures upon the occurrence of a change of Control. However, it is possible that following a Change of Control, the Fund will not

have sufficient funds at that time to make the required purchase of outstanding Debentures or that restrictions contained in other indebtedness will restrict those purchases.

Absence of Covenant Protection

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

Update for Tax Legislation

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

The Fund may be subject to this distribution tax in respect of a taxation year of the Fund commencing earlier than January 1, 2011 if, prior to such date, the Fund engages in “undue expansion” as set out in the guidelines released by the Department of Finance on December 15, 2006 and which was incorporated by reference in Bill C-52. The implementation of the legislation could have an adverse effect on the Fund, its ability to pay distributions and the market value of its units.

On July 14, 2008 the Department of Finance published proposed amendments to the *Income Tax Act* (Canada) (the “Tax Act”) which are intended to facilitate the conversion of a SIFT into corporate form on a tax deferred basis (the “Conversion Rules”). The Conversion Rules address many of the principal substantive and administrative issues that currently arise when structuring the conversion of a SIFT under the Tax Act.

The Fund is considering these legislative changes and their possible impact on the Fund.

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 six-month periods ended June 30, 2008 approximately 34% and 34% (2007 – 32% and 33%) 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 June 30, 2008, the Fund had outstanding forward foreign exchange contracts as follows:

Settlement dates	Face Value \$US	Average rate \$Cdn
July 2008	2,000,000	1.0045
August 2008	2,500,000	1.0049
September 2008	1,000,000	1.0051
October 2008	1,000,000	1.0056
November 2008	1,000,000	1.0058

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

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

The Fund’s Chief Executive Officer and Chief Financial Officer certified the appropriateness of the financial disclosures in the MD&A and unaudited interim consolidated financial statements for the period ended June 30, 2008. These executives also certified that they are responsible for the design of disclosure controls and procedures and internal control over financial reporting. The Audit Committee reviewed this MD&A and the attached unaudited interim consolidated financial statements and the Board of Trustees approved the documents prior to their release.

There have been no changes in internal control over financial reporting during the quarter ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, the Fund’s internal control over financial reporting.

END OF SUBORDINATION

As indicated in Note 7 to the financial statements, distributions on the Class D LP Units held by Inc are subordinated and were not exchangeable for Units of the Fund until the Subordination End Date. As a result of the Fund achieving a specified EBITDA target for the year ended December 31, 2007 and a distribution target for each of the fiscal years ended December 31, 2007 and 2006, the Subordination End Date occurred during the quarter ended March 31, 2008. As a result, effective April 1, 2008, distributions to Inc. on the Class D LP Units are made monthly and are no longer subordinated.

FORWARD-LOOKING STATEMENTS

This MD&A includes forward-looking statements. Forward-looking statements relate to, among other things, anticipated financial performance, business prospects, strategies, market forces, and commitments. Many of these statements can be identified by words such as “believe”, “expects”, “expected”, “will”, “intends”, “projects”, “anticipates”, “estimates”, “continues” or similar words.

The Fund believes the expectations reflecting in such statements are reasonable but no assurance is given that such expectations will be correct. All forward-looking statements are based on the Fund's beliefs and assumptions based on information available at the time the assumption was made and on management's experience and perception of historical trends, current conditions and expected further developments as well as other factors deemed appropriate in the circumstances. In addition to other assumptions made in this MD&A, assumptions have been made in respect of factors such as, but not limited to, the following:

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

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

ADDITIONAL INFORMATION

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

INVESTOR RELATIONS

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