STERLING SHOES INCOME FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS
NOVEMBER 10, 2006

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 nine-month periods ended September 30, 2006, and the audited consolidated financial statements and accompanying notes of Sterling Shoes Income Fund for the initial 173-day period ended December 31, 2005. Results have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). 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 "Reconciliation of Cash Provided by Operating Activities to 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 five separate retail banners: Sterling, Joneve, Shoe Warehouse, Freedman's and Gia. 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 125 stores as at November 10, 2006. 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 November 10, 2006, 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 also holds 1,328,372 special voting units of the Fund (equal to the number of Subordinated Exchangeable Class D LP Units Inc holds in Sterling Shoes LP), which entitle the holder to one vote per special voting unit at meetings of unitholders of the Fund ("Unitholders").

Once certain EBITDA and distribution targets are met, and in certain other limited circumstances, the Subordinated Exchangeable Class D LP Units ("Class D LP Units") become exchangeable, on a one for one basis, into Units. See Note 7 of the Fund's financial statements for the three-month period ended September 30, 2006 and the Fund's initial public offering final prospectus dated September 30, 2005 (the "Prospectus") for further details.

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

BASIS OF MANAGEMENT'S DISCUSSION AND ANALYSIS

The Fund's results of operations reflect the Fund's operations for the three and nine-month periods ended September 30, 2006. The Fund was inactive until its acquisition of an 80% interest in Sterling Shoes LP on July 12, 2005. Therefore, comparative results for the three and nine-month periods ended September 30, 2005 are not available for the Fund. However, in order to enhance the usefulness of this MD&A, certain financial and operating results of the Fund for the three and nine-month periods ended September 30, 2006 are compared to the unaudited results of Inc for the three and nine-month periods ended September 30, 2005. This includes the results of the Fund for the 81-day period ended September 30, 2005. Such information is for reference purposes only and is not intended to represent a comprehensive comparison of the consolidated financial results.

RECENT EVENTS

The Board of Trustees of the Fund has approved an increase in our monthly cash distributions commencing November 1, 2006. Distributions will increase by 14.3% from $0.105 to $0.12 per trust unit. The November distribution of $0.12 per unit will be payable on December 15, 2006 to unitholders of record on November 30, 2006.

Our strong performance has enabled us to reward our unitholders with two significant increases in our monthly distributions since completing our initial public offering in July 2005. The Fund's monthly payout at $0.12 per unit is now 34% more than when we went public. Furthermore, for 2005, we were able to make a special, one-time year-end payment of $0.16 per trust unit.

We increased sales by 23.7% during the third quarter of 2006 compared to the same period in 2005, which included same-store sales growth of 6.4%. Year-to-date, overall sales and same-store sales have increased 23.1% and 7.3%, respectively. Our Ontario expansion continues to unfold as planned. We opened 12 stores during the third quarter of 2006; 11 stores in the Ontario market and one store in Alberta. We closed one under-performing store in Regina, Saskatchewan. We expect to open our 25th store in Ontario during the fourth quarter of 2006.

We continue to expand our market presence in some of Ontario's high profile malls under the Sterling banner, and to add Shoe Warehouse outlets in Ontario where suitable locations become available. We believe that there is significant potential for growth across Canada using the formats that have proven successful for us and we continue to evaluate and identify opportunities to add new stores both in new regions and in regions already served by us.

Our strategy in terms of financing our growth is to use our credit facilities in order to deliver as much of our net income as possible directly to our Unitholders. We have not yet had to access any of the credit facilities designated for capital expenditure, despite opening 27 new stores (25 net openings), relocating 5 stores and renovating 4 stores since July 12, 2005, as at November 10, 2006. This is due to the increasing profitability and cash flow from our existing and recently opened stores.

Our 125 stores operate under five retail banners in British Columbia, Alberta, Saskatchewan, Manitoba and Ontario as follows:

Number of Stores Operating							
	November 10, 2006						July 12, 2005
Province	Shoe Warehouse	Sterling	Joneve	Freedman	Gia	Total	Total
British Columbia	33	17	5	6	1	62	59
Alberta	15	8	2	-	-	25	24
Saskatchewan	2	1	-	-	-	3	4
Manitoba	8	3	-	-	-	11	11
Ontario	6	17	-	1	-	24	2
Total	64	46	7	7	1	125	100

We are in the process of completing the build-out of one new store, which we expect to open during the fourth quarter of 2006. We are also currently renovating two stores and relocating two stores during the fourth quarter of 2006. We expect to have 126 stores operating by the end of 2006.

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

SUMMARY FINANCIAL INFORMATION

	Three-months ended September 30		Nine-months ended September 30	
Statement of Income Items ($000's)	**2006**	**2005[(1)]**	**2006**	**2005[(1)]**
Sales	$ 26,968	$ 21,805	$ 71,173	$ 57,819
Cost of Sales[(1)]	(11,308)	(10,239)	(31,541)	(28,292)
Gross Margin[(1)]	15,660	11,566	39,632	29,527
As a percentage of sales	*58.1%*	*53.0%*	*55.7%*	*51.1%*
Store and selling expenses	(8,893)	(6,916)	(24,289)	(19,392)
General and administrative expenses	(1,485)	(1,070)	(4,146)	(10,293)
EBITDA [(2)]	5,282	3,580	11,197	(158)
Adjusted EBITDA [(2)]	5,197	3,524	10,932	7,312
As a percentage of sales	*19.3%*	*16.2%*	*15.4%*	*12.6%*
Interest expense	(90)	(101)	(233)	(259)
Loss on disposal	0	0	(43)	0
Amortization	(696)	(563)	(1,915)	(1,283)
Income before non-controlling interest [(3)]	4,497	2,917	9,006	(1,700)
Non-controlling interest [(3)] [(4)]	(904)	(606)	(1,814)	(606)
Net income	$ 3,594	$ 2,311	$ 7,192	$ (2,306)
Maintenance capital expenditures [(5)]	816	423	2,044	N/A

Notes:

(1) Results for the three and nine-month periods ended September 30, 2005 are not strictly comparable as Inc was privately held, had a January 31st year end, and did not prepare quarterly reports for its shareholders. Results shown for the three and nine-month periods ended September 30, 2005 include the results of Inc for the period January 1, 2005 to July 11, 2005 and those of the Fund for the 81-days ended September 30, 2005.

Also, Inc calculated its obsolescence provision with respect to inventory on an annual basis only, at its year-end (January 31st), whereas the Fund reviews inventory for obsolescence on a monthly basis and reflects management's estimate for obsolescence on a quarterly basis. As a result, the Fund's cost of sales for the nine-month period ended September 30, 2005 are not comparable to the cost of sales of Inc for the nine-month period ended September 30, 2005 without adjustment for the effects of the inventory obsolescence provision. Inc also paid management fees based on the twelve-month results ending January 31, 2005. See "Basis of Management's Discussion and Analysis". Also, certain figures have been reclassified to conform with the current period's presentation.

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

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

(4) Distributions to the non-controlling interest are made quarterly will be subordinated if certain distributable cash targets are not met. The non-controlling interest is held by Inc, which retained a 20% interest in the business of Sterling Shoes LP.

(5) "Maintenance capital expenditures" is not a recognized measure under GAAP. Maintenance capital expenditures include those required to upgrade existing stores and to maintain information systems and equipment and our warehouse. Maintenance capital expenditures have not been calculated for the nine-month period ended September 30, 2005.

For the three and nine-month periods ended September 30, 2006, the Fund generated distributable cash of $0.646 per unit and $1.303 per unit respectively. Distributions were $0.315 and $0.883 for these periods respectively. Distributions declared reflect the Fund's May 2006 17% increase in distribution rates from $1.075 per annum to $1.26 per annum.

The table below summarizes the distributions declared during the three and nine-month periods ended September 30, 2006 for Units of the Fund and to Inc on its units of Sterling Shoes LP:

	Periods Ended September 30, 2006	
	Three Months	**Nine Months**
Trust Units	$ 1,673,749	$ 4,693,510
Inc's ownership in Sterling Shoes LP	418,437	1,173,378
Total	$ 2,092,186	$ 5,866,888

OPERATING RESULTS

Sales

Sales were $27.0 million in the third quarter of 2006 representing a quarterly increase of 23.7% versus the same period in 2005. During this time the Fund achieved same-store sales growth of 6.4% in those stores that were open for at least 12 months leading up to July 1, 2006. 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, 2005, and sales from new stores opened since October 1, 2005.

For the nine-month period ended September 30, 2006, sales increased to $71.2 million or 23.1% over the same period in 2005. During the nine-month period ended September 30, 2006 the Fund achieved same-store sales growth of 7.3% over the same period during 2005.

Same-store sales increased over the three and nine-month periods ended September 30, 2006 through a combination of merchandising, product selection, advertising, co-marketing, brand awareness, rapid trend response times, and appropriate renovations. The retail environment across Canada has been very robust over the past 12 months. Sterling Shoes has been successful in achieving positive same-store sales growth over each of the past six years. Based on historical performance, we believe that our existing stores will grow at least as fast as economic growth in the regions in which we operate in the future.

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

Cost of sales and gross margin

Cost of sales as a percentage of sales for the three and nine-month periods ended September 30, 2006 were 41.9% and 44.3% respectively, compared to 47.0% and 48.9% for the same periods during 2005.

Decreases in cost of sales were achieved through a number of areas:

- Lower product costs resulting from better pricing on our private label products.
- Improved purchasing economies of scale.
- Better terms on branded merchandise.
- Pricing stability in most markets.
- The strength of the retail environment during the period contributed to improved margins as the Fund was able to maintain higher margins later into the season than the prior year.
- Also, the strength of the Canadian dollar contributed towards reducing our cost of sales, as some of our purchases are denominated in U.S. dollars.

Cost of sales performance for the corresponding nine-month period in 2005 are not directly comparable as it was the practice of Inc at that time to record its product obsolescence provision for the fiscal year-ended January 31 in the month of January.

Store and selling expenses

Store and selling expenses for the three and nine-month periods ended September 30, 2006 were 33.0% and 34.1% of sales respectively, compared to 31.7% and 33.5% for the same periods during 2005. Store and selling expenses have a fixed underlying core, but are largely variable as a percentage of sales. The Fund opened 12 new stores during the third quarter of 2006 and employed additional resources in those stores to ensure that new staff were properly trained and that new stores opened smoothly. These one-time start-up costs contributed to higher store and selling expenses during the quarter.

General and administrative expenses

General and administrative ("G&A") expenses for the three and nine-month periods ended September 30, 2006 were 5.5% and 5.8% of sales respectively, compared to 4.2% and 17.8% during the same periods in 2005. After removing management fees and bonuses and normalizing management salaries relating to the fiscal year ended January 31, 2005, G&A expenses were 4.7% for the nine-months ended September 30, 2005. On that basis, increases included additional management personnel, additional professional service fees related to being a reporting issuer and the adjustment to market of management's compensation arrangements, including bonuses and the Fund's obligations under its long-term incentive plan.

Bonuses are based on pre-determined Adjusted EBITDA targets, as determined in the sole discretion of the Trustees of the Fund for each fiscal period. The LTIP pool is based on the amount by which distributable cash per annum (annualized for fiscal periods of less than 12 months) exceeds a base threshold of $1.075 per Unit per annum. A percentage of that excess is determined in accordance with the formula outlined in the Prospectus and forms the LTIP pool.

Adjusted EBITDA (see "Non-GAAP Measures")

Adjusted EBITDA for the three and nine-month periods ended September 30, 2006 was 19.3% and 15.4% of sales respectively, compared to 16.2% and 12.6% for the same periods during 2005.

Improvements in Adjusted EBITDA during these periods are largely attributable to the increases in gross margin, offset slightly by the increases in store and selling expenses and G&A, each of which are discussed above.

As discussed earlier, results for the nine-month period ended September 30, 2006 are not directly comparable to the results of Inc without adjustment for the effects of the inventory obsolescence provision and taking into account a number of 'year-end' adjustments that were recorded by Inc for the twelve-month period ended January 31, 2005.

Income before non-controlling interest

Income before non-controlling interest for the three and nine-month periods ended September 30, 2006 was 16.7% and 12.7% of sales respectively, compared to income before non-controlling interest of 13.4% and a net loss of 2.9% for the same periods during 2005.

After removing management fees and bonuses and a number of other normalizing items relating to the fiscal year ended January 31, 2005, income before non-controlling interest was 10.2% of sales for the nine-month period ended September 30, 2005.

SELECTED QUARTERLY FINANCIAL INFORMATION

in ($000's) except per Unit amounts	Q3-2006	Q2-2006	Q1-2006	Q4-2005	81-day period ended Sept 30, 2005
Sales	$ 26,968	$ 25,159	$ 19,046	$ 24,128	$ 19,544
Income before non-controlling interest	$ 4,497	$ 2,429	$ 2,078	$ 1,405	$ 3,032
Net income	$ 3,594	$ 1,940	$ 1,663	$ 1,124	$ 2,426
Basic and fully diluted income per Unit	$ 0.676	$ 0.365	$ 0.313	$ 0.212	$ 0.457
Cash distributions per Unit	$ 0.315	$ 0.300	$ 0.269	$ 0.429	$ 0.237

Additional quarterly financial information is not available. As a private company, Inc did not prepare quarterly reports for its shareholders and had a January 31 year-end.

CASH FLOW AND LIQUIDITY

The table below reconciles net income to cash flow from operations for the three and nine-month periods ended September 30, 2006. Increased sales late in the fourth quarter reduced inventories of Fall product into January. During January and February the Fund replenished its inventory for existing and new stores in anticipation of the peak sales months of April and May. During April and May strong sales depleted these inventories to some degree as the Fund began to prepare for more new store openings and the Fall season by, again, building up its inventory for the strong back-to-school and Fall sales season from mid-August through October.

The Fund invested significantly in working capital in the three-month period ended September 30, 2006.

in ($000's)	Three-months Ended Sept 30, 2006	Nine-months Ended Sept 30, 2006
Income before non-controlling interest	$ 4,497	$ 9,006
Add charges (deduct credits) to operations not requiring a current cash payment:		
Amortization leaseholds and equipment	687	1,888
Amortization of deferred financing costs	9	27
Amortization of deferred lease inducements	(86)	(265)
Loss on disposal of leaseholds and equipment	-	43
	5,107	10,700
Net change in non-cash working capital balances related to operations:		
Accounts receivable	(328)	(447)
Inventory	(5,431)	(8,491)
Prepaid expenses and deposits	(381)	(535)
Accounts payable and accrued liabilities	3,744	5,261
Cash provided by operations	$ 2,711	$ 6,487

The Fund had capital expenditures of $2.2 million and $5.2 million during the three and nine-month periods ended September 30, 2006. Of this amount $1.3 million and $3.1 million were invested in leaseholds and equipment to furnish new stores. The Fund incurred maintenance capital expenditures of $0.8 million and $2.0 million, respectively, during the three and nine-month periods ended September 30, 2006, which were related to budgeted upgrades to IT infrastructure, store renovations and store relocations. The Fund has opened 22 new stores and renovated or relocated 9 stores since January 1, 2006.

The Fund has a $7.5 million term facility, which is available for the general funding of new store facilities. As at September 30, 2006, we have not drawn on this credit facility due to increasing profitability and cash flow from new and existing stores.

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. Sterling Shoes LP and the Fund may make additional distributions in excess of monthly distributions during the year, as the Board of the Fund and the Board of Sterling Shoes GP Inc. (collectively, the “Boards”) determine.

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 Distributable Cash generated in any one period. The Fund’s policy is to make stable monthly distributions to Unitholders based on estimated Distributable Cash for the year.

After taking the foregoing factors into account, cash distributions have been made as follows:

Distribution History

Year / Month		**Distributions / Unit**
2005		
July / August (1)	$	0.14737
September		0.08958
October		0.08958
November		0.08958
December		0.08958
December (2)		0.16000
Total 2005	$	**0.66569**
2006		
January	$	0.08958
February		0.08958
March		0.08958
April		0.08958
May (3)		0.10500
June		0.10500
July		0.10500
August		0.10500
September (4)		0.10500
Nine-month period ended September 30, 2006	$	**0.88332**

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.

Distributions are paid on the 15th of each month 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. Distributions on the Class D LP Units of the Sterling Shoes LP are intended to be paid quarterly will be subordinated if certain financial tests are not met.

Effective May 1, 2006 the Fund raised its monthly distribution from $0.08958 per Unit to $0.105 per Unit. The Fund announced a further increase in its monthly distribution effective November 1, 2006 from $0.105 per Unit to $0.12 per Unit. The Fund declared distributions to Unitholders of $1.7 million and $4.7 million respectively for the three and nine-month periods ended September 30, 2006. Furthermore, Sterling Shoes LP declared distributions to Inc, the holder of the Class D LP Units, of $0.4 million and $1.2 million for the three and nine-month periods ended September 30, 2006, respectively.

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. Accordingly, on December 13, 2005 the Fund announced a special distribution to Unitholders of record on December 30, 2005 to ensure the Fund was not liable for income taxes under Part I of the Tax Act. On January 16, 2006 the Fund paid $0.16 per Unit, representing the Fund's estimate of the distribution required to achieve this result.

The Fund may issue an unlimited number of Units and an unlimited number of Special Voting Units. Each Unit is transferable and represents an equal, undivided beneficial interest in any distribution from the Fund and the net assets of the Fund. All Units are of the same class with equal rights and privileges and are not subject to future calls or assessments. Each Unit and each Special Voting Unit entitle the holder to one vote per unit at all meetings of Unitholders.

As at September 30, 2006 and November 10, 2006, 5,313,488 Units and 1,328,372 Special Voting Units were outstanding. This total amount has remained unchanged since July 12, 2005.

Distributable cash for the period is calculated after "Non-GAAP Measures", below.

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. 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. 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.

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 and does not have a standardized meaning prescribed by 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 issuers and, accordingly, may not be comparable to distributable cash as reported by such issuers. 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 Cash Provided by Operating Activities to Distributable Cash".

RECONCILIATION OF CASH PROVIDED BY OPERATING ACTIVITIES TO DISTRIBUTABLE CASH

On August 4, 2006 the Canadian Securities Administrators ("CSA") released Revised Staff Notice 52-306 revising their view with respect to the reconciliation of distributable cash. Previously, the CSA allowed for distributable cash to be presented from net income and cash flow from operations. Revised Staff Notice 52-306 states that distributable cash is in all circumstances a cash flow measure and distributable cash is fairly presented only when presented from, or reconciled to, cash flow from operations.

As recommended by the CSA, we have used cash provided by operating activities as the starting point for our determination of distributable cash.

The following table reconciles cash provided by operating activities to the Fund's distributable cash generated based on the financial statements of the Fund for the three and nine-month periods ended September 30, 2006.

in $000's except per unit amounts and payout ratios	**Three-months Ended Sept 30, 2006**	**Nine-months Ended Sept 30, 2006**
Cash provided by operating activities	$ 2,711	$ 6,488
Add: Increase in non-cash working capital balances related to operations	2,396	4,212
Less: Maintenance capital expenditures	(816)	(2,044)
Distributable Cash generated (1)	$ 4,291	$ 8,655
Distributable Cash available for distribution to Unitholders(2)	$ 3,433	$ 6,924
Distributable Cash available for distribution to non-controlling interest(2)	$ 858	$ 1,731
Distributable Cash generated per Unit (2) - (5,313,488 Units)	$ 0.64610	$ 1.30315
Distributions declared per Unit	$ 0.31500	$ 0.88332
Payout ratio	48.75%	67.78%

Notes:

(1) Distributions on the non-controlling interest to Inc, which retained a 20% interest in the business of Sterling Shoes LP, are made quarterly and will be subordinated if certain targets have not been met.

SEASONALITY

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

CAPITAL RESOURCES

We have utilized a $5 million, three-year committed non-revolving loan with a single lender. We have a $10 million operating facility, which is available for working capital requirements, capital expenditures and for general corporate purposes. We have an additional $7.5 million term facility, which is available for general future funding of new store facilities. As at September 30, 2006 we have utilized a portion ($1.5 million) of our operating facility to fund the investment in inventory for new and existing stores for the peak Fall selling season.

OFF-BALANCE SHEET FINANCING

The Fund has no off balance sheet arrangements.

CONTRACTUAL OBLIGATIONS

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

	2006	2007	2008	2009	2010
Inventory purchase commitments	206				
Long-term debt			5,000		
Minimum rental commitments (1)	2,874	10,865	9,977	8,880	7,191
	3,080	10,865	14,977	8,880	7,191

Note:

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

LONG-TERM INCENTIVE PLAN

Officers and key employees of the Fund are eligible to participate in the Fund's 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, the Fund sets aside a pool of funds based upon the amount, if any, by which the Fund's Distributable Cash exceeds cash distribution thresholds (as defined in the LTIP plan documents). A third-party trustee then purchases Units of the Fund in the market, as required, 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 of Sterling Shoes GP Inc. and the Compensation Committee have 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.

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 $49,562 and $148,687 for the three and nine-months periods ended September 30, 2006 (2005 – $49,562 and $148,687 respectively).

(b) The Fund purchased equipment from a company in which Mannie Druker, a trustee and officer of the Fund has an interest, for $354,622 and $544,012 respectively during the three and nine-month periods ended September 30, 2006 (2005 – $11,288 and $441,354 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 interim consolidated financial statements for the period ended September 30, 2006. Management believes that the following items represent the Fund's only critical accounting estimates.

Inventory Valuation

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

The estimation method has been consistently applied to the Sterling Shoes business 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 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.

CHANGES IN ACCOUNTING POLICIES

It is the Fund's policy to adopt all applicable accounting pronouncements as they are issued, which may be in advance of the effective date of the pronouncement. There have been no changes in accounting policy for the period from January 1, 2006 to September 30, 2006.

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 a decline in sales generated 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 Will 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 Fund 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.

October 31, 2006 Announcement by the Minister of Finance

On October 31, 2006, the federal Minister of Finance announced a proposal that, if enacted, would tax publicly-traded income trusts on distributions of income to their unitholders. Existing publicly-traded income trusts would not be subject to the proposed tax until their 2011 taxation years. The proposal would have important consequences for publicly-traded income trusts and their investors.

The rate of the proposed tax on distributions of income would approximate the combined federal and provincial tax rate applicable to income earned by Canadian public corporations. The applicable rate in 2011 would be based on tax rates at that time. Currently, based on information released by the federal Department of Finance in conjunction with the announcement of the proposed tax, the rate in 2011 would be 31.5% but this is subject to changes in tax rates between now and 2011.

The proposed tax that would be imposed on income trusts may result in a reduction in the level of distributions made to their unitholders. Distributions subject to the proposed tax and received by unitholders of income trusts would be characterized as eligible dividends from a Canadian public corporation. Generally, individual unitholders resident in Canada would be subject to tax based on the enhanced gross-up and dividend tax credit and, consequently, would receive an after-tax return from their now reduced distribution of income approximately equal to the after-tax return if pre-tax income of the income trust had been distributed directly to the investor and taxed in the hand of the investor. However, reduced distributions will be an absolute cost to other types of investors including pension funds, Registered Retirement Savings Plans (RRSPs) and non-residents who would not benefit from characterization of the distribution as dividends.

Draft legislation implementing this proposal has not yet been released. It is not possible at this time for the Fund to determine whether the proposal will be enacted as proposed, or at all, and, if enacted, what impact this proposal would have on the Fund or its Unitholders. As more information becomes available, the Fund will assess the strategic and economic issues arising from this proposal.

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 35% to 40% of the Fund's product purchases are denominated in U.S. dollars. During the third quarter of 2006 approximately 50% 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 September 30, 2006 there are no foreign exchange contracts outstanding.

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

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.

DISCLOSURE CONTROLS AND PROCEDURES

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

As of the end of the period covered by this report, the Fund's management evaluated the effectiveness of the design and operation of its disclosure controls and procedures, under the supervision of, and with the participation of the Chief Executive Officer and Chief Financial Officer. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Fund's disclosure controls and procedures, as defined in Multilateral Instrument 52-109 - *Certification of Disclosure in Issuers Annual and Interim Filings* are effective to provide reasonable assurance that material information relating to the Fund is made known to management on a timely basis and is included in this report, the financial statements and notes, and the annual information form.

FORWARD-LOOKING STATEMENTS

Certain statements in this MD&A 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 following factors: 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, competitive and economic environment, impact of changes to tax treatment of income trusts or dividend tax credits, foreign exchange, seasonality, fluctuation of cash distributions and nature of Units 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 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

Daniel S. Gumprich
Chief Financial Officer
2580 Viscount Way
Richmond, BC V6V 1N1
Phone: (640) 270-6114