

No. S117081
Vancouver Registry

IN THE SUPREME COURT OF BRITISH COLUMBIA
IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985,
c. C-36, AS AMENDED

AND

IN THE MATTER OF THE *CANADA BUSINESS CORPORATIONS ACT*,
R.S.C. 1985, c. C-44

AND

IN THE MATTER OF STERLING SHOES INC. and STERLING SHOES GP INC.

FIRST REPORT OF THE MONITOR
ALVAREZ & MARSAL CANADA INC.

NOVEMBER 16, 2011

**IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,
R.S.C. 1985, c. C-36, AS AMENDED
AND
IN THE MATTER OF THE *CANADA BUSINESS CORPORATIONS ACT*,
R.S.C. 1985, c. C-44
AND
IN THE MATTER OF STERLING SHOES INC. and STERLING SHOES GP INC.**

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10, 2011

1.0 INTRODUCTION

- 1.1 Alvarez & Marsal Canada Inc. ("**A&M**" or the "**Monitor**") was appointed as Monitor pursuant to the order (the "**Initial Order**") pronounced by this Honourable Court on October 21, 2011 (the "**Order Date**") on the application of Sterling Shoes Inc. ("**Sterling**") and Sterling Shoes GP Inc. ("**Sterling GP**") (together, the "**Petitioners**") under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "**CCAA**"). The proceedings brought by the Petitioners under the CCAA will be referred to herein as the "**CCAA Proceedings**". The Petitioners and Sterling Shoes Limited Partnership (the "**Partnership**") will be referred to herein as the "**Petitioner Parties**" or the "**Company**". A copy of the Initial Order is attached hereto as Appendix "**A**".
- 1.2 The Initial Order provides for, among other things, a stay of proceedings against the Petitioner Parties until and including November 18, 2011 or such later date as ordered by this Honourable Court (the "**Stay Period**").
- 1.3 The Initial Order, together with select motion material and other documentation filed in the CCAA, including the First Affidavit of Daniel Gumprich sworn October 21, 2011 (the "**Gumprich Affidavit**"), the Proposed Monitor's Report dated October 21, 2011 (the "**Proposed Monitor's Report**") and the notice to creditors dated October 26, 2011 as prescribed under the CCAA are posted on the Monitor's website at www.alvarezandmarsal.com/sterling (the "**Monitor's Website**").

2.0 PURPOSE OF REPORT

- 2.1 This is the Monitor's first report (the "**First Report**"). It has been prepared to provide this Honourable Court and the stakeholders of the Petitioner Parties with an update on the business and financial affairs of the Company and the status of its restructuring efforts to date. Specifically, the First Report includes:
- a) A summary of the initial activities of the Monitor;
 - b) The current status of the Company's operations, including proposed retail banner and store rationalization and the status of on-going merchandise supply;
 - c) An update of the Company's cash-flow forecast and comments on variances of actual cash receipts and disbursements from those forecast for the period ending November 12, 2011;

- d) An update and comments on the forbearance agreement (the “**Forbearance Agreement**”) between the Company and its primary operating lender, Bank of Montreal (“**BMO**”);
- e) The Monitor’s comments and views with respect to the status of the Company’s restructuring efforts to date;
- f) The Monitor’s comments and views on the Company’s request for an extension of the Stay Period beyond November 18, 2011 to December 30, 2011 and certain amendments to the Initial Order sought by the Petitioner Parties; and
- g) The Monitor’s conclusion and recommendations to this Honourable Court.

3.0 **TERMS OF REFERENCE**

- 3.1 In preparing this report, A&M has necessarily relied upon unaudited financial and other information supplied, and representations made to us, by certain senior management of the Company (“**Management**”). Although this information has been subject to review, A&M has not conducted an audit nor otherwise verified the accuracy or completeness of any of the information prepared by Management or otherwise provided by the Petitioner Parties. Accordingly, A&M expresses no opinion and does not provide any other form of assurance on the accuracy of any information contained in this report, or otherwise used to prepare this report.
- 3.2 Certain of the information referred to in this report consists of financial forecasts and/or projections prepared by Management. An examination or review of financial forecasts and projections and procedures, as outlined by the Canadian Institute of Chartered Accountants, has not been performed. Readers are cautioned that since financial forecasts and/or projections are based upon assumptions about future events and conditions that are not ascertainable, actual results will vary from the projections, even if the assumptions materialize, and the variations could be significant.
- 3.3 Capitalized terms not defined in this report are used as defined in the Gumprich Affidavit.
- 3.4 Unless otherwise stated, all monetary amounts contained in this report are expressed in Canadian dollars.

4.0 **INITIAL ACTIVITIES OF THE MONITOR**

- 4.1 Since the date of the Initial Order, the Monitor’s activities have included the following:
 - a) numerous meetings and discussions with Management and the Company’s legal and financial advisors regarding the Company’s business and financial affairs, including the

Cash Flow Statement (as defined below in Section 6.1), operational restructuring activities, review and approval of payments of pre-filing obligations, review of the Petitioner Parties' purchase order file and related cancellations and deferments of merchandise deliveries, employee and creditor matters and other matters relating to the CCAA Proceedings generally;

- b) discussions with legal counsel and financial advisors to BMO regarding the Cash Flow Statement, the status of certain restructuring matters, weekly reporting matters pursuant to the Forbearance Agreement, the long-term financial model being developed by the Company and the CCAA Proceedings generally;
- c) meetings and discussions with representatives of Capital West Partners to assess and review the status of alternative recapitalization and/or restructuring transactions;
- d) meetings and discussions with the Company and its legal counsel and review of draft documentation regarding a request for proposals to be delivered to liquidation firms, as well as a draft agency agreement, sale guidelines and related documentation;
- e) meetings and discussions with the Company, its real estate leasing consultant and its legal counsel regarding the preparation of a preliminary store closure analysis and draft documentation in respect of potential lease assignments and/or disclaimers;
- f) telephone conferences and correspondence with representatives of Sports Industry Credit Association who hold proxy's from a number of purported unsecured trade creditors of the Company for the sole purpose of obtaining information about Sterling;
- g) establishment of the Monitor's Website and posting thereto of Court and other relevant materials; and
- h) preparation and issuance of statutory notices required under the CCAA and the Initial Order, including the following creditor communication and notices:
 - i. notice to creditors published in the Globe and Mail (National Edition) on October 28, 2011 and November 4, 2011, a copy of which is attached as Appendix "B",
 - ii. notice in the prescribed form as referenced in paragraph 42 of the Initial Order, which was mailed on October 26, 2011 to approximately 534 creditors and potential creditors of the Company regarding the CCAA Proceedings (noting that the Initial Order and other related Court materials may be accessed through the Monitor's Website), a copy of which is attached as Appendix "C", and
 - iii. Form 1 and Form 2 notices issued to the Office of the Superintendent of Bankruptcy in the prescribed form as required under section 23(1)(f) of the CCAA.

- 4.2 The Monitor continues to monitor the business and financial affairs of the Petitioner Parties in accordance with the CCAA.

5.0 **UPDATE OF THE COMPANY'S BUSINESS AFFAIRS**

Status of the Company's Operations

- 5.1 Since the date of the Initial Order, the Company has been operating on an uninterrupted basis. Its retail store operations continue to offer private label and national brand name shoes and accessories under five retail banners (Sterling, Shoe Warehouse, Freedman, Joneve and Gia) from 158 store locations in B.C., Alberta, Saskatchewan, Manitoba and Ontario. As of the date of the First Report, the Company has not closed or shuttered any of its retail locations, however, Management has informed certain employees that it intends to close Joneve and Gia (two of its five retail banners) as part of the overall restructuring of the Petitioner Parties. These banners, which comprise 15 of the Company's 158 stores, are expected to be discontinued during 2012. It is at this point uncertain whether the stores they occupy will be taken over by one of the remaining banners or closed and the leases disclaimed or assigned.
- 5.2 The Monitor's review of daily sales reports and other related operating data provided by Management indicates that there has not been a material deterioration of the Company's overall business since the Order Date.
- 5.3 The Company has been able to continue to source merchandise from its existing suppliers and manufacturers, although there has been a delay in the fulfillment and shipment/release of certain purchase orders issued prior to the date of the Initial Order. These delays have arisen primarily due to the insistence of certain suppliers and vendors on obtaining renegotiated payment terms. In addition, since the Initial Order date, the Company has been working with its suppliers to cancel approximately \$1.6 million of the approximately \$5.2 million total outstanding purchase orders issued prior to the Order Date for receipt of inventory before December 31, 2011. These cancellations were for the most part at the request of the Company as Management determined that the merchandise to be delivered under these purchase orders was not required on a go-forward basis.
- 5.4 The Company continues to review its future merchandise requirements going forward and Management advises that the Company's supply chain processes are adjusting to new conditions/terms of vendors and the flow of merchandise for Spring 2012 appears to be on track.

Cash Management System

- 5.5 The Initial Order provides that the Company shall be entitled to continue to utilize the central cash management system that existed prior to the Order Date (the “**Cash Management System**”) or to replace it with a substantially similar central cash management system. To date, the Company has maintained the original Cash Management System.

Payment of Pre-Filing Amounts to Trade Creditors

- 5.6 Pursuant to paragraph 6(d) of the Initial Order, the Petitioner Parties are entitled, but not required, to pay or honour certain obligations incurred prior to the Order Date. Those obligations include: “... all amounts payable to third party customs brokers, agents, freight carriers, freight forwarders, warehousemen, shippers and creditors with the right to retain good or exercise possessory liens, provided that any such payments are approved by the Monitor”.
- 5.7 As at November 12, 2011, the Company (with the consent of the Monitor) has made payments totalling \$985,000 to select creditors with pre-filing claims, being customs brokers, freight carriers and similar freight service providers (collectively, the “**Supplier Payments**”). The Supplier Payments are enumerated in the table below:

Sterling Shoes Inc., et al. Summary of Payments to Pre-filing Creditors Pursuant to Paragraph 6(d) of the Initial Order as at November 12, 2011		
Creditor	Category	Amount Paid (SCAD)
Carson	Customs	\$ 250,441
Carson	Customs	236,305
Vitran Express Canada Inc.	Freight	119,529
Remco	Freight	30,831
Alltype Transport	Freight	76
The Fashion Distributors	Freight	112,909
Carson	Customs	46,112
Carson	Customs	25,691
The Fashion Distributors	Logistics	75,005
Vitran	Freight	89,023
Total		\$ 985,923

- 5.8 The Monitor’s primary consideration in deciding whether to authorize the Company to make the Supplier Payments was whether the failure to pay a particular claim could result in a serious disruption to the Company’s business. Given that the suppliers in question were identified by Management as holding significant volumes of core merchandise, the Monitor considered that if

the relevant suppliers were to detain the goods in question it would have a materially adverse effect on the Company's business.

5.9 Prior to approving and Supplier Payments, the Monitor required Management to confirm the nature of the commercial arrangements between its freight carriers and customs brokers so as to assess the risk of interruption in the supply and distribution of merchandise to the Company's stores.

5.10 In addition, the Monitor had its legal counsel review certain contracts between the Company and certain suppliers to assess the ability or right of those suppliers to retain goods or assert possessory liens against goods that were in their possession. That review confirmed the following:

- a) a number of supplier contracts contain provisions that appear to operate in effect as contractual lien rights; and
- b) in certain cases, the supplier may have lien rights pursuant to the B.C. Warehouse Lien Act and/or the Sale of Goods Act.

5.11 Based on the foregoing, the Monitor is satisfied that the Supplier Payments were appropriate in the circumstances and in keeping with the terms of the Initial Order and the purposes of the CCAA Proceedings.

5.12 During the course of the Monitor's review and assessment of the Supplier Payments, it has become apparent that Management underestimated the extent of the pre-filing claims of critical suppliers when it prepared the Cash Flow Statement that was filed at the inception of the CCAA Proceedings. The Cash Flow Statement forecasted payments of pre-filing obligations in the cumulative amount of \$854,000 (excluding HST). The Company has already exceeded this forecast amount and Management advises that, in order to alleviate any further risk of disruption to the Company's supply chain, an additional \$350,000 to \$400,000 (including HST) will be required to satisfy the claims of other creditors that would be considered critical suppliers and which fall under paragraph 6(d) of the Initial Order. Given the material variance from the forecast payments of pre-filing obligations, the Monitor felt it was appropriate to bring this matter to the attention of this Honourable Court. The Monitor has approved an additional \$200,000 (approximately) of payments to pre-filing creditors during the week of November 14, 2011.

Notice of Suspension and Delisting from TSX

- 5.13 Subsequent to the date of the Initial Order, Sterling received notice from the Toronto Stock Exchange (the “**TSX**”) that the TSX intended to suspend trading of Sterling’s common stock and Convertible Debentures (TSX symbol “SSI” and “SSI.DB”, respectively) and that Sterling would be delisted at the close of the market on November 25, 2011 for failure to meet certain listing requirements.

September 30, 2011 Unaudited Financial Statements

- 5.14 On November 10, 2011, Sterling released its unaudited consolidated financial statements and Managements’ Discussion and Analysis for the quarter ended September 30, 2011 and posted same on the Company’s website (www.sterlingshoes.com) as well as on SEDAR (www.sedar.com). A copy of the Company’s unaudited consolidated financial statements for the period ended September 30, 2011 is attached hereto as Appendix “D”.

Changes to the Sterling Board of Directors

- 5.15 Effective October 20 and 24, 2011, respectively, Mr. James Bruce and Mr. Sol Oshry resigned from the Board of Directors of Sterling, leaving five directors on the Board. As of the date of this First Report, the Board has not sought to appoint replacement Directors for these vacancies.

Compliance with the Initial Order

- 5.16 Based on the Monitor’s review of the Company’s business affairs since the date of the Initial Order, including through regular and on-going discussion with Management and Sterling’s legal and financial advisors, the Monitor is satisfied that the Company has acted in compliance with the terms of the Initial Order.

6.0 CASH FLOW STATEMENT AND VARIANCE ANALYSIS

- 6.1 The Company previously filed with this Honourable Court a weekly cash flow forecast for the period ending December 31, 2011 (the “**Cash Flow Statement**”) which had been reviewed by A&M in its capacity as Proposed Monitor of Sterling. A&M’s comments with respect to the Cash Flow Statement and its review of same are included in the Proposed Monitor’s Report dated October 21, 2011 and are not repeated herein.
- 6.2 As part of the Monitor’s ongoing oversight and monitoring of the business and financial affairs of Sterling, the Monitor has undertaken weekly reviews of the Company’s actual cash flow with that forecast by Management and contained in the Cash Flow Statement. The Company’s actual cash

receipts and disbursements as compared to the Cash Flow Statement for the four (4) week period October 16, 2011¹ through November 12, 2011 is summarized in the table below:

Sterling Shoes Inc. et al. Actual Consolidated Cash Flow Compared to CCAA Cash Flow Statement (Note 1) For the 4 Week Period October 16 to November 12, 2011							
(\$000's)	Week 4 12-Nov			Week 4 (Cumulative)			
	Actual	Forecast	Variance	Actual	Forecast	Variance	
Receipts (incl. taxes)	\$ 2,307	\$ 2,232	\$ 75	\$ 10,392	\$ 9,826	\$ 566	
Disbursements							
Vendors - trade payments	(247)	(257)	10	(951)	(1,966)	1,015	
Vendors - LCs drawn down	(161)	(130)	(31)	(667)	(520)	(147)	
	(408)	(387)	(21)	(1,618)	(2,486)	868	
Payroll	(954)	(810)	(144)	(1,805)	(1,578)	(227)	
Rent	-	(75)	75	(1,683)	(1,725)	42	
Sales tax	(10)	-	(10)	(103)	(100)	(3)	
Deposits	-	-	-	(14)	(200)	186	
Pre-filing related payments	-	-	-	(882)	(854)	(28)	
Other / Drawdown of Accord LC	(1,573)	(183)	(1,390)	(1,935)	(784)	(1,151)	
	(2,945)	(1,455)	(1,490)	(8,040)	(7,727)	(313)	
Cash Flow from Operations	(638)	777	(1,415)	2,352	2,099	253	
CAPEX	-	-	-	-	-	-	
Professional fees	(62)	(233)	171	(456)	(1,206)	750	
Interest / Forbearance fee	(3)	-	(3)	(182)	(159)	(23)	
Term Loan	-	-	-	-	-	-	
Net Cash Flow	(703)	544	(1,247)	1,714	734	980	
Bank Position							
Opening Bank Exposure	(11,855)	(14,253)	2,398	(14,270)	(14,443)	173	
Closing Bank Position	(12,558)	(13,709)	1,151	(12,556)	(13,709)	1,153	
Opening balance	\$ (1,862)	\$ (2,344)	\$ 482	\$ (2,344)	\$ (2,344)	\$ -	
(Opened) / Cancelled	(134)	(130)	(4)	(158)	(520)	362	
Drawn	1,661	130	1,531	2,167	520	1,647	
LCs (Spring orders)	(335)	(2,344)	2,009	(335)	(2,344)	2,009	
Total Bank Position	\$ (12,892)	\$ (16,053)	\$ 3,161	\$ (12,892)	\$ (16,053)	\$ 3,161	

Note:
(1) "Cash Flow Statement" as defined in and attached to the Proposed Monitor's Report dated October 21, 2011.
(2) Adjustments to opening balances previously reported include cancellation of certain outstanding cheques post filing.

6.3 In summary, the Company has experienced a net favourable cash flow variance of approximately \$3.2 million for the four week period ended November 12, 2011. The principal components of the favourable variance are described below:

- a) Sales and other receipts – positive variance of \$566,000 includes \$278,000 of realized gains on the closing of forward exchange contracts held at the BMO. The remaining

¹ The date of the Initial Order was October 21, 2011; however, the first week of the Cash Flow Statement includes a forecast for the week of October 16th through 22nd which captures the date of the Initial Order.

positive variance is due to higher than anticipated sales receipts largely realized from the Shoewarehouse and Sterling banners;

- b) Merchandise purchases – the net positive variances of \$868,000 vendor payments relate to deferred shipments of merchandise. In effect this variance is partially a timing difference in nature as these represent delayed purchases for the approaching holiday and for Spring 2012 seasons;
- c) Payroll and employee benefits – a net negative variance of \$227,000 was experienced for the four week period as a result of greater than anticipated retail staff being required during the period;
- d) Professional fees – originally estimated to be approximately \$1.2 million for the subject period which is partially a timing difference relating to some lagging of invoices from the various professional firms involved in this matter but it does appear that the Company was overly conservative at the outset of the CCAA Proceedings in estimating these amounts.

6.4 It is expected that once Management has more fully developed the Company's near term operational restructuring plans and other related activities, that it will file with this Honourable Court a revised cash flow forecast that will reflect the impact of said restructuring plans and activities. The Monitor continues to assist Management with the development of these alternative cash flow forecasts which reflect various operating and restructuring scenarios.

7.0 **FORBEARANCE AGREEMENT AND FINANCING**

7.1 As reported in the Proposed Monitor's Report, the Company and BMO entered into the Forbearance Agreement which provides for, among other things, continued availability under an existing credit agreement which has a maximum aggregate availability of \$20.0 million. The Forbearance Agreement expires on December 31, 2011.

7.2 Pursuant to the terms of the Forbearance Agreement, the Company is required to meet certain terms, including weekly reporting of variances from the Cash Flow Statement. In addition, the Company is required to meet certain financial covenants and borrowing availability requirements. The Monitor has reviewed the Management-prepared weekly reporting provided to BMO since the date of the Initial Order. It appears that the Company is in compliance with the terms of the Forbearance Agreement.

8.0 **RESTRUCTURING EFFORTS**

- 8.1 Management continues to assess and develop plans in respect of certain operational restructuring activities including in relation to future banner and store rationalization and inventory liquidation initiatives.
- 8.2 Notwithstanding that the store platform and retail banners currently operated by the Company remain intact as of the date of this First Report, Management issued a letter dated November 8, 2011 to certain employees and store management advising that it will be discontinuing the Gia and Joneve retail banners in 2012. Depending on whether any of the stores are taken over by any of the remaining banners, the total number of employees potentially affected by the discontinuance of the Gia and Joneve banners may be as many as 80. Management has also advised employees of its B-Code division that it would be discontinuing that business in 2012.
- 8.3 Since the date of the Initial Order, Sterling has terminated the employment of one salaried employee in its corporate head office effective November 10, 2011.
- 8.4 In consultation with BMO and its legal and financial advisors, the Company has been working on an “Operational Restructuring Plan” (as defined in the Forbearance Agreement) which includes potential store closures, realty lease assignments and/or disclaimers, and a liquidation strategy for merchandise at closed retail store locations. The Monitor has been assisting the Company and its legal counsel in developing its near-term plans with respect to these initiatives and is satisfied that the Company’s plans are aligned with, and take into consideration, the interests of its stakeholders.
- 8.5 The Monitor understands that as part of the Company’s operational restructuring plans, the Company initiated certain preliminary activities during the week commencing November 14, 2011, including:
- a) Through its real estate consultant, approaching potential target assignees to enter into confidentiality agreements to allow the Company to commence a lease assignment strategy for certain stores which may be closed;
 - b) Approaching liquidators to enter into confidentiality agreements with a view to providing access to a data room containing information related to inventories and store locations being considered for closure.
 - c) Development of its Operational Restructuring Plan which will be submitted to BMO by November 18, 2011 in accordance with the terms of the Forbearance Agreement; and

- d) On-going collaboration with Capital West Partners in the development of its solicitation and marketing process in respect of a potential recapitalization or capital transaction involving Sterling's business and assets.

8.6 The Monitor is advised that it is the Company's intention to present a number of these restructuring initiatives, and all related agreements, for approval by this Honourable Court during the week of December 5, 2011. The Monitor will be filing a special purpose report in advance of that application.

9.0 **EXTENSION OF THE STAY PERIOD AND AMENDMENT TO INITIAL ORDER**

Extension of the Stay Period

9.1 The Monitor understands that the Company will make be making an application to this Honourable Court for an order (the "**Stay Extension Order**") extending the Stay Period until December 30, 2011.

9.2 In relation to the Company's request for an extension of the Stay Period, the Monitor has specifically considered, among other things:

- a) the Cash Flow Statement of the Petitioner Parties up to and including December 30, 2011 and the liquidity and availability of financing for the Company's operations during that period of time;
- b) whether there would be any material financial prejudice to any of the Company's creditors, employees, customers or collaboration partners as a result of an extension of the Stay Period; and
- c) whether, on balance, Management is acting in good faith and with due diligence and dispatch, and whether the Petitioner Parties' prospects of effecting a viable restructuring would be enhanced by an extension of the Stay Period.

9.3 It is the Monitor's view that the Company will have sufficient liquidity and/or sufficient financing from its principal lender, BMO, to allow it to operate in the normal course up to and including December 30, 2011 based on the Cash Flow Statement. The Cash Flow Statement does not reflect an acceleration of cash receipts (and related expenses) that would be expected if a liquidation or partial liquidation is commenced during December 2011 as this process has not yet been approved by his Honourable Court. It is expected that a revised cash flow forecast will be prepared and presented to this Honourable Court in future applications seeking approval of the Company's restructuring plans referred above.

- 9.4 Since the date of the Initial Order, the Company appears to have met its obligations in the normal course including payment of amounts due on account of the salaries and wages of its employees, statutory remittances for employee withholdings and exigible sales taxes, realty lease payments and trade vendor payments, a significant portion of which have been on a cash in advance basis.
- 9.5 Management, in consultation with BMO, the Company's advisors and the Monitor, have undertaken significant efforts in respect of its near-term operational restructuring plans and have also continued to work with the Company's financial advisors, Capital West Partners to develop strategies in respect of a potential recapitalization, sale transaction and/or financial restructuring plan(s).

Proposed Amendment to Paragraph 13(d) of the Initial Order

- 9.6 The Monitor understands that the Company will be seeking this Honourable Court's approval to amend the Initial Order by deleting the existing paragraph 13(d) thereof and replacing it with the following:

13 . . . (d) subject to further court order, liquidate inventories in such manner and at such locations, including leased premises, as they deem suitable or desirable for the purpose of maximizing the proceeds and recovery therefrom, provided such is done in accordance with the terms of any applicable leases.

- 9.7 The Monitor is advised that the amendment sought by the Company is intended to allay the concerns of various landlords of the Company's retail store locations that the Company may seek to initiate an inventory liquidation prior to negotiating and/or seeking Court approval of sale guidelines to govern any liquidation process.
- 9.8 The Monitor is of the view that the amendment sought is appropriate and sufficient to address the landlords' expressed concerns.

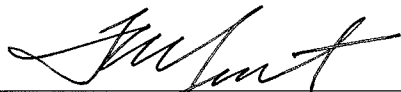
10.0 MONITOR'S CONCLUSION AND RECOMMENDATIONS

- 10.1 It is the Monitor's view that the Company is acting in good faith and has made significant progress with its restructuring efforts in the relatively short period of time since the commencement of the CCAA Proceedings. Accordingly, the Monitor respectfully recommends that this Honourable Court:

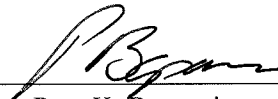
- a) extend the stay of proceedings, to December 30, 2011; and
- b) order that the paragraph 13(d) of the Initial Order be amended as proposed by the Petitioner Parties.

All of which is respectfully submitted to this Honourable Court this 16th day of November, 2011.

**Alvarez & Marsal Canada Inc.,
in its capacity as Monitor of Sterling Shoes Inc.
and Sterling Shoes GP Inc.**

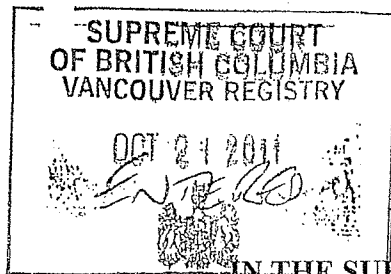


Per: Todd M. Martin
Senior Vice President



Per: Pam K. Boparai
Vice President

APPENDIX A



No. S117081

Vancouver Registry

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C.
1985, c. C-36

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AND

IN THE MATTER OF STERLING SHOES INC. and STERLING SHOES GP INC.

PETITIONERS

ORDER MADE AFTER APPLICATION

BEFORE THE HONOURABLE)
MADAM JUSTICE BROWN) 21/October/2011
)

THE APPLICATION of the Petitioners coming on for hearing at Vancouver, British Columbia, on the 21st day of October, 2011 (the "**Order Date**"); AND ON HEARING Peter L. Rubin and Andrew Crabtree, counsel for the Petitioners and Sterling Shoes Limited Partnership, and those other counsel listed on Schedule "A" hereto; AND UPON READING the material filed, including the First Affidavit of Daniel Gumprich sworn October 20, 2011 and the consent of Alvarez & Marsal Canada Inc. to act as Monitor; AND UPON BEING ADVISED that the secured creditors who are likely to be affected by the charges created herein were given notice; AND pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985 c. C-36 as amended

(the "CCAA"), the British Columbia Supreme Court Civil Rules and the inherent jurisdiction of this Honourable Court;

THIS COURT ORDERS AND DECLARES THAT:

JURISDICTION

1. The Petitioners are companies to which the CCAA applies. Although not a Petitioner, Sterling Shoes Limited Partnership (the "**Partnership**") shall enjoy the benefits of the protections provided to the Petitioners, and shall be subject to the same restrictions as the Petitioners, under this Order (the Petitioner Parties, together with the Partnership, collectively, the "**Petitioner Parties**").

SUBSEQUENT HEARING DATE

2. The hearing of the Petitioners' application for an extension of the Stay Period (as defined in paragraph 17 of this Order) and for any ancillary relief shall be held at the Courthouse at 800 Smithe Street, Vancouver, British Columbia at 9:00 a.m. on Friday the 18th day of November 2011 or such other date as this Court may order.

PLAN OF ARRANGEMENT

3. The Petitioners shall have the authority to file and may, subject to further order of this Court, file with this Court a plan of compromise or arrangement (hereinafter referred to as the "**Plan**").

POSSESSION OF PROPERTY AND OPERATIONS

4. Subject to this Order and any further Order of this Court, the Petitioner Parties shall remain in possession and control of their current and future assets, undertakings and properties of every nature and kind whatsoever, and wherever situate including all proceeds thereof (the "**Property**"), and continue to carry on their business (the "**Business**") in the ordinary course and in a manner consistent with the preservation of the Business and the Property. The Petitioner Parties shall be authorized and empowered to continue to retain and employ the employees, consultants, agents, experts, accountants, counsel and such other persons (collectively,

"**Assistants**") currently retained or employed by them, with liberty to retain such further Assistants as they deem reasonably necessary or desirable in the ordinary course of business or for carrying out the terms of this Order.

5. THIS COURT ORDERS that the Petitioner Parties shall be entitled to continue to utilize the central cash management system currently in place as described in the Affidavit #1 of Daniel Gumprich sworn October 20, 2011 or replace it with another substantially similar central cash management system (the "**Cash Management System**") and that any present or future bank providing the Cash Management System shall not be under any obligation whatsoever to inquire into the propriety, validity or legality of any transfer, payment, collection or other action taken under the Cash Management System, or as to the use or application by the Petitioner Parties of funds transferred, paid, collected or otherwise dealt with in the Cash Management System, shall be entitled to provide the Cash Management System without any liability in respect thereof to any Person (as hereinafter defined) other than the Petitioner Parties, pursuant to the terms of the documentation applicable to the Cash Management System, and shall be, in its capacity as provider of the Cash Management System, an unaffected creditor under the Plan with regard to any claims or expenses it may suffer or incur in connection with the provision of the Cash Management System.

6. The Petitioner Parties shall be entitled, but not required, to pay or honour, as applicable, the following expenses which may have been incurred prior to the Order Date:

- (a) all outstanding wages, salaries, amounts in respect of director remuneration, employee and pension benefits (including long and short term disability payments), vacation pay and expenses (but excluding severance pay), payable before or after the Order Date, in each case incurred in the ordinary course of business and consistent with the relevant compensation policies and arrangements existing at the time incurred (collectively "**Wages**");
- (b) the fees and disbursements of any Assistants retained or employed by the Petitioner Parties which are related to the Petitioner Parties' restructuring, at their standard rates and charges, including payment of the fees and disbursements of

legal counsel retained by the Petitioner Parties, whenever and wherever incurred, in respect of:

- (i) these proceedings or any other similar proceedings in other jurisdictions in which the Petitioner Parties or any subsidiaries or affiliated companies of the Petitioner Parties are domiciled or carry on business;
- (ii) any litigation in which the Petitioner Parties are named as a party or is otherwise involved, whether commenced before or after the Order Date; and
- (iii) any related corporate, tax, employee benefits or similar matters;
- (c) any warranty and return policy, customer deposits, gift cards, gift certificates and similar loyalty programs offered by the Petitioner Parties;
- (d) all amounts payable to third party customs brokers, agents, freight carriers, freight forwarders, warehousemen, shippers and creditors with the right to retain goods or exercise possessory liens, provided that any such payments are approved by the Monitor; and
- (e) any amounts payable in respect of customs and duties.

7. Except as otherwise provided herein, the Petitioner Parties shall be entitled to pay all expenses reasonably incurred by the Petitioner Parties in carrying on the Business in the ordinary course following the Order Date, and in carrying out the provisions of this Order, provided such payments do not vary, in the aggregate, in a material way from the Cash Flow Forecast as may be updated or amended from time to time with the approval of the Bank of Montreal (the "**Lender**"), which expenses shall include, without limitation:

- (a) all expenses and capital expenditures reasonably incurred and which are necessary for the preservation of the Property or the Business including, without limitation, payments on account of insurance (including directors' and officers' insurance), maintenance and security services, provided that any single capital expenditure

exceeding \$50,000 or aggregate expenditure exceeding \$150,000 shall be approved by the Monitor and Lender;

- (b) all obligations incurred by the Petitioner Parties after the Order Date, including without limitation, with respect to goods and services actually supplied to the Petitioner Parties following the Order Date (including those under purchase orders outstanding at the Order Date but excluding any interest on the Petitioner Parties' obligations incurred prior to the Order Date); and
- (c) fees and disbursements of the kind referred to in paragraph 6(b) which may be incurred after the Order Date.

8. The Petitioner Parties are authorized to remit, in accordance with legal requirements, or pay:

- (a) any statutory deemed trust amounts in favour of the Crown in right of Canada or of any Province thereof or any other taxation authority which are required to be deducted from Wages, including, without limitation, amounts in respect of (i) employment insurance, (ii) Canada Pension Plan, (iii) Quebec Pension Plan, and (iv) income taxes or any such claims which are to be paid pursuant to Section 6(3) of the CCAA;
- (b) all goods and services or other applicable sales taxes (collectively, "**Sales Taxes**") required to be remitted by the Petitioner Parties in connection with the sale of goods and services by the Petitioner Parties, but only where such Sales Taxes accrue or are collected after the Order Date, or where such Sales Taxes accrued or were collected prior to the Order Date but not required to be remitted until on or after the Order Date; and
- (c) any amount payable to the Crown in right of Canada or of any Province thereof or any political subdivision thereof or any other taxation authority in respect of municipal property taxes, municipal business taxes or other taxes, assessments or levies of any nature or kind which are entitled at law to be paid in priority to claims of secured creditors.

9. Until such time as a real property lease is disclaimed in accordance with the CCAA, the Petitioner Parties shall pay all amounts constituting rent or payable as rent under real property leases (including, for greater certainty, common area maintenance charges, utilities and realty taxes and any other amounts payable as rent to the landlord under the lease) based on the terms of existing lease arrangements or as otherwise may be negotiated between the Petitioner Parties and the landlord from time to time ("**Rent**"), for the period commencing from and including the Order Date, twice-monthly in equal payments on the first and fifteenth day of the month in advance (but not in arrears). On the date of the first of such payments, any Rent relating to the period commencing from and including Order Date shall also be paid.

10. Except as specifically permitted herein, the Petitioner Parties are hereby directed, until further Order of this Court:

- (a) to make no payments of principal, interest thereon or otherwise on account of amounts owing by the Petitioner Parties to any of its creditors as of the Order Date except as authorized by this Order;
- (b) to make no payments in respect of any financing leases which create security interests;
- (c) to grant no security interests, trust, mortgages, liens, charges or encumbrances upon or in respect of any of its Property, nor become a guarantor or surety, nor otherwise become liable in any manner with respect to any other person or entity except as authorized by this Order;
- (d) to not grant credit except in the ordinary course of the Business only to its customers for goods and services actually supplied to those customers, provided such customers agree that there is no right of set-off in respect of amounts owing for such goods and services against any debt owing by the Petitioner Parties to such customers as of the Order Date; and
- (e) to not incur liabilities except in the ordinary course of Business.

FINANCIAL ARRANGEMENTS

11. Notwithstanding any other provision in this Order:

- (a) the Petitioner Parties are hereby authorized and empowered to borrow, repay and re-borrow from the Lender such amounts from time to time as the Petitioner Parties consider necessary and the Lender approves, and the Lender shall be entitled to revolve its loan facility as set forth in the amended/updated commitment letter dated July 6, 2010, as amended by amendments dated March 15, 2011, August 25, 2011 and October 14, 2011, and as further amended by the forbearance agreement dated as of October 20, 2011 between Sterling Shoes Limited Partnership, as borrower, and the Petitioners, as guarantors (collectively, the "**Lender Loan Facility**") and collect interest, fees and costs on the Lender Loan Facility, subject to such amendments as are agreed between the Lender and the Petitioner Parties;
- (b) the Lender Loan Facility shall be secured by the same security (the "**Lender Security**") as secured the Lender Loan Facility as at the Order Date; and
- (c) the Petitioner Parties are authorized to deal with the Lender and perform all of their obligations to the Lender under and pursuant to the Lender Loan Facility, in accordance with the terms of the Lender Loan Facility.

12. Except as expressly set out in this Order, BMO shall be an unaffected creditor in these proceedings and under this Order and any plan of compromise or arrangement and, for greater certainty, shall not be subject to the stay of proceedings granted under paragraphs 17 to 23 of this Order.

RESTRUCTURING

13. Subject to such requirements as are imposed by the CCAA and as may be contained in the Lender Loan Facility, the Petitioner Parties shall have the right to:

- (a) permanently or temporarily cease, downsize or shut down all or any part of its Business or operations and commence marketing efforts in respect of any of its

redundant or non-material assets and to dispose of redundant or non-material assets not exceeding \$50,000 in any one transaction or \$200,000 in the aggregate.

- (b) terminate the employment of such of its employees or temporarily lay off such of its employees as it deems appropriate;
- (c) pursue all avenues of refinancing for its Business or Property, in whole or part; and
- (d) liquidate inventories in such manner and at such locations, including leased premises, as they deem suitable or desirable for the purpose of maximizing the proceeds and recovery therefrom;

all of the foregoing to permit the Petitioner Parties to proceed with an orderly restructuring of the Business (the "**Restructuring**").

14. The Petitioner Parties shall provide each of the relevant landlords with notice of the Petitioner Parties' intention to remove any fixtures from any leased premises at least seven (7) days prior to the date of the intended removal. The relevant landlord shall be entitled to have a representative present in the leased premises to observe such removal and, if the landlord disputes the Petitioner Parties' entitlement to remove any such fixture under the provisions of the lease, such fixture shall remain on the premises and shall be dealt with as agreed between any applicable secured creditors who claim a security interest in the fixtures, such landlord and the Petitioner Parties, or by further Order of this Court upon application by the Petitioner Parties, the landlord or the applicable secured creditors on at least two (2) clear days' notice to the other parties. If the Petitioner Parties disclaim the lease governing such leased premises in accordance with Section 32 of the CCAA, it shall not be required to pay Rent under such lease pending resolution of any dispute concerning such fixtures (other than Rent payable for the notice period provided for in Section 32(5) of the CCAA), and the disclaimer of the lease shall be without prejudice to the Petitioner Parties' claim to the fixtures in dispute.

15. If a notice of disclaimer is delivered pursuant to Section 32 of the CCAA, then: (a) during the period prior to the effective time of the disclaimer, the landlord may show the affected leased premises to prospective tenants during normal business hours on giving the Petitioner Parties and the Monitor 24 hours' prior written notice; and (b) at the effective time of the disclaimer, the

landlord shall be entitled to take possession of any such leased premises without waiver of or prejudice to any claims the landlord may have against the Petitioner Parties, or any other rights the landlord might have, in respect of such lease or leased premises and the landlord shall be entitled to notify the Petitioner Parties of the basis on which it is taking possession and gain possession of and re-lease such leased premises to any third party or parties on such terms as the landlord considers advisable, provided that nothing herein shall relieve the landlord of its obligation to mitigate any damages claimed in connection therewith.

16. Pursuant to Section 7(3)(c) of the *Personal Information Protection and Electronics Documents Act*, S.C. 2000, c. 5 and Section 18(1)(o) of the *Personal Information Protection Act*, S.B.C. 2003, c. 63, and any regulations promulgated under authority of either Act, as applicable (the “**Relevant Enactment**”), the Petitioner Parties, in the course of these proceedings, is permitted to, and hereby shall, disclose personal information of identifiable individuals in their possession or control to stakeholders, their advisors, prospective investors, financiers, buyers or strategic partners (collectively, “**Third Parties**”), but only to the extent desirable or required to negotiate and complete the Restructuring or to prepare and implement the Plan or transactions for that purpose; provided that the Third Parties to whom such personal information is disclosed enter into confidentiality agreements with the Petitioner Parties binding them in the same manner and to the same extent with respect to the collection, use and disclosure of that information as if they were an organization as defined under the Relevant Enactment, and limiting the use of such information to the extent desirable or required to negotiate or complete the Restructuring or to prepare and implement the Plan or transactions for that purpose, and attorning to the jurisdiction of this Court for the purposes of that agreement. Upon the completion of the use of personal information for the limited purposes set out herein, the Third Parties shall return the personal information to the Petitioner Parties or destroy it. If the Third Parties acquire personal information as part of the Restructuring or the preparation and implementation of the Plan or transactions in furtherance thereof, such Third Parties may, subject to this paragraph and any Relevant Enactment, continue to use the personal information in a manner which is in all respects identical to the prior use thereof by the Petitioner.

STAY OF PROCEEDINGS, RIGHTS AND REMEDIES

17. Until and including November 18, 2011, or such later date as this Court may order (the “**Stay Period**”), no action, suit or proceeding in any court or tribunal (each, a “**Proceeding**”) against or in respect of the Petitioner Parties or the Monitor, or affecting the Business or the Property, shall be commenced or continued except with the written consent of the Petitioner Parties and the Monitor or with leave of this Court, and any and all Proceedings currently under way against or in respect of the Petitioner Parties or affecting the Business or the Property are hereby stayed and suspended pending further Order of this Court.

18. During the Stay Period, all rights and remedies of any individual, firm, corporation, governmental body or agency, or any other entities (all of the foregoing, collectively being “**Persons**” and each being a “**Person**”) against or in respect of the Petitioner Parties or the Monitor, or affecting the Business or the Property, are hereby stayed and suspended except with the written consent of the Petitioner Parties and the Monitor or leave of this Court.

19. Nothing in this Order, including paragraphs 17 and 18, shall: (i) empower the Petitioner Parties to carry on any business which the Petitioner Parties are not lawfully entitled to carry on; (ii) affect such investigations, actions, suits or proceedings by a regulatory body as are permitted by Section 11.1 of the CCAA; (iii) prevent the filing of any registration to preserve or perfect a mortgage, charge or security interest (subject to the provisions of Section 39 of the CCAA relating to the priority of statutory Crown securities); or (iv) prevent the registration or filing of a lien or claim for lien or the commencement of a Proceeding to protect lien or other rights that might otherwise be barred or extinguished by the effluxion of time, provided that no further step shall be taken in respect of such lien, claim for lien or Proceeding except for service of the initiating documentation on the Petitioner Parties.

NO INTERFERENCE WITH RIGHTS

20. During the Stay Period, no Person shall discontinue, fail to honour, alter, interfere with, repudiate, terminate or cease to perform any right, renewal right, contract, agreement, licence or permit in favour of or held by the Petitioner Parties, except with the written consent of the Petitioner Parties and the Monitor or leave of this Court.

CONTINUATION OF SERVICES

21. During the Stay Period, all Persons having oral or written agreements with the Petitioner Parties or mandates under an enactment for the supply of goods and/or services, including without limitation all computer software, communication and other data services, centralized banking services, payroll services, insurance, transportation, services, utility or other services to the Business or the Petitioner Parties, are hereby restrained until further Order of this Court from discontinuing, altering, interfering with, or terminating the supply of such goods or services as may be required by the Petitioner Parties, and that the Petitioner Parties shall be entitled to the continued use of its current premises, telephone numbers, facsimile numbers, internet addresses and domain names, provided in each case that the normal prices or charges for all such goods or services received after the Order Date are paid by the Petitioner Parties in accordance with normal payment practices of the Petitioner Parties or such other practices as may be agreed upon by the supplier or service provider and the Petitioner Parties and the Monitor, or as may be ordered by this Court.

NON-DEROGATION OF RIGHTS

22. Notwithstanding any provision in this Order, no Person shall be prohibited from requiring immediate payment for goods, services, use of leased or licensed property or other valuable consideration provided on or after the Order Date, nor shall any Person be under any obligation to advance or re-advance any monies or otherwise extend any credit to the Petitioner Parties on or after the Order Date. Nothing in this Order shall derogate from the rights conferred and obligations imposed by the CCAA.

PROCEEDINGS AGAINST DIRECTORS AND OFFICERS

23. During the Stay Period, and except as permitted by subsection 11.03(2) of the CCAA, no Proceeding may be commenced or continued against the directors or officers of the Petitioner Parties with respect to any claim against the directors or officers that arose before the date hereof and that relates to any obligations of the Petitioner Parties whereby the directors or officers are alleged under any law to be liable in their capacity as directors or officers for the payment or performance of such obligations, until a compromise or arrangement in respect of the Petitioners,

if one is filed, is sanctioned by this Court or is refused by the creditors of the Petitioners or this Court. Nothing in this Order, including in this paragraph, shall prevent the commencement of a Proceeding to preserve any claim against a director or officer of the Petitioner Parties that might otherwise be barred or extinguished by the effluxion of time, provided that no further step shall be taken in respect of such Proceeding except for service of the initiating documentation on the applicable director or officer.

DIRECTORS AND OFFICERS INDEMNIFICATION AND CHARGE

24. The Petitioner Parties shall indemnify their directors and officers against obligations and liabilities that they may incur as directors or officers of the Petitioner Parties after the commencement of the within proceedings, except to the extent that, with respect to any director or officer, the obligation or liability was incurred as a result of the director's or officer's gross negligence or wilful misconduct.

25. The directors and officers of the Petitioner Parties shall be entitled to the benefit of and are hereby granted a charge (the "**Directors' Charge**") on the Property, which charge shall not exceed an aggregate amount of \$1,500,000 as security for the indemnity provided in paragraph 24 of this Order. The Directors' Charge shall have the priority set out in paragraphs 36 and 38 herein.

26. Notwithstanding any language in any applicable insurance policy to the contrary, (a) no insurer shall be entitled to be subrogated to or claim the benefit of the Directors' Charge, and (b) the Petitioner Parties' directors and officers shall only be entitled to the benefit of the Directors' Charge to the extent that they do not have coverage under any directors' and officers' insurance policy, or to the extent that such coverage is insufficient to pay amounts indemnified in accordance with paragraph 24 of this Order.

APPOINTMENT OF MONITOR

27. Alvarez & Marsal Canada Inc. is hereby appointed pursuant to the CCAA as the Monitor, an officer of this Court, to monitor the business and financial affairs of the Petitioner Parties with the powers and obligations set out in the CCAA or set forth herein, and that the Petitioner Parties and its shareholders, officers, directors, and Assistants shall advise the Monitor of all material

steps taken by the Petitioner Parties pursuant to this Order, and shall co-operate fully with the Monitor in the exercise of its powers and discharge of its obligations and provide the Monitor with the assistance that is necessary to enable the Monitor to adequately carry out the Monitor's functions.

28. The Monitor, in addition to its prescribed rights and obligations under the CCAA, is hereby directed and empowered to:

- (a) monitor the Petitioner Parties' receipts and disbursements;
- (b) report to this Court at such times and intervals as the Monitor may deem appropriate with respect to matters relating to the Property, the Business, and such other matters as may be relevant to the proceedings herein;
- (c) assist the Petitioner Parties, to the extent required by the Petitioner Parties, in its dissemination, to the Lender and its counsel financial and other information as agreed to between the Petitioner Parties and the Lender which may be used in these proceedings including reporting on a basis to be agreed with the Lender;
- (d) advise the Petitioner Parties in their preparation of the Petitioner Parties' cash flow statements and reporting as required by the Lender, which information shall be reviewed with the Monitor and delivered to the Lender and its counsel on a periodic basis;
- (e) advise the Petitioners in their development of the Plan and any amendments to the Plan;
- (f) assist the Petitioners, to the extent required by the Petitioners, with the holding and administering of creditors' or shareholders' meetings for voting on the Plan;
- (g) have full and complete access to the Property, including the premises, books, records, data, including data in electronic form, and other financial documents of the Petitioner Parties, to the extent that is necessary to adequately assess the Petitioner Parties' business and financial affairs or to perform its duties arising under this Order;

- (h) be at liberty to engage independent legal counsel or such other persons as the Monitor deems necessary or advisable respecting the exercise of its powers and performance of its obligations under this Order; and
- (i) perform such other duties as are required by this Order or by this Court from time to time.

29. The Monitor shall not take possession of the Property and shall take no part whatsoever in the management or supervision of the management of the Business and shall not, by fulfilling its obligations hereunder, or by inadvertence in relation to the due exercise of powers or performance of duties under this Order, be deemed to have taken or maintained possession or control of the Business or Property, or any part thereof, and nothing in this Order shall be construed as resulting in the Monitor being an employer or a successor employer, within the meaning of any statute, regulation or rule of law or equity, for any purpose whatsoever.

30. Nothing herein contained shall require or allow the Monitor to occupy or to take control, care, charge, possession or management (separately and/or collectively, "**Possession**") of any of the Property that might be environmentally contaminated, might be a pollutant or a contaminant, or might cause or contribute to a spill, discharge, release or deposit of a substance contrary to any federal, provincial or other law respecting the protection, conservation, enhancement, remediation or rehabilitation of the environment or relating to the disposal of waste or other contamination including, without limitation, the *Canadian Environmental Protection Act*, the *Fisheries Act*, the *British Columbia Environmental Management Act*, the *British Columbia Fish Protection Act* and regulations thereunder (the "**Environmental Legislation**"), provided however that nothing herein shall exempt the Monitor from any duty to report or make disclosure imposed by applicable Environmental Legislation. For greater certainty, the Monitor shall not, as a result of this Order or anything done in pursuance of the Monitor's duties and powers under this Order, be deemed to be in Possession of any of the Property within the meaning of any Environmental Legislation, unless it is actually in possession.

31. The Monitor shall provide any creditor of the Petitioner Parties and the Lender with information provided by the Petitioner Parties in response to reasonable requests for information made in writing by such creditor addressed to the Monitor. The Monitor shall not have any

responsibility or liability with respect to the information disseminated by it pursuant to this paragraph. In the case of information that the Monitor has been advised by the Petitioner Parties is confidential, the Monitor shall not provide such information to creditors unless otherwise directed by this Court or on such terms as the Monitor and the Petitioner Parties may agree.

32. In addition to the rights and protections afforded the Monitor under the CCAA or as an officer of this Court, the Monitor shall incur no liability or obligation as a result of its appointment or the carrying out of the provisions of this Order, save and except for any gross negligence or wilful misconduct on its part. Nothing in this Order shall derogate from the rights and protections afforded the Monitor by the CCAA or any applicable legislation.

ADMINISTRATION CHARGE

33. The Monitor, counsel to the Monitor, counsel to the Petitioner Parties and the Petitioner Parties' financial advisors shall be paid their reasonable fees and disbursements, in each case at their standard rates and charges, by the Petitioner Parties as part of the cost of these proceedings. The Petitioner Parties are hereby authorized and directed to pay the accounts of the Monitor, counsel to the Monitor, counsel to the Petitioner Parties and the Petitioner Parties' financial advisors on a periodic basis and, in addition, the Petitioner Parties are hereby authorized to pay to the Monitor, counsel to the Monitor, and counsel to the Petitioner Parties, retainers in the amounts of \$50,000 respectively to be held by them as security for payment of their respective fees and disbursements outstanding from time to time.

34. The Monitor and its legal counsel shall pass their accounts from time to time, and for this purpose the accounts of the Monitor and its legal counsel are hereby referred to a judge of the British Columbia Supreme Court and may be heard on a summary basis.

35. The Monitor, counsel to the Monitor, counsel to the Petitioner Parties and the Petitioner Parties' financial advisors shall be entitled to the benefit of and are hereby granted a charge (the "**Administration Charge**") on the Property, which charge shall not exceed an aggregate amount of \$500,000, as security for their respective fees and disbursements incurred at the standard rates and charges of the Monitor, counsel to the Monitor, counsel to the Petitioner Parties and the Petitioner Parties' financial advisors, both before and after the making of this Order which are

related to the Petitioner Parties' restructuring. For greater certainty, in respect of the fees and disbursements of the Petitioner Parties' financial advisors, the authorization granted in paragraph 33 herein and the scope of the Administration Charge shall refer to and include only obligations relating to monthly work fees and reasonable out-of-pocket expenses and not the payment of any success fees, restructuring fees or other amounts whether triggered upon implementation of a restructuring transaction or otherwise. The Administration Charge shall have the priority set out in paragraphs 36 and 38 hereof.

VALIDITY AND PRIORITY OF CHARGES CREATED BY THIS ORDER

36. The priorities of the Administration Charge, the Directors' Charge, and the Lender Security as among them, shall be as follows:

First – Administration Charge (to the maximum amount of \$350,000;

Second – Directors' Charge (to the maximum amount of \$500,000);

Third – Lender Security;

Fourth – Administration Charge (to the maximum amount of a further \$150,000); and

Fifth – Directors' Charge (to the maximum amount of a further \$1,000,000).

37. Any security documentation evidencing, or the filing, registration or perfection of, the Administration Charge and the Directors' Charge (collectively, the "**Charges**") shall not be required, and that the Charges shall be effective as against the Property and shall be valid and enforceable for all purposes, including as against any right, title or interest filed, registered or perfected subsequent to the Charges coming into existence, notwithstanding any failure to file, register or perfect any such Charges.

38. Each of the Administration Charge and the Directors' Charge (all as constituted and defined herein) shall constitute a mortgage, security interest, assignment by way of security and charge on the Property and such Charges shall rank in priority to all other security interests, trusts, liens, mortgages, charges and encumbrances and claims of secured creditors (including the Lenders, except that as set out in paragraph 36 only \$350,000 of the \$500,000 Administrative

Charge and \$500,000 of the \$1,500,000 Directors' Charge shall rank in priority to the Lender Security) statutory or otherwise (collectively, "**Encumbrances**"), in favour of any Person.

39. Except as otherwise expressly provided herein, or as may be approved by this Court, the Petitioner Parties shall not grant or suffer to exist any Encumbrances over any Property that rank in priority to, or *pari passu* with the Charges, unless the Petitioner Parties obtain the prior written consent of the Monitor and the beneficiaries of the Administration Charge and the Director's Charge.

40. The Administration Charge and the Director's Charge shall not be rendered invalid or unenforceable and the rights and remedies of the chargees entitled to the benefit of the Charges (collectively, the "**Chargees**") shall not otherwise be limited or impaired in any way by (a) the pendency of these proceedings and the declarations of insolvency made herein; (b) any application(s) for bankruptcy order(s) issued pursuant to the BIA, or any bankruptcy order made pursuant to such applications; (c) the filing of any assignments for the general benefit of creditors made pursuant to the BIA; or (d) any negative covenants, prohibitions or other similar provisions with respect to borrowings, incurring debt or the creation of Encumbrances, contained in any existing loan documents, lease, mortgage, security agreement, debenture, sublease, offer to lease or other agreement (collectively, an "**Agreement**") which binds the Petitioner Parties; and notwithstanding any provision to the contrary in any Agreement:

- (a) the creation of the Charges shall not create or be deemed to constitute a breach by the Petitioner Parties of any Agreement to which they are a party;
- (b) none of the Chargees shall have any liability to any Person whatsoever as a result of any breach of any Agreement caused by or resulting from the creation of the Charges;;and
- (c) the payments made by the Petitioner Parties pursuant to this Order and the granting of the Charges, do not and will not constitute preferences, fraudulent conveyances, transfers at undervalue, oppressive conduct, or other challengeable or voidable transactions under any applicable law.

41. THIS COURT ORDERS that any Charge created by this Order over leases of real property in Canada shall only be a Charge in the Petitioner Parties' interest in such real property leases.

SERVICE AND NOTICE

42. The Monitor shall (i) without delay, publish in the Globe & Mail (National Edition) a notice containing the information prescribed under the CCAA, (ii) within five days after Order Date, (A) make this Order publicly available in the manner prescribed under the CCAA, (B) send, in the prescribed manner, a notice to every known creditor who has a claim against the Petitioner Parties of more than \$1000, and (C) prepare a list showing the names and addresses of those creditors (excluding employees) and the estimated amounts of those claims, and make it publicly available in the prescribed manner, all in accordance with Section 23(1)(a) of the CCAA and the regulations made thereunder.

43. The Petitioner Parties and the Monitor are at liberty to serve this Order, any other materials and orders in these proceedings, any notices or other correspondence, by forwarding true copies thereof by prepaid ordinary mail, courier, personal delivery or electronic transmission to the Petitioner Parties' creditors or other interested parties at their respective addresses as last shown on the records of the Petitioner Parties and that any such service or notice by courier, personal delivery or electronic transmission shall be deemed to be received on the next business day following the date of forwarding thereof, or if sent by ordinary mail, on the third business day after mailing.

44. Any Person that wishes to be served with any application and other materials in these proceedings must deliver to the Monitor by way of ordinary mail, courier, personal delivery or electronic transmission a request to be added to a service list (the "**Service List**") to be maintained by the Monitor. The Monitor shall post and maintain an up to date form of the Service List on its website at: www.alvarezandmarsal.com/sterling.

45. Any party to these proceedings may serve any court materials in these proceedings by emailing a PDF or other electronic copy of such materials to counsels' email addresses as

recorded on the Service List from time to time, and the Monitor shall post a copy of all prescribed materials on its website at: www.alvarezandmarsal.com/sterling.

46. Notwithstanding paragraphs 44 and 45 of this Order, service of the Petition, the Notice of Hearing of Petition, the Affidavit #1 of Daniel Gumprich this Order and any other pleadings in this proceeding (collectively, the "**Materials**"), shall be made on the federal and British Columbia Crowns in accordance with the *Crown Liability and Proceedings Act*, R.S.C. 1985, c. C-50, and regulations thereto, in respect of the federal Crown, and the *Crown Proceeding Act*, R.S.B.C. 1996, c. 89, in respect of the British Columbia Crown.

GENERAL

47. The Petitioner Parties or the Monitor may from time to time apply to this Court for advice and directions in the discharge of its powers and duties hereunder.

48. Nothing in this Order shall prevent the Monitor from acting as an interim receiver, a receiver, a receiver and manager, or a trustee in bankruptcy of the Petitioner Parties, the Business or the Property.

49. THIS COURT REQUESTS the aid and recognition of other Canadian and foreign Courts, tribunal, regulatory or administrative bodies, including any Court or administrative tribunal of any Federal or State Court or administrative body in the United States of America, to act in aid of and to be complementary to this Court in carrying out the terms of this Order where required. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to make such orders and to provide such assistance to the Petitioner Parties and to the Monitor, as an officer of this Court, as may be necessary or desirable to give effect to this Order, to grant representative status to the Monitor in any foreign proceeding, or to assist the Petitioner Parties and the Monitor and their respective agents in carrying out the terms of this Order.

50. Each of the Petitioner Parties and the Monitor be at liberty and is hereby authorized and empowered to apply to any court, tribunal, regulatory or administrative body, wherever located, for the recognition of this Order and for assistance in carrying out the terms of this Order and the Monitor is authorized and empowered to act as a representative in respect of the within proceedings for the purpose of having these proceedings recognized in a jurisdiction outside

Canada, including acting as a foreign representative of the Petitioner to apply to the United States Bankruptcy Court for relief pursuant to Chapter 15 of the *United States Bankruptcy Code*, 11 U.S.C. §§ 101-1330, as amended.

51. The Petitioner Parties may (subject to the provisions of the CCAA and the BIA) at any time file a voluntary assignment in bankruptcy or a proposal pursuant to the commercial reorganization provisions of the BIA if and when the Petitioner Parties determine that such a filing is appropriate.

52. The Petitioner Parties are hereby at liberty to apply for such further interim or interlocutory relief as it deems advisable within the time limited for Persons to file and serve Responses to the Petition.

53. Leave is hereby granted to hear any application in these proceedings on two (2) clear days' notice after delivery to all parties on the Service List of such Notice of Application and all affidavits in support, subject to the Court in its discretion further abridging or extending the time for service.

54. Any interested party (including the Petitioner Parties and the Monitor) may apply to this Court to vary or amend this Order on not less than seven (7) days' notice to all parties on the Service List and to any other party or parties likely to be affected by the order sought or upon such other notice, if any, as this Court may order.

55. Endorsement of this Order by counsel appearing on this application is hereby dispensed with.

56. This Order and all of its provisions are effective as of 12:01 a.m. local Vancouver time on the Order Date.

THE FOLLOWING PARTIES APPROVE THE FORM OF THIS ORDER AND CONSENT TO EACH OF THE ORDERS, IF ANY, THAT ARE INDICATED ABOVE AS BEING BY CONSENT:



Signature of

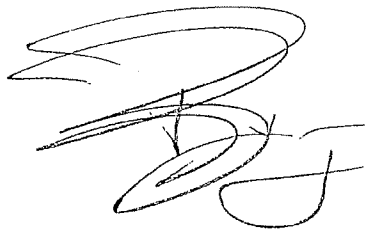
☐ Party ☒ Lawyer for the Petitioner Parties

PETER L. RUBIN

BY THE COURT



REGISTRAR



Schedule "A"

Name of Counsel	Party
Colin Brousson	Bank of Montreal
John Grieve	Monitor – Alvarez & Marsal Canada Inc.

APPENDIX B

has repeatedly said it doesn't have the keys to unlock enterprise e-mail messages - security is one of the service's key selling

der ally headlines and we believe the government ... is now applying its security policy in a consistent manner to all handset

A spokeswoman for Twitter was not immediately available for comment. Microsoft and Face-

opportunity, as most of the India's 866 million cellphone users are upgrading to smart phones.

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LEGALS

NO. S-117081
VANCOUVER REGISTRY

IN THE SUPREME COURT OF BRITISH COLUMBIA
IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT,
R.S.C. 1985, C. C-36, AS AMENDED (THE "CCAA")

AND

IN THE MATTER OF THE CANADA BUSINESS CORPORATIONS ACT,
R.S.C. 1985, C. C-44

AND

IN THE MATTER OF STERLING SHOES INC. AND STERLING SHOES GP INC.
(TOGETHER, THE "PETITIONERS")

TAKE NOTICE THAT on October 21, 2011, the Petitioners commenced proceedings under the CCAA in the Supreme Court of British Columbia (the "Court") and were granted an initial order (the "Initial Order").

The Initial Order, among other things, stays all proceedings against or in respect of the Petitioners and Sterling Shoes Limited Partnership ("Sterling LP"). Pursuant to the Initial Order, Alvarez & Marsal Canada Inc. was appointed Monitor (the "Monitor") of the business and financial affairs of the Petitioners and Sterling LP.

A copy of the Initial Order has been posted on the Monitor's website at: www.alvarezandmarsal.com/sterling

The Monitor will post additional relevant information and documentation related to the Petitioners' CCAA proceedings on the Monitor's website as they become available. Interested parties may contact the Monitor directly for further information at:

Tom Powell
Alvarez & Marsal Canada Inc.
400 Burrard Street, Suite 1680
Commerce Place
Vancouver, BC V6C 3A6
Telephone: (+1) 604-639-0846
Facsimile: (+1) 604-638-7441
Email: tpowell@alvarezandmarsal.com

DIVIDENDS



CANADIAN UTILITIES LIMITED
An ATCO Company

DIVIDEND NOTICE

NOTICE is hereby given that the Board of Directors has declared the following quarterly dividends payable December 1, 2011 to shareholders of record on November 10, 2011:

- Class A non-voting shares, \$0.4025 per share
- Class B common shares, \$0.4025 per share
- Series W Preferred shares, \$0.3625 per share
- Series X Preferred shares, \$0.3750 per share
- Series Y Preferred shares, \$0.1945 per share

These dividends are eligible dividends for Canadian income tax purposes.

By Order of the Board
P. Spruin
Vice President, Administration & Corporate Secretary

Calgary, Alberta
October 20, 2011



An ATCO Company

DIVIDEND NOTICE

NOTICE is hereby given that the Board of Directors has declared the following quarterly dividends payable December 1, 2011 to shareholders of record on November 10, 2011:

- Series 1 Preferred shares, \$0.28750 per share
- Series 2 Preferred shares, \$0.41875 per share
- Series 4 Preferred shares, \$0.23750 per share

These dividends are eligible dividends for Canadian income tax purposes.

By Order of the Board
P. Spruin
Corporate Secretary

Calgary, Alberta
October 20, 2011

TO SUBSCRIBE CALL 1-866-3

10/28/11



400 Burrard Street
Suite 1680, Commerce Place
Vancouver, BC V6C 3A6
Phone: 604.638.7440 Fax: 604.638.7441
www.alvarezandmarsal.com

October 26, 2011

To the Creditors of Sterling Shoes Inc., Sterling Shoes Limited Partnership and Sterling Shoes GP Inc. (collectively "Sterling" or the "Company"):

On October 21, 2011, Sterling Shoes Inc. and Sterling Shoes GP Inc. commenced proceedings (the "Proceedings") in the Supreme Court of British Columbia (the "Court") under the *Companies' Creditors Arrangement Act* (the "CCAA") and the *Canada Business Corporations Act*. On the same day, the Court granted an order (the "Initial Order"), which, among other things, stays all proceedings against or in respect of the Company until November 18, 2011 (the "Stay Period"). The Stay Period may be extended from time to time by the Court on subsequent applications by the Company. Also pursuant to the Initial Order, Alvarez & Marsal Canada Inc. was appointed monitor (the "Monitor") of the business and financial affairs of the Company.

Copies of the Initial Order and all materials filed in the Proceedings may be obtained at the Monitor's website www.alvarezandmarsal.com/sterling or on request from the Monitor at: (+1) 604-639-0846.

In accordance with the terms of the Initial Order, Sterling continues to operate in the ordinary course of business while under protection from its creditors.

Pursuant to the Initial Order, all persons having oral or written agreements with the Petitioner or statutory or regulatory mandates for the supply of goods and/or services are restrained from discontinuing the supply of such goods or services. The Company must pay such persons the normal prices or charges for all such goods or services received after the date of the Initial Order in accordance with the normal payment practices of Sterling or on such other terms as may be agreed upon by the supplier, the Company and the Monitor, or as may be ordered by the Court. The Company is reviewing its purchase orders relating to inventory purchases that were outstanding as at October 21, 2011 and will be contacting suppliers directly should there be a change in the status of those orders.

The Initial Order prohibits the Company from making payment of amounts relating to the supply of goods or services prior to October 21, 2011, other than under certain conditions as set out in the Initial Order.

To date, no claims procedure has been approved by the Court and creditors are therefore not required to file a proof of claim at this time. We will in due course forward a Proof of Claim form for completion by creditors. The Company is also working to formulate a Plan of Arrangement to be voted on by its creditors. The timing for circulation of the Plan of Arrangement and the meeting at which it will be voted on is not yet known.

If you have any questions regarding the foregoing or require further information, please consult the Monitor's website at www.alvarezandmarsal.com/sterling or should you wish to speak to a representative of the Monitor, please contact Mr. Tom Powell at: (+1) 604-639-0846.

Yours very truly,

Alvarez & Marsal Canada Inc.
in its capacity as court-appointed Monitor of
Sterling Shoes Inc. and Sterling Shoes GP Inc.

Per: 
Todd M. Martin
Senior Vice President

APPENDIX D

Interim Consolidated Financial Statements of

STERLING SHOES INC.

September 30, 2011

(Unaudited - Expressed in thousands of Canadian dollars)

STERLING SHOES INC.

Consolidated Statement of Financial Position

(Unaudited - Expressed in thousands of Canadian dollars, except per share and number of share figures.)

	As at September 30, 2011	As at December 31, 2010
ASSETS		
CURRENT		
Cash	\$ -	7,444
Accounts receivable	289	359
Inventory [note 4]	40,227	28,614
Prepaid expenses and deposits	400	336
	40,916	36,753
NON-CURRENT		
Leascholds & Equipment [note 5]	17,350	17,969
Deferred Income Taxes [note 14]	-	-
Intangible Assets [note 6]	-	16,623
	17,350	34,592
	\$ 58,266	\$ 71,345
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT		
Operating loan [note 7]	\$ 10,227	\$ -
Accounts payable and accrued liabilities	17,043	16,225
Convertible Debentures [note 8]	25,000	-
Term loan [note 7]	4,000	1,000
	56,270	17,225
NON-CURRENT		
Deferred Income Taxes [note 14]	-	793
Term Loan [note 7]	-	3,500
Convertible Debentures [note 8]	-	23,264
Deferred Lease Inducements	1,474	1,653
	1,474	29,210
SHAREHOLDERS' EQUITY		
Shareholders' capital	59,809	59,809
Equity component of Debentures [note 8]	2,657	2,657
Accumulated Deficit	(61,944)	(37,556)
	522	24,910
	\$ 58,266	\$ 71,345

GOING CONCERN AND SUBSEQUENT EVENTS [note 1]

COMMITMENTS [note 9]

On behalf of the Board of Directors

(signed) Rick Mahler
Director(signed) Dave Alves
Director

See accompanying notes to the interim consolidated financial statements

STERLING SHOES INC.

Consolidated Statements of Loss and Comprehensive Loss

(Unaudited - Expressed in thousands of Canadian dollars, except per share and number of share figures.)

	Three-month period ended		Nine-month period ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
SALES	\$ 26,960	\$ 32,218	\$ 73,284	\$ 87,679
COST OF SALES	14,953	21,537	38,210	50,108
GROSS MARGIN	12,007	10,681	35,074	37,572
EXPENSES				
Store and selling	10,817	11,215	31,565	33,418
General and administrative	2,290	1,909	6,758	5,607
Conversion costs	-	90	-	398
Amortization of leaseholds and equipment	939	867	2,675	2,745
	14,046	14,082	40,998	42,168
Loss before interest, financing expense and disposal	(2,039)	(3,401)	(5,924)	(4,596)
Impairment of intangible assets [note 6]	16,623	-	16,623	-
Interest and financing expense	798	653	2,212	1,955
Accelerated interest accretion on convertible debentures [note 8]	-	-	1,120	-
Unrealized (gain) / loss on foreign exchange	(1,057)	-	(974)	-
Loss on disposal of leaseholds and equipment	124	2	276	220
NET LOSS BEFORE TAXES	(19,647)	(4,056)	(25,181)	(6,771)
Deferred income taxes (expense) / recovery [note 14]	(577)	-	793	-
NET LOSS AND TOTAL COMPREHENSIVE LOSS	(20,224)	(4,056)	(24,388)	(6,771)
Basic and Diluted net loss per share	\$ (3.04)	\$ (0.61)	\$ (3.67)	\$ (1.02)
Basic weighted average number of shares outstanding	6,641,860	6,641,860	6,641,860	6,641,860
Diluted weighted average number of shares outstanding	7,823,885	7,823,885	7,823,885	7,823,885

See accompanying notes to the interim consolidated financial statements

STERLING SHOES INC.

Consolidated Statement of Changes in Equity

For the nine-month period ended September 30, 2011

(Unaudited - Expressed in thousands of Canadian dollars, except per share and number of share figures.)

	Number of shares	Par value of shares	Shareholders' capital	Equity component of Debentures [note 9]	Accumulated deficit	Shareholders' equity
BALANCE, January 1, 2010	6,641,860	\$ 9.00	\$9,809	2,657	(32,248)	\$ 30,218
Net loss for the period	-	-	-	-	(6,771)	(6,771)
BALANCE, September 30, 2010	6,641,860	\$ 9.00	\$9,809	2,657	(39,019)	\$ 23,447
Net loss for the period	-	-	-	-	1,463	1,463
BALANCE, December 31, 2010	6,641,860	\$ 9.00	\$9,809	2,657	(37,556)	\$ 24,910
Net loss for the period	-	-	-	-	(24,388)	(24,388)
BALANCE, September 30, 2011	6,641,860	\$ 9.00	\$9,809	2,657	(61,944)	\$ 522

See accompanying notes to the interim consolidated financial statements

STERLING SHOES INC.

Consolidated Statements of Cash Flows

(Unaudited - Expressed in thousands of Canadian dollars, except per share and number of share figures.)

	Three-month period ended		Nine-month period ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
OPERATING ACTIVITIES				
Net Loss	\$ (20,224)	\$ (4,056)	\$ (24,388)	\$ (6,771)
Items not involving cash				
Impairment of intangible assets	16,623	-	16,623	-
Deferred income taxes expense / (recovery)	877	-	(793)	-
Amortization of leaseholds and equipment	939	867	2,675	2,745
Loss on disposal of leaseholds and equipment	124	2	276	220
Amortization of deferred lease inducements	(78)	(92)	(250)	(318)
Accreted interest expense	1,329	188	1,733	552
	(710)	(3,091)	(4,124)	(3,572)
Change in non-cash working capital balances related to operations				
Accounts receivable	142	(1,171)	71	(1,096)
Inventory	(4,730)	(354)	(11,613)	(814)
Prepaid expenses and deposits	(0)	(78)	(64)	(147)
Accounts payable and accrued liabilities	4,180	5,453	820	3,231
	(408)	3,850	(10,786)	1,174
Cash (used in) / provided by operating activities	(1,118)	759	(14,910)	(2,398)
INVESTING ACTIVITIES				
Acquisition of leaseholds and equipment	(395)	(950)	(2,398)	(1,710)
Proceeds from disposal of assets	66	-	66	-
Lease inducements received	-	-	71	-
Cash used in investing activities	(329)	(950)	(2,261)	(1,710)
FINANCING ACTIVITIES				
Term loan	-	(250)	(500)	(250)
Cash used in financing activities	-	(250)	(500)	(250)
CASH OUTFLOW DURING THE PERIOD	(1,447)	(441)	(17,671)	(4,358)
CASH, BEGINNING OF PERIOD	(8,780)	202	7,444	4,119
CASH, END OF PERIOD	\$ (10,227)	\$ (239)	\$ (10,227)	\$ (239)
Supplemental cash flow information				
Interest paid	\$ 182	\$ 74	\$ 1,186	\$ 1,013

See accompanying notes to the interim consolidated financial statements

NOTICE OF NO AUDITOR REVIEW OF INTERIM CONSOLIDATED FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim consolidated financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim consolidated financial statements of Sterling Shoes Inc. for the three and nine month periods ending September 30, 2011 and 2010 have been prepared by management and approved by the Board of Directors of the Company.

The Company's independent auditor has not performed a review of these interim consolidated financial statements.

DATED this 10th day of November, 2011

STERLING SHOES INC.

(signed) Rick Mahler
Director

(signed) Dave Alves
Director

STERLING SHOES INC.

Notes to Interim Consolidated Financial Statements

September 30, 2011

(Unaudited - Expressed in thousands of Canadian dollars, unless otherwise specified and except for per share amounts.)

1. BASIS OF PRESENTATION AND GOING CONCERN

Nature of operations

Sterling Shoes Inc. (the “Company”) is an incorporated entity headquartered in Richmond, B.C., Canada. The head office, principal address and registered and records office of the Company are located at 2580 Viscount Way, Richmond, British Columbia, V6V 1N1.

The Company operates retail stores in five provinces in shopping malls, high-streets and strip malls, principally in Western Canada. The Company is a footwear retailer offering a broad selection of private label and national brand name shoes and accessories through five separate retail banners: Sterling, Joneve, Shoe Warehouse, Freedman Shoes, and Gia.

Creditor Protection Proceedings

On October 21, 2011, the Company obtained an Initial Order (the “Order”) from the Supreme Court of British Columbia (the “Court”) under the Companies’ Creditors Arrangement Act (Canada), R.S.C. 1985, c. C-36, as amended (the “CCAA”). The Company will continue to operate during this period of restructuring.

The Court granted protection under the CCAA for an initial period expiring on November 18, 2011 to be extended as required and approved by the Court. The Company expects to seek an extension on or before November 18, 2011. While the Company is under CCAA protection, all proceedings on the part of its creditors are stayed.

The Order permits the Company to pay all expenses incurred in carrying on the business after the date of the Order, including goods and services delivered by suppliers. The terms and conditions of the restructuring plan have not yet been determined by the Company.

Alvarez and Marsal Canada Inc. has been appointed Monitor pursuant to the Initial Order.

Basis of presentation and going concern

These unaudited interim consolidated financial statements have been prepared on a going concern basis, which assumes that the Company will continue to realize certain assets and discharge certain liabilities while operations are ongoing during this restructuring period. The CCAA filing provides the Company with temporary relief and financial support to enable it to continue to operate with minimal disruption while a restructuring plan is developed and implemented.

Certain adjustments have been made in the financial statements as at September 30, 2011:

a. Reclassification of convertible debentures (Note 8)

On September 27, 2011, the Company announced that its Board of Directors resolved that the Company would not make the interest payment on its Convertible Debentures (Note 8) that was due to be paid on October 31, 2011. The Company has notified the Debenture Trustee that it will default on its interest payment on the Debentures. As at September 30, 2011, the Debentures were reclassified to current liabilities and shown at face value to reflect the fact that the Debentures became a demand loan upon the Company’s default. As a result, the remaining

STERLING SHOES INC.

Notes to Interim Consolidated Financial Statements

September 30, 2011

(Unaudited - Expressed in thousands of Canadian dollars, unless otherwise specified and except for per share amounts.)

unamortized interest accretion of \$1.1 million was expensed during the three-months ended September 30, 2011.

b. Write-down of deferred income tax asset (Note 14)

The Company is experiencing negative cash flow from operations and there is no certainty as to when or if it will return to positive cash generation. In light of these conditions, the value of the deferred income tax asset was written down to \$nil at September 30, 2011 resulting in an income tax expense of \$577 thousand for the three months ended September 30, 2011 and an income tax recovery of \$793 thousand (2010 - \$Nil and \$Nil) for the nine months ended September 30, 2011.

c. Impairment of intangible assets (Note 6)

At September 30, 2011, the Company determined that the fair value of the intangible assets was \$nil, resulting in a non-cash impairment charge of \$16.6 million for the three-months ended September 30, 2011. The impairment arose primarily due to future economic uncertainty and the higher cost of capital assumptions in the valuation methodology.

Amended banking facilities (Note 7)

On October 20, 2011, the Company concluded negotiations with the Bank of Montreal as to the terms and conditions of the forbearance agreement (the "Forbearance Agreement"). Pursuant to the Forbearance Agreement, the Bank of Montreal will continue to provide the Company with availability under the Amended Facility, including an overadvance limit of up to \$2.5 million, on the terms and conditions set out in the Amended Facility, as amended by the Forbearance Agreement.

The Forbearance Agreement expires on December 31, 2011 (or such earlier time as provided in the Forbearance Agreement on the occurrence of certain events).

Notice of Delisting

On October 27, 2011 the Company received notice from the Toronto Stock Exchange (the "TSX") that its common shares and convertible debentures (Symbol: SSI and SSI.DB, respectively) will be delisted at the close of market on November 25, 2011 for failure to meet the continued listing requirements of TSX. The common shares and debentures will remain suspended from trading until that date.

Significant uncertainties related to Creditor Protection Proceedings

Should the stay period in the CCAA proceedings and any subsequent extensions thereof not be sufficient in duration or scope to allow the Company to develop and present a restructuring plan under the CCAA or should the restructuring plan not be accepted by affected creditors or confirmed by the Court and, in any such case, should the Company lose the protection of the stay of proceedings, creditors may immediately enforce their rights and remedies against the Company and its assets which would in all likelihood lead to liquidation proceedings. Failure to implement a restructuring plan and obtain sufficient exit financing within the time granted by the Court would in all likelihood also lead to liquidation of the Company's assets.

As the Company is in the process of completing the restructuring plan, the financial statements do not reflect any write-downs of leaseholds and equipment and associated inventory write-downs if

STERLING SHOES INC.

Notes to Interim Consolidated Financial Statements

September 30, 2011

(Unaudited - Expressed in thousands of Canadian dollars, unless otherwise specified and except for per share amounts.)

a store closure program is determined to be necessary. The financial statements also do not reflect any adjustment to the Company's indebtedness that may result from the restructuring plan.

There can be no assurance that a restructuring plan proposed by the Company will be supported by the Company's creditors or confirmed by the Court or that it will be consummated or successful. The Company's financial statements do not contain any adjustments to the amounts or classification of assets and liabilities that might be necessary should the Company be unable to continue in business.

Financial Statements

These interim consolidated financial statements include the accounts of the Company, and its wholly owned subsidiaries. Wholly owned subsidiaries are entities in which the Company has control, directly or indirectly, where control is defined as the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. All intercompany transactions have been eliminated.

Details of the Company's subsidiaries at September 30, 2011 are as follows:

Name	Place of incorporation	Interest %	Principal activity
Sterling Shoes LP	Manitoba, Canada	100%	Limited partner
Sterling Shoes GP Inc.	British Columbia, Canada	100%	General partner

These interim consolidated financial statements are prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34, Interim Financial Reporting ("IAS 34") and IFRS 1, First-Time Adoption of International Financial Reporting Standards ("IFRS 1"). Subject to certain transition elections disclosed in Note 4, we have consistently applied the same accounting policies in our opening IFRS balance sheet as at January 1, 2010 and throughout all periods presented, as if these policies had always been in effect. Note 3 discloses the impact of the transition to IFRS on our reported balance sheet, comprehensive income and cash flows, including the nature and effect of significant changes in accounting policies from those used in our consolidated financial statements for the year ended December 31, 2010.

The policies applied in these interim consolidated financial statements are presented in Note 2 and are in accordance with IFRS. Any subsequent changes to IFRS that are given effect in our annual consolidated financial statements for the year ending December 31, 2011 could result in restatement of these interim consolidated financial statements. In previous periods, the Company prepared its interim consolidated financial statements in accordance with Canadian GAAP.

These interim consolidated financial statements were approved and authorized for issue by the Board of Directors on November 10, 2011.

STERLING SHOES INC.

Notes to Interim Consolidated Financial Statements

September 30, 2011

(Unaudited - Expressed in thousands of Canadian dollars, unless otherwise specified and except for per share amounts.)

2. ACCOUNTING POLICIES

a) *Presentation currency and foreign currency translation*

Functional currency is the currency of the primary economic environment in which an entity operates and is normally the currency in which the entity primarily generates and expends cash. The majority of the Company's business is transacted in Canadian dollars and, accordingly, these interim consolidated financial statements have been measured and expressed in that currency.

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

b) *Inventory*

The Company determines inventory cost based on a weighted average cost formula and values inventory at the lower of cost and net realizable value. Net realizable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale.

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

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

c) *Financial Instruments*

Financial assets and financial liabilities are initially recognized at fair value including transaction costs. Their subsequent measurement is dependent on their classification as described below. Their classification depends on the purpose for which the financial instruments were acquired or issue, their characteristics and the Company's designation of such instruments. The standards require that all financial assets be classified either as FVTPL, available-for-sale ("AFS"), held-to-maturity ("HTM"), or loans and receivables. The standards require that all financial assets, including all derivatives, be measured at fair value with the exception of loans and receivables, debt securities classified as HTM, and AFS financial assets that do not have a reliable measurable fair value.

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

Cash	Fair value through profit and loss ("FVTPL")
Accounts receivable	Loans and receivables
Accounts payable	Other liabilities
Bank indebtedness	Other liabilities
Long-term debt	Other liabilities

STERLING SHOES INC.

Notes to Interim Consolidated Financial Statements

September 30, 2011

(Unaudited - Expressed in thousands of Canadian dollars, unless otherwise specified and except for per share amounts.)

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

Financial liabilities designated at FVTPL accounted for in the same manner as FVTPL financial assets. The Company has not designated any non-derivative financial liabilities as FVTPL.

Held-to-maturity – HTM financial assets are non-derivative financial assets with fixed or determinable payments and a fixed maturity, other than loans and receivables that an entity has the positive intention and ability to hold to maturity. These financial assets are measured at amortized cost. The Company does not have any HTM financial assets as at March 31, 2011.

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

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

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

d) Income Taxes

Deferred income taxes are accounted for using the asset and liability method. The liability method requires that income taxes reflect the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities and their tax bases. Deferred income tax assets and liabilities are determined based on the difference between the tax basis of the Company's assets and liabilities and the amounts reported in the financial statements. Deferred tax assets or liabilities are calculated using currently enacted or substantially enacted tax rates that are expected to be in effect in the periods in which the differences are expected to be settled. The effect of a change in tax rates or tax legislation is recognized in the period of substantive enactment. Deferred tax assets are recognized when it is considered probable that there will be sufficient taxable income for them to be realized.

e) Use of Estimates

The preparation of financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingencies at the date of the financial statements and the reported amount of revenues and expenses during the period. Areas requiring significant management estimates include the valuation of inventory, the valuation of intangible assets, the valuation of the liability and equity components of the convertible unsecured subordinated debentures, the recorded amounts of

STERLING SHOES INC.

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accrued liabilities, the estimation of deferred income taxes, and the useful life of leaseholds and equipment. Actual results could differ from these estimates.

f) Accounting Judgments

In the process of selecting accounting policies and interpreting and applying guidance under IFRS, management made various judgments that can significantly impact the consolidated financial statements. Areas requiring significant management judgements include the identification of Cash Generating Units, and segments, as well as the determination of fair value as deemed cost for intangible assets on transition to IFRS and the assessment of the probability of realizing future tax assets.

g) Cash

Cash consists of cash on hand and bank balances.

h) Leaseholds and equipment

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

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

Amortization is pro-rated in the year of acquisition.

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

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

i) Intangible assets

Identifiable intangible assets, including store banners and private label brand names are carried at deemed cost, being the fair value amount of the assets as at December 31, 2010. 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 the assets may be impaired. In performing a formal impairment assessment, the Company estimates the recoverable amount of the asset by performing a

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comparison of the asset's carrying value to the higher of fair value less costs to sell and value in use, which is defined as the present value of future cash flows expected to be derived from the asset in its current state. 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 the higher of fair value less costs to sell and value in use.

j) Deferred lease inducements

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

k) Transaction costs

Transaction costs attributable to financial instruments classified as other than FVTPL are included in the recognized amount of the related financial instrument and recognized over the life of the instrument using the effective interest rate method. The convertible debentures have an effective interest rate of 10.7%.

l) Revenue recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured.

Revenue is measured at the fair value of the consideration received at the point of sale excluding discounts, sales tax and duty, and a provision for sales returns.

m) Net income (loss) per share

Basic net income (loss) per share of the Company is calculated by dividing the net income (loss) by the weighted average number of shares outstanding during the reporting period. Diluted net income (loss) per share is calculated by dividing the net income (loss), adjusted for the interest expense on the Convertible Debentures (Note 8), by the sum of the weighted average number of shares outstanding used in the basic net income (loss) per share calculation and the number of shares that would be issued assuming conversion of all Convertible Debentures. As at September 30, 2011 the Convertible Debentures were not included in the computation of diluted net loss per share for the three and nine month periods ended September 30, 2011 because to do so would have been anti-dilutive.

n) Long-term incentive plan

Under the terms of a long-term incentive plan ("LTIP") the Board may grant, at its discretion, LTIP rights to employees or non-employees who are, at the time of such grant, providing service to the Company. The grant of an LTIP right will be based on the performance during the prior year as determined and approved by the Board.

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LTIP shares will vest on the 3rd anniversary of the purchase of shares which in the meantime will be held by the LTIP plan trustee. The cost is expensed evenly over the three year vesting period. As at September 30, 2011, the Company did not accrue any liability in respect of the LTIP (2010 - \$nil). During the three and nine month periods ended September 30, 2011 the Company recorded \$17 thousand and \$50 thousand compensation expense (2010 - \$nil and \$nil).

o) Provisions

Provisions are recognized where a legal or constructive obligation has been incurred as a result of past events, it is probable that an outflow of resources embodying economic benefit will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. If material, provisions are measured at the present value of the expenditures expected to be required to settle the obligation. The Company has recognized no such provisions in these interim consolidated financial statements.

3. ADOPTION OF INTERNATIONAL REPORTING STANDARDS ("IFRS")

These interim consolidated financial statements comply with IFRS, including the application of IFRS 1 First-Time Adoption of International Financial Reporting Standards.

IFRS 1 First-Time Adoption of International Financial Reporting Standards

Adoption of IFRS requires the application of IFRS 1, "First-time Adoption of International Financial Reporting Standards", which provides guidance for an entity's initial adoption of IFRS. IFRS 1 gives entities adopting IFRS for the first time a number of optional exemptions and mandatory exceptions, in certain areas, to the general requirement for full retrospective application of IFRS.

Elections upon first time adoption of IFRS:

The following are the optional exemptions available under IFRS 1 that the Company applied in the conversion from Canadian GAAP to IFRS.

Fair value or revaluation as deemed cost

IFRS 1 provides an option to allow a first-time IFRS adopter to elect to use the amount determined under a previous GAAP revaluation as the deemed cost of intangible assets so long as the revaluation was broadly comparable to fair value under IFRS. Management considers the September 30, 2009 Canadian GAAP impairment of the carrying value of our intangible assets, specifically the store banners and private label brand names, as a "revaluation broadly comparable to fair value"; the Company has elected that amount to be deemed IFRS cost as of that date. The IFRS carrying value of those intangible assets on transition to IFRS is therefore consistent with the Canadian GAAP carrying value on the transition date.

Borrowing Costs

IAS 23 "Borrowing Costs" requires capitalization of eligible borrowing costs directly attributable to the acquisition or construction of qualifying assets. Under Canadian GAAP, the Company's accounting policy was to expense interest costs in connection with development activity. A first-

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time adopter may elect to apply the transitional provisions prescribed by IAS 23, and thereby be exempt from having to apply the standard to past transactions. The Company has elected to utilize this exemption, and will therefore apply IAS 23 on a strictly prospective basis from the date of transition to IFRS (meaning for eligible projects with a commencement date after January 1, 2010).

Share-Based Payments

IFRS 1 permits the application of IFRS 2 “Share-Based Payments” only to equity instruments granted after November 7, 2002 that had not vested by the date of transition to IFRS. The Company has applied this exemption and will apply IFRS 2 for equity instruments granted after November 7, 2002 that had not vested by January 1, 2010.

Business Combination

IFRS 1 provides an option to apply IFRS 3, Business Combinations, (“IFRS 3”) on a full retrospective basis or prospectively from the transition date onwards. The full retrospective basis would require restatement of all business combinations that occurred prior to the transition date. The Company has elected not to retrospectively apply IFRS 3 to business combinations that occurred prior to the transition date and such business combinations have not been restated.

Mandatory Exceptions under IFRS

Estimates

In accordance with IFRS 1, an entity’s estimates under IFRS at the date of transition to IFRS must be consistent with estimates made for the same date under previous GAAP unless those estimates were in error. The Company’s IFRS estimates as at the transition date are consistent with its Canadian GAAP estimates as at that date.

Financial Statement Impact on Transition to IFRS

There are no adjustments to balances in the Company’s financial statements on transition from Canadian GAAP to IFRS as at January 1, 2010, nor are there any adjustments to financial statement balances and results as at and for the year ended December 31, 2010. There are, however, some financial statement presentation and disclosure changes on adoption of IFRS, particularly regarding note disclosure. While there are no adjustments to financial statement balances on transition to IFRS, management has modified some of its accounting policies to conform with IFRS requirements.

4. INVENTORY

	September 30, 2011	December 31, 2010
Inventory at carrying value	\$ 40,514	\$ 30,665
Obsolescence provision	(287)	(2,051)
Inventory at lower of cost or net realizable value	\$ 40,227	\$ 28,614

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5. LEASEHOLDS AND EQUIPMENT

	Leasehold Improvements	Furniture and Equipment	Computer Equipment and Software	Total
Balance at December 31, 2010	\$ 15,488	\$ 11,948	\$ 5,423	\$ 32,859
Additions	683	357	1,358	2,398
Disposals	(334)	(248)	-	(582)
Cost at September 30, 2011	15,837	12,057	6,781	34,675
Accumulated depreciation at December 31, 2010	(7,006)	(5,743)	(2,141)	(14,890)
Retirements	143	97	-	240
Depreciation/depletion	(1,116)	(859)	(700)	(2,675)
Accumulated Depreciation at September 30, 2011	\$ (7,979)	\$ (6,505)	\$ (2,841)	\$ (17,325)
Net book value at September 30, 2011	\$ 7,858	\$ 5,552	\$ 3,940	\$ 17,350

6. INTANGIBLE ASSETS

	September 30, 2011	December 31, 2010
Store banners	\$ -	\$ 10,005
Private label brand names	-	6,618
	\$ -	\$ 16,623

At September 30, 2011, the Company determined that the fair value of the intangible assets was \$nil, resulting in a non-cash impairment charge of \$16.6 million for the three-months ended September 30, 2011.

7. BANK INDEBTEDNESS

	September 30, 2011	December 31, 2010
Operating Loan	\$ 10,227	\$ -
Term Loan	\$ 4,000	\$ 4,500
	\$ 14,227	\$ 4,500

Prior to obtaining the CCAA Order under the CCAA, the Company had a revolving credit facility of up to \$20 million (the "Operating Loan") with the Bank of Montreal, which was available for working capital requirements, capital expenditures and for general corporate purposes. The Company also had utilized \$4 million of a \$5 million credit facility with the Bank of Montreal (the "Term Loan") for funding capital expenditures including new store facilities.

During the third quarter ended September 30, 2011, the Company reached an agreement with the Bank of Montreal to amend its Operating Loan and Term Loan, including provisions for overadvance (the "Amended Facility"). The Amended Facility was made on a demand basis and contained step-down provisions which would have permanently reduced the availability of the overadvance limit by October 20, 2011. The overadvance limit under the Amended Facility was designed (and provided) by the Bank of Montreal to provide the Company with the additional liquidity necessary to address seasonal fluctuations.

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On October 20, 2011, the Company concluded negotiations with the Bank of Montreal as to the terms and conditions of a forbearance agreement (the "Forbearance Agreement") to address its liquidity needs while the Company restructures its affairs under the CCAA. Pursuant to the Forbearance Agreement, the Bank of Montreal will continue to provide an availability under the Amended Facility, including an overadvance limit of up to \$2.5 million, on the terms and conditions set out in the Amended Facility, as amended by the Forbearance Agreement.

As the Forbearance Agreement expires on December 31, 2011 (or such earlier time as provided in the Forbearance Agreement on the occurrence of certain events), the Company has entered into discussions with the Bank on the terms of an overadvance limit and availability after December 31, 2011 in amounts sufficient to allow it to complete its restructuring.

Loans under the Amended Facility, as amended by the Forebearance Agreement, are pre-payable without any penalties and bear interest at a floating rate based on the Canadian dollar prime rate rates plus an applicable margin to those rates. The Amended Facility is secured by a general security agreement covering all assets of Sterling Shoes LP, Sterling Shoes GP Inc. and the Company.

The Amended Facility is subject to customary terms and conditions, including limits on incurring additional indebtedness, granting liens or selling assets without the consent of the lender, and to customary financial covenants, including the maintenance of a minimum senior fixed charge coverage ratio. The Amended Facility also requires the Company to meet certain conditions in order to make interest payments on the Debentures.

The Amended Facility is a demand facility and could be called for payment at any time. In the event that the Amended Facility is called for payment, or if we are unsuccessful in negotiating terms for further financing with the Bank of Montreal or other replacement borrowings, there would be a material negative impact on the Company's business, financial condition and results of operations.

8. CONVERTIBLE DEBENTURES

	September 30, 2011	December 31, 2010
Principal amount	\$ 25,000	\$ 25,000
Equity component	(2,657)	(2,657)
Accretion	2,657	1,400
Deferred financing fees, net of amortization	-	(479)
Convertible unsecured subordinated debentures (current)	\$ 25,000	\$
Convertible unsecured subordinated debentures (non-current)	\$	\$ 23,264

The convertible unsecured subordinated debentures (the "Debentures") bear interest at an annual rate of 6.5% payable semi-annually in arrears on October 31 and April 30 in each year. The

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maturity date for the Debentures is October 31, 2012. On September 27, 2011, the Company announced that its Board of Directors resolved that the Company would not make the interest payment on its Debentures that was due to be paid on October 31, 2011. Accrued interest expense on the Debentures was included in accounts payable and accrued liabilities in the consolidated statement of financial position as at September 30, 2011

The Debentures are convertible at any time at the option of the holders into shares ("Shares") of the Company at a conversion rate of approximately 47.281 Shares per \$1 principal amount of Debentures, which is equal to a conversion price of \$21.15 per Share. After October 31, 2010 and on or before October 31, 2011, the Company 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 Company will have the right to redeem all or a portion of the Debentures equal to the principal amount plus accrued and unpaid interest.

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

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

9. COMMITMENTS

(a) *Minimum rental commitments*

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

2011	\$	4,041
2012		15,067
2013		13,809
2014		12,355
2015		11,197
Thereafter		22,834
	\$	79,303

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

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(b) *Letters of credit*

The Company had letters of credit outstanding on September 30, 2011 securing inventory purchase commitments totaling \$2.6 million (December 31, 2010 - \$3.4 million and January 1, 2010 - \$2.7 million). The last of these letters of credit expires on December 31, 2011 for \$1.5 million.

10. FINANCIAL INSTRUMENTS

(a) *Fair value*

Financial instruments consist of cash at fair value, accounts receivable, term loans, accounts payable, foreign exchange contracts, and the debentures. The fair values of all financial instruments, other than cash, the Debentures (Note 8), and the foreign exchange contracts, approximate their carrying values due to their short term or floating rate nature.

Cash is stated at fair value. Prior to the CCAA filing, the fair value of the Debentures is determined by calculating its present value using the estimated market interest rate for loans with similar terms, conditions, and maturities. Given the current uncertainties, there is no reliable information available to practicably determine the fair value of the Convertible Debentures as at September 30, 2011 (December 31, 2010 - \$21.9 million). As at September 30, 2011, the Debentures were reclassified to current liabilities and shown at face value of \$25 million.

(b) *Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its obligations associated with financial liabilities and commitments as they become due. Liquidity risk also includes the risk of not being able to liquidate assets in a timely manner at a reasonable price. As described above, on September 27, 2011 the Company announced that it would not make the interest payment on its Debentures that was due to be paid on October 31, 2011.

The Company faces several risks and uncertainties that materially impact the Company's liquidity position, cash flows and future operating results throughout the remainder of 2011 and future years. Refer to Note 1 basis of presentation and going concern.

The following table shows the maturity dates for the Company's liabilities at September 30, 2011:

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in \$000's	2011	2012	2013	2014	2015
Operating loan	10,227				
Accounts payable and accrued liabilities	17,043				
Convertible Debentures	25,000				
Term Loan	4,000				
	<u>56,270</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>

The Company's future obligations under operating leases are discussed in Note 9. Deferred lease inducements will not result in cash outflow for the Company.

The Company's ability to maintain and sustain its future operations will depend upon its ability to emerge from the CCAA proceedings and to (i) restructure, refinance or amend terms of its existing debt obligations; (ii) remain in compliance with its debt covenants to the Amended Facility; (iii) obtain additional equity or debt financing; (iv) achieve revenue growth and improve gross margins; and (v) achieve greater operating efficiencies and reduce expenses.

(c) *Interest rate risk*

Interest rate risk is the risk that the Company's financial instruments or cash flows associated with the instrument will fluctuate due to changes in market interest rates. The Company's interest rate risk arises primarily from the Debentures, the Operating Loan, and the Term Loan, including access to the overadvance amount "Amended Facility" as amended by the Forebearance Agreement (Note1). The interest rate on the Debentures is at a fixed rate (Note 8). The Amended Facility bear interest at a floating rate based on the Canadian dollar prime rate plus an applicable margin to those rates. Based on the average carrying value of the Amended Facility, a fluctuation in interest rate of 1% would represent a \$35 and \$70 change to the net loss for the three-month and nine-month periods ended September 30, 2011 (2010 - \$13 and \$38), respectively.

(d) *Foreign exchange risk*

Foreign exchange risk is the risk that the value of a financial asset or liability or commitment will fluctuate due to changes in foreign exchange rates. The Company's foreign exchange risk arises primarily from its inventory purchases. Substantially all footwear sold in Canada is manufactured outside of Canada and hence, the cost of substantially all inventory purchases is exposed to currency fluctuations. During the three-month and nine-month periods ended September 30, 2011, approximately 30% and 28% (2010- 41% and 40%) of product purchases were denominated in US dollars.

From time to time, the Company enters into contracts to manage the foreign exchange risk associated with anticipated purchases in US dollars. At September 30, 2011, the Company had forward foreign exchange contracts as follows:

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Settlement dates	Face Value \$US	Average rate \$Cdn
Oct 2011	1,545	0.995
Nov 2011	2,020	0.995
Dec 2011	1,100	0.996
Jan 2012	1,000	0.977
Feb 2012	2,000	0.971
Mar 2012	1,500	0.968
Apr 2012	500	0.964
May 2012	500	0.964
Jun 2012	500	0.964
Jul 2012	500	0.964

As at September 30, 2011, the cumulative unrealized gain on these contracts was \$762 (2010 – \$57) which is included in accounts payable and accrued liabilities in the consolidated statement of financial position.

(e) *Credit risk*

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

11. MANAGEMENT OF CAPITAL

The Company's capital structure consisted of the following components at September 30, 2011: Shareholders' equity of \$522 (December 31, 2010 - \$24,910) and the Debentures of \$25 million (December 31, 2010 - \$23.3 million). The Company was not in compliance with its bank covenants at September 30, 2011.

The Company is experiencing negative cash flow from operations and there is no certainty as to when or if we will return to positive cash generation. This led to its CCAA filing on October 21, 2011. In light of these conditions, there is significant uncertainty regarding the Company's ability to continue as a going concern, which is dependent on achieving on-going cash flow from operating activities and receiving additional support from our creditors and suppliers, as well as obtaining additional sources of financing.

Given the Company's current level of cash flows from operations, the Company will need to rely upon outside sources and third party financings to obtain sufficient capital to implement a restructuring plan and continue as a going concern.

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12. RELATED PARTY TRANSACTIONS

- (a) The Company leases its head office from a company in which a director of the Company has an interest. Rent expense recognized on this lease was \$79 and \$237 for the three-month and nine-month periods ended September 30, 2011 (2010 - \$79 and \$227) and is included in general and administrative expenses in the consolidated statement of loss and comprehensive loss.
- (b) The Company purchased equipment from a company in which a director of the Company has an interest for \$7 and \$86 during the three-month and nine-month periods ended September 30, 2011 (2010 - \$47 and \$60).

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

13. KEY MANAGEMENT COMPENSATION

Remuneration of directors and key management personnel comprises:

	Three-month period ended		Nine-month period ended	
	Sept 30, 2011	Sept 30, 2010	Sept 30, 2011	Sept 30, 2010
Short-term benefits	\$ (445)	\$ (308)	\$ (1,325)	\$ (915)
	\$ (445)	\$ (308)	\$ (1,325)	\$ (915)

Short-term benefits comprise salaries, bonuses and directors' fees. The Company had seven key management personnel as at September 30, 2011 (2010 – four).

14. INCOME TAXES

Prior to the conversion to incorporated status on July 1, 2010, Sterling was a unit trust for income tax purposes and, accordingly, was taxable only on any taxable income not allocated to the unitholders. Any income tax obligations relating to the distributions were the obligations of the unitholders. Commencing July 1, 2010, the Company is subject to tax at statutory rates.

STERLING SHOES INC.

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(a) Income tax expense:

	Three-month period ended September 30, 2011		Nine-month period ended September 30, 2011	
Current tax expense				
Current period	\$	-	\$	-
Adjustment to prior year		-		-
	\$	-	\$	-
Deferred tax expense				
Origination and reversal of temporary differences	\$	577	\$	(793)
Other				
	\$	577	\$	(793)
Total income tax expense (recovery)	\$	577	\$	(793)

The tax rate used in the calculations above is the corporate tax rate of 26.5% payable by corporate entities on taxable profits under tax laws in Canada.

(b) Reconciliation of the effective tax rate:

Income tax expense differs from the amounts that would be obtained by applying the Canadian statutory income tax rate to income before income taxes. These differences are as follows:

	Three-month period ended September 30, 2011		Nine-month period ended September 30, 2011	
Loss before income taxes	\$	(19,647)	\$	(25,181)
Income tax at statutory rates (26.5%)		(5,206)		(6,673)
Non-deductible expenses		2,207		2,216
Change in valuation allowance		3,415		3,415
Change in deferred income tax on application of future enacted rates		170		252
Other		(8)		(3)
Deferred income taxes expense (recovery)	\$	577	\$	(793)

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(c) *Deferred tax assets and liabilities:*

- (i) The tax effect of temporary differences that give rise to deferred income tax liabilities and deferred income tax assets are as follows:

	September 30, 2011	December 31, 2010
Operating losses	\$ (1,759)	\$ (704)
Leasehold & improvements	(1,078)	(814)
Other temporary differences	(577)	-
Deferred income tax asset	(3,414)	(1,518)
Valuation allowance	(3,414)	-
Net deferred income tax asset	-	(1,518)
Intangible Asset - store banners	-	1,251
Intangible asset - private label brand names	-	827
Other temporary differences	-	233
Deferred income tax liability	-	2,311
Net deferred income tax (asset)/liability	\$ -	\$ 793

In addition the Company has a capital loss of \$27 million. The related future tax asset of approximately \$3.4 million has not been recognized as the management is of the view that such asset would unlikely be realized in the future.

15. SEGMENTED INFORMATION

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

16. SUBSEQUENT EVENTS

Refer to discussion under Note 1 basis of presentation and going concern.

STERLING SHOES INC.

(formerly Sterling Shoes Income Fund)

MANAGEMENT'S DISCUSSION AND ANALYSIS**November 10, 2011**

The following management's discussion and analysis ("MD&A") should be read in conjunction with the audited consolidated financial statements and accompanying notes ("Financial Statements") of Sterling Shoes Inc. ("Sterling" or the "Company") for the three and nine month periods ended September 30, 2011. Results have been prepared in accordance with International Financial Reporting Standards ("IFRS" and reported in Canadian dollars unless otherwise indicated). The 2010 prior period comparative financial information throughout this report has been restated in accordance with IFRS; however, 2009 information is presented in accordance with Canadian GAAP and has not been restated. The fiscal year-end of the Company 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-IFRS measures to assist in assessing our financial performance. Non-IFRS measures do not have any standard meaning prescribed by IFRS and are therefore unlikely to be comparable to similar measures presented by other issuers. See "Non-IFRS Measures".

OVERVIEW OF THE COMPANY AND OUR BUSINESS

Sterling Shoes Inc. ("Sterling" or the "Company") is incorporated under the laws of the Province of British Columbia. The business of Sterling is conducted by Sterling Shoes Limited Partnership ("Sterling Shoes LP"), all of the interests in which are owned, directly or indirectly, by Sterling. The Company operates 158 retail stores in shopping malls, high-streets and strip malls in locations from British Columbia to Ontario. The Company offers a broad selection of private label and national brand name shoes and accessories through five separate retail banners: Sterling, Joneve, Shoe Warehouse, Freedman Shoes, and Gia.

The divisions are clearly distinguished from each other by brand experience, product offering and target customer, providing our markets with a diverse and memorable selection of fashionable and functional footwear.

Each of our banners targets a specific consumer group through different product, merchandising, location, pricing, service and advertising strategies. Sterling, Freedman, Joneve, Gia and Shoe Warehouse, compete with other local, regional and national footwear retailers. The fragmented nature of the Canadian retail footwear industry and our five distinct retail banners means that we compete against a wide variety of participants at various levels of the value chain. Examples of who we believe to be the principal competitors for our banners are provided below.

Shoe Warehouse	Sterling/Gia	Freedman	Joneve
Payless Shoe Source	ALDO	Brown's	Gravity Pope
The Shoe Company	Spring	B2	Brown's
Winners	Steve Madden	Nine West	B2
Softmoc	Town Shoes	Town Shoes	Holt Renfrew
Zellers	Little Burgundy	Holt Renfrew	Umeboshi and other
Style Sense	Apparel stores selling mid-to-	Harry Rosen	independent retailers
Walmart	high range fashion footwear	The Bay	
		Naturalizer	

There are 6,641,860 common shares (the “Shares”) and 25,000 convertible debentures (the “Debentures”) issued and outstanding as at November 10, 2011. The Company has received notice from the Toronto Stock Exchange (the “TSX”) that the Shares and Debentures (Symbol: SSI and SSI.DB, respectively) will be delisted at the close of market on November 25, 2011 for failure to meet the continued listing requirements of TSX. The Shares and Debentures will remain suspended from trading until that date. The notice follows the initial order obtained by the Company under the *Companies’ Creditors Arrangement Act* on Friday, October 21, 2011. See “Recent Events – CCAA Order and TSX Delisting”.

RECENT EVENTS

CCAA Order and TSX Delisting

The Company has been facing liquidity and profitability issues with significant and unexpected declines in sales revenue in recent years. Despite progress being made in streamlining processes and cost-reduction initiatives, we continue to face balance sheet and declining and/or negative same store sales challenges. Our worsening financial performance has made it impossible to service our debt obligations, including our trade creditors. Our financial performance, demonstrated by the decline in our share price, together with poor economic conditions, undermined our efforts to address our business issues.

As a result, on October 21, 2011, the Company announced that it and Sterling Shoes GP Inc. (the general partner of Sterling Shoes LP) obtained an Initial Order (the “CCAA Order”) from the Supreme Court of British Columbia (the “Court”) under the *Companies’ Creditors Arrangement Act* (Canada), R.S.C. 1985, c. C-36, as amended (the “CCAA”). The Company will continue to operate during the restructuring under the CCAA.

The Court granted protection under the CCAA for an initial period expiring on November 18, 2011 to be extended as required and if approved by the Court. The Company expects to seek an extension of the CCAA Order on or before November 18, 2011. While the Company is under CCAA protection, all proceedings against or in respect of the Company are stayed.

The CCAA Order permits the Company to pay all expenses incurred in carrying on the business after the date of the CCAA Order, including the cost of goods and services delivered by suppliers. The terms and conditions of the restructuring plan have not yet been determined by the Company.

Alvarez and Marsal Canada Inc. has been appointed Monitor pursuant to the CCAA Order.

In connection with obtaining the CCAA Order, we entered into a forbearance agreement with our senior debt lender, the Bank of Montreal. See “*Capital Resources*”.

Non-Payment of Debenture Interest

The Company’s credit facility with the Bank of Montreal includes certain provisions and covenants limiting the Company’s ability to make the interest payments on the Debentures. Due to a continued challenging retail environment and the cash flow situation of the Company, the Company announced on September 27, 2011 that the Board of Directors had determined that the Debenture interest amount that was due and payable on October 31, 2011 would not be paid.

Restructuring

We operate a number of divisions, some of which are unprofitable; however, we continue to believe that there is a viable core business. In order to avoid possible enforcement proceedings by creditors, and other potential events that could harm our business, we require the protections afforded by a stay of proceedings to implement a restructuring for the benefit of the Company. We believe that the best way to preserve enterprise value for the Company is to develop a restructuring plan under the CCAA.

The key elements of a plan of compromise or arrangement will include the following:

- Closing non-performing or under-performing stores and/or banners;
- Reducing corporate overhead; and
- Pursuing strategies to grow the more successful aspects of the business.

Resignation of Directors

Mr. James Bruce resigned as a director of the Company effective October 20, 2011. Mr. Sol Oshry resigned as a director of the Company effective October 24, 2011.

INTERNATIONAL FINANCIAL REPORTING STANDARDS (“IFRS”)

The Canadian Accounting Standards Board (AcSB) requires all publicly accountable entities to adopt IFRS for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company is required to prepare both current and comparative financial information using IFRS.

The International Accounting Standards Board (“IASB”) is responsible for the development and publication of IFRS standards and has indicated that IFRS standards will continue to change in the coming years. Upcoming changes which could affect Sterling include:

- Provisions & Contingencies
- Financial Statement Presentation
- Leases
- Income taxes
- Financial Instruments
- Revenue.

While the conceptual framework for IFRS and Canadian GAAP are similar, there are significant differences in recognition, measurement and disclosure requirements.

In determining what constitutes a significant change to accounting policies, the Company identified areas of difference between IFRS and Canadian GAAP which present greater risk of potential future financial statement impact. Information on those accounting policy changes that management considers most significant to the Company are presented below.

Impairment of Assets

During the quarter ended September 30, 2011, the Company recorded a non-cash impairment charge of \$16.6 million to write-down the valuation of its intangible assets to \$nil.

Under both Canadian GAAP and IFRS, intangible assets are reviewed at least annually for impairment or whenever indicators of impairment are present. If such an indicator exists, a formal impairment assessment is performed.

Under Canadian GAAP, this is a two-step impairment test in which (1) undiscounted future cash flows are compared to the carrying value; and (2) if those undiscounted cash flows are less than the carrying value, the asset is written down to the fair value.

In performing a formal impairment assessment under IFRS, the entity estimates the recoverable amount of the asset by performing a one-step impairment test, which requires a comparison of the carrying value of the asset to the higher of value in use and fair value less costs to sell. Value in use is defined as the present value of future cash flows expected to be derived from the asset in its current state.

As a result of this difference, in principle, impairment charges may be more likely under IFRS than are currently identified and recorded under Canadian GAAP. The extent of any new write downs, however, may be partially offset by the requirement under IAS 36, "Impairment of Assets" to reverse any previous impairment losses where circumstances have changed such that the impairments have been reduced. Canadian GAAP prohibits reversal of impairment losses. The adoption of these standards did not result in a change to the carrying value of our assets on transition to IFRS.

Under IAS 36, "Impairment of Assets" to reverse any previous impairment losses may be reversed where circumstances have changed such that the impairments have been reduced. Canadian GAAP prohibits reversal of impairment losses. The adoption of these new standards does not result in a change to the carrying value of our assets on transition to IFRS.

This discussion reflects management's most recent assumptions and expectations; circumstances may arise, such as changes in IFRS, regulations or economic conditions, which could change these assumptions or expectations. Any further changes to the election of IFRS 1 exemptions, the selection of IFRS accounting policies and any related adjustments to the financial statements would be subject to approval by the board of directors prior to being finalized. Accordingly, the discussion above is subject to change. (See also Note 4 of the Interim Consolidated Financial Statements for information relating to elections, mandatory exemptions and financial statement impact for first time adoption of IFRS)

SUMMARY FINANCIAL INFORMATION

	Three months ended Sept 30		Nine months ended Sept 30	
Statement of Income Items (\$000's)	2011	2010	2011	2010
Sales	\$ 26,960	32,218	73,284	87,679
Cost of Sales	(14,953)	(21,537)	(38,210)	(50,108)
Gross Margin	12,007	10,681	35,074	37,572
<i>As a percentage of sales</i>	<i>44.5%</i>	<i>33.2%</i>	<i>47.9%</i>	<i>42.9%</i>
Store and selling expenses	(10,817)	(11,215)	(31,565)	(33,418)
General and administrative expenses	(2,290)	(2,000)	(6,758)	(6,005)
EBITDA ⁽¹⁾	(1,100)	(2,534)	(3,249)	(1,851)
<i>As a percentage of sales</i>	<i>-4.1%</i>	<i>-7.9%</i>	<i>-4.4%</i>	<i>-2.1%</i>
Impairment of intangible assets	(16,623)	-	(16,623)	-
Interest expense	(1,918)	(653)	(3,332)	(1,955)
Loss on disposal	(124)	(2)	(276)	(220)
Unrealized Gain / (Loss) on foreign exchange	1,057	-	974	-
Amortization of leaseholds and equipment	(939)	(867)	(2,675)	(2,745)
Loss before taxes	(19,647)	(4,056)	(25,181)	(6,771)
Deferred income taxes (expense) / recovery	(577)	-	793	-
Net loss	(20,224)	(4,056)	(24,388)	(6,771)

	Sept 30, 2011	December 31, 2010
Balance Sheet Items (\$000's)		
Total assets	58,266	71,345
Long-term financial liabilities	1,474	29,210

Notes:

(1) See definition of EBITDA under "Non-IFRS Measures".

OPERATING RESULTS

Sales

Sales were \$27.0 million during the three-month period ended September 30, 2011, representing a decrease of 16.3% from the \$32.2 million in the same period in 2010. For the nine-month period ended September 30, 2011, sales were \$73.3 million compared to \$87.7 million in 2010 representing a 16.4% decline. Same-store sales for the three and nine-month periods ended September 30, 2011 decreased by 15.9% and 17.3%, compared to the same periods during 2010. The decline in sales resulted primarily from the weak retail environment.

Our ability to grow sales will depend on a number of factors including our ability to source sufficient capital, our ability to successfully identify and respond to changes in trends and customer tastes, our ability to hire, train, motivate, manage and retain qualified 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, 2011 was 55.5% and 52.1%, compared to 66.8% and 57.1% respectively for the same periods during 2010.

For the three-month period ended September 30, 2011 gross margin as a percentage of sales increased to 44.5% compared to 33.2% during the same period in 2010. For the nine month period ended September 30, 2011 gross margin as a percentage of sales increased to 47.9% compared to 42.9% during the same period in 2010.

We continued to make progress with respect to gross margins for the three and nine-months in 2011. Gross margins improved over the same periods in 2010 due to reduced markdowns taken in the current period and comparative charges incurred in 2010 with respect to clearing our old inventory.

Store and selling expenses

Store and selling expenses for the three and nine-months ended September 30, 2011 were 40.1% and 43.1% of sales, compared to 34.8% and 38.1% for the same periods during 2010, respectively largely due to the impact of lower sales. Store and selling expenses have a large fixed underlying component, primarily consisting of expenses relating to occupancy and employee costs. In nominal dollars, store and selling expenses were \$398 thousand and \$1.9 million lower in 2011, as compared to the same three and nine month period in 2010. The decrease in nominal dollars resulted from our initiatives over the past 12 months to improve store operations.

General and administrative expenses

General and administrative (“G&A”) expenses increased by \$290 thousand for the three-month period ended September 30, 2011 compared to the same period in 2010 and increased by \$753 thousand for the nine-month period ended September 30, 2011 compared to the prior year. The increase is due to restructuring expenses incurred. Due largely to the impact of lower sales in 2011, G&A expenses represent 8.5% and 9.2% of sales, compared to 6.2% and 6.8% during the same periods in 2010, respectively.

EBITDA (see “Non-IFRS Measures”)

EBITDA for the three and nine-months ended September 30, 2011 was negative 4.1% and negative 4.4% of sales, respectively, compared to negative 7.9% and negative 2.1% for the same periods during 2010, due to the increase in gross margin and reduction in store and selling expenses.

Interest expense

Interest expense with respect to funds utilized under the credit facilities for the three and nine months ended September 30, 2011 was \$182 thousand and \$380 thousand respectively, compared to \$75 thousand and \$201 thousand in 2010. This was due to higher average debt balances this year.

The proceeds of the Debentures have been allocated 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% (at the date of issuance), the estimated market interest rate for similar debentures having no conversion rights.

The conversion option was valued at \$2,657 thousand at the date of issuance. The liability portion of the Debentures is being accreted to its face value over the term of the debt.

Interest expense with respect to the convertible debentures for the three-month and nine-month periods ended September 30, 2011 was \$1.7 million and \$3.0 million (2010 - \$579 thousand and \$1.8 million), respectively, of which \$1.3 million and \$1.7 million (2010 - \$188 thousand and \$552 thousand), respectively, related to this interest accretion. As a result of the Company defaulting on the interest payment on the Debentures, the Debentures were repayable upon demand and, as such, have been reclassified to current liabilities and reflected at face value on the balance sheet. Included in the interest accretion amounts for the three and nine month periods ended September 30, 2011 was \$1.1 million related to accelerated interest accretion to bring the Convertible Debentures to face value at September 30, 2011.

The Company's credit facility with the Bank of Montreal includes certain provisions and covenants limiting the Company's ability to make the interest payments on the Debentures. Due to a continued challenging retail environment and the cash flow situation of the Company, the Company announced on September 27, 2011 that the Board of Directors had determined that the Debenture interest amount that was due and payable on October 31, 2011 would not be paid. While the Company operates under the CCAA Order, no interest on the Debentures will be paid.

Inventory

As noted earlier, in late 2010 management aggressively reduced prices on aged inventory to make room for higher margin inventory and improve inventory turnover, which carried into the first quarter of 2011. Over the past few months we continued to build our supply chain and merchandise planning group. Progress in the supply chain group continued during the third quarter of 2011. We reduced the permanent employee count in our Richmond warehouse while improving capacity and increasing throughput. In the current three and nine month periods, we have saved \$0.7 million and \$2.0 million, respectively, in freight, logistics, and warehousing costs versus the same period in 2010.

At September 30, 2011, on a valuation basis, we had \$3.0 million, or 8.0% more inventory than at September 30, 2010. On a unit basis, we had 10.3% fewer units of inventory at September 30, 2011 compared to the same time a year earlier. The Company had 69% less aged inventory than at the same point a year earlier.

SELECTED QUARTERLY FINANCIAL INFORMATION

in (\$000's) except per Share amounts	Q3-2011	Q2-2011	Q1-2011	Q4-2010	Q3-2010	Q2-2010	Q1-2010	Q4-2009
Sales	\$ 26,960	\$ 26,960	\$ 22,011	\$ 39,348	\$ 32,218	\$ 28,606	\$ 26,855	\$ 41,195
(Loss) / Income before taxes	\$ (19,647)	\$ (1,075)	\$ (4,463)	\$ (108)	\$ (4,056)	\$ (1,754)	\$ (961)	\$ 6,238
Net (Loss) / Income	\$ (20,224)	\$ (811)	\$ (3,357)	\$ 1,463	\$ (4,056)	\$ (1,754)	\$ (961)	\$ 6,238
Basic (loss) / income per Share	\$ (3.044)	\$ (0.122)	\$ (0.505)	\$ 0.220	\$ (0.611)	\$ (0.264)	\$ (0.145)	\$ 0.939
Diluted (loss) / income per Share	\$ (3.044)	\$ (0.122)	\$ (0.505)	\$ 0.212	\$ (0.611)	\$ (0.264)	\$ (0.145)	\$ 0.820
Cash dividends/distributions per Share	\$ 0.000	\$ 0.000	\$ 0.000	\$ 0.000	\$ 0.000	\$ 0.000	\$ 0.000	\$ 0.037
Number of stores open at end of period	158	160	161	162	162	160	161	162

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. 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.

CASH FLOW AND LIQUIDITY

We assess liquidity in terms of our ability to generate sufficient cash flow to fund our operations. Net cash flow is affected by the following items:

- operating activities, including the level of accounts receivable, inventory, prepaid expenses and deposits and accounts payable and accrued liabilities;
- investing activities, including capital expenditures; and
- external financing, including bank credit facilities and other capital market activities, providing both short and long-term financing. See “Capital Resources”.

The Company has been facing liquidity and profitability issues with significant and unexpected declines in sales revenue in recent years. Despite progress being made in streamlining processes and cost-reduction initiatives, we continue to face balance sheet and declining and/or negative same store sales challenges. Our worsening financial performance has made it impossible to service our debt obligations, including our trade creditors. Our financial performance, demonstrated by the decline in our share price, together with poor economic conditions, undermined our efforts to address our business issues. This led to our CCAA filing on October 21, 2011.

In light of these conditions, there is significant uncertainty regarding the Company’s ability to continue as a going concern, which is dependent on achieving on-going cash flow from operating activities and receiving additional support from our creditors and suppliers, as well as obtaining additional third party sources of financing to implement the restructuring plan. We cannot provide assurance that the Company will generate sufficient cash from operations or obtain sufficient borrowings, on reasonable terms or at all, to meet our liquidity needs. Failure to do so would most likely result in liquidation proceedings.

BMO Forebearance Agreement

We have entered into a Forebearance Agreement with the Bank of Montreal as part our Amended Facility. The Amended Facility is a demand facility and could be called for payment at any time. In the event that the Amended Facility is called for payment, or if we are unsuccessful in negotiating terms for further financing with the Bank of Montreal or other replacement borrowings, there would be a material negative impact on our business, financial condition and results of operations. See “*Capital Resources*”.

CCAA

Should the stay period in the CCAA proceedings and any subsequent extensions thereof not be sufficient in duration or scope to allow the Company to develop and present a restructuring plan under the CCAA or should the restructuring plan not be accepted by affected creditors or confirmed by the Court and, in any such case, should the Company lose the protection of the stay of proceedings, creditors may immediately enforce their rights and remedies against the Company and its assets which would in all likelihood lead to liquidation proceedings. Failure to implement a restructuring plan and obtain sufficient exit financing within the time granted by the Court would in all likelihood also lead to liquidation of the Company’s assets.

There can be no assurance that a restructuring plan proposed by the Company will be supported by the Company’s creditors or confirmed by the Court or that it will be consummated or successful. The Company’s financial statements do not contain any adjustments to the amounts or classification of assets and liabilities that might be necessary should the Company be unable to continue in business.

Cash Flow from Operations

The table below reconciles net loss to cash flow from operations for the three-month and nine-month periods ended September 30, 2011 and 2010.

in (\$000's)	Three-months ended Sept 30		Nine-months ended Sept 30	
	2011	2010	2011	2010
Net loss	\$ (20,224)	(4,056)	(24,388)	(6,771)
Add charges (deduct credits) to operations not requiring a cash payment:				
Impairment of intangible assets	16,623	-	16,623	-
Deferred income taxes expense / (recovery)	577	-	(793)	-
Amortization of leaseholds and equipment	939	867	2,675	2,745
Accreted interest expense	1,329	188	1,733	552
Amortization of deferred leasehold inducements	(78)	(92)	(250)	(318)
Loss on disposal of leaseholds and equipment	124	2	276	220
	(710)	(3,091)	(4,124)	(3,572)
Net change in non-cash working capital balances related to operations:				
Accounts receivable	142	(1,171)	71	(1,096)
Inventory	(4,730)	(354)	(11,613)	(814)
Prepaid expenses and deposits	(0)	(78)	(64)	(147)
Accounts payable and accrued liabilities	4,180	5,453	820	3,231
Cash (used in)/ provided by operating activities	\$ <u>(1,118)</u>	<u>759</u>	<u>(14,910)</u>	<u>(2,398)</u>

For the three-month period ended September 30, 2011, cash used in operations was \$1.1 million as compared to cash provided by operations of \$759 thousand in the same period of 2010. Cash used in operations was \$14.9 million for the nine-month period ended September 30, 2011 as compared to \$2.4 million for the same period in 2010.

Capital Expenditures

We incurred maintenance capital expenditures of \$0.4 million during the three-month period ended September 30, 2010 (2010 - \$0.6 million), which were related to upgrades to our information technology system and store renovations. We did not open any new stores in the third quarter of 2011 and therefore did not invest in any new capital expenditures during this time (2010 - \$0.3 million (net of leasehold inducements)). During the nine months ended September 30, 2011, we incurred capital expenditures of \$2.4 million (2010 - \$1.7 million) of which \$1.4 million was invested in IT infrastructure (2010 - \$0.7 million).

CAPITAL RESOURCES

Cash flow from operations, bank borrowings and debentures issued have been the primary funding sources for working capital requirements and capital expenditures over the last several years.

Prior to obtaining the CCAA Order, we had a revolving credit facility of up to \$20 million (the "Operating Loan") with the Bank of Montreal, which is available for working capital requirements, capital expenditures and for general corporate purposes. We also had utilized \$4 million of a \$5 million credit facility with the Bank of Montreal (the "Term Loan") for funding capital expenditures including new store facilities.

During the third quarter we reached agreement with the Bank of Montreal to amend our Operating Loan and Term Loan, including provisions for overadvance (the "Amended Facility"). The Amended Facility was made on a demand basis and contained step-down provisions which would

have permanently reduced the availability of the overadvance limit by October 20, 2011. The overadvance limit under the Amended Facility was designed (and provided) by the Bank of Montreal to provide us with the additional liquidity necessary to address seasonal fluctuations.

On October 20, 2011, we concluded negotiations with the Bank of Montreal as to the terms and conditions of a forbearance agreement (the "Forbearance Agreement") to address our liquidity needs while we restructure our affairs under the CCAA. Pursuant to the Forbearance Agreement, the Bank of Montreal will continue to provide us with availability under the Amended Facility, including an overadvance limit of up to \$2.5 million, on the terms and conditions set out in the Amended Facility, as amended by the Forbearance Agreement.

As the Forbearance Agreement expires on December 31, 2011 (or such earlier time as provided in the Forbearance Agreement on the occurrence of certain events), we have entered into discussions with the Bank on the terms of an overadvance limit and availability after December 31, 2011 in amounts sufficient to allow us to complete its restructuring. We can give no assurances that we will be successful in these discussions on reasonable terms or at all.

Loans under the Amended Facility, as amended by the Forebearance Agreement, are pre-payable without any penalties and bear interest at a floating rate based on the Canadian dollar prime rate rates plus an applicable margin to those rates. The Amended Facility is secured by a general security agreement covering all assets of Sterling Shoes LP, Sterling Shoes GP Inc. and the Company.

The Amended Facility is subject to customary terms and conditions, including limits on incurring additional indebtedness, granting liens or selling assets without the consent of the lender, and to customary financial covenants, including the maintenance of a minimum senior fixed charge coverage ratio. The Amended Facility also requires us to meet certain conditions in order to make interest payments on the Debentures.

The Amended Facility is a demand facility and could be called for payment at any time. In the event that the Amended Facility is called for payment, or if we are unsuccessful in negotiating terms for further financing with the Bank of Montreal or other replacement borrowings, there would be a material negative impact on our business, financial condition and results of operations.

OFF-BALANCE SHEET FINANCING

We enter 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 September 30, 2011, letters of credit totaling \$2.6 million are outstanding. The last of these letters of credit expires on December 31, 2011 for \$1.5 million. There are no other off-balance sheet arrangements.

CONTRACTUAL OBLIGATIONS

We have the following inventory purchase, long-term debt and minimum rental commitments for premises, for the remainder of the current fiscal year and over the next four fiscal periods, in thousands of dollars:

in \$000's	2011	2012	2013	2014	2015
Inventory purchase commitments	2,606				
Convertible Debentures	25,000				
Operating and Term Loans	14,227				
Minimum rental commitments ⁽¹⁾	4,041	15,067	13,809	12,355	11,197
	<u>45,874</u>	<u>15,067</u>	<u>13,809</u>	<u>12,355</u>	<u>11,197</u>

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

DIVIDENDS

The Company did not declare any dividends to the Shareholders for the three and nine month periods ended September 30, 2011 (2010 - \$Nil in distributions).

NON-IFRS 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. Accordingly, our management believes that EBITDA and Adjusted EBITDA are important supplemental measures in evaluating our performance and in determining whether to invest in Shares. EBITDA and Adjusted EBITDA are not earnings measures recognized by IFRS and do not have standardized meanings prescribed by IFRS and are therefore unlikely to be comparable to similar measures presented by other issuers.

You are cautioned that EBITDA and Adjusted EBITDA should not be construed as an alternative to net income or loss determined in accordance with IFRS as indicators of our performance or to cash flows from operating, investing and financing activities as measures of our liquidity and cash flows.

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

"Net Senior Debt" is not a recognized measure under IFRS. Net Senior Debt is equal to net bank indebtedness combining Operating loan balance and Term loan balance.

INCOME TAXES

Upon converting Sterling Shoes to a corporation, income taxes are now calculated differently from that of an income fund. See "Critical Accounting Estimates." Given the current liquidity and profitability issues that the Company is facing, the value of the deferred income tax asset was written down to \$nil at September 30, 2011 resulting in an income tax expense of \$577 thousand for the three months ended September 30, 2011 and an income tax recovery of \$793 thousand for the nine months ended September 30, 2011 (2010 - \$Nil and \$Nil).

TRANSACTIONS WITH RELATED PARTIES

- (a) The Company paid rent to a company in which Mannie Druker, a director, has an interest, amounting to \$79 thousand and \$237 thousand for the three-month and nine-month periods ended September 30, 2011 (2010 – \$79 thousand and \$227 thousand) respectively.
- (b) The Company purchased equipment from a company in which Mannie Druker, a director, has an interest for \$7 thousand and \$86 thousand during the three-month and nine-month periods ended September 30, 2011 (2010 – \$47 thousand and \$60 thousand).

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 Company's financial statements for the three-month and nine-month periods ended September 30, 2011. Management believes that the following items represent the Company's critical accounting estimates.

Intangible assets

Identifiable intangible assets, including store banners and private label brand names are carried at deemed cost, being the fair value amount of the assets as at December 31, 2010. 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 the assets may be impaired. In performing a formal impairment assessment, the Company estimates the recoverable amount of the asset by performing a comparison of the asset's carrying value to the higher of fair value less costs to sell and value in use, which is defined as the present value of future cash flows expected to be derived from the asset in its current state. 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 the higher of fair value less costs to sell and value in use.

At September 30, 2011 the Company determined that the fair value of the intangible assets was \$nil, resulting in a non-cash impairment charge of \$16.6 million for the three-months ended September 30, 2011. The impairment arose primarily due to future economic uncertainty and the higher cost of capital assumptions in the valuation methodology.

Future income taxes

Future income tax assets and liabilities are determined based on the difference between the tax basis of 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.

As noted previously, given the current liquidity and profitability issues that the Company is facing, the value of the deferred income tax asset was written down to \$nil at September 30, 2011.

Convertible Debentures

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

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

As at September 30, 2011, the Debentures were repayable upon demand and, as such, have been reclassified to current liabilities and reflected at face value on the balance sheet.

RISKS AND UNCERTAINTIES

A detailed discussion of our significant business risks is provided in our 2010 Annual Information Form and our MD&A for the fiscal year ended December 31, 2010, both of which can be found at www.sedar.com. There have been no changes to these risks in the third quarter and nine months of 2011 other than as discussed above under “*Capital Resources*” and further discussed below.

Liquidity and Going Concern Uncertainty

The Company is experiencing negative cash flow from operations and there is no certainty as to when or if we will return to positive cash generation. This led to our CCAA filing on October 21, 2011. In light of these conditions, there is significant uncertainty regarding the Company’s ability to continue as a going concern, which is dependent on achieving on-going cash flow from operating activities and receiving additional support from our creditors and suppliers, as well as obtaining additional sources of financing.

Given the Company’s current level of cash flows from operations, the Company will need to rely upon outside sources and third party financings to obtain sufficient capital to implement a restructuring plan and continue as a going concern. We cannot provide assurance that the Company will generate sufficient cash from operations or obtain sufficient borrowings, on reasonable terms or at all, to meet our liquidity needs. Failure to do so would most likely result in liquidation proceedings.

BMO Forebearance Agreement

We have entered into a Forebearance Agreement with the Bank of Montreal as part of our Amended Facility. The Amended Facility is a demand facility and could be called for payment at any time. In the event that the Amended Facility is called for payment, or if we are unsuccessful in negotiating terms for further financing with the Bank of Montreal or other replacement borrowings, there would be a material negative impact on our business, financial condition and results of operations.

CCAA

Should the stay period in the CCAA proceedings and any subsequent extensions thereof not be sufficient in duration or scope to allow the Company to develop and present a restructuring plan under the CCAA or should the restructuring plan not be accepted by affected creditors or confirmed by the Court and, in any such case, should the Company lose the protection of the stay of proceedings, creditors may immediately enforce their rights and remedies against the Company and its assets which would in all likelihood lead to liquidation proceedings. Failure to implement a restructuring plan and obtain sufficient exit financing within the time granted by the Court would in all likelihood also lead to liquidation of the Company's assets.

There can be no assurance that a restructuring plan proposed by the Company will be supported by the Company's creditors or confirmed by the Court or that it will be consummated or successful. The Company's financial statements do not contain any adjustments to the amounts or classification of assets and liabilities that might be necessary should the Company be unable to continue in business.

TSX Delisting

With the delisting of the Shares and the Debentures from the TSX on November 25, 2011, there will be no market through which the Shares and the Debentures may be sold. There is no assurance that an alternate listing for the Shares and Debentures will be sought or obtained. As a result there is no liquidity for the Shares or the Debentures.

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 45% of the Company's product purchases are denominated in U.S. dollars. The Company does not hold or issue financial instruments for trading or speculative purposes. From time to time, the Company enters into contracts to manage the foreign exchange risk associated with anticipated purchases in US dollars.

At September 30, 2011, the Company had forward foreign exchange contracts as follows:

Settlement dates	Face Value \$US	Average rate \$Cdn
Oct 2011	1,545	0.995
Nov 2011	2,020	0.995
Dec 2011	1,100	0.996
Jan 2012	1,000	0.977
Feb 2012	2,000	0.971
Mar 2012	1,500	0.968
Apr 2012	500	0.964
May 2012	500	0.964
Jun 2012	500	0.964
Jul 2012	500	0.964

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.

CERTIFICATION OF DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for designing disclosure controls and procedures that: (a) provide reasonable assurance that material information required to be disclosed by us is accumulated and communicated to management to allow timely decisions regarding required disclosure; and (b) ensure that information required to be disclosed by us is recorded, processed, summarized, and reported within the time periods specified in applicable securities legislation.

Our management is responsible for designing, establishing and maintaining an adequate system of internal control over financial reporting. Our internal control system was designed based on the Internal Control – Integrated Framework (“COSO Framework”) published by The Committee of Sponsoring Organizations of the Treadway Commission to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes, in accordance with International Financial Reporting Standards (“IFRS”).

Our Chief Executive Officer and Chief Financial Officer certified the appropriateness of the financial disclosures in the MD&A and consolidated financial statements for the three and nine months ended September 30, 2011. These executives also certified that they are responsible for the design of disclosure controls and procedures and internal control over financial reporting. There have been no changes in internal control over financial reporting during the quarter ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

The Company’s board of directors and Audit Committee reviewed and approved the September 30, 2011 consolidated financial statements and this management’s discussion and analysis prior to its release.

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. Without limiting the generality of the foregoing, we have made forward-looking statements with respect to our restructuring under the CCAA, our ability to continue as a going concern and the viability of our core business.

We believe 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 our 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;
- tax laws;
- operating performance and risks;
- exchange rates; and
- cost of labour and services.

By its nature, such forward-looking information is subject to various risks and uncertainties that are known and unknown, including our ability to develop and implement a restructuring plan and successfully emerge from the CCAA, general economic conditions and markets and, in particular, the uncertainty of current economic conditions, the cost and availability of capital, the possibility of further deterioration in our working capital position, the impact on our liquidity and interest costs if we are offside of the covenants in our debt facilities, our ability to increase profitability and manage growth, risks associated with leasing and expansion, competition, inventory and sourcing risk, our ability to identify and respond to changing consumer fashion preferences, risks associated with international purchasing, reliance on key personnel, dependence on consumer spending, unseasonable weather conditions, uncertainties arising from world events, intellectual property risks, foreign exchange fluctuations on imported merchandise, labour relations, seasonality and fluctuations in cash distributions, , restrictions on potential growth, future issuances of shares by Sterling or future disposition of shares held by SSI Investments Inc., income tax matters, changes in accounting standards, including the transition to IFRS, and increases in interest rates. These risks are discussed in our most recent annual information form and in this management’s discussion and analysis and 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 Sterling Shoes Inc. 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 Sterling, including the Company’s Annual Information Form and other public filings, are available on SEDAR (www.sedar.com) and on our website at www.SterlingShoesInc.com.

INVESTOR RELATIONS

Daniel S. Gumprich
Chief Financial Officer
2580 Viscount Way
Richmond, BC V6V 1N1
Phone: (604) 270-6114

**FORM 51-102F3
MATERIAL CHANGE REPORT**

1. Name and Address of Corporation

Sterling Shoes Inc.
2580 Viscount Way
Richmond, BC
V6V 1N1 Canada
(the "Fund")

2. Date of Material Change

October 26, 2011

3. News Release

On October 27, 2011, the Company issued a news release through the newswire services of Marketwire. A copy of the press release is attached as Schedule "A".

4. Summary of Material Change

Sterling Shoes Inc. (the "Company") has received notice from the Toronto Stock Exchange (the "TSX") that its common shares and convertible debentures (Symbol: SSI and SSI.DB, respectively) will be delisted at the close of market on November 25, 2011 for failure to meet the continued listing requirements of TSX. The common shares and debentures will remain suspended from trading until that date. The notice follows the initial order obtained by the Company under the *Companies' Creditors Arrangement Act* on Friday, October 21, 2011.

5. Full Description of Material Change

See attached press release.

6. Reliance on Subsection 7.1(2) or (3) of National Instrument 51-102

Not Applicable.

7. Omitted Information

Not Applicable.

8. Executive Officer

Dan Gumprich
Sterling Shoes Inc.
2580 Viscount Way
Richmond, BC
V6V 1N1 Canada

9. Date of Report

October 27, 2011



STERLING SHOES LIMITED PARTNERSHIP

STERLING SHOES RECEIVES NOTICE OF DELISTING FROM THE TORONTO STOCK EXCHANGE

Vancouver, B.C. October 27, 2011 – Sterling Shoes Inc. (the “Company”) has received notice from the Toronto Stock Exchange (the “TSX”) that its common shares and convertible debentures (Symbol: SSI and SSI.DB, respectively) will be delisted at the close of market on November 25, 2011 for failure to meet the continued listing requirements of TSX. The common shares and debentures will remain suspended from trading until that date. The notice follows the initial order obtained by the Company under the *Companies’ Creditors Arrangement Act* on Friday, October 21, 2011.

About Sterling Shoes Inc.

Sterling Shoes is a leading Vancouver-based footwear retailer offering a broad selection of private label and brand name shoes and accessories across five Canadian provinces through its five separate retail banners: Sterling, Joneve, Shoe Warehouse, Freedman Shoes and Gia. Since 1987, Sterling Shoes has grown from five shopping mall locations to 158 stores (as at October 26, 2011) located primarily in high-traffic, high-visibility locations within enclosed shopping malls, on high streets and in strip malls. Sterling Shoes currently employs approximately 1,100 employees.

For further information, please visit us at www.SterlingShoesInc.com, or contact:

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

Additional information about Sterling Shoes Inc. can be found in the disclosure documents filed by Sterling Shoes Inc. with the securities regulatory authorities, available at www.sedar.com.