

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.

SECOND REPORT OF THE MONITOR
ALVAREZ & MARSAL CANADA INC.

DECEMBER 7, 2011

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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**".
- 1.2 On November 18, 2011 the Petitioner Parties sought and obtained an order from this Honourable Court extending the stay of proceedings contained in the Initial Order from November 18, 2011 to December 30, 2011 (the "**Stay of Proceedings**"). In addition, the Petitioner Parties sought and obtained an order approving an amendment to paragraph 13(d) of the Initial Order.
- 1.3 The Petitioner Parties have filed a notice of application dated December 6, 2011 (the "**Notice of Application**") to be heard on December 9, 2011 seeking an order (the "**Approval Order**") approving the following:
- a) commencement of a store closure plan and execution by the Partnership of an Agency Agreement (subsequently defined) between the Partnership and Century Services LP, by its general partner, Century Services Inc. ("**Century**"), which will allow the Partnership to undertake a liquidation of store merchandise in 53 retail locations (the "**Closing Stores**");
 - b) a sale and investment solicitation process ("**SISP**") which will be undertaken with the assistance of, and in consultation with, Capital West Partners ("**CapWest**");
 - c) a key employee incentive plan ("**KEIP**") for select management and employees of the Partnership (the "**Key Employees**") and a charge in favour of the Key Employees in respect of the Partnership's obligations pursuant to the KEIP;
 - d) an extension of the forbearance agreement (the "**Forbearance Agreement**") between the Company and its primary operating lender, Bank of Montreal ("**BMO**") to March 31, 2012; and
 - e) the Company's request for an extension of the Stay of Proceedings to March 31, 2012 (the "**Stay Period**").

- 1.4 In support of the Notice of Application, the Petitioner Parties are relying on the Third and Fourth Affidavits of Mr. Daniel Gumprich (Sterling's Chief Financial Officer), sworn December 6, 2011 (which are referred to herein as the "**Gumprich #3 Affidavit**" and the "**Gumprich #4 Confidential Affidavit**", respectively) and an affidavit of Mr. Steven Richardson, a Director of Sterling sworn December 5, 2011 (the "**Richardson Confidential Affidavit**").
- 1.5 The Initial Order, together with select motion material and other documentation filed in 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 second report (the "**Second Report**") and it has been prepared as a special purpose report to provide this Honourable Court and the Company's stakeholders with the Monitor's comments and recommendations in respect of the Notice of Application.
- 2.2 In addition to the foregoing, the Monitor has also included herein its comments with respect to the Company's actual cash receipts and disbursements for the period ended December 3, 2011 and the Company's Revised Cash Flow Statement for the period ending March 31, 2012 (defined below).

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 and the variations could be material.

3.3 Unless otherwise stated, all monetary amounts contained in this report are expressed in Canadian dollars.

4.0 **STORE CLOSURES AND AGENCY AGREEMENT**

4.1 The Company has developed an operational restructuring plan which, includes among other things, a plan to reduce the number of retail banners currently operating and close unprofitable retail store locations. Subject to the approval of this Honourable Court, the Company plans to undertake a store closure plan and a liquidation of merchandise at the Closing Stores (53 store locations out of a total of 158 stores) and enter into an agency agreement with a third party liquidation firm for the conduct of a liquidation sales process to commence on or around December 9, 2011.

Store Closure Plan

4.2 Management has identified the Closing Stores which have been generating losses at the store contribution level during the 2009 to 2011 period and/or have nominal long term strategic value. Attached as Appendix “A” is a summary listing of the Closing Stores

4.3 The Monitor has reviewed an analysis prepared by Management which indicates that the Closing Stores generated in aggregate, a net cash operating loss at the store level of approximately \$1.5 million for the trailing twelve months to September 30, 2011. Included in the Closing Stores are 15 Joneve and Gia banner stores that Management considers to no longer be of strategic value to the Company. A total of 16, 6 and 31 store locations in British Columbia, Alberta and Ontario, respectively, are expected to be closed no later than February 29, 2012. Approximately 370 full time and part time employees will be affected by these store closures.

4.4 As part of its development of a plan to close a number of unprofitable store locations, Management (in conjunction with its third party real estate leasing consultant) also undertook a detailed review of the realty leases in respect of the Closing Stores to determine the extent to which the realty leases, if any, had any market value. The Monitor was consulted by Management in the course of its due diligence and is satisfied that Management has made an informed and reasonable decision to exit the Closing Store locations and the accompanying leases, should that become necessary.

4.5 Management’s store closure plan has also been considered by the Company’s financial advisor, CapWest, in order to assess the impact that the store closures might have on the SISP. CapWest has advised the Monitor that it is of the view that the proposed store closures are not expected to

have a material negative impact on the marketability and/or market value of the Company's remaining business and assets.

- 4.6 Pursuant to the terms of the Forbearance Agreement (defined subsequently), Management was required to provide a fully developed operational restructuring plan on or before November 18, 2011 which was to include “. . . *proposed store closures, employee redundancy and inventory realization*”. The Monitor has confirmed that BMO is supportive of Management's decision in respect of the Closing Stores.

Request for Proposals – Liquidation Firms

- 4.7 After consultation with the Monitor and the financial advisor for BMO, the Company identified seven third party liquidation firms from which to solicit proposals for the liquidation of merchandise at the Closing Stores. The selected liquidation firms were determined to have the requisite expertise, financial and human resources and retail experience in the Canadian market to undertake a liquidation of the Closing Stores' merchandise. In addition, the following issues were considered by the Company and the Monitor in selecting potential liquidation firms:
- a) the scope and scale of the proposed liquidation;
 - b) the proposed timing of the liquidation given the pending 2011 Holiday Season;
 - c) the geographic dispersion of the Closing Stores;
 - d) the relative value of the merchandise to be liquidated;
 - e) the particular retail segment, being shoe wear and accessories; and
 - f) the independence and objectivity of the liquidation firm (i.e. had it previously performed any appraisals or valuations of Sterling merchandise in the past).
- 4.8 A request for proposal document, a form of confidentiality agreement and a draft agency agreement (collectively, the “**Request for Proposal**”) were dispatched by the Company to each of the seven liquidation firms on or around November 21, 2011. Attached hereto as Appendix “**B**” is a undatd master copy of the Request for Proposal sent to the seven liquidation firms.
- 4.9 Confidentiality agreements were executed and returned to the Company by all seven selected liquidation firms and they were granted access to a virtual data room, organized by Management.
- 4.10 The Request for Proposal included among other things, the following terms:
- a) confidentiality agreements must be signed and returned prior to granting access to the virtual data room maintained by the Company;

- b) confidential proposals were to be submitted to the legal counsel to the Monitor on or before 5:00pm (Pacific time) on November 28, 2011;
 - c) proposals received and determined to be “Conforming Proposals” were to be in the form of a draft agency agreement which was provided to the selected liquidation firms during the week of November 21, 2011; and
 - d) provision of a “Guaranteed Amount” and an upfront payment of 90% of the Guaranteed Amount and a refundable deposit of \$250,000 to be paid to and held in trust by the Monitor.
- 4.11 During the period November 18, 2011 through to November 28, 2011, the selected liquidation firms had access to the Company’s virtual data room which contained detailed financial and operating data in respect of the Closing Stores and merchandise inventories. Queries by the selected liquidation firms and related responses were documented by the Company and were available to all parties with access to the data room.
- 4.12 Four proposals were received, including two joint venture proposals from six of the selected liquidation firms. The proposals were received by the Monitor’s legal counsel before the deadline of November 28, 2011 and all interested parties remitted the required deposit to the Monitor of \$250,000 in accordance with the Request for Proposal. While varying in certain commercial terms, all four proposals followed the form of draft agency agreement previously forwarded to them by the Company.
- 4.13 During the week of November 28, 2011, Management sought clarification on certain terms contained in the proposals from a number of the interested liquidation firms. The Monitor was consulted throughout the period during which clarifications were sought and is of the view that these matters were handled by Management in a commercially reasonable and fair manner.
- 4.14 On or around December 6, 2011, the Company, in consultation with the Monitor and the financial advisor to BMO, selected Century as having the preferred proposal to undertake the liquidation of the merchandise at the Closing Stores. The Monitor is advised that the three other liquidation firms who submitted proposals have since been notified that they have not been selected.

Agency Agreement

- 4.15 Pursuant to the Notice of Application, the Company is seeking an order of this Honourable Court *inter alia*, that the Partnership be authorized to enter into an agency agreement with Century dated December 6, 2011 (the “**Agency Agreement**”), and that the transaction contemplated therein is approved. An unredacted copy of the Agency Agreement has been attached to the

Gumprich #4 Confidential Affidavit. The Petitioners are seeking a sealing order in respect of the Gumprich #4 Confidential Affidavit on the basis that the Agency Agreement contains commercially sensitive and confidential information which, if it were made publicly available, could be detrimental to the interests of the Petitioner Parties and Century. For the same reason, certain commercial terms of the Agency Agreement are not disclosed herein; however, a number of key terms are summarized below:

- a) the liquidation sale contemplated under the Agency Agreement will commence on the day the Agency Agreement is approved by this Honourable Court, but no later than December 9, 2011 (the “**Sale Commencement Date**”) and will conclude on or before February 29, 2012 unless extended by mutual agreement between Century and the Partnership (the “**Sale Termination Date**”);
- b) Century is appointed by the Partnership as its exclusive agent for the purpose of conducting the liquidation of merchandise at the Closing Stores;
- c) “Sale Guidelines” (as defined in the Agency Agreement) form part of the Agency Agreement and will govern certain aspects of the proposed liquidation of merchandise at the Closing Stores. The Monitor is advised by counsel to the Petitioner Parties that 41 of the 53 Closing Stores landlords have been consulted on the form of Sale Guidelines and that the remaining landlords have been put on notice by the Company of the Notice of Application and the Company’s intentions to proceed with an application on December 9, 2011 to approve the Sale Guidelines;
- d) Century will pay a guaranteed percentage of the aggregate cost value of the merchandise as at the Sales Commencement Date to the Partnership (the “**Guaranteed Amount**”). Ninety percent (90%) of the Guaranteed Amount will be paid to the Partnership no later than the day of the Agency Agreement is approved by this Honourable Court. The balance of the Guaranteed Amount will be paid upon completion of a final inventory reconciliation process and accounting between Century and the Partnership;
- e) Century is responsible for all normal store operating expenses incurred during the liquidation but shall be entitled to recover the expenses incurred from the sales proceeds realized on the sales of merchandise after payment of the Guaranteed Amount;
- f) Century is to provide a letter of credit in support of a portion of the store operating expenses for which it is responsible and is to provide a letter of credit in support of the remaining balance (10%) of the Guaranteed Amount; and

- g) Century is entitled to a fee based on the aggregate cost value of the liquidated merchandise as well as a commission on the sale of the Company owned furniture, fixtures and equipment located at the Closing Stores.

4.16 In addition to the foregoing, the Agency Agreement is conditional upon the Approval Order granting a charge (the “**Agent’s Charge**”) over the Merchandise and Proceeds, except for the Guaranteed Amount (all as defined in the Agency Agreement) in favour of Century in the amount of the \$9.5 million as security for all of the obligations of the Partnership to Century under the Agency Agreement. The Agent’s Charge is sought in recognition of the fact that Century will be paying the Partnership 90% of the Guaranteed Amount on the day the Approval Order is obtained, notwithstanding Century will not recover that amount until well into the liquidation process. The Monitor is advised that the Agent’s Charge is intended to rank in priority to all of the charges provided for in the Initial Order and the security of BMO. The Monitor has confirmed that BMO has agreed to the quantum and priority of the Agent’s Charge.

Summary of the Monitor’s Assessment

- 4.17 The Monitor is of the view that Management has carefully considered and analyzed the commercial and financial implications of its decision to close 53 stores.
- 4.18 The Monitor is satisfied with the process undertaken by Management in soliciting proposals for the liquidation of the merchandise at the Closing Stores and is of the view that the integrity of the solicitation process was maintained. Further, the Monitor is of the belief that the process was conducted fairly and that there was sufficient transparency built into the process such that the Monitor can report to this Honourable Court with such assurances.
- 4.19 The Monitor, in conjunction with Management and the financial advisor to BMO, performed a detailed review of the four competing proposals (draft agency agreements) received from the submitting liquidators and is satisfied that the Company’s selection of Century as the preferred bidder is commercially reasonable. The Monitor has based its assessment on a number of the commercial terms of Century’s proposal which are superior to the terms of the other proposals received including the Guaranty Percentage and Guaranteed Amount, the treatment of any cost to retail factor and merchandise threshold adjustments and the Company’s participation level in the recovery of liquidation sales proceeds that are over and above the Guaranteed Amount and related expenses and fees.

- 4.20 The Monitor is of the view that the Agent's Charge is appropriate within the context of the Agency Agreement as currently drafted and that the quantum and priority ranking of the Agent's Charge is appropriate and reasonable.
- 4.21 As noted above, the Company has sought a Sealing Order with respect to a copy of the unredacted Agency Agreement due to certain competitively sensitive information being contained therein. The Monitor supports the Company's request for a Sealing Order in respect of the unredacted Agency Agreement.

5.0 SALE AND INVESTMENT SOLICITATION PROCESS

Engagement of Capital West Partners and Efforts to Date

- 5.1 In August 2011, a special committee of Sterling's Board of Directors (the "**Special Committee**") engaged CapWest to commence a process to assess various strategic alternatives for the Company including a financing or sale, in whole or a part, of the Company's business.
- 5.2 CapWest and the Special Committee entered into an engagement agreement dated August 19, 2011 (the "**CapWest Agreement**"). An unredacted copy of the CapWest Agreement is appended to the Gumprich #4 Confidential Affidavit. Prior to the date of the Initial Order, CapWest completed a review of the financial position and operating performance of the Company and identified a number of strategic alternatives to pursue. In addition, Capwest approached a number of potential investors or interested parties, most of which executed non-disclosure and standstill agreements and received a business restructuring plan document.
- 5.3 With a view to maximizing value and to ensure the SISP is conducted fairly and effectively, it is the Company's intention to continue with the engagement of CapWest as financial advisor and to have CapWest continue to seek indicative non-binding offers for all or part of the Company's remaining business. Non-binding expressions of interest are expected to be received and finalized in February 2012 with a view to closing a transaction by the end of April 2012. A copy of the SISP is attached hereto as Appendix "C".
- 5.4 Since the date of the Initial Order, CapWest has continued with its engagement and, in particular, has continued to solicit potential investors and/or interested parties regarding a potential equity investment and/or purchase of the Company's business and assets. To date, CapWest has:
- a) contacted 50 prospective purchasers/investors;
 - b) received 13 executed non-disclosure agreements from interested parties; and

- c) contacted both strategic and financial investors of which approximately 30% are strategic or industry players and the balance being financial investors, including private equity investors in Canada and the U.S.

5.5 The Monitor will oversee and facilitate the SISP where possible but will not control the process or represent the Company in that regard. It is the Monitor's intention to work collaboratively with the Company and CapWest to ensure that this Honourable Court and other interested parties are kept informed of the process and that the process remain fair and transparent. To achieve this the Monitor will ensure that it receives:

- a) all material transaction documents in advance of their release to interested parties including, for example confidential information memoranda, investor presentations, bid instructions, non-disclosure agreements and purchase agreements and the Monitor will have unfettered access to the virtual data room;
- b) invitations to all material internal CapWest and Company meetings relating to the SISP and copies of internal documents prepared by the Company and CapWest relating to the SISP;
- c) invitations, on reasonable notice, to attend all material external meetings with interested parties including management presentations, site visits, and the like; and
- d) copies of expressions of interest and offers received from all interested parties.

5.6 An unredacted copy of the CapWest Agreement is attached to the Gumprich #4 Confidential Affidavit. The Monitor is of the view that the terms of the CapWest Agreement are fair and commercially reasonable given the Company's circumstances, CapWest's experience in the retail sector, the market for the Company's business and the work performed to date by CapWest. The Monitor understands that the Company will be seeking a sealing order for the CapWest Agreement and the Monitor supports such request due to certain competitively sensitive aspects or terms of the CapWest Agreement.

5.7 The Monitor has confirmed that BMO supports the continued retention of CapWest and its ongoing involvement in the SISP and that BMO has approved the fee structure, including any success fees that may be earned by CapWest.

6.0 **KEY EMPLOYEE INCENTIVE PLAN**

6.1 The Company has developed a KEIP which is designed to provide incentives to certain Management and other key employees of Sterling to continue to pursue and implement an operational and financial restructuring of Sterling during the pendency of the CCAA Proceedings.

A fundamental principle of the proposed KEIP is to retain certain key employees and management and to tie incentive compensation to the successful execution of various operational and financial restructuring initiatives undertaken by the Company. That is, remuneration or compensation under the KEIP is not simply time based but rather, is tied specifically to restructuring milestones.

6.2 The Monitor is advised that the key terms of the KEIP include:

- a) a total incentive compensation pool of \$500,000 to be allocated between a limited number of Management and other Sterling employees;
- b) individual amounts to be paid out under the KEIP will be made as follows:
 - i. one third paid upon the earlier of substantial completion of the liquidation and store closure process and February 29, 2012,
 - ii. one third paid upon execution of a definitive agreement to acquire, restructure or recapitalize Sterling's business, and
 - iii. one third, and any other amounts not previously paid, upon the earlier of the implementation of a plan of compromise or arrangement and emergence from the CCAA Proceedings and the closing of a sales transaction and/or a recapitalization or restructuring agreement; and
- c) The Company's obligations pursuant to the KEIP and the agreements executed by those key management and employees participating in the KEIP are to be secured by a charge (the "**KEIP Charge**") against the Property (as defined in the Initial Order) ranking behind the Agent's Charge, the Court ordered charges provided for in the Initial Order and the BMO security.

6.3 The Monitor has confirmed that Sterling's Board of Directors approved the KEIP on December 5, 2011 with respect to both the aggregate amount payable thereunder and the individual entitlements. Further, the Monitor has confirmed that BMO have agreed to the KEIP and the KEIP Charge subject only to the approval of same by this Honourable Court.

6.4 The Monitor is satisfied that a KEIP is appropriate in the circumstances, that the aggregate amount of the payments under the proposed KEIP is reasonable and that the number and identity of the individuals entitled to participate in the proposed KEIP is appropriate given the relative scale and complexity of the Company's business and its planned operational and financial restructuring plans.

- 6.5 In order to preserve the confidential and sensitive nature of the individuals that would be entitled to participate in the proposed KEIP, the Company will be seeking a Sealing Order in connection with the details of the KEIP and the individual entitlements. The Monitor supports the Company's request for a sealing order.

7.0 **FIRST AMENDMENT TO FORBEARANCE AGREEMENT**

- 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. The Forbearance Agreement was subsequently amended on December 6, 2011 ("**Amended Forbearance Agreement**"). A summary of select terms of the Amended Forbearance Agreement is as follows:

- a) the maximum aggregate availability has been reduced from \$20.0 million to \$15.0 million, and is further reduced to \$10.0 million upon receipt of the Initial Guaranty Payment (as defined in the Agency Agreement);
- b) extension of the forbearance period to March 31, 2012;
- c) provision for overadvance limits that allow for sufficient liquidity during the period ending March 31, 2012; and
- d) financial covenants that permit negative budget to actual sales receipt to a maximum percentage is sufficient in Management's view to allow Sterling to continue to access the loan facility under the terms of the Amended Forbearance Agreement.

8.0 **CCAA CASH FLOW FORECAST**

- 8.1 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 was 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 are included in the Proposed Monitor's Report dated October 21, 2011 and are not repeated herein.
- 8.2 As part of the Monitor's ongoing oversight and monitoring of the business and financial affairs of the Company, the Monitor has undertaken weekly reviews of the Company's actual cash flow in comparison 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 seven week period October 16, 2011¹ through December 3, 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 7 Week Period October 16 to December 3, 2011			
	October 16 - December 3, 2011 (Cumulative)		
(\$000's)	Actual	Forecast	Variance
Receipts (incl. taxes)	\$ 18,914	\$ 18,025	\$ 889
Disbursements			
Vendors	(3,586)	(3,002)	(584)
Payroll	(3,013)	(2,606)	(407)
Rent	(3,402)	(3,375)	(27)
Sales tax	(417)	(530)	113
Deposits	(23)	(200)	177
Pre-filing related payments	(1,143)	(854)	(289)
Other / Drawdown of Accord LC	(2,212)	(1,436)	(776)
	(13,796)	(12,003)	(1,793)
Cash Flow from Operations	5,118	6,022	(904)
CAPEX	-	-	-
Professional fees	(1,018)	(1,687)	669
Interest / Forbearance fee	(286)	(241)	(45)
Term Loan	-	-	-
Net Cash Flow	3,814	4,094	(280)
Bank Position			
Opening Bank Exposure (Note 2)	(14,270)	(14,443)	173
Closing Bank Position	(10,455)	(10,349)	(107)
Opening balance	\$ (2,344)	\$ (2,344)	\$ -
(Opened) / Cancelled	(294)	(1,661)	1,367
Drawn	2,269	911	1,358
LCs (Spring orders)	(369)	(3,094)	2,725
Total Bank Position	\$ (10,824)	\$ (13,443)	\$ 2,620
Notes:			
(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.			

8.3 In summary, the Company has experienced a favourable net cash flow variance of approximately \$2.6 million for the seven week period ended December 3, 2011. The principal components of the favourable variance are described below:

- a) sales and other receipts – the positive variance of \$889,000 relates primarily to higher than anticipated sales receipts, largely realized from the Shoewarehouse and Sterling

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 16 through October 22 which captures the date of the Initial Order.

banners totalling \$611,000. The remaining \$278,000 relates to realized gains on the closing of forward exchange contracts held at BMO;

- b) merchandise purchases – the net negative variance of \$584,000 for vendor payments arise from timing differences as shipments relating to the Spring 2012 season are being received earlier than anticipated;
- c) payroll and employee benefits – the net negative variance of \$407,000 was experienced for the seven week period as a result of greater than expected retail staff being required during the period as well as group insurance payments and vacation payouts that were not included in the forecast;
- d) other/drawdown of Accord LC – the negative variance of \$776,000 is due to an earlier than expected drawdown of a \$1.5 million letter of credit held under a factoring facility. Excluding the drawdown of the letter of credit, other expenses are approximately \$700,000 lower than expected primarily due to timing differences for sales, general and administrative costs (marketing, information technology, supplies, etc.); and
- e) professional fees – the favourable variance of \$669,000 relates to timing differences caused by delayed invoicing by the various professional firms as well as lower than expected professional fees being incurred.

Revised Cash Flow Statement

8.4 The Company has prepared a revised weekly cash flow forecast of its receipts and disbursements for the eighteen week period ending March 31, 2012 (the “**Revised Cash Flow Statement**”). In preparing the Revised Cash Flow Statement, Management has adopted the probable and hypothetical assumptions set out in accompanying notes to the Revised Cash Flow Statement. A copy of the Revised Flow Statement and accompanying notes are attached hereto as Appendix “**D**”.

8.5 In summary and as indicated in the Revised Cash Flow Statement:

- a) total cash receipts forecast from the sales of inventory (including applicable sales taxes) during the eighteen week period ending March 31, 2011 (the “Forecast Period”) are approximately \$35.4 million, including the estimated realizations from the liquidation pursuant to the Agency Agreement and in particular, payment of the Initial Guaranty Payment;

- b) total forecast proceeds from the liquidation of inventory for the Forecast Period have been conservatively estimated by Management and have been included in forecast cash receipts;
- c) total payments to trade vendors are forecast to be approximately \$12.5 million for the Forecast Period and it is assumed that a number of trade vendors, primarily overseas vendors, will continue to insist on more restrictive trade terms, including in some cases deposits;
- d) payroll and payroll remittances (for both store and corporate employees) and store and head office rent are forecast to be consistent with historical levels, after taking into account store closures, and will be approximately \$6.9 million and \$4.6 million, respectively, for the Forecast Period;
- e) statutory sales tax remittances are forecast to be maintained on a current basis throughout the Forecast Period;
- f) forecast deposits total approximately \$300,000 and relate to potential pre-payments for imported goods;
- g) other operating expenses of \$3.6 million relate to general overhead costs;
- h) estimated net cash flow from operations for the Forecast Period is approximately \$6.3 million before anticipated professional fees, restructuring costs and interest; and
- i) forecast bank indebtedness including, outstanding letters of credit is expected to be reduced by approximately \$2.9 million during the Forecast Period with a forecast balance at March 31, 2012 of approximately \$7.4 million.

- 8.6 It should be noted that the Revised Cash Flow Statement indicates an expected closing bank indebtedness position of \$11.8 million as at December 3, 2011 (refer to Appendix “D”). However, the actual bank indebtedness position as at December 3, 2011 was \$10.8 million (refer to the table at paragraph 8.2). The positive variance relates to timing differences which are expected to reverse in the forecast period. In addition, notes (2), (4) and (5) of the notes accompanying the Revised Cash Flow Statement reference “proposed closures of stores in December 2011”, “store closures” or “closures” in December 2011. For greater clarity, these references are simply in respect of the commencement of the liquidation of the Closing Stores and the proposed store closure process which is not expected to be completed until February 29, 2012.
- 8.7 While not reflected on the Revised Cash Flow Statement, the net book value of the Company’s inventories during the Forecast Period are estimated to reduce from approximately \$34.6 million

as at December 3, 2011 to approximately \$22.1 million as at March 31, 2012. The primary reason for the decline in inventories relates to the liquidation of merchandise at Closing Stores outlined above.

8.8 The Monitor has undertaken a review of the Revised Cash Flow Statement. A&M's review consisted of inquiries, analytical procedures and discussions related to information supplied to us by Management and certain employees of the Company. Since hypothetical assumptions need not be supported, our procedures with respect to them were limited to evaluating whether they were consistent with the purpose of the Revised Cash Flow Statement. We have also reviewed the information and documents provided by Management in support of the probable assumptions, as well as the preparation and presentation of the Cash Flow Statement.

8.9 Based on our review, nothing has come to our attention that causes the Monitor to believe that, in all material respects:

- a) the hypothetical assumptions are not consistent with the purpose of the Cash Flow Statement;
- b) as at the date of this report, the probable assumptions developed by Management are not suitably supported and consistent with the plans of the Company or do not provide a reasonable basis for the Revised Cash Flow Statement, given the hypothetical assumptions; or
- c) the Revised Cash Flow Statement does not reflect the probable and hypothetical assumptions.

8.10 Since the Revised Cash Flow Statement is based on assumptions regarding future events, actual results will vary from the information presented even if the hypothetical assumptions occur, and the variations may be material. Accordingly, A&M expresses no assurance as to whether the Revised Cash Flow Statement will be achieved.

8.11 The Revised Cash Flow Statement has been prepared solely for purposes described in Note 1 of the Revised Cash Flow Statement and readers are cautioned that it may not be appropriate for any other purpose.

9.0 **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 extending the Stay Period until March 31, 2012.

- 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 Revised Cash Flow Statement of the Petitioner Parties up to and including March 31, 2012 and the liquidity and availability of financing from BMO 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 or customers 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 Based on the review of the Amended Forbearance Agreement and the Revised Cash Flow Statement, 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 March 31, 2012.
- 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 its financial advisor and the Monitor, have undertaken significant efforts in respect of its near-term operational restructuring plan. Should this Honourable Court approve the SISP as contemplated, the Monitor is satisfied that such a process remains in the interests of the stakeholders of the Petitioner Parties and that an extension of the Stay Period as sought by the Petitioner Parties to allow the Company and its advisors sufficient time to advance a potential recapitalization, sales transaction and/or financial restructuring plan is appropriate and reasonable in the circumstances.

10.0 **PRIORITY OF CHARGES**

- 10.1 The Petitioner Parties propose that the relative priority of the CCAA Charges as well as additional charges now sought, namely, the Agent's Charge and the KEIP Charge, be as follows:
- a) First – Agent's Charge (to the maximum of \$9.5 million in respect of the Merchandise and Proceeds as defined in the Agency Agreement);
 - b) Second – Administration Charge (to the maximum amount of \$350,000);

- c) Third – Directors’ Charge (to the maximum amount of \$500,000);
- d) Fourth – BMO Security;
- e) Fifth – Administration Charge (to the maximum amount of a further \$150,000);
- f) Sixth – Directors’ Charge (to the maximum amount of a further \$1,000,000); and
- g) Seventh – KEIP Charge (to the maximum amount of \$500,000).

10.2 The Monitor is of the view that the relative priorities of the charges referred above are appropriate and reasonable in the circumstances.

11.0 **MONITOR’S CONCLUSIONS AND RECOMMENDATIONS**

11.1 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) approve the Agency Agreement and grant the Agent’s Charge;
- b) approve the CapWest Agreement and the SISP;
- c) approve the KEIP and grant the KEIP Charge;
- d) extend the Stay Period to March 31, 2012;
- e) approve the Sealing Orders in respect of the Gumprich #4 Confidential Affidavit and the Richardson Confidential Affidavit; and
- f) approve the priority of Court order charges as presented herein.

All of which is respectfully submitted to this Honourable Court this 7th day of December, 2011.

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



Todd M. Martin
Senior Vice President

Pam K. Boparai
Vice President

APPENDIX A

LIST OF CLOSING STORES

Store No.	Store	Address	Province
180	Freedman	Unit 104 – 240 Leighland Avenue, Oakville	Ontario
144	Freedman	Unit 70A – 100 Anderson Road S, Calgary	Alberta
146	Freedman	1854 West 4 th Avenue, Vancouver	British Columbia
86	Freedman	640 Granville Street, Vancouver	British Columbia
140	Freedman	Unit 1572 – 6551 No. 3 Road, Richmond	British Columbia
142	Freedman	Unit 304 – 306, 1950 Harvey Avenue, Kelowna	British Columbia
89	Freedman	1315 Government Street, Victoria	British Columbia
186	Freedman	Unit H013 – 9350 Yonge Street, Richmond Hill	Ontario
42	Joneve	777 Park Royal North, West Vancouver	British Columbia
40	Joneve	Unit D058 – 700 West Georgia Street, Vancouver	British Columbia
45	Joneve	1075 Robson Street, Vancouver	British Columbia
47	Joneve	Unit 155 -100 Anderson Road South, Calgary	Alberta
124	Joneve	Unit 444 – 19705 Fraser Highway, Langley	British Columbia
60	Joneve	Unit 1245 – 6455 Macleod Trail SW, Calgary	Alberta
190	Joneve	Unit 1320 – 110 Place D'Orleans Drive, Orleans	Ontario
194	Joneve	Unit 1177 – 25 The West Mall, Toronto	Ontario
184	Joneve	Unit DD6B – 100 Bayshore Drive, Ottawa	Ontario
183	Joneve	Unit 237 – 1105 Wellington Road South, London	Ontario
193	Joneve	Unit 254 – 25 Peel Centre Drive, Brampton	Ontario
80	Joneve	Unit 175 – 109 th Street & Princess Elizabeth Avenue, Edmonton	Alberta

44	Joneve	Unit 2303 – 4700 Kingsway, Burnaby	British Columbia
187	Joneve	550 King Street North, Waterloo	Ontario
113	Gia	Unit 2156A Metrotown, 4700 Kingsway, Burnaby	British Columbia
41	Sterling	2230 West 4 th Avenue, Vancouver	British Columbia
70	Sterling	Unit 800 – 5111 Northland Drive N.W., Calgary	Alberta
150	Sterling	Unit E3 – 17600 Yonge Street, Newmarket	Ontario
152	Sterling	Unit A005B PO Box 147 – 220 Yonge Street, Toronto	Ontario
155	Sterling	Unit B211 – 5100 Erin Mills Parkway, Mississauga	Ontario
182	Sterling	Unit 88A – 221 Glendale Avenue, St. Catharines	Ontario
71	Sterling	Unit 127 – 4747 67 th Street, Red Deer	Alberta
156	Sterling	Unit M021 – 2960 Kingsway Drive, Kitchener	Ontario
158	Sterling	Unit 0255A – 999 Upper Wentworth Street, Hamilton	Ontario
163	Sterling	Unit C6B – 3100 Howard Avenue, Windsor	Ontario
166	Sterling	Unit 2022 – 419 King Street West, Oshawa	Ontario
171	Sterling	Unit E008 – 9350 Yonge Street, Richmond Hill	Ontario
173	Sterling	Unit J9 – 435 Stone Road West, Guelph	Ontario
176	Sterling	Unit 140 – 25 Peel Centre Drive, Brampton	Ontario
181	Sterling	Unit C1A – 390 North Front Street, Belleville	Ontario
168	Sterling	Unit 277 – 1105 Wellington Road South, London	Ontario
177	Sterling	Unit B-34 – 120 Adelaide Street West, Toronto	Ontario

28	Sterling	1073 Robson Street, Vancouver	British Columbia
161	Sterling	Unit 2-924 – 100 City Centre Drive, Mississauga	Ontario
178	Sterling	Unit 306 – 355 Hespeler Road, Cambridge	Ontario
162	Sterling	Unit 99 – 300 Borough Drive, Scarborough	Ontario
157	Sterling	Unit D006 – 509 Bayfield Street, Barrie	Ontario
159	Sterling	Unit 32 – 5000 Highway 7 East, Markham	Ontario
160	Sterling	Unit U072B – 1680 Richmond Street, London	Ontario
172	Sterling	Unit 0539 – 900 Dufferin Street, Toronto	Ontario
169	Sterling	Unit B205 – 1 Promenade Circle, Thornhill	Ontario
185	Sterling	Unit U019 – 945 Gardiners Road, Kingston	Ontario
22	Shoe Warehouse	Unit E – 1675 152 nd Street, Surrey	British Columbia
123	Shoe Warehouse	Unit 130 – 7515 Market Crossing, Burnaby	British Columbia
108	Shoe Warehouse	Unit 63 – 1644 Hillside Avenue, Victoria	British Columbia

APPENDIX B



STERLING SHOES LIMITED PARTNERSHIP

Date

Company

Address

City, Province, Postal Code

Dear Sirs:

**Re: Sterling Shoes Limited Partnership ("Sterling" or the "Company")
Request For Proposal – Potential Inventory Liquidation**

This letter serves as a request for proposal in respect of Sterling's selection of an agent, who would act on an exclusive basis to assist the Company in the potential liquidation of certain inventory (the "**Merchandise**"), as well as select furniture, fixtures and equipment ("**FF&E**"), located at certain of the Company's retail store locations ("**Closing Stores**") through the conduct of "store closing", "sale on everything", "everything must go" or similar theme sales (the "**Sale**") at the Closing Stores.

Confidentiality agreements have previously been dispatched to select interested parties ("**Qualified Parties**"). Upon receipt by the Company of an executed confidentiality agreement from a Qualified Party, that Qualified Party will be provided access to a virtual data room maintained by the Company, which will contain select financial and other information relating to the Closing Stores, the Merchandise and FF&E located therein, and store leases, as well as other relevant financial information.

Requests for additional financial information and site visits should be directed to the Company or the Monitor at the addresses below:

Daniel Gumprich
Sterling Shoes Limited Partnership
2580 Viscount Way, Richmond, BC, V6V 1N1
tel: 604.270.6114 ext 101 fax: 604.278.7751
daniel@sterlingshoes.com

Todd M. Martin, Managing Director
Alvarez & Marsal Canada ULC
400 Burrard Street
Suite 1680, Commerce Place
Vancouver, BC, V6C 3A6
Direct: 604.638.7445
Mobile: 778.918.0110
tmartin@alvarezandmarsal.com



STERLING SHOES LIMITED PARTNERSHIP

Important Notice to Qualified Parties

PARTICIPATION BY A QUALIFIED PARTY AND SUBMISSION OF A PROPOSAL IN THIS SOLICITATION PROCESS IS EXPRESSLY SUBJECT TO THE TERMS AND CONDITIONS OF THE CONFIDENTIALITY AGREEMENT SIGNED BY SUCH QUALIFIED PARTY AS WELL AS COMPLIANCE WITH THE TERMS AND PROVISIONS OF THIS REQUEST FOR PROPOSAL. FURTHER, ALL INFORMATION CONTAINED IN THIS REQUEST FOR PROPOSAL IS EXPRESSLY SUBJECT TO TERMS OF THE AGENCY AGREEMENT TO BE POSTED IN THE VIRTUAL DATA ROOM. THE COMPANY RESERVES THE RIGHT TO SUSPEND OR MODIFY THE PROPOSAL SOLICITATION PROCESS OR WITHDRAW ANY OR ALL OF THE CLOSING STORES FROM THE SALE AT ANY TIME PRIOR TO EXECUTION OF A DEFINITIVE AGENCY AGREEMENT AT ITS SOLE DISCRETION FOR ANY REASON WHATSOEVER. THE COMPANY RESERVES THE RIGHT TO ACCEPT ANY PROPOSAL OR REJECT ANY AND ALL PROPOSALS AND TO EXCLUDE ANY QUALIFIED PARTY FROM ANY FURTHER PARTICIPATION IN THIS PROPOSAL SOLICITATION PROCESS AT ITS SOLE DISCRETION FOR ANY REASON WHATSOEVER.

Requests for Proposal ("RFP")

For purposes of this RFP, Qualified Parties are requested and expected to comply with and/or observe and understand the following:

1. To be considered, any and all proposals submitted by Qualified Parties must:
 - (a) conform to each and every one of the requirements outlined herein (subject to such compliance, as may be determined in the sole discretion of the Company) (a "Conforming Proposal"); and
 - (b) be received, in writing by **no later than 5:00 o'clock pm (Pacific Time) on Friday, November 25, 2011** (the "Initial Proposal Deadline").

It is the present intention of the Company to only consider proposals that are Conforming Proposals and that arrive on or before the Initial Proposal Deadline.

2. Proposals must be marked as "**Strictly Confidential**" and delivered in a sealed envelope on or before the Initial Proposal Deadline as follows:

Mr. Daniel Gumprich, Chief Financial Officer
Sterling Shoes Limited Partnership
2580 Viscount Way, Richmond, BC, V6V 1N1
tel: 604.270.6114 ext 101 fax: 604.278.7751
daniel@sterlingshoes.com

3. Promptly upon receipt of any Conforming Proposal(s), the Company shall determine, in consultation with the Monitor (as defined below), which of the Conforming

2580 VISCOUNT WAY RICHMOND, BC, CANADA, V6V 1N1 | TEL 604.270.6114 FAX 604.278.7751



STERLING SHOES LIMITED PARTNERSHIP

Proposals, if any, constitutes the preferred proposal received, taking into account all relevant circumstances as determined by the Company in its sole discretion (the "**Accepted Proposal**"). The Accepted Proposal shall be in the form of an agency agreement which will be provided to Qualified Parties on about November 21, 2011 in order to assist Qualified Parties with the preparation of their proposals (the "**Agency Agreement**"). The Agency Agreement may be subject to further negotiations between the Company and the Qualified Party who submits the Accepted Proposal. The Company reserves the right, in its sole discretion, to accept any Conforming Proposal or reject all Conforming Proposals, or any components of a Qualified Party's Conforming Proposal, or to seek clarification or enhancement of a Qualified Party's Conforming Proposal. Conforming Proposals shall provide that the proposal remains open for acceptance until **5:00 p.m. (Pacific Time) on Friday, December 2, 2011**.

4. The Company is operating and conducting the RFP process after having been granted certain protections under an initial order (as amended and extended, the "**Initial Order**") made by the British Columbia Supreme Court (the "**Court**") under the *Companies' Creditors Arrangement Act* ("**CCAA**") on October 21, 2011, on the application of Sterling Shoes Inc. and Sterling Shoes GP Inc., the Company's general partner. Accordingly, any Accepted Proposal will be subject to Court approval which shall be sought by the Company on or about **December 9, 2011**, or such other time as the Company and the successful Qualified Party agree. Qualified Parties may request a copy of the Initial Order granted in the CCAA proceedings by contacting the Company at the above noted address or obtaining a copy from the website of the monitor appointed by the Court under the Initial Order, Alvarez & Marsal Canada Inc. (the "**Monitor**"), at www.alvarezandmarsal.com/sterling.

Select Terms and Guidelines

Any Qualified Party who desires to submit a Conforming Proposal to serve as the Company's exclusive agent to conduct the Sale at the Closing Stores, must ensure that its proposal conforms to the following guidelines in order to be considered a Conforming Proposal. As noted above, any proposal that the Company determines not to be a Conforming Proposal may not be considered for designation as the Accepted Proposal.

1. The Qualified Party submitting the Accepted Proposal shall be allowed to conduct the Sale as a "store closing", "sale on everything", "everything must go" or similar theme sale at the Closing Stores consistent with the terms of the Agency Agreement. The Agency Agreement will set forth the specific terms and conditions of the agency relationship desired by the Company. In the event there is any inconsistency between the terms of the Agency Agreement and this RFP, the terms of Agency Agreement shall prevail, unless otherwise determined by the Company, in its discretion. **The Company reserves the right to make such changes to the Agency Agreement as it**



STERLING SHOES LIMITED PARTNERSHIP

determines in its sole discretion to be in the Company's interests (prior to execution of the Agency Agreement by the Company and the successful Qualified Party).

2. Any proposal that is submitted should include payment of a "Guaranteed Amount" and a "Merchant's Sharing Recovery Amount" to the Company for the Closing Stores. Conforming Proposals should provide that the Company shall receive an initial upfront payment of an amount equal to not less than 90% of the estimated Guaranteed Amount, such amount being determined by reference to the aggregate Cost Value of the Merchandise on the Sale Commencement Date as reflected in the Company's books and records (excluding the Additional Merchant Merchandise and Additional Agent Merchandise (each as defined below)). Qualified Parties will also be required to furnish one or more irrevocable standby letter(s) of credit to the Company for an amount not less than the remaining unpaid portion of the estimated Guaranteed Amount.
3. All proposals must be presented as a percentage of the "Cost Value" of the Merchandise subject to the Sale. "Cost Value" shall be as defined in the Agency Agreement.
4. The aggregate Cost Value of the Merchandise subject to the Sale will be determined based on a SKU and retail price based physical inventory count ("**Inventory Taking**") to be conducted by RGIS or other independent outside inventory service ("**Inventory Taking Service**") to be mutually selected by the Company and the Qualified Party. Fifty percent (50%) of the costs of the Inventory Taking Service shall be an "Expense" of the Sale payable by the Qualified Party. The Company, the Qualified Party, the Monitor and the Company's lender may each have their employees or representatives present at each Closing Store location to observe and test the physical counting, and review and test the listing, tabulation and pricing of the Merchandise. Conforming Proposals should include an estimate of the costs associated with the Inventory Taking.
6. Conforming Proposals should provide that the Qualified Party is unconditionally responsible for all "Expenses" incurred in conducting the Sale. Sale-related Expenses shall be detailed in the Agency Agreement and shall expressly include the costs associated with the transfer of merchandise among and between the Closing Stores. Qualified Parties will also be required to furnish one or more irrevocable standby letter(s) of credit to the Company for an amount equal to not less than two (2) weeks' estimated Expenses.
7. The Company presently projects that the successful Qualified Party will be given undisturbed possession of the Closing Stores on or about **December 12, 2011** (the



STERLING SHOES LIMITED PARTNERSHIP

- “Sale Commencement Date”)** and that inventory at cost will approximate **million**. The successful Qualified Party will be required to complete the Sale and vacate the Closing Stores by no later than **February 29, 2012**, or such later date as may be agreed to by the Company and the successful Qualified Party, and with the consent of the affected landlord of the Closing Store if the extension is proposed to go beyond the sale termination date provided for in the Sale Guidelines (the **“Sale Termination Date”**).
8. All Conforming Proposals shall be accompanied by bank draft or certified cheque in the amount of CDN\$250,000 (the **“Deposit”**) to the order of “Alvarez & Marsal Canada Inc., Monitor, in trust” which may be negotiated forthwith by the Monitor notwithstanding that the Qualified Party’s Conforming Proposal has not been accepted, the whole to ensure the seriousness of the proposal and to serve as liquidated damages in the event that the Conforming Proposal is accepted but does not close due to the fault of the Qualified Party. If the Conforming Proposal is accepted, the Deposit shall be deemed to be a non-refundable cash deposit and shall be held and applied against the Guaranteed Amount. The Deposit shall be returned, without interest, to the unsuccessful Qualified Parties, and to the successful Qualified Party in the event the Accepted Proposal does not close due to the fault of the Company or the Accepted Proposal does not receive Court approval.
 9. Sales completed between the Sale Commencement Date and the completion of the Inventory Taking at each particular Closing Store (the **“Gross Rings Period”**) shall be recorded and accounted for under the “gross rings” method, inclusive of a shrinkage adjustment of the Cost Value of the Merchandise sold during the Gross Rings Period applicable to each of the Closing Stores, such shrinkage adjustment to be specified in the Conforming Proposals.
 10. The successful Qualified Party shall be required to provide the Company with not less than thirty (30) days’ advance written notice (**“Vacate Notice”**) of its vacating of a Closing Store (as to each such Closing Store, the **“Vacate Date”**). A Qualified Party’s obligations to pay all Expenses, including **“Occupancy Expenses”** (as set out in the Agency Agreement), for each Closing Store subject to Vacate Notice shall continue until the Vacate Date for each such Closing Store. The Vacate Date shall be later than the Sale Termination Date.
 11. The successful Qualified Party shall utilize the Company’s existing point-of-sale system for recording all sales of goods in the Closing Stores to ensure accurate sales audit functions, as well as accurate calculations of the proceeds from the Sale.
 12. Conforming Proposals may include provisions providing for a Qualified Party’s use of the Company’s current credit card systems and servicing arrangements (including the

- Company's credit card terminals and processor(s), and credit card processor coding) during the course of the Sale; provided, however, that the Qualified Parties may make arrangements for the use of their own merchant identification numbers.
13. The successful Qualified Party may use the Company's trade name and logo type in connection with advertising and promotion of the Sale; provided, however, that the form and content of all advertising and promotional material is subject to the Company's prior approval, which approval shall not be unreasonably withheld or delayed, and will conform with sale guidelines which will be attached as an Exhibit to the Agency Agreement and which will remain subject to negotiations between the Company and its respective landlords and approval of the Court (the “**Sale Guidelines**”).
14. Conforming Proposals should include a proposal for goods of like quality to Merchandise in the Closing Stores on the Sale Commencement Date transferred from the Company's continuing stores to the Closing Stores after the Sale Commencement Date (the “**Additional Merchant Merchandise**”), which may be included or excluded from any Accepted Proposal at the Company's sole option. If included in the Sale at the Company's option, Additional Merchant Merchandise will be transferred at the Company's expense to Closing Stores within twelve (12) days of Sale Commencement Date. Conforming Proposals should clearly state a separate net minimum guarantee adjustment for the Additional Merchant Merchandise and related adjustments to the inventory threshold and other related amounts in the event that the Company elects to include the Additional Merchant Merchandise in the Sale. The maximum aggregate amount of Additional Merchant Merchandise and Additional Agent Merchandise included in any Conforming Proposal should not exceed twenty-five percent (25%) of the Cost Value of the Merchandise as at the Sale Commencement Date, with the amount of Additional Agent Merchandise in no event being more than ten percent (10%) of the Cost Value of the Merchandise at the Sale Commencement Date.
15. Proposals may also include a proposal for the right to “augment” the Merchandise at the Closing Stores with additional goods of like kind and quality to Merchandise in the Closing Stores on the Sale Commencement Date purchased by the Qualified Party from the Company's current suppliers, subject to the prior approval of the Company which will not be unreasonably withheld (the “**Additional Agent Merchandise**”). Any proposal which includes an augmentation component should clearly identify the amount of any additional consideration to be received by the Company in consideration of its permitting the successful Qualified Party to augment the Merchandise with Additional Agent Merchandise as part of the Sale. The amount of Additional Merchant Merchandise and the aggregate amount of Additional Merchant Merchandise and Additional Agent Merchandise included in any Conforming Proposal should not exceed the limitations set out above.

16. Each Qualified Party may also include as part of its proposal an offer to assist the Company in its disposition of the Company's owned FF&E located in the Closing Stores, at the Company's sole election. Each such proposal should conform to the following:
- a) The successful Qualified Party will exercise normal and prudent care of cash registers and all other FF&E at the Closing Stores, whether the property of Company or otherwise;
 - b) Each Qualified Party may include in its proposal a proposed fixtures disposition fee for the disposition of the Company's owned FF&E, which fee should be calculated based upon a percentage of net recoveries thereon by the Company; and
 - c) At the election of the Company, the successful Qualified Party will sell such owned FF&E during the course of or after the conclusion of the Sale, if so requested by the Company.
17. The Company is also prepared to consider, but shall not be obligated to accept, any proposal for the purchase by the Qualified Party of the Company's owned FF&E. Any Qualified Party who desires to make such a proposal should include all pertinent terms thereof in its Conforming Proposal.
18. Unless otherwise provided in any Court order or agreement between the Company and a landlord, the Qualified Parties shall comply in all material respects with the terms and provisions of any leases and other occupancy agreements for any of the Closing Stores, as well as federal, provincial, and local laws, ordinances, rules and regulations and with terms of any licenses or permits obtained.
19. Qualified Parties should provide for an employee incentive bonus plan for those Company employees to be utilized in connection with the Sale. The amount of the incentive being offered to retained employees, and the timing of payment, should be set forth with specificity in the proposal and shall not exceed ten percent (10%) of the aggregate base payroll of the Company (excluding commissions and bonuses in effect on the Sale Commencement Date).



AS NOTED ABOVE, THE COMPANY RESERVES THE RIGHT TO REJECT ANY OR ALL PROPOSALS SUBMITTED IN RESPONSE TO THIS REQUEST FOR PROPOSALS AND/OR WITHDRAW ANY OR ALL OF THE CLOSING STORES AT ANY TIME IN ITS SOLE DISCRETION PRIOR TO EXECUTION OF A DEFINITIVE AGENCY AGREEMENT.

Any requests for additional information or clarification of the matters addressed herein shall be directed to the undersigned.

Yours very truly,

Sterling Shoes Limited Partnership

Daniel Gumprich
Chief Financial Officer

SOLICITATION PROCESS

Background

Sterling Shoes Inc. and Sterling Shoes GP Inc. (the “**Petitioners**”) initiated a court-supervised restructuring of its finances and operations. On October 21, 2011, the Petitioners obtained an order (the “**Order**”) from the Supreme Court of British Columbia (the “**Court**”) providing protection under the *Companies' Creditors Arrangement Act* (the “**CCAA**”). Sterling Shoes Limited Partnership (“**Sterling LP**”) was also subject to the terms and conditions of the Order (together with the Petitioners, the “**Company**”). On November 18, 2011, the Company obtained an extension of the stay of proceedings provided in the Order until December 30, 2011.

Scope of the Process

As part of its restructuring under the CCAA, the Company will conduct a process (the “**Solicitation Process**”) to solicit offers to acquire, restructure or recapitalize the Company’s business.

The Company retains the right to discontinue the Solicitation Process at any time if it decides in its sole discretion to pursue other strategic restructuring alternatives.

Supervision and Reporting

- The Solicitation Process will be undertaken by the Company, with the assistance of Capital West Partners (the “**Financial Advisor**”) with oversight by and input from Alvarez & Marsal Canada Inc in its capacity as Monitor (the “**Monitor**”).
- The Monitor will provide periodic updates to the Court and the Petitioner’s stakeholders and make recommendations to the Court, as appropriate, during the Solicitation Process.
- The Company will seek Court approval of any final agreement or agreements.

Outline of the Procedure

- Upon execution of a confidentiality agreement, the Company will make available confidential information concerning the Company’s business (including access to a data room) to potential purchasers or bidders (“**Potential Bidders**”).
- The Company, with the assistance of the Financial Advisor, and in consultation with the Monitor, will identify proposals which are in the best interest of the Company and other stakeholders to pursue, and one or more of the Potential Bidders will be invited to participate in the submission and negotiation of a binding offer (the “**Bidders**”) with such binding offer being subject to Court

approval. Copies of all proposals, expressions of interest or letters of intent received by the Financial Advisor will be provided to the Monitor.

- The Company may make presentations to the Bidders regarding the opportunity.
- The Company reserves the right to reject any or all of the offers received and to adjust, extend or amend any of the timelines set out below, unless the Monitor objects, in which case advice and directions will be sought from the Court.

Solicitation Process Outline and Timelines

Phase I – Non-Binding Proposals	
Activity	Timing
<ul style="list-style-type: none"> ▪ Contacting additional potential investors ▪ Negotiating additional confidentiality agreements ▪ Distributing a revised business plan and granting access to the Potential Bidders to an electronic data room 	Ongoing
<ul style="list-style-type: none"> ▪ Satisfying additional information requests and preliminary questions from the Potential Bidders 	December 2011
Phase II – Management Meetings and Non Binding Proposals	
Activity	Timing
<ul style="list-style-type: none"> ▪ Preparing for and delivering presentations to the Potential Bidders 	January 2012
<ul style="list-style-type: none"> ▪ Receiving and reviewing non-binding proposals from the Potential Bidders for an investment or purchase of all or part of the Company 	February 2012
Phase III – Binding Proposals and Closing	
Activity	Timing
<ul style="list-style-type: none"> ▪ Selecting proposals to participate in a final, binding proposal process ▪ Responding to due diligence requests from the Bidders ▪ Receiving and reviewing the final, binding proposals from the Bidders 	February 2012
<ul style="list-style-type: none"> ▪ Selecting the preferred proposal 	February/March 2012
<ul style="list-style-type: none"> ▪ Negotiating and executing definitive agreements in respect of the winning proposal, subject to Court approval 	March/April 2012

▪ Obtaining Court approval for the proposed agreement	
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APPENDIX D

Sterling Shoes Inc., Sterling Shoes CP Inc. and Sterling Shoes Limited Partnership
Consolidated Cash Flow Forecast (Note 1)
For the Twenty-four Week Period from October 16, 2011 to March 31, 2012
(CDN \$000's)

Week	1-6c	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	Total
For the Week ending:	Actual	Forecast	Variance	Forecast	Variance	Forecast	Variance	Forecast	Variance	Forecast	Variance	Forecast	Variance	Forecast	Variance	Forecast	Variance	Forecast	Variance	Forecast	Variance	Forecast	Variance	Forecast	Variance	Total
	1-6c	7-Dec	10-Dec	17-Dec	24-Dec	31-Dec	7-Jan	14-Jan	21-Jan	28-Jan	4-Feb	11-Feb	18-Feb	25-Feb	3-Mar	10-Mar	17-Mar	24-Mar	31-Mar	7-Apr	14-Apr	21-Apr	28-Apr	5-May	12-May	Total
2	\$ 16,545	\$ 2,506	\$ 2,415	\$ 9,724	\$ 2,181	\$ 3,065	\$ 1,489	\$ 1,489	\$ 992	\$ 969	\$ 935	\$ 917	\$ 993	\$ 1,069	\$ 1,077	\$ 1,095	\$ 1,347	\$ 1,557	\$ 1,617	\$ 1,496	\$ 35,444	\$ 51,989				
3	(3,092)	(956)	(568)	(410)	(187)	(201)	(641)	(530)	(653)	(173)	(765)	(973)	(1,069)	(451)	(1,074)	(1,299)	(1,207)	(395)	(930)	(12,482)	(15,574)					
4	(2,825)	(190)	(982)	(312)	(703)	(192)	(587)	(222)	(587)	(1477)	-	(527)	(132)	(527)	(298)	(701)	(135)	(541)	(135)	(6,918)	(9,743)					
5	(1,690)	(75)	-	-	-	418	(1,112)	-	(1,112)	-	(1,112)	-	-	-	(1,112)	-	-	-	-	-	(4,643)	(6,333)				
6	(199)	(493)	-	-	-	(408)	-	-	-	-	(543)	-	-	-	-	32	-	-	138	(1,274)	(1,473)					
7	(18)	(46)	(64)	(72)	(89)	(23)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(294)	(312)				
8	(1,106)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(1,106)	
9	(2,062)	(232)	(208)	(293)	(293)	(249)	(158)	(158)	(268)	(268)	(268)	(268)	(148)	(148)	(148)	(148)	(148)	(148)	(148)	(148)	(148)	(148)	(148)	(148)	(5,641)	
Total Disbursements	(10,992)	(3,567)	(1,897)	(1,087)	(1,272)	(655)	(2,498)	(910)	(1,508)	(588)	(2,688)	(1,648)	(1,349)	(1,126)	(2,600)	(2,143)	(1,490)	(1,084)	(1,075)	(29,190)	(40,182)					
Cash Flow from Operations	5,553	(1,061)	518	8,637	909	2,410	(1,609)	82	(539)	347	(1,771)	(655)	(280)	(49)	(1,505)	(801)	67	533	421	6,254	11,807					
Professional fees	(844)	(282)	(277)	(282)	(313)	(160)	(122)	(122)	(122)	(144)	(105)	(100)	(100)	(100)	(122)	(155)	(100)	(100)	(127)	(2,833)	(3,677)					
Interest / Forbearance fee	(186)	(72)	-	(50)	-	(47)	-	-	-	-	(85)	-	-	-	-	(19)	-	-	(85)	(358)	(544)					
Capital expenditures	-	-	-	-	-	-	(30)	(30)	(30)	(30)	(30)	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(454)	(454)					
Net Cash Flow	4,523	(1,415)	241	8,305	596	2,203	(1,161)	(70)	(691)	173	(1,991)	(793)	(418)	(209)	(1,717)	(939)	(71)	395	171	2,609	7,132					
Bank Position	(14,443)	(9,920)	(11,334)	(11,094)	(2,789)	(2,192)	10	(1,151)	(1,221)	(1,912)	(1,739)	(3,730)	(4,523)	(4,941)	(5,150)	(6,867)	(7,806)	(7,877)	(7,482)	(9,920)	(14,443)					
Closing Bank Position	(9,920)	(11,334)	(11,094)	(2,789)	(2,192)	10	(1,151)	(1,221)	(1,912)	(1,739)	(3,730)	(4,523)	(4,941)	(5,150)	(6,867)	(7,806)	(7,877)	(7,482)	(9,920)	(14,443)						
Letters of Credit																										
Opening balance	\$ (2,344)	\$ (360)	\$ (479)	\$ (729)	\$ (979)	\$ (1,229)	\$ (1,229)	\$ (1,151)	\$ (1,073)	\$ (995)	\$ (917)	\$ (839)	\$ (778)	\$ (717)	\$ (656)	\$ (595)	\$ (468)	\$ (341)	\$ (214)	\$ (360)	(2,344)					
Opened	(285)	(250)	(250)	(250)	(250)	-	(47)	(47)	(47)	(47)	(47)	(47)	(41)	(141)	(141)	(141)	(89)	(89)	(89)	(89)	(2,440)					
Drawn	2,268	131	-	-	-	-	125	125	125	125	125	125	202	202	202	202	216	216	216	216	2,428	4,696				
Closing Letters of Credit	(360)	(479)	(729)	(979)	(1,229)	(1,229)	(1,151)	(1,073)	(995)	(917)	(839)	(778)	(717)	(656)	(595)	(468)	(341)	(214)	(87)	(87)	(87)	(87)				
Total Bank Position	\$ (10,280)	\$ (11,814)	\$ (11,823)	\$ (3,768)	\$ (3,422)	\$ (1,219)	\$ (2,302)	\$ (2,294)	\$ (2,907)	\$ (2,656)	\$ (4,569)	\$ (5,301)	\$ (5,658)	\$ (5,806)	\$ (7,462)	\$ (8,274)	\$ (8,218)	\$ (7,696)	\$ (7,398)	\$ (7,398)	\$ (7,398)					

Daniel S. Gump
Daniel Gump
Chief Financial Officer

Date _____

December 6, 2011

Notes:

See following page.

Sterling Shoes Inc., Sterling Shoes GP Inc. and Sterling Shoes Limited Partnership
Consolidated Cash Flow Forecast (Note 1)
For the Twenty-four Week Period from October 16, 2011 to March 31, 2012

Notes:

- 1 The purpose of this Cash Flow Statement is to set out the liquidity requirements of Sterling Shoes Inc, Sterling Shoes GP Inc. and Sterling Shoes Limited Partnership during the CCAA Proceedings. Since projections are based on assumptions regarding future events, actual results will vary from the information presented, and the variations may be material.
- 2 Cash receipts are based on estimated sales for the remainder of 2011 and the first quarter of 2012. These estimates were calculated using actual weekly sales for 2010 and 2011 with certain adjustments to reflect the recent sales activities at the Company's stores and the proposed closure of stores in December 2011. Cash receipts are uncertain and actual trends may vary from the budget. Cash receipts also assume that the Company will continue to purchase inventory throughout the period. Cash receipts include proceeds from the liquidation of inventory based on a conservative estimate of the best offer received from liquidators for the purchase of the inventory relating to the stores being closed and additional surplus inventory identified by Management as well as HST collected.
- 3 Payments to vendors are based on the expected delivery dates for purchase orders currently open.
- 4 Payroll payments are based on recent payroll expenses with appropriate adjustments for the expected increased sales activity during the December 2011 holiday season and reductions resulting from store closures. These amounts include payroll withholding taxes and other employee related expenses.
- 5 Rent payments are based on ongoing monthly lease obligations to store landlords. Rent payments reflect the proposed closure of certain stores in December.
- 6 Sales tax payments are based on the sales tax collected and net of input tax credits based on an 11% effective HST/GST rate across all provinces in which the Company operates.
- 7 Deposits include anticipated deposits which are expected to be paid to overseas suppliers.
- 8 Pre-filing payments include remaining freight payments to suppliers which are expected to be paid in order that goods can be released.
- 9 Other expenses include selling, general and administrative expenses. These expenses include travel and promotion, recurring professional fees (audit and tax), head office rent and communication expenses and insurance. These estimates have been forecast based on recent levels of monthly expenses and assumed to be spread evenly across each month and paid each week. The actual total for weeks 1 to 6 includes a drawdown on an Accord LC for \$1.5 million.
- 10 Professional fees relating to the filing are based on estimates provided by advisors of the Company and the secured lender for consulting and legal services as well as those of the monitor.
- 11 Interest and forbearance fees include bank interest and fees relating to the forbearance agreement with Bank of Montreal.
- 12 Letters of credit are based on those currently open and as well as the new letters of credit which are assumed may be required to place orders for purchases to be delivered in the first half of 2012.
- 13 The Cash Flow Statement indicates and expected bank position of (\$11,814,000) as at December 3, 2011. However, the actual bank position is \$990,000 lower at (\$10,824,000). The positive variance is primarily related to timing differences which are expected to reverse by March 31, 2012.