CELEBRATING

50

YEARS

1959 2009

2009 ANNUAL REPORT

McRae Industries, Inc.

CORPORATE PROFILE

McRae Industries, Inc. was founded in 1959 as a manufacturer and distributor of children's shoes. Today, McRae Industries has grown into a widely diversified company involved in manufacturing, sales and distribution of military footwear, western and work boots; and sales and distribution of bar code reading and printing devices. The company also operates other smaller businesses.

McRae Industries, Inc. has offices throughout the United States. Its corporate headquarters is located in Mt. Gilead, North Carolina.

SELECTED CONSOLIDATED FINANCIAL DATA

The following Selected Consolidated Financial Data of the Company presented below for each of the five years in the periods indicated has been derived from our audited and consolidated financial statements as adjusted to reflect the office products business as a discontinued operation.

FISCAL YEAR ENDED (In thousands, except for per share data)	**8/1/2009**	**8/2/2008**	**7/28/2007**	**7/29/2006**	**7/30/2005**
INCOME STATEMENT DATA:					
Net revenues	**$ 62,213**	$ 80,021	$ 68,271	$ 68,852	$ 62,404
Net (loss) earnings from continuing operations	**(514)**	5,041	3,818	3,390	1,574
Net earnings from discontinued operations	**0**	0	0	0	1,870
Net (loss) earnings	**(514)**	5,041	3,818	3,390	3,444
Net earnings from continuing operations per common share:					
Basic Earnings per share (a):					
Class A	**0.11**	2.75	2.13	1.90	1.09
Class B	**0**	0	0	0	0
Diluted Earnings per share (b):					
Class A	**0.11**	2.27	1.75	1.54	0.79
Class B	**NA**	NA	NA	NA	NA
BALANCE SHEET DATA:					
Total assets	**$ 49,763**	$ 51,536	$ 45,973	$ 42,355	$ 43,010
Long-term liabilities	**2,139**	698	0	0	0
Working Capital	**32,822**	34,321	29,413	27,868	27,017
Shareholders' equity	**42,318**	43,783	39,808	36,931	36,986
Weighted average number of common shares outstanding:					
Class A	**$ 2,089,686**	$ 2,098,714	$ 2,111,633	$ 2,147,827	$ 1,993,172
Class B	**438,915**	446,262	454,645	492,323	775,327
Weighted average number of common shares outstanding (c)	**$ 2,528,601**	$ 2,544,976	$ 2,566,278	$ 2,640,150	$ 2,768,499
Cash dividends declared per common share (d)	**$ 0.36**	$ 0.3525	$ 0.325	$ 0.32	$ 0.30

(a) This calculation uses the two-class method under which all undistributed earnings are allocated to Class A Common Stock in the earnings per share calculation; thus, no earnings are allocated to the holders of Class B Common Stock. See Note 1 to the consolidated financial statements included in this report.

(b) This calculation uses the if-converted method which assumes all Class B Common Stock is converted into Class A Common Stock; thus, there are no holders of Class B Common Stock to participate in undistributed earnings. See Note 1 to the consolidated financial statements included in this report.

(c) Includes both Class A and Class B Common Stock

(d) Dividends were paid only on Class A Common Stock

LETTER TO SHAREHOLDERS

Dear Fellow Shareholders:

Fiscal 2009 proved to be a difficult year for McRae Industries. I am sorry to report that the Company experienced its second operating loss over the past 25 years. Net revenues decreased 22% from $80.0 million for fiscal 2008 to $62.2 million for fiscal 2009. Net consolidated earnings declined from $5.0 million in fiscal 2008 to a consolidated net loss of $514,000 in fiscal 2009. These disappointing results were attributable to a series of challenging events within each of our core business units.

Our military boot business, McRae Footwear, saw net revenues decline from $22.6 million for fiscal 2008 to $11.7 million for fiscal 2009, resulting in a decrease in net earnings from $2.0 million in fiscal 2008 to a net loss of approximately $248,000 in fiscal 2009. The decline in revenues was attributable to several key factors. First, the U.S. Government significantly decreased its requirements for military combat boots as a result of excessive inventory levels. Our Government contracts provide for a minimum and maximum quantity of military combat boots to be purchased. This factor allowed the Government to set its requirement levels near the minimum quantity that they were obligated to purchase. This decrease in production levels combined with direct labor inefficiencies associated with the production of a new military boot design were the primary factors that negatively affected McRae Footwear's gross profit and net earnings for the year. While we do not anticipate an increase in orders from the U.S. Government during the coming fiscal year, the installation of our new Gusbi pouring machine has positioned us to bid on different styles of military combat boots than we have in the past. In addition, we have initiated a strategy to market and sell military boots to commercial enterprises.

Dan Post Boot Company, our western and work boot business, reported net revenues of $43.5 million in fiscal 2009 compared with net revenues of $44.8 million in fiscal 2008. Net earnings fell from $2.2 million in fiscal 2008 to $954,000 in fiscal 2009. The decrease in net revenue was primarily the result of supply chain disruptions caused by new material requirements for our children's footwear products and a softening in the market for our work boot products. The decline in net earnings was primarily attributable to various costs associated with the supply chain disruption and the write-off of software and integration services associated with an unsuccessful ERP installation. In response to

these issues, we have successfully implemented the new material requirements for our children's shoes and expect to be back to full production in the first quarter of fiscal 2010. We are optimistic that our western footwear products will have a strong first half of the year for fiscal 2010, while the work boot business is expected to remain soft during the same timeframe.

On April 1, 2009, we completed the sale of significantly all of the assets and liabilities of Compsee, our mobility solutions business, to CSI Enterprises, Inc (CSI). While we continue to manufacture our proprietary products under the name McRae Technologies, Inc. exclusively for CSI, we do not expect revenues from this business activity to be material in scope for fiscal 2010. As a result of the sale of this business unit, net revenues decreased from $12.1 million in fiscal 2008 to $6.8 million in fiscal 2009. The net loss increased from $200,000 in fiscal 2008 to $1.2 million in fiscal 2009, primarily the result of costs and expenses associated with the sale and winding-down activities of this business unit.

I am encouraged to report that despite our operational struggles for fiscal 2009, the Company's financial condition remained strong. At August 1, 2009, our cash and cash equivalents totaled $11.3 million as compared with $13.8 million at August 2, 2008, while working capital amounted to $31.8 million as compared with $33.6 million for the same two periods. In a strategic move to preserve cash, we borrowed $1.4 million in February 2009 to pay for our new military boot production equipment. We also have two lines of credit totaling $4.75 million, all of which was currently available at year end.

While fiscal 2009 was certainly a disappointing year in revenues and profits, we are pleased that we were able to make strides in implementing our strategy of concentrating on the synergy that exists with our core footwear businesses. We believe that this change in focus provides a tremendous opportunity to increase revenues, earnings and shareholder value in the years to come.

On behalf of the Board of Directors, officers and other associates, we thank our shareholders, business partners, vendors and customers for their continued goodwill and support.

Sincerely,

D. Gary McRae

D. Gary McRae
President

FINANCIAL STATEMENTS
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Report of Independent Certified Public Accountants

To the Board of Directors and Shareholders of
McRae Industries, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of McRae Industries, Inc. (a Delaware corporation) and subsidiaries as of August 1, 2009 and August 2, 2008, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended August 1, 2009. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of McRae Industries, Inc. and subsidiaries as of August 1, 2009 and August 2, 2008, and the results of their operations and their cash flows for each of the three years in the period ended August 1, 2009 in conformity with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Charlotte, North Carolina
November 12, 2009

CONSOLIDATED BALANCE SHEETS

McRae Industries, Inc. and Subsidiaries

(In thousands, except share data)	**August 1, 2009**	**August 2, 2008**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 11,310	$ 13,822
Accounts receivable, less allowances of $844 and $1,158, respectively	9,891	9,964
Inventories, net	12,856	15,473
Income tax receivable	2,363	0
Prepaid expenses and other current assets	120	429
Deferred tax assets	1,588	1,688
Total current assets	38,128	41,376
Property and equipment, net	3,156	1,687
Other assets:		
Real estate held for investment	3,366	3,358
Amounts due from split-dollar life insurance	2,288	2,288
Trademarks	2,824	2,824
Other	1	3
Total other assets	8,479	8,473
Total assets	$ 49,763	$ 51,536

See notes to consolidated financial statements

CONSOLIDATED BALANCE SHEETS

McRae Industries, Inc. and Subsidiaries

(In thousands, except share data)	**August 1, 2009**	**August 2, 2008**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Bank note payable-current portion	$ 184	$ 0
Accounts payable	3,373	3,792
Accrued employee benefits	160	992
Accrued payroll and payroll taxes	861	1,018
Other	728	1,253
Total current liabilities	5,306	7,055
Bank note payable net of current portion	1,126	0
Deferred tax liabilities	1,013	698
Total liabilities	7,445	7,753
Commitments and contingencies (Note 7)		
Shareholders' equity:		
Common Stock:		
Class A, $1 par value; authorized 5,000,000 shares issued and outstanding, 2,083,854 and 2,093,043 shares, respectively	2,084	2,093
Class B, $1 par value; authorized 2,500,000 Shares; issued and outstanding, 436,384 and 441,252 shares, respectively	436	441
Retained earnings	39,798	41,249
Total shareholders' equity	42,318	43,783
Total liabilities and shareholders' equity	$ 49,763	$ 51,536

See notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF OPERATIONS

McRae Industries, Inc. and Subsidiaries

(In thousands, except for share and per share data

For Years Ended	**August 1, 2009**	**August 2, 2008**	**July 28, 2007**
Net revenues	$ 62,213	$ 80,021	$ 68,271
Cost of revenues	47,771	56,810	49,775
Gross profit	14,442	23,211	18,496
Selling, general and administrative expenses	14,926	15,533	13,336
Operating (loss) profit	(484)	7,678	5,160
Other income	276	487	462
Interest expense	(15)	(29)	(19)
(Loss) earnings before income taxes	(223)	8,136	5,603
Provision for income taxes	291	3,095	1,785
Net (loss) earnings	$ (514)	$ 5,041	$ 3,818

(Loss) earnings per common share:

(Loss) earnings per common share:			
Basic earnings per share:			
Class A	$ .11	$ 2.75	$ 2.13
Class B	0	0	0
Diluted earnings per share:			
Class A	.11	2.27	1.75
Class B	NA	NA	NA
Weighted average number of common shares outstanding:			
Class A	2,089,686	2,098,714	2,111,633
Class B	438,915	446,262	454,645
Total	2,528,601	2,544,976	2,566,278

See notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

McRae Industries, Inc and Subsidiaries

(Dollars in thousands)

	Common Stock, $1 par value					
	Class A		**Class B**		**Additional Paid-in Capital**	**Retained Earnings**
	Shares	**Amount**	**Shares**	**Amount**		
Balance, July 29, 2006	2,116,751	$2,117	457,603	$ 457	$ 0	$ 34,356
Purchase of ESOP distribution shares	(16,174)	(16)	(4,101)	(4)		(234)
Conversion of Class B to Class A Stock	4,347	4	(4,347)	(4)		
Cash Dividend ($.325 per Class A common stock)						(686)
Net earnings						3,818
Balance, July 28, 2007	2,104,924	$2,105	449,155	$ 449	$ 0	$ 37,254
Purchase of ESOP distribution shares	(14,689)	(15)	(3,721)	(4)		(286)
Purchase of other shares	(521)		(853)	(1)		(22)
Conversion of Class B to Class A Stock	3,329	3	(3,329)	(3)		
Cash Dividend ($.3525 per Class A common stock)						(738)
Net earnings						5,041
Balance, August 2, 2008	2,093,043	$2,093	441,252	$ 441	$ 0	$ 41,249
Purchase of ESOP distribution shares	(10,816)	(11)	(2,741)	(3)		(178)
Purchase of other shares			(500)			(7)
Conversion of Class B to Class A Stock	1,627	2	(1,627)	(2)		
Cash Dividend ($.36 per Class A common stock)						(752)
Net loss						(514)
Balance, August 1, 2009	2,083,854	$2,084	436,384	$436	$ 0	$ 39,798

See notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

McRae Industries, Inc. and Subsidiaries

(In thousands)

For Years Ended	**August 1, 2009**	**August 2, 2008**	**July 28, 2007**
Cash Flows from Operating Activities:			
Net (loss) earnings	$ (514)	$ 5,041	$ 3,818
Adjustments to reconcile net (loss)earnings to net cash (used in) provided by operating activities:			
Depreciation	564	485	575
Gain on sale of assets	(51)	(383)	(1,091)
Deferred income taxes	415	(485)	191
Changes in operating assets and liabilities:			
Accounts receivable	(376)	(770)	(1,555)
Accounts receivable valuation allowances	(246)	438	(23)
Inventories	2,617	587	(295)
Prepaid expenses and other current assets	285	(219)	(82)
Accounts payable	108	(18)	887
Accrued employee benefits	(832)	516	(126)
Accrued payroll and payroll taxes	(157)	50	(46)
Income taxes	(2,363)	240	191
Other	(525)	(62)	26
Net cash (used in) provided by operating activities	**(1,075)**	**5,420**	**2,470**
Cash Flows from Investing Activities:			
Proceeds from sale of land and bar code business	296	449	113
Purchase of land for investment	(36)	(56)	(456)
Capital expenditures	(2,056)	(188)	(422)
Collections on notes receivable	0	20	17
Net cash (used in)provided by investing activities	**(1,796)**	**225**	**(748)**
Cash Flows from Financing Activities:			
Bank loan proceeds	1,400	0	0
Purchase of common stock	(199)	(328)	(254)
Principal repayments of bank notes payable	(90)	0	0
Dividends paid	(752)	(738)	(686)
Net cash provided by (used in) financing activities	**359**	**(1,066)**	**(940)**
Net (Decrease) Increase in Cash and Cash equivalents	(2,512)	4,579	782
Cash and Cash Equivalents at Beginning of Year	13,822	9,243	8,461
Cash and Cash Equivalents at End of Year	**$ 11,310**	**$ 13,822**	**$ 9,243**

Note: Inventories and capital expenditures for fiscal 2007 contain a $70 non-cash activity related to the transfer of bar code inventory to fixed assets. Proceeds from sale of land and purchase of land contain a non-cash section 1031 exchange component totaling $1,430.
During fiscal 2009, the Company’s sale of Compsee was financed with a note receivable of $598.

See notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
McRae Industries, Inc. and Subsidiaries
For the Years Ended August 1, 2009, August 2, 2008, and July 28, 2007

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business

McRae Industries, Inc., (the “Company”, which may be referred to as “we”, “us” or “our”), is a Delaware corporation organized in 1983 and is the successor to a North Carolina corporation organized in 1959. Our principal lines of business are: manufacturing and selling military combat boots; importing and selling western and work boots; and manufacturing and selling our proprietary bar code equipment.

On March 31, 2009, the Company sold substantially all of the assets of the bar code business for approximately $792,000, which did not result in a gain or loss. The assets sold included accounts receivables, various demonstration equipment, certain office furniture and fixtures, the Compsee trade name, domain names, and other registered trademarks. The buyer also assumed all of the accounts payable and specific accrued liabilities. The Company received $194,000 at closing and a promissory note for $598,000 due on September 30, 2009. In addition, the Company executed a one-year supply agreement with the buyer to manufacture and exclusively sell a variety of our proprietary bar code products. Accordingly, the name of this business was changed and now operates under the name of McRae Technologies, Inc.

Principles of Consolidation

The consolidated financial statements include the accounts of all of the Company’s wholly owned subsidiaries and other businesses over which we exercise significant control. All significant intercompany transactions and balances have been eliminated in consolidation.

Total assets and net revenues for each of our main business units are as follows:

	(In thousands)		
	2009	**2008**	**2007**
Total Assets:			
Bar Code	$ 1,178	$ 4,154	$ 5,944
Military Boots	4,082	3,597	3,614
Western/Work Boots	23,298	24,251	23,931

	(In thousands)		
	2009	**2008**	**2007**
Total Net Revenues:			
Bar Code	$ 6,837	$ 12,102	$ 13,505
Military Boots	11,675	22,575	16,373
Western/Work Boots	43,452	44,761	38,184
Other	249	583	209

Use of Estimates

The timely preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates. The economic price adjustment related to our military combat boot contract is subject to certain price variations for leather.

Cash and Cash Equivalents

Cash and cash equivalents consist of certificates of deposit purchased with an original maturity date of three months or less.

Accounts Receivable

Accounts receivable are stated at amounts expected to be collected from outstanding balances. Probable uncollectible accounts are reserved for by a charge to earnings and a credit to a valuation allowance based on the assessment of the current status of individual accounts. Balances that are still outstanding after using reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. The Company performs on-going credit evaluations of its customers' financial condition and establishes an allowance for losses on trade receivables based upon factors surrounding the credit risk of specific customers, historical trends, and other information.

Inventories

Inventories are stated at the lower of cost or market value using the last-in, first-out (LIFO) method for military boots and using the first-in, first-out (FIFO) method for all other inventories. We regularly review inventory quantities on hand and record a provision for excess and obsolete inventory based primarily on our estimated forecast and demand requirements for the next twelve months. Actual demand and market conditions may be different from those projected by our management primarily as a result of fashion cycles and trends and the overall financial condition of competitors in the western and work boot business. A percentage point error in our inventory allowances would approximate $5,800 for the fiscal year ended August 1, 2009.

Long-Lived Assets

Long-lived assets to be held are reviewed for events or changes in circumstances that indicate that their carrying value may not be recoverable. The Company periodically reviews the carrying value of long-lived assets, to determine whether or not an impairment to such value has occurred by assessing their net realizable values based on estimated undiscounted cash flows over their remaining useful lives.

Based on its most recent analysis, the Company believes that no impairment of long-lived assets exists as of August 1, 2009 and August 2, 2008, respectively.

Revenue Recognition

Sales of the Company are recognized as revenues when goods are shipped and title passes to the buyer. Our military boot sales to the U.S. Government under our current contract are recognized as revenues when the goods are received at their designated depot.

Our western and work boot business records an allowance for sales returns. This is calculated applying historical return data to sales subject to potential returns.

McRae Technologies, Inc., formerly Compsee, Inc., a subsidiary, enters into maintenance agreements on bar code equipment and revenues are recognized over the term of the maintenance contract, usually one year. The revenues from these agreements, if any, are deferred and recognized over the term of the related agreements.

Intangible Assets

Goodwill and intangible assets with indefinite lives are tested for impairment using a fair value approach at the “reporting unit” level. A reporting unit is the operating segment, or a business one level below that operating segment (the “component” level) if discrete financial information is prepared and regularly reviewed by management at the component level. An impairment charge is recognized for any amount by which the carrying amount of a reporting unit’s goodwill exceeds its fair value. Discounted cash flows are used to establish fair values. Intangible assets with indefinite lives are tested for impairment and written down to fair value as required.

As of August 1, 2009, all trademarks were evaluated for impairment and no adjustment to their carrying value was required.

Income Taxes

The Company accounts for income taxes under the asset and liability method. Federal and state income taxes are computed at current tax rates, less tax credits. Taxes are adjusted both for items that do not have tax consequences and for the cumulative effect of any changes in tax rates from those previously used to determine deferred tax assets or liabilities. Tax provisions include amounts that are currently payable, plus changes in deferred tax assets and liabilities that arise because of temporary differences between the time when items of income and expense are recognized for financial reporting and income tax purposes. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not such assets will be realized.

In June 2006, the Financial Accounting Standards Board (“FASB”) issued FASB Interpretation (“FIN”) No. 48 “Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement 109.” FIN 48 establishes a single model to address accounting for uncertain tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The Company adopted the provisions of FIN 48 on July 29, 2007. Upon adoption, the Company recognized no adjustment in the amount of unrecognized tax benefits. As of the date of adoption, the Company had no unrecognized tax benefits. The Company’s policy is to recognize interest and penalties that would be assessed in relation to the settlement value of unrecognized tax benefits as a component of income tax expense. The Company has recognized no interest or penalties since the adoption of FIN 48.

The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax in multiple state jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal income tax examinations for years before 2004. However, to the extent allowed by law, the tax authorities may have the right to examine prior periods where net operating losses were generated and carried forward, and make adjustments up to the amount of the net operating loss carryforward amount.

Earnings per Share

Under our Articles of Incorporation, we may pay dividends on our Class A Common Stock in excess of the dividends we pay on our Class B Common Stock. As a result, we have computed our earnings per share in compliance with Statement of Financial Accounting Standards (SFAS) No. 128, “Earnings per Share”. This guidance requires companies that have multiple classes of equity securities to use the “two class” or “if converted method” in computing earnings per share.

For our primary or basic earnings per share calculation, we use the two-class method, which implies a different dividend rate for our Class B Common Stock. Consequently, all undistributed earnings are allocated to Class A Common Stock in the earnings per share calculation. The result of this calculation allocates no earnings per share to the holders of Class B Common Stock.

For our diluted earnings per share calculation, we use the if-converted method. This calculation assumes that all Class B Common Stock is converted into Class A Common Stock. As a result, there are no holders of Class B Common Stock to participate in undistributed earnings.

While we have presented our earnings per share in accordance with Statement of Financial Accounting Standards (SFAS) No. 128, we believe that the holders of Class A and Class B Common Stock have equal rights to the Company’s undistributed earnings. Consequently, we believe that the calculation that best expresses economic reality is to calculate earnings per share using the total Class A and Class B Common Stock outstanding.

The Company had no common stock equivalents issued or outstanding for the three-year period ended August 1, 2009.

Recently Issued Accounting Standards

In September 2006, SFAS No. 157, “Fair Value Measurements” was issued to define fair value, establish a framework for measuring fair value in generally accepted accounting principles (GAAP), and expand disclosures about fair value measurements. The Company has adopted this standard for our fiscal year beginning August 2008 and it did not have a material impact on the financial statements.

In February 2007, Statement of Financial Accounting Standards (SFAS) No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of FASB Statement No. 115” was issued to permit entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The Company has adopted this standard for our fiscal year beginning in August 2008 and did not have a material impact on the financial statements.

In May 2008, SFAS No. 163, “Accounting for Financial Guarantee Insurance Contracts, an interpretation of FASB Statement No. 60” was issued to clarify how FASB Statement No. 60 applies to financial guarantee insurance contracts. The Company does not have nor expects to have in the future any financial guarantee insurance contracts. This Standard is applicable to our fiscal year beginning in August 2009.

In May 2009, SFAS No. 165, “Subsequent Events”, was issued to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. The Company complies with this standard. The Company has evaluated subsequent events through November 12, 2009.

In June 2009, SFAS No. 166, “Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140”, was issued to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor’s continuing involvement, if any, in transferred financial assets. The Company is evaluating the impact of this standard which is applicable to us for reporting periods after November 15, 2009.

In June 2009, SFAS No. 167, “Amendments to FASB Interpretation No. 46(R),” was issued to improve financial reporting by enterprises involved with variable interest entities. This standard is applicable to the first annual reporting period that begins after November 15, 2009. While we currently are not involved with any variable interest entities, this standard would apply to our fiscal year beginning August 2010.

In June 2009, SFAS No. 168, “The FASB Accounting Standards Codification and the Hierarchy of Generally Accepting Accounting Principles, a replacement of FASB Statement No. 162,” was issued to announce that the codification will become the source of authoritative U.S. generally accepted accounting principles recognized by the FASB to be applied by nongovernmental entities. This standard is applicable to our fiscal year beginning August 2010.

Research and Development

Research and development costs related to future products are expensed in the year incurred and are included in SG&A expenses. There were no research and development expenses for fiscal 2009. During 2008 and 2007 costs were $1,000 and $544,000, respectively.

Advertising

The Company charges advertising costs when incurred as a component of SG&A expenses. Advertising expense amounted to $542,000, $600,000, and $613,000 for fiscal years 2009, 2008, and 2007, respectively.

Shipping and Handling

Shipping and handling costs that are charged to and reimbursed by the customer are recognized as revenues, while the related expenses, including buying, postage, external distribution and warehousing costs incurred by the Company are recorded as components of cost of goods sold in the consolidated statements of operations.

Split-Dollar Life Insurance

The Company is party to a split-dollar arrangement with respect to certain life insurance policies. We record an amount that is to be realized under the split dollar agreement. This amount is the actual premiums paid by the Company or the actual cash surrender value of the policy, whichever is less.

Real Estate Held for Investment

Real estate held for investment is land recorded at cost plus the cost of any improvements. Land is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable.

Reclassifications

Certain 2008 amounts have been restated to conform to the 2009 presentation.

2. INVENTORIES

Current costs exceeded the LIFO value of inventories by approximately $647,000 and $651,000 at August 1, 2009 and August 2, 2008, respectively. Year-end inventories valued under the LIFO method were $1,254,000 and $1,461,000 at August 1, 2009 and August 2, 2008, respectively. For fiscal 2009, lower FIFO pricing decreased the LIFO reserve, which decreased the net loss by approximately $2,600 as compared to a $15,200 decrease in net earnings for fiscal 2008.

The components of inventory at each year-end are as follows:

	(In thousands) Fiscal Year Ended	
	2009	**2008**
Raw materials	$ 803	$ 1,154
Work-in-process	331	391
Finished goods	11,722	13,928
	$ 12,856	$ 15,473

3. PROPERTY AND EQUIPMENT

Property and equipment are recorded at cost. Depreciation for financial reporting purposes is provided using the straight-line method over the estimated useful lives of the assets. Accelerated depreciation methods are used for income tax reporting purposes. Estimated useful lives range from three years for computer equipment to thirty-one and one-half years for buildings. Expenditures for routine maintenance and repairs are charged to expense as incurred.

Property and equipment at August 1, 2009 and August 2, 2008, consisted of the following:

	(In thousands) Fiscal Year Ended	
	2009	**2008**
Land and improvements	$ 385	$ 385
Buildings	4,003	3,977
Machinery and equipment	4,290	2,718
Furniture and fixtures	1,275	1,368
Construction in progress	263	0
	10,216	8,448
Less: Accumulated depreciation	(7,060)	(6,761)
	$ 3,156	$ 1,687

Depreciation expense for fiscal 2009, 2008 and 2007 was $564,000, $485,000 and $575,000, respectively.

4. NOTES PAYABLE AND LINES OF CREDIT

Notes Payable

	(In thousands) Fiscal Year Ended 2009	2008
Note payable- bank	$ 1,310	$ 0
Less current portion	(184)	0
Note payable less current portion	$ 1,126	$ 0

The note payable-bank bears interest at a variable rate, which is the bank's prime lending rate. At August 1, 2009, the interest rate was 3.25%. Principal and interest payments are due in thirty-five monthly installments in the amount of $18,683 and one balloon payment of $857,802 due on January 27, 2012. The loan is secured by military boot production equipment and does not contain any loan covenants. Interest charges for this note totaled approximately $22,000 for the fiscal 2009 year.

Lines of Credit

The Company has a $3,000,000 revolving line of credit with a bank. The Company had no outstanding borrowings under this line of credit as of August 1, 2009 and August 2, 2008. This line of credit provides for interest on outstanding balances to be paid monthly at the prime rate less 0.5%. This line of credit expires in November 2010 and is secured by the inventory and accounts receivable of the Company's western and work boot subsidiary. There were no borrowings under this line of credit for fiscal 2009.

The Company has an additional $1,750,000 line of credit with a bank. This line is restricted to 100% of the outstanding accounts receivable due from the U.S. Government. There were no outstanding borrowings under this line of credit as of August 1, 2009 and August 2, 2008. The line of credit expires in January 2010 and provides for interest on outstanding balances to be paid monthly at the prime rate. There were no borrowings under this line of credit for fiscal 2009.

Interest charges for fiscal 2009, 2008 and 2007 were approximately $15,000, $29,000, and $19,000, respectively.

5. EMPLOYEE BENEFIT PLANS

The Company's employee benefit program consists of an employee stock ownership plan, a 401-K retirement plan, a cash bonus program, incentive awards, and other specified employee benefits as approved by the Board of Directors.

The employee stock ownership plan (ESOP) covers substantially all employees. Its principal investments include shares of Class A Common Stock and Class B Common Stock of the Company and collective funds consisting of short-term cash, fixed-income, and equity investments. There have been no contributions to the ESOP in fiscal years 2009, 2008 or 2007.

The Company has a 401-K retirement plan, which covers substantially all employees. Employees can contribute up to 25% of their annual salary to the plan. At its sole discretion, the Board of Directors determines the amount and timing of any Company matching contribution. The Company's contribution was $179,000, $178,000, and $164,000 for the fiscal years ended August 1, 2009, August 2, 2008 and July 28, 2007, respectively.

Employee benefit program expense amounted to $339,000, $1,187,000, and $641,000 in 2009, 2008 and 2007, respectively.

6. INCOME TAXES

Significant components of the provision for income taxes are as follows (in thousands):

	2009	2008	2007
Current expense			
Federal	$ (146)	$ 3,210	$ 1,628
State	22	370	(34)
	(124)	3,580	1,594
Deferred expense (benefit)			
Federal	353	(412)	162
State	62	(73)	29
	$ 291	$ 3,095	$ 1,785

The components of the provision (benefit) for deferred income taxes are as follows (in thousands):

	2009	2008	2007
Depreciation	$ 277	$ 27	$ (40)
Accrued employee benefits	316	(196)	48
Allowances for doubtful accounts	127	(133)	(3)
Allowance for sales returns	(8)	(33)	12
Inventory	(79)	(293)	(74)
State net operating loss carry forward	(4)	87	(120)
Like Kind Exchange	0	0	391
ERP System write-off	(287)	0	0
Other	73	56	(23)
Deferred income taxes, expense (benefit)	$ 415	$ (485)	$ 191

Deferred tax liabilities and assets at each year-end are as follows (in thousands):

	2009	2008
Deferred tax liabilities		
Amortization	$ (380)	$ (307)
Gain on Like Kind Exchange	(391)	(391)
Depreciation	(242)	0
Total deferred tax liabilities	(1,013)	(698)
Deferred tax assets		
Self Insurance	76	76
Accrued employee benefits	61	377
Allowances for doubtful accounts	190	317
Allowance for sales returns	131	123
Inventory	712	634
State net operating loss carry forward	132	128
Depreciation	0	33
ERP System write-off	287	0
Other	(1)	0
Total deferred tax assets	1,588	1,688
Net deferred tax assets	$ 575	$ 990

State net operating loss carry forwards of $11 million will expire through fiscal 2019.

The reconciliation of income tax computed at the U.S. federal statutory tax rate to actual income tax expense are (in thousands):

	2009		2008		2007	
	Amount	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**
Tax at U.S. statutory rate	$(21)	34.0%	$1,903	34.0 %	$1,897	34.0 %
State income taxes, net of federal tax benefit	(4)	6.3%	353	6.3 %	351	6.3 %
Tax adjustments	249	(111.7)%	0	0	0	0
Other – net	67	(30.1)%	(471)	(8.9)%	(59)	(1.1)%
	$ 291	(101.4)%	$1,785	31.9 %	$2,189	39.2 %

The items included as "other-net" relate to book to tax deferrals, permanent differences, adjustment for non tax consolidated entities, and prior year tax provision to return adjustments.

Total income tax payments during fiscal years 2009, 2008 and 2007 were approximately $448,000, $3,426,000 and $1,488,000, respectively.

7. COMMITMENTS AND CONTINGENCIES

Lease Agreements

The Company leases certain offices and equipment under non-cancelable operating leases. Rental expenses on all operating leases were $448,000, $451,000 and $434,000 for fiscal 2009, 2008, and 2007, respectively.

The Company leases approximately 34,000 square feet of office and warehouse space to Connected Office Products, Inc. The original lease covered a base year period and two one-year option periods. In July 2006, the lease was amended to cover a five-year period beginning on September 1, 2006. These lease and facility charge payments are reported as a component of "Other Income". The future minimum lease and facility charge payments are as follows:

	2010	**2011**	**2012**
Lease Payments	$50,000	$50,000	$ 8,333
Facility Charges	$60,736	$61,946	$10,358

Concentrations

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash investments and receivables. The Company maintains substantially all of its cash and certificates of deposits with a financial institution in amounts that are in excess of the federally insured limits. At August 1, 2009, approximately $11 million was in excess of the federally insured limit. Management performs periodic evaluations of the relative credit standing of this financial institution.

Concentrations of credit risk with respect to receivables are minimal due to the large number of entities comprising the Company's customer base and their dispersion across many different industries. The Company does not require collateral on trade accounts receivable. As of August 1, 2009 and August 2, collateral on trade accounts receivable. As of August 1, 2009 and August 2, 2008, 21 customers accounted for 34% and 43% of accounts receivable, respectively.

Synthetic rubber used in our vulcanizing military boot operations is currently available and purchased from the only domestic supplier. Synthetic rubber is available from foreign suppliers, however an exemption would be required from the Government to purchase synthetic rubber in the foreign market. The Vibram rubber specified outsoles is a registered product available only from Quabaug Corporation and we are dependent on their ability to supply our needs. This supplier provided Vibram rubber outsoles for approximately 1.7 million and 3.7 million at August 1, 2009 and August 2, 2008, respectively.

Sales to the U.S. Government amounted to 19%, 28% and 24% of total consolidated net revenues for fiscal 2009, 2008, and 2007, respectively.

Other

Under the terms of sale to the U.S. Government, the negotiated contract prices of combat boots are subject to renegotiation if certain conditions are present. Management does not currently expect renegotiation, if any, to have a material adverse effect on the Company’s consolidated financial position or results of operations.

8. SHAREHOLDERS’ EQUITY

Common Stock

The Company’s Bylaws provide for seven directors, two of whom are elected by the holders of the Class A Common Stock voting as a separate class, and five of whom are elected by the holders of the Class B Common Stock voting as a separate class. On all other matters (except matters required by law or the Company’s Certificate of Incorporation or Bylaws to be approved by a different vote), the holders of Class A Common Stock and Class B Common Stock vote together as a single class with each share of Class A Common Stock entitled to one-tenth vote and each share of Class B Common Stock entitled to one vote. Each share of Class B Common Stock can be converted to Class A Common Stock on a share for share basis. All dividends paid on Class B Common Stock must also be paid on Class A Common Stock in an equal amount.

During fiscal 1999, the Company adopted the McRae Industries, Inc. 1998 Incentive Equity Plan (the Plan). Under the Plan, 100,000 shares of the Company’s Class A Common Stock are reserved for issuance to certain key employees of the Company. At August 1, 2009, there were 100,000 shares available for future grants under the Plan.

The common stock is currently quoted in the Pink Sheets and stockholders are able to trade their shares in the over-the-counter markets or private transactions.

9. FAIR VALUE OF FINANCIAL INSTRUMENTS

Management used the following methods and assumptions to estimate the fair value of financial instruments:

The fair value of our cash and cash equivalents, accounts and notes receivable, accounts payable accrued liabilities approximate their carrying values because of the short maturities of these instruments.

The amount due from Split-Dollar Life Insurance policies represents the value of the Company’s rights under split-dollar arrangements. Under these arrangements, the Company is entitled to be repaid cumulative premiums paid, or if less, the net cash surrender value of the policies.

The fair value of our long-term bank note payable approximate carrying values based on variable interest rates in effect at the balance sheet dates for similar debt instruments.

10. SUBSEQUENT EVENTS

On September 2, 2009, the Company declared a cash dividend of $.09 per share on its Class A Common Stock payable on September 30, 2009 to shareholders of record on September 16, 2009.

On September 30, 2009, the Company received payment on note receivable related to the sale of the bar code business in the amount of $597,632 and the associated accrued interest of $11,175.

On November 4, 2009, the U.S. Government exercised the first option of the contract awarded on November 7, 2008. This option provides for the purchase of a minimum quantity of 17,556 pair and a maximum quantity of 100,002 pair. We expect the actual boot requirements for fiscal 2010 to be near the minimum level.

11. RELATED PARTY TRANSACTIONS

The Company leases administrative and sales office space in Clarksville, Tennessee for the western boot business from the President of Dan Post Boot Company. The annual rent is $56,000.

McRae Industries, Inc.

CORPORATE PROFILE

McRae Industries, Inc. was founded in 1959 as a manufacturer and distributor of children's shoes. Today, McRae Industries has grown into a widely diversified company involved in manufacturing, sales and distribution of military footwear, western and work boots; and sales and distribution of bar code reading and printing devices. The company also operates other smaller businesses.

McRae Industries, Inc. has offices throughout the United States. Its corporate headquarters is located in Mt. Gilead, North Carolina.

SELECTED CONSOLIDATED FINANCIAL DATA

The following Selected Consolidated Financial Data of the Company presented below for each of the five years in the periods indicated has been derived from our audited and consolidated financial statements as adjusted to reflect the office products business as a discontinued operation.

FISCAL YEAR ENDED (In thousands, except for per share data)	**8/1/2009**	**8/2/2008**	**7/28/2007**	**7/29/2006**	**7/30/2005**
INCOME STATEMENT DATA:					
Net revenues	**$ 62,213**	$ 80,021	$ 68,271	$ 68,852	$ 62,404
Net (loss) earnings from continuing operations	**(514)**	5,041	3,818	3,390	1,574
Net earnings from discontinued operations	**0**	0	0	0	1,870
Net (loss) earnings	**(514)**	5,041	3,818	3,390	3,444
Net earnings from continuing operations per common share:					
Basic Earnings per share (a):					
Class A	**0.11**	2.75	2.13	1.90	1.09
Class B	**0**	0	0	0	0
Diluted Earnings per share (b):					
Class A	**0.11**	2.27	1.75	1.54	0.79
Class B	**NA**	NA	NA	NA	NA
BALANCE SHEET DATA:					
Total assets	**$ 49,763**	$ 51,536	$ 45,973	$ 42,355	$ 43,010
Long-term liabilities	**2,139**	698	0	0	0
Working Capital	**32,822**	34,321	29,413	27,868	27,017
Shareholders' equity	**42,318**	43,783	39,808	36,931	36,986
Weighted average number of common shares outstanding:					
Class A	**$ 2,089,686**	$ 2,098,714	$ 2,111,633	$ 2,147,827	$ 1,993,172
Class B	**438,915**	446,262	454,645	492,323	775,327
Weighted average number of common shares outstanding (c)	**$ 2,528,601**	$ 2,544,976	$ 2,566,278	$ 2,640,150	$ 2,768,499
Cash dividends declared per common share (d)	**$ 0.36**	$ 0.3525	$ 0.325	$ 0.32	$ 0.30

(a) This calculation uses the two-class method under which all undistributed earnings are allocated to Class A Common Stock in the earnings per share calculation; thus, no earnings are allocated to the holders of Class B Common Stock. See Note 1 to the consolidated financial statements included in this report.

(b) This calculation uses the if-converted method which assumes all Class B Common Stock is converted into Class A Common Stock; thus, there are no holders of Class B Common Stock to participate in undistributed earnings. See Note 1 to the consolidated financial statements included in this report.

(c) Includes both Class A and Class B Common Stock

(d) Dividends were paid only on Class A Common Stock

LETTER TO SHAREHOLDERS

Dear Fellow Shareholders:

Fiscal 2009 proved to be a difficult year for McRae Industries. I am sorry to report that the Company experienced its second operating loss over the past 25 years. Net revenues decreased 22% from $80.0 million for fiscal 2008 to $62.2 million for fiscal 2009. Net consolidated earnings declined from $5.0 million in fiscal 2008 to a consolidated net loss of $514,000 in fiscal 2009. These disappointing results were attributable to a series of challenging events within each of our core business units.

Our military boot business, McRae Footwear, saw net revenues decline from $22.6 million for fiscal 2008 to $11.7 million for fiscal 2009, resulting in a decrease in net earnings from $2.0 million in fiscal 2008 to a net loss of approximately $248,000 in fiscal 2009. The decline in revenues was attributable to several key factors. First, the U.S. Government significantly decreased its requirements for military combat boots as a result of excessive inventory levels. Our Government contracts provide for a minimum and maximum quantity of military combat boots to be purchased. This factor allowed the Government to set its requirement levels near the minimum quantity that they were obligated to purchase. This decrease in production levels combined with direct labor inefficiencies associated with the production of a new military boot design were the primary factors that negatively affected McRae Footwear's gross profit and net earnings for the year. While we do not anticipate an increase in orders from the U.S. Government during the coming fiscal year, the installation of our new Gusbi pouring machine has positioned us to bid on different styles of military combat boots than we have in the past. In addition, we have initiated a strategy to market and sell military boots to commercial enterprises.

Dan Post Boot Company, our western and work boot business, reported net revenues of $43.5 million in fiscal 2009 compared with net revenues of $44.8 million in fiscal 2008. Net earnings fell from $2.2 million in fiscal 2008 to $954,000 in fiscal 2009. The decrease in net revenue was primarily the result of supply chain disruptions caused by new material requirements for our children's footwear products and a softening in the market for our work boot products. The decline in net earnings was primarily attributable to various costs associated with the supply chain disruption and the write-off of software and integration services associated with an unsuccessful ERP installation. In response to

these issues, we have successfully implemented the new material requirements for our children's shoes and expect to be back to full production in the first quarter of fiscal 2010. We are optimistic that our western footwear products will have a strong first half of the year for fiscal 2010, while the work boot business is expected to remain soft during the same timeframe.

On April 1, 2009, we completed the sale of significantly all of the assets and liabilities of Compsee, our mobility solutions business, to CSI Enterprises, Inc (CSI). While we continue to manufacture our proprietary products under the name McRae Technologies, Inc. exclusively for CSI, we do not expect revenues from this business activity to be material in scope for fiscal 2010. As a result of the sale of this business unit, net revenues decreased from $12.1 million in fiscal 2008 to $6.8 million in fiscal 2009. The net loss increased from $200,000 in fiscal 2008 to $1.2 million in fiscal 2009, primarily the result of costs and expenses associated with the sale and winding-down activities of this business unit.

I am encouraged to report that despite our operational struggles for fiscal 2009, the Company's financial condition remained strong. At August 1, 2009, our cash and cash equivalents totaled $11.3 million as compared with $13.8 million at August 2, 2008, while working capital amounted to $31.8 million as compared with $33.6 million for the same two periods. In a strategic move to preserve cash, we borrowed $1.4 million in February 2009 to pay for our new military boot production equipment. We also have two lines of credit totaling $4.75 million, all of which was currently available at year end.

While fiscal 2009 was certainly a disappointing year in revenues and profits, we are pleased that we were able to make strides in implementing our strategy of concentrating on the synergy that exists with our core footwear businesses. We believe that this change in focus provides a tremendous opportunity to increase revenues, earnings and shareholder value in the years to come.

On behalf of the Board of Directors, officers and other associates, we thank our shareholders, business partners, vendors and customers for their continued goodwill and support.

Sincerely,

D. Gary McRae

D. Gary McRae
President

FINANCIAL STATEMENTS
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Report of Independent Certified Public Accountants

To the Board of Directors and Shareholders of
McRae Industries, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of McRae Industries, Inc. (a Delaware corporation) and subsidiaries as of August 1, 2009 and August 2, 2008, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended August 1, 2009. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of McRae Industries, Inc. and subsidiaries as of August 1, 2009 and August 2, 2008, and the results of their operations and their cash flows for each of the three years in the period ended August 1, 2009 in conformity with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Charlotte, North Carolina
November 12, 2009

CONSOLIDATED BALANCE SHEETS
McRae Industries, Inc. and Subsidiaries

(In thousands, except share data)	**August 1, 2009**	**August 2, 2008**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 11,310	$ 13,822
Accounts receivable, less allowances of $844 and $1,158, respectively	9,891	9,964
Inventories, net	12,856	15,473
Income tax receivable	2,363	0
Prepaid expenses and other current assets	120	429
Deferred tax assets	1,588	1,688
Total current assets	38,128	41,376
Property and equipment, net	3,156	1,687
Other assets:		
Real estate held for investment	3,366	3,358
Amounts due from split-dollar life insurance	2,288	2,288
Trademarks	2,824	2,824
Other	1	3
Total other assets	8,479	8,473
Total assets	$ 49,763	$ 51,536

See notes to consolidated financial statements

CONSOLIDATED BALANCE SHEETS

McRae Industries, Inc. and Subsidiaries

(In thousands, except share data)	**August 1, 2009**	**August 2, 2008**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Bank note payable-current portion	$ 184	$ 0
Accounts payable	3,373	3,792
Accrued employee benefits	160	992
Accrued payroll and payroll taxes	861	1,018
Other	728	1,253
Total current liabilities	5,306	7,055
Bank note payable net of current portion	1,126	0
Deferred tax liabilities	1,013	698
Total liabilities	7,445	7,753
Commitments and contingencies (Note 7)		
Shareholders' equity:		
Common Stock:		
Class A, $1 par value; authorized 5,000,000 shares issued and outstanding, 2,083,854 and 2,093,043 shares, respectively	2,084	2,093
Class B, $1 par value; authorized 2,500,000 Shares; issued and outstanding, 436,384 and 441,252 shares, respectively	436	441
Retained earnings	39,798	41,249
Total shareholders' equity	42,318	43,783
Total liabilities and shareholders' equity	$ 49,763	$ 51,536

See notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF OPERATIONS

McRae Industries, Inc. and Subsidiaries

(In thousands, except for share and per share data

For Years Ended	**August 1, 2009**	**August 2, 2008**	**July 28, 2007**
Net revenues	$ 62,213	$ 80,021	$ 68,271
Cost of revenues	47,771	56,810	49,775
Gross profit	14,442	23,211	18,496
Selling, general and administrative expenses	14,926	15,533	13,336
Operating (loss) profit	(484)	7,678	5,160
Other income	276	487	462
Interest expense	(15)	(29)	(19)
(Loss) earnings before income taxes	(223)	8,136	5,603
Provision for income taxes	291	3,095	1,785
Net (loss) earnings	$ (514)	$ 5,041	$ 3,818
(Loss) earnings per common share:			
(Loss) earnings per common share:			
Basic earnings per share:			
Class A	$ .11	$ 2.75	$ 2.13
Class B	0	0	0
Diluted earnings per share:			
Class A	.11	2.27	1.75
Class B	NA	NA	NA
Weighted average number of common shares outstanding:			
Class A	2,089,686	2,098,714	2,111,633
Class B	438,915	446,262	454,645
Total	2,528,601	2,544,976	2,566,278

See notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

McRae Industries, Inc and Subsidiaries

(Dollars in thousands)

	Common Stock, $1 par value					
	Class A		Class B		Additional Paid-in	Retained
	Shares	Amount	Shares	Amount	Capital	Earnings
Balance, July 29, 2006	2,116,751	$2,117	457,603	$ 457	$ 0	$ 34,356
Purchase of ESOP distribution shares	(16,174)	(16)	(4,101)	(4)		(234)
Conversion of Class B to Class A Stock	4,347	4	(4,347)	(4)		
Cash Dividend ($.325 per Class A common stock)						(686)
Net earnings						3,818
Balance, July 28, 2007	2,104,924	$2,105	449,155	$ 449	$ 0	$ 37,254
Purchase of ESOP distribution shares	(14,689)	(15)	(3,721)	(4)		(286)
Purchase of other shares	(521)		(853)	(1)		(22)
Conversion of Class B to Class A Stock	3,329	3	(3,329)	(3)		
Cash Dividend ($.3525 per Class A common stock)						(738)
Net earnings						5,041
Balance, August 2, 2008	2,093,043	$2,093	441,252	$ 441	$ 0	$ 41,249
Purchase of ESOP distribution shares	(10,816)	(11)	(2,741)	(3)		(178)
Purchase of other shares			(500)			(7)
Conversion of Class B to Class A Stock	1,627	2	(1,627)	(2)		
Cash Dividend ($.36 per Class A common stock)						(752)
Net loss						(514)
Balance, August 1, 2009	2,083,854	$2,084	436,384	$436	$ 0	$ 39,798

See notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

McRae Industries, Inc. and Subsidiaries

(In thousands)

For Years Ended	**August 1, 2009**	**August 2, 2008**	**July 28, 2007**
Cash Flows from Operating Activities:			
Net (loss) earnings	$ (514)	$ 5,041	$ 3,818
Adjustments to reconcile net (loss)earnings to net cash (used in) provided by operating activities:			
Depreciation	564	485	575
Gain on sale of assets	(51)	(383)	(1,091)
Deferred income taxes	415	(485)	191
Changes in operating assets and liabilities:			
Accounts receivable	(376)	(770)	(1,555)
Accounts receivable valuation allowances	(246)	438	(23)
Inventories	2,617	587	(295)
Prepaid expenses and other current assets	285	(219)	(82)
Accounts payable	108	(18)	887
Accrued employee benefits	(832)	516	(126)
Accrued payroll and payroll taxes	(157)	50	(46)
Income taxes	(2,363)	240	191
Other	(525)	(62)	26
Net cash (used in) provided by operating activities	**(1,075)**	**5,420**	**2,470**
Cash Flows from Investing Activities:			
Proceeds from sale of land and bar code business	296	449	113
Purchase of land for investment	(36)	(56)	(456)
Capital expenditures	(2,056)	(188)	(422)
Collections on notes receivable	0	20	17
Net cash (used in)provided by investing activities	**(1,796)**	**225**	**(748)**
Cash Flows from Financing Activities:			
Bank loan proceeds	1,400	0	0
Purchase of common stock	(199)	(328)	(254)
Principal repayments of bank notes payable	(90)	0	0
Dividends paid	(752)	(738)	(686)
Net cash provided by (used in) financing activities	**359**	**(1,066)**	**(940)**
Net (Decrease) Increase in Cash and Cash equivalents	(2,512)	4,579	782
Cash and Cash Equivalents at Beginning of Year	13,822	9,243	8,461
Cash and Cash Equivalents at End of Year	**$ 11,310**	**$ 13,822**	**$ 9,243**

Note: Inventories and capital expenditures for fiscal 2007 contain a $70 non-cash activity related to the transfer of bar code inventory to fixed assets. Proceeds from sale of land and purchase of land contain a non-cash section 1031 exchange component totaling $1,430.
During fiscal 2009, the Company's sale of Compsee was financed with a note receivable of $598.

See notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
McRae Industries, Inc. and Subsidiaries
For the Years Ended August 1, 2009, August 2, 2008, and July 28, 2007

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business

McRae Industries, Inc., (the “Company”, which may be referred to as “we”, “us” or “our”), is a Delaware corporation organized in 1983 and is the successor to a North Carolina corporation organized in 1959. Our principal lines of business are: manufacturing and selling military combat boots; importing and selling western and work boots; and manufacturing and selling our proprietary bar code equipment.

On March 31, 2009, the Company sold substantially all of the assets of the bar code business for approximately $792,000, which did not result in a gain or loss. The assets sold included accounts receivables, various demonstration equipment, certain office furniture and fixtures, the Compsee trade name, domain names, and other registered trademarks. The buyer also assumed all of the accounts payable and specific accrued liabilities. The Company received $194,000 at closing and a promissory note for $598,000 due on September 30, 2009. In addition, the Company executed a one-year supply agreement with the buyer to manufacture and exclusively sell a variety of our proprietary bar code products. Accordingly, the name of this business was changed and now operates under the name of McRae Technologies, Inc.

Principles of Consolidation

The consolidated financial statements include the accounts of all of the Company’s wholly owned subsidiaries and other businesses over which we exercise significant control. All significant intercompany transactions and balances have been eliminated in consolidation.

Total assets and net revenues for each of our main business units are as follows:

	(In thousands)		
	2009	**2008**	**2007**
Total Assets:			
Bar Code	$ 1,178	$ 4,154	$ 5,944
Military Boots	4,082	3,597	3,614
Western/Work Boots	23,298	24,251	23,931

	(In thousands)		
	2009	**2008**	**2007**
Total Net Revenues:			
Bar Code	$ 6,837	$ 12,102	$ 13,505
Military Boots	11,675	22,575	16,373
Western/Work Boots	43,452	44,761	38,184
Other	249	583	209

Use of Estimates

The timely preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates. The economic price adjustment related to our military combat boot contract is subject to certain price variations for leather.

Cash and Cash Equivalents

Cash and cash equivalents consist of certificates of deposit purchased with an original maturity date of three months or less.

Accounts Receivable

Accounts receivable are stated at amounts expected to be collected from outstanding balances. Probable uncollectible accounts are reserved for by a charge to earnings and a credit to a valuation allowance based on the assessment of the current status of individual accounts. Balances that are still outstanding after using reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. The Company performs on-going credit evaluations of its customers' financial condition and establishes an allowance for losses on trade receivables based upon factors surrounding the credit risk of specific customers, historical trends, and other information.

Inventories

Inventories are stated at the lower of cost or market value using the last-in, first-out (LIFO) method for military boots and using the first-in, first-out (FIFO) method for all other inventories. We regularly review inventory quantities on hand and record a provision for excess and obsolete inventory based primarily on our estimated forecast and demand requirements for the next twelve months. Actual demand and market conditions may be different from those projected by our management primarily as a result of fashion cycles and trends and the overall financial condition of competitors in the western and work boot business. A percentage point error in our inventory allowances would approximate $5,800 for the fiscal year ended August 1, 2009.

Long-Lived Assets

Long-lived assets to be held are reviewed for events or changes in circumstances that indicate that their carrying value may not be recoverable. The Company periodically reviews the carrying value of long-lived assets, to determine whether or not an impairment to such value has occurred by assessing their net realizable values based on estimated undiscounted cash flows over their remaining useful lives.

Based on its most recent analysis, the Company believes that no impairment of long-lived assets exists as of August 1, 2009 and August 2, 2008, respectively.

Revenue Recognition

Sales of the Company are recognized as revenues when goods are shipped and title passes to the buyer. Our military boot sales to the U.S. Government under our current contract are recognized as revenues when the goods are received at their designated depot.

Our western and work boot business records an allowance for sales returns. This is calculated applying historical return data to sales subject to potential returns.

McRae Technologies, Inc., formerly Compsee, Inc., a subsidiary, enters into maintenance agreements on bar code equipment and revenues are recognized over the term of the maintenance contract, usually one year. The revenues from these agreements, if any, are deferred and recognized over the term of the related agreements.

Intangible Assets

Goodwill and intangible assets with indefinite lives are tested for impairment using a fair value approach at the “reporting unit” level. A reporting unit is the operating segment, or a business one level below that operating segment (the “component” level) if discrete financial information is prepared and regularly reviewed by management at the component level. An impairment charge is recognized for any amount by which the carrying amount of a reporting unit’s goodwill exceeds its fair value. Discounted cash flows are used to establish fair values. Intangible assets with indefinite lives are tested for impairment and written down to fair value as required.

As of August 1, 2009, all trademarks were evaluated for impairment and no adjustment to their carrying value was required.

Income Taxes

The Company accounts for income taxes under the asset and liability method. Federal and state income taxes are computed at current tax rates, less tax credits. Taxes are adjusted both for items that do not have tax consequences and for the cumulative effect of any changes in tax rates from those previously used to determine deferred tax assets or liabilities. Tax provisions include amounts that are currently payable, plus changes in deferred tax assets and liabilities that arise because of temporary differences between the time when items of income and expense are recognized for financial reporting and income tax purposes. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not such assets will be realized.

In June 2006, the Financial Accounting Standards Board (“FASB”) issued FASB Interpretation (“FIN”) No. 48 “Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement 109.” FIN 48 establishes a single model to address accounting for uncertain tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The Company adopted the provisions of FIN 48 on July 29, 2007. Upon adoption, the Company recognized no adjustment in the amount of unrecognized tax benefits. As of the date of adoption, the Company had no unrecognized tax benefits. The Company’s policy is to recognize interest and penalties that would be assessed in relation to the settlement value of unrecognized tax benefits as a component of income tax expense. The Company has recognized no interest or penalties since the adoption of FIN 48.

The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax in multiple state jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal income tax examinations for years before 2004. However, to the extent allowed by law, the tax authorities may have the right to examine prior periods where net operating losses were generated and carried forward, and make adjustments up to the amount of the net operating loss carryforward amount.

Earnings per Share

Under our Articles of Incorporation, we may pay dividends on our Class A Common Stock in excess of the dividends we pay on our Class B Common Stock. As a result, we have computed our earnings per share in compliance with Statement of Financial Accounting Standards (SFAS) No. 128, “Earnings per Share”. This guidance requires companies that have multiple classes of equity securities to use the “two class” or “if converted method” in computing earnings per share.

For our primary or basic earnings per share calculation, we use the two-class method, which implies a different dividend rate for our Class B Common Stock. Consequently, all undistributed earnings are allocated to Class A Common Stock in the earnings per share calculation. The result of this calculation allocates no earnings per share to the holders of Class B Common Stock.

For our diluted earnings per share calculation, we use the if-converted method. This calculation assumes that all Class B Common Stock is converted into Class A Common Stock. As a result, there are no holders of Class B Common Stock to participate in undistributed earnings.

While we have presented our earnings per share in accordance with Statement of Financial Accounting Standards (SFAS) No. 128, we believe that the holders of Class A and Class B Common Stock have equal rights to the Company’s undistributed earnings. Consequently, we believe that the calculation that best expresses economic reality is to calculate earnings per share using the total Class A and Class B Common Stock outstanding.

The Company had no common stock equivalents issued or outstanding for the three-year period ended August 1, 2009.

Recently Issued Accounting Standards

In September 2006, SFAS No. 157, “Fair Value Measurements” was issued to define fair value, establish a framework for measuring fair value in generally accepted accounting principles (GAAP), and expand disclosures about fair value measurements. The Company has adopted this standard for our fiscal year beginning August 2008 and it did not have a material impact on the financial statements.

In February 2007, Statement of Financial Accounting Standards (SFAS) No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of FASB Statement No. 115” was issued to permit entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The Company has adopted this standard for our fiscal year beginning in August 2008 and did not have a material impact on the financial statements.

In May 2008, SFAS No. 163, “Accounting for Financial Guarantee Insurance Contracts, an interpretation of FASB Statement No. 60” was issued to clarify how FASB Statement No. 60 applies to financial guarantee insurance contracts. The Company does not have nor expects to have in the future any financial guarantee insurance contracts. This Standard is applicable to our fiscal year beginning in August 2009.

In May 2009, SFAS No. 165, “Subsequent Events”, was issued to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. The Company complies with this standard. The Company has evaluated subsequent events through November 12, 2009.

In June 2009, SFAS No. 166, “Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140”, was issued to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor’s continuing involvement, if any, in transferred financial assets. The Company is evaluating the impact of this standard which is applicable to us for reporting periods after November 15, 2009.

In June 2009, SFAS No. 167, “Amendments to FASB Interpretation No. 46(R),” was issued to improve financial reporting by enterprises involved with variable interest entities. This standard is applicable to the first annual reporting period that begins after November 15, 2009. While we currently are not involved with any variable interest entities, this standard would apply to our fiscal year beginning August 2010.

In June 2009, SFAS No. 168, “The FASB Accounting Standards Codification and the Hierarchy of Generally Accepting Accounting Principles, a replacement of FASB Statement No. 162,” was issued to announce that the codification will become the source of authoritative U.S. generally accepted accounting principles recognized by the FASB to be applied by nongovernmental entities. This standard is applicable to our fiscal year beginning August 2010.

Research and Development

Research and development costs related to future products are expensed in the year incurred and are included in SG&A expenses. There were no research and development expenses for fiscal 2009. During 2008 and 2007 costs were $1,000 and $544,000, respectively.

Advertising

The Company charges advertising costs when incurred as a component of SG&A expenses. Advertising expense amounted to $542,000, $600,000, and $613,000 for fiscal years 2009, 2008, and 2007, respectively.

Shipping and Handling

Shipping and handling costs that are charged to and reimbursed by the customer are recognized as revenues, while the related expenses, including buying, postage, external distribution and warehousing costs incurred by the Company are recorded as components of cost of goods sold in the consolidated statements of operations.

Split-Dollar Life Insurance

The Company is party to a split-dollar arrangement with respect to certain life insurance policies. We record an amount that is to be realized under the split dollar agreement. This amount is the actual premiums paid by the Company or the actual cash surrender value of the policy, whichever is less.

Real Estate Held for Investment

Real estate held for investment is land recorded at cost plus the cost of any improvements. Land is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable.

Reclassifications

Certain 2008 amounts have been restated to conform to the 2009 presentation.

2. INVENTORIES

Current costs exceeded the LIFO value of inventories by approximately $647,000 and $651,000 at August 1, 2009 and August 2, 2008, respectively. Year-end inventories valued under the LIFO method were $1,254,000 and $1,461,000 at August 1, 2009 and August 2, 2008, respectively. For fiscal 2009, lower FIFO pricing decreased the LIFO reserve, which decreased the net loss by approximately $2,600 as compared to a $15,200 decrease in net earnings for fiscal 2008.

The components of inventory at each year-end are as follows:

	(In thousands) Fiscal Year Ended	
	2009	**2008**
Raw materials	$ 803	$ 1,154
Work-in-process	331	391
Finished goods	11,722	13,928
	$ 12,856	$ 15,473

3. PROPERTY AND EQUIPMENT

Property and equipment are recorded at cost. Depreciation for financial reporting purposes is provided using the straight-line method over the estimated useful lives of the assets. Accelerated depreciation methods are used for income tax reporting purposes. Estimated useful lives range from three years for computer equipment to thirty-one and one-half years for buildings. Expenditures for routine maintenance and repairs are charged to expense as incurred.

Property and equipment at August 1, 2009 and August 2, 2008, consisted of the following:

	(In thousands) Fiscal Year Ended	
	2009	**2008**
Land and improvements	$ 385	$ 385
Buildings	4,003	3,977
Machinery and equipment	4,290	2,718
Furniture and fixtures	1,275	1,368
Construction in progress	263	0
	10,216	8,448
Less: Accumulated depreciation	(7,060)	(6,761)
	$ 3,156	$ 1,687

Depreciation expense for fiscal 2009, 2008 and 2007 was $564,000, $485,000 and $575,000, respectively.

4. NOTES PAYABLE AND LINES OF CREDIT

Notes Payable

	(In thousands) Fiscal Year Ended 2009	2008
Note payable- bank	$ 1,310	$ 0
Less current portion	(184)	0
Note payable less current portion	$ 1,126	$ 0

The note payable-bank bears interest at a variable rate, which is the bank's prime lending rate. At August 1, 2009, the interest rate was 3.25%. Principal and interest payments are due in thirty-five monthly installments in the amount of $18,683 and one balloon payment of $857,802 due on January 27, 2012. The loan is secured by military boot production equipment and does not contain any loan covenants. Interest charges for this note totaled approximately $22,000 for the fiscal 2009 year.

Lines of Credit

The Company has a $3,000,000 revolving line of credit with a bank. The Company had no outstanding borrowings under this line of credit as of August 1, 2009 and August 2, 2008. This line of credit provides for interest on outstanding balances to be paid monthly at the prime rate less 0.5%. This line of credit expires in November 2010 and is secured by the inventory and accounts receivable of the Company's western and work boot subsidiary. There were no borrowings under this line of credit for fiscal 2009.

The Company has an additional $1,750,000 line of credit with a bank. This line is restricted to 100% of the outstanding accounts receivable due from the U.S. Government. There were no outstanding borrowings under this line of credit as of August 1, 2009 and August 2, 2008. The line of credit expires in January 2010 and provides for interest on outstanding balances to be paid monthly at the prime rate. There were no borrowings under this line of credit for fiscal 2009.

Interest charges for fiscal 2009, 2008 and 2007 were approximately $15,000, $29,000, and $19,000, respectively.

5. EMPLOYEE BENEFIT PLANS

The Company's employee benefit program consists of an employee stock ownership plan, a 401-K retirement plan, a cash bonus program, incentive awards, and other specified employee benefits as approved by the Board of Directors.

The employee stock ownership plan (ESOP) covers substantially all employees. Its principal investments include shares of Class A Common Stock and Class B Common Stock of the Company and collective funds consisting of short-term cash, fixed-income, and equity investments. There have been no contributions to the ESOP in fiscal years 2009, 2008 or 2007.

The Company has a 401-K retirement plan, which covers substantially all employees. Employees can contribute up to 25% of their annual salary to the plan. At its sole discretion, the Board of Directors determines the amount and timing of any Company matching contribution. The Company's contribution was $179,000, $178,000, and $164,000 for the fiscal years ended August 1, 2009, August 2, 2008 and July 28, 2007, respectively.

Employee benefit program expense amounted to $339,000, $1,187,000, and $641,000 in 2009, 2008 and 2007, respectively.

6. INCOME TAXES

Significant components of the provision for income taxes are as follows (in thousands):

	2009	2008	2007
Current expense			
Federal	$ (146)	$ 3,210	$ 1,628
State	22	370	(34)
	(124)	3,580	1,594
Deferred expense (benefit)			
Federal	353	(412)	162
State	62	(73)	29
	$ 291	$ 3,095	$ 1,785

The components of the provision (benefit) for deferred income taxes are as follows (in thousands):

	2009	2008	2007
Depreciation	$ 277	$ 27	$ (40)
Accrued employee benefits	316	(196)	48
Allowances for doubtful accounts	127	(133)	(3)
Allowance for sales returns	(8)	(33)	12
Inventory	(79)	(293)	(74)
State net operating loss carry forward	(4)	87	(120)
Like Kind Exchange	0	0	391
ERP System write-off	(287)	0	0
Other	73	56	(23)
Deferred income taxes, expense (benefit)	$ 415	$ (485)	$ 191

Deferred tax liabilities and assets at each year-end are as follows (in thousands):

	2009	2008
Deferred tax liabilities		
Amortization	$ (380)	$ (307)
Gain on Like Kind Exchange	(391)	(391)
Depreciation	(242)	0
Total deferred tax liabilities	(1,013)	(698)
Deferred tax assets		
Self Insurance	76	76
Accrued employee benefits	61	377
Allowances for doubtful accounts	190	317
Allowance for sales returns	131	123
Inventory	712	634
State net operating loss carry forward	132	128
Depreciation	0	33
ERP System write-off	287	0
Other	(1)	0
Total deferred tax assets	1,588	1,688
Net deferred tax assets	$ 575	$ 990

State net operating loss carry forwards of $11 million will expire through fiscal 2019.

The reconciliation of income tax computed at the U.S. federal statutory tax rate to actual income tax expense are (in thousands):

	2009		2008		2007	
	Amount	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**
Tax at U.S. statutory rate	$(21)	34.0%	$1,903	34.0 %	$1,897	34.0 %
State income taxes, net of federal tax benefit	(4)	6.3%	353	6.3 %	351	6.3 %
Tax adjustments	249	(111.7)%	0	0	0	0
Other – net	67	(30.1)%	(471)	(8.9)%	(59)	(1.1)%
	$ 291	(101.4)%	$1,785	31.9 %	$2,189	39.2 %

The items included as “other-net” relate to book to tax deferrals, permanent differences, adjustment for non tax consolidated entities, and prior year tax provision to return adjustments.

Total income tax payments during fiscal years 2009, 2008 and 2007 were approximately $448,000, $3,426,000 and $1,488,000, respectively.

7. COMMITMENTS AND CONTINGENCIES

Lease Agreements

The Company leases certain offices and equipment under non-cancelable operating leases. Rental expenses on all operating leases were $448,000, $451,000 and $434,000 for fiscal 2009, 2008, and 2007, respectively.

The Company leases approximately 34,000 square feet of office and warehouse space to Connected Office Products, Inc. The original lease covered a base year period and two one-year option periods. In July 2006, the lease was amended to cover a five-year period beginning on September 1, 2006. These lease and facility charge payments are reported as a component of “Other Income”. The future minimum lease and facility charge payments are as follows:

	2010	**2011**	**2012**
Lease Payments	$50,000	$50,000	$ 8,333
Facility Charges	$60,736	$61,946	$10,358

Concentrations

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash investments and receivables. The Company maintains substantially all of its cash and certificates of deposits with a financial institution in amounts that are in excess of the federally insured limits. At August 1, 2009, approximately $11 million was in excess of the federally insured limit. Management performs periodic evaluations of the relative credit standing of this financial institution.

Concentrations of credit risk with respect to receivables are minimal due to the large number of entities comprising the Company’s customer base and their dispersion across many different industries. The Company does not require collateral on trade accounts receivable. As of August 1, 2009 and August 2, collateral on trade accounts receivable. As of August 1, 2009 and August 2, 2008, 21 customers accounted for 34% and 43% of accounts receivable, respectively.

Synthetic rubber used in our vulcanizing military boot operations is currently available and purchased from the only domestic supplier. Synthetic rubber is available from foreign suppliers, however an exemption would be required from the Government to purchase synthetic rubber in the foreign market. The Vibram rubber specified outsoles is a registered product available only from Quabaug Corporation and we are dependent on their ability to supply our needs. This supplier provided Vibram rubber outsoles for approximately 1.7 million and 3.7 million at August 1, 2009 and August 2, 2008, respectively.

Sales to the U.S. Government amounted to 19%, 28% and 24% of total consolidated net revenues for fiscal 2009, 2008, and 2007, respectively.

Other

Under the terms of sale to the U.S. Government, the negotiated contract prices of combat boots are subject to renegotiation if certain conditions are present. Management does not currently expect renegotiation, if any, to have a material adverse effect on the Company’s consolidated financial position or results of operations.

8. SHAREHOLDERS’ EQUITY

Common Stock

The Company’s Bylaws provide for seven directors, two of whom are elected by the holders of the Class A Common Stock voting as a separate class, and five of whom are elected by the holders of the Class B Common Stock voting as a separate class. On all other matters (except matters required by law or the Company’s Certificate of Incorporation or Bylaws to be approved by a different vote), the holders of Class A Common Stock and Class B Common Stock vote together as a single class with each share of Class A Common Stock entitled to one-tenth vote and each share of Class B Common Stock entitled to one vote. Each share of Class B Common Stock can be converted to Class A Common Stock on a share for share basis. All dividends paid on Class B Common Stock must also be paid on Class A Common Stock in an equal amount.

During fiscal 1999, the Company adopted the McRae Industries, Inc. 1998 Incentive Equity Plan (the Plan). Under the Plan, 100,000 shares of the Company’s Class A Common Stock are reserved for issuance to certain key employees of the Company. At August 1, 2009, there were 100,000 shares available for future grants under the Plan.

The common stock is currently quoted in the Pink Sheets and stockholders are able to trade their shares in the over-the-counter markets or private transactions.

9. FAIR VALUE OF FINANCIAL INSTRUMENTS

Management used the following methods and assumptions to estimate the fair value of financial instruments:

The fair value of our cash and cash equivalents, accounts and notes receivable, accounts payable accrued liabilities approximate their carrying values because of the short maturities of these instruments.

The amount due from Split-Dollar Life Insurance policies represents the value of the Company’s rights under split-dollar arrangements. Under these arrangements, the Company is entitled to be repaid cumulative premiums paid, or if less, the net cash surrender value of the policies.

The fair value of our long-term bank note payable approximate carrying values based on variable interest rates in effect at the balance sheet dates for similar debt instruments.

10. SUBSEQUENT EVENTS

On September 2, 2009, the Company declared a cash dividend of $.09 per share on its Class A Common Stock payable on September 30, 2009 to shareholders of record on September 16, 2009.

On September 30, 2009, the Company received payment on note receivable related to the sale of the bar code business in the amount of $597,632 and the associated accrued interest of $11,175.

On November 4, 2009, the U.S. Government exercised the first option of the contract awarded on November 7, 2008. This option provides for the purchase of a minimum quantity of 17,556 pair and a maximum quantity of 100,002 pair. We expect the actual boot requirements for fiscal 2010 to be near the minimum level.

11. RELATED PARTY TRANSACTIONS

The Company leases administrative and sales office space in Clarksville, Tennessee for the western boot business from the President of Dan Post Boot Company. The annual rent is $56,000.

EXECUTIVE OFFICERS AND DIRECTORS

EXECUTIVE OFFICERS

D. Gary McRae
Chairman of the Board, President,
Chief Executive Officer, and Treasurer

James W. McRae
Vice-President and Secretary

Victor A. Karam
President, McRae Footwear

Marvin G. Kiser, Sr.
Vice-President of Finance

DIRECTORS

D. Gary McRae
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Chief Executive Officer, and Treasurer

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Vice-President and Secretary

Victor A. Karam
President, McRae Footwear

Marvin G. Kiser, Sr.
Vice-President of Finance

Hilton J. Cochran*
Former President,
Cochran Insurance Agency, Inc.

Brady W. Dickson*
Consultant

William H. Swan*
Retired President of Bob Swan Company

**Members of Audit and Compensation Committees*

SHAREHOLDER INFORMATION

SHAREHOLDERS

Requests for interim and annual reports or more information about the Company should be directed to:

Office of the Secretary
McRae Industries, Inc.
P. O. Box 1239
Mount Gilead, North Carolina 27306

TRANSFER AGENT, REGISTRAR, AND DIVIDEND DISBURSING AGENT

American Stock Transfer & Trust Company
10150 Mallard Creek Road, Suite 307
Charlotte, North Carolina 28262

STOCK

McRae's common stock is traded on the PinkSheets (MRINA and MRINB).

ANNUAL MEETING

December 17, 2009
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