McRae Industries

ANNUAL REPORT 2015

CORPORATE PROFILE

McRae Industries, Inc. was founded in 1959 as a manufacturer and distributor of children's shoes. Today, McRae Industries is involved in manufacturing, sales and distribution of high quality, reasonably priced boot products targeted to the western/lifestyle and work boot markets. In addition, we continue to take pride in manufacturing military combat boots for the U. S. Government. The company also operates other smaller businesses.

McRae Industries, Inc. corporate headquarters is located in Mount 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.

FISCAL YEARS ENDED	8/1/15	8/2/14	8/3/13	7/28/12	7/30/11
(In thousands, except per share data)					
INCOME STATEMENT DATA:					
Net revenues	$ 108,673	$ 103,629	$ 97,071	$ 75,684	$ 74,748
Net earnings (loss)	6,641	7,548	7,498	4,842	3,829
Net earnings per common share					
Basic Earnings per share[(a)]:					
Class A	3.77	4.18	4.54	2.73	2.22
Class B	0.52	0.48	0.77	0.00	0.00
Diluted Earnings per share[(b)]:					
Class A	3.17	3.51	3.79	2.27	1.84
Class B	NA	NA	NA	NA	NA
BALANCE SHEET DATA:					
Total assets	$ 78,344	$ 71,186	$ 64,909	$ 58,763	$ 53,811
Long-term liabilities	1,513	1,536	1,399	1,702	1,334
Working capital	51,251	51,181	44,451	40,582	36,559
Shareholders' equity	67,828	62,450	56,067	50,781	47,029
Weighted average number of common shares outstanding:					
Class A	2,038,645	2,038,469	2,035,034	2,038,902	2,053,042
Class B	391,879	392,055	399,878	414,853	423,697
Weighted average number of common shares outstanding[(c)]:	2,430,524	2,430,524	2,434,912	2,453,755	2,476,739
Cash dividends per Class A common share:	$ 0.52	$ 0.48	$ 0.36	$ 0.36	$ 0.36
Cash dividends per Class B common share	$ 0.52	$ 0.48	$ 0.27	$ 0.00	$ 0.00
Special Cash dividend per Class A and Class B common share	$ 0.00	$ 0.00	$ 0.50	$ 0.00	$ 0.00

(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

LETTER TO SHAREHOLDERS

Dear Fellow Shareholders:

It gives me great pleasure to present the McRae Industries' 55th Annual Report to you.

Fiscal 2015 proved to be an excellent year for your Company. Revenues increased 4.9% to $108.7 million for fiscal 2015, up from $103.6 million for fiscal 2014. Net earnings decreased from $7.5 million for fiscal 2014 to $6.6 million for fiscal 2015. This decrease in net earnings was primarily attributable to inefficiencies in our McRae Footwear manufacturing operations.

Our western/lifestyle boot segment, which includes western wear, ladies fashion and children footwear products, experienced a slight increase in net revenues. Net revenues for this boot segment totaled $67.1 million for fiscal 2015 as compared to $66.3 for fiscal 2014. This increase was primarily driven by our Dan Post and El Dorado brand sales. The El Dorado brand is a premium boot brand that was introduced in fiscal 2015 in conjunction with Boot Barn and is sold exclusively in Boot Barn Stores.

Net revenues for our work boot segment, which includes Dan Post, Laredo, John Deere and McRae Industrial branded work boot products along with our military boots, increased by 11.5% as net revenues climbed to $41.3 million for fiscal 2015 as compared to $37.0 million for fiscal 2014. All of our work boot brands, except for John Deere, experienced revenue growth as the economy continued to improve. Our military boot business revenues increased by 16%, climbing to $29.0 million for fiscal 2015 as compared to $25.0 million for fiscal 2014; however, inefficiencies associated with the hiring and training of a significant number of new employees, in anticipation of additional business in 2016, negatively impacted gross margins and profitability for this segment.

The Company's financial position continues to be strong as our working capital totaled $51.3 million, which was nearly the same as last year. Our cash and cash equivalents position totaled $15.4 million for fiscal 2015 as compared to $18.9 million for fiscal 2014. This reduction in cash was the result of three major activities: the expansion of our military boot manufacturing facility, the implementation of a new ERP system to enable us to more effectively manage our western and work boot business, and an increase in our investment portfolio to achieve a higher return on our excess cash. We believe that the Company's current cash position will be sufficient to support our fiscal 2016 operating activities.

Revenues increased 4.9% to $108.7 million for fiscal 2015, up from $103.6 million for fiscal 2014.

We have been fortunate to see our western/lifestyle segment net revenues grow nearly 203%, from $33.0 million for fiscal 2009 to $67.1 million for fiscal 2015; however, we now see this growth beginning to slow, especially in the higher price points associated with the women's fashion boots. While we do not believe that the western market is going to experience a precipitous downturn, it is prudent to be cautious about the market outlook for this segment of our business. As a result, one of our strategies to increase revenue in this market segment is to introduce exciting new boot designs for the core western market, a market in which Dan Post has a small market share, at the Denver WESA show in January 2016. We are hopeful that these products, along with the introduction of fresh designs in our traditional western styles, will bolster our western/lifestyle sales.

In our work boot segment, we expect our military boot sales to increase for fiscal 2016 as product demand related to our existing hot weather and temperate weather military boot contracts has increased. In addition, during fiscal 2015, we received a contract from the US Government to produce a significant quantity of flame retardant military boots. The growth potential for our commercial military business has been augmented by the introduction of new imported boot styles that have been well accepted in the commercial market. We also manufacture a military boot product that is currently being sold in Army & Air Force Exchange Service stores and expect to have another style ready to ship early in calendar 2016.

Our branded work boot business is very competitive because of the number of established players in this market. We introduced several new Dan Post work styles at the Denver Market in January of 2015. As a result of these styles being well accepted by our retailers, we plan to build and market the Dan Post Work Certified product line. We are confident that this is the best strategy to gain market share in this product category.

Fiscal 2016 promises to be exciting and challenging, but not without business opportunities to grow and expand our business. Your management will work hard to take advantage of these opportunities and produce acceptable results for all Company stakeholders.

I would like to take this opportunity to thank Bill Swan for his fourteen years of excellent service as a member of the McRae Industries Board of Directors. During Bill's tenure on the Board, the Company has grown and prospered for which Bill played an important role in this success.

This Board of Directors and I wish to express our sincere gratitude to all of our team members, business partners and shareholders for their continued support.

Sincerely,

D. Gary McRae

D. Gary McRae
President

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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 financial statements of **McRae Industries, Inc.** (a Delaware corporation) **and Subsidiaries**, which comprise the consolidated balance sheets as of August 1, 2015 and August 2, 2014, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended August 1, 2015, and the related notes to the financial statements.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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, 2015 and August 2, 2014, and the results of their operations and their cash flows for each of the three years in the period ended August 1, 2015, in accordance with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Charlotte, North Carolina
November 4, 2015

CONSOLIDATED BALANCE SHEETS

McRae Industries, Inc. and Subsidiaries

(In thousands, except share data)	**August 1, 2015**	**August 2, 2014**
ASSETS		
Current assets:		
Cash and cash equivalents	$15,437	$18,880
Short term securities	500	76
Accounts and notes receivable, less allowances of $1,975 and $1,586, respectively	15,636	13,428
Inventories, net	25,757	22,288
Income tax receivable	122	938
Prepaid expenses and other current assets	532	553
Deferred tax assets	2,270	2,218
Total current assets	60,254	58,381
Property and equipment, net	5,817	3,222
Other assets:		
Deposits	14	14
Long term securities	3,553	872
Real estate held for investment	3,594	3,585
Amounts due from split-dollar life insurance	2,288	2,288
Trademarks	2,824	2,824
Total other assets	12,273	9,583
Total assets	$78,344	$71,186

The accompanying notes are an integral part of these consolidated financial statements

CONSOLIDATED BALANCE SHEETS
McRae Industries, Inc. and Subsidiaries

(In thousands, except share data)	August 1, 2015	August 2, 2014
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$5,599	$3,778
Accrued employee benefits	1,627	1,798
Accrued payroll and payroll taxes	1,225	1,161
Other	552	463
Total current liabilities	9,003	7,200
Deferred tax liabilities	1,513	1,536
Total liabilities	10,516	8,736
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Common Stock:		
Class A, $1 par value; authorized 5,000,000 shares issued and outstanding, 2,039,335 and 2,038,543 shares, respectively	2,040	2,039
Class B, $1 par value; authorized 2,500,000 shares; issued and outstanding, 391,189 and 391,981 shares, respectively	391	392
Retained earnings	65,397	60,019
Total shareholders' equity	67,828	62,450
Total liabilities and shareholders' equity	$78,344	$71,186

The accompanying notes are an integral part of these consolidated financial statements

CONSOLIDATED STATEMENTS OF OPERATIONS
McRae Industries, Inc. and Subsidiaries

(In thousands, except share data)

For Years Ended	**August 1, 2015**	**August 2, 2014**	**August 3, 2013**
Net revenues	$108,673	$103,629	$97,071
Cost of revenues	79,347	73,488	67,539
Gross profit	29,326	30,141	29,532
Selling, general and administrative expenses	19,025	18,660	18,005
Operating profit	10,301	11,481	11,527
Other income	324	311	204
Interest expense	(2)	(3)	(2)
Earnings before income taxes	10,623	11,789	11,729
Provision for income taxes	3,982	4,241	4,231
Net earnings	$6,641	$7,548	$7,498

Earnings per common share:			
Earnings per common share:			
Basic earnings per share:			
Class A	$3.77	$4.18	$4.54
Class B	0.52	0.48	0.77
Diluted earnings per share:			
Class A	3.17	3.51	3.79
Class B	NA	NA	NA
Weighted average number of common shares outstanding:			
Class A	2,038,645	2,038,469	2,035,034
Class B	391,879	392,055	399,878
Total	2,430,524	2,430,524	2,434,912

The accompanying notes are an integral part of these 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		
	Shares	Amount	Shares	Amount	Retained Earnings
Balance, July 28, 2012	2,030,880	$2,031	408,376	$408	$48,342
Purchase of ESOP distribution shares	(6,315)	(6)	(1,486)	(1)	(135)
Purchase of other shares	(1,231)	(1)			(18)
Issuance of Class A Shares	300	0			5
Conversion of Class B to Class A Stock	13,971	14	(13,971)	(14)	0
Cash Dividend ($.36 per Class A common stock)					(732)
Cash Dividend ($.27 per Class B common stock)					(107)
Special Cash Dividend ($.50 per Class A and B common stock)					(1,217)
Net earnings					7,498
Balance, August 3, 2013	2,037,605	$2,038	392,919	$393	$53,636
Conversion of Class B to Class A Stock	938	1	(938)	(1)	0
Cash Dividend ($.48 per Class A common stock)					(978)
Cash Dividend ($.48 per Class B common stock)					(187)
Net earnings					7,548
Balance, August 2, 2014	2,038,543	$2,039	391,981	$392	$60,019
Conversion of Class B to Class A Stock	792	1	(792)	(1)	0
Cash Dividend ($.52 per Class A common stock)					(1,060)
Cash Dividend ($.52 per Class B common stock)					(203)
Net earnings					6,641
Balance, August 1, 2015	2,039,335	$2,040	391,189	$391	$65,397

The accompanying notes are an integral part of these consolidated financial statements

CONSOLIDATED STATEMENTS OF CASH FLOWS
McRae Industries, Inc. and Subsidiaries

(In thousands)

For Years Ended	**August 1, 2015**	**August 2, 2014**	**August 3, 2013**
Cash Flows from Operating Activities:			
Net earnings	$6,641	$7,548	$7,498
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation	785	748	686
Amortization of bond premiums	3	10	11
(Gain) loss on sale of assets	0	(40)	(282)
Deferred income taxes	(75)	87	(441)
Changes in operating assets and liabilities:			
Accounts receivable, net	(2,208)	1,966	(3,612)
Inventories	(3,469)	758	(3,474)
Prepaid expenses and other assets	21	(85)	(87)
Accounts payable	1,821	(276)	681
Accrued employee benefits	(171)	91	549
Accrued payroll and payroll taxes	64	(48)	206
Income tax receivable/payable	816	(1,012)	283
Other	89	64	(347)
Net cash provided by operating activities	**4,317**	**9,811**	**1,671**
Cash Flows from Investing Activities:			
Proceeds from sale of assets	0	87	390
Proceeds from maturing bond	0	0	75
Purchase of land for investment	(9)	(7)	(59)
Capital expenditures	(3,380)	(650)	(891)
Proceeds from sale of securities	75	0	0
Purchase of securities	(3,183)	0	(1,044)
Net cash used in investing activities	**(6,497)**	**(570)**	**(1,529)**
Cash Flows from Financing Activities:			
Purchase of common stock	0	0	(161)
Issuance of common stock	0	0	5
Dividends paid	(1,263)	(1,165)	(2,056)
Net cash used in financing activities	**(1,263)**	**(1,165)**	**(2,212)**
Net (Decrease) Increase in Cash and Cash equivalents	(3,443)	8,076	(2,070)
Cash and Cash Equivalents at Beginning of Year	18,880	10,804	12,874
Cash and Cash Equivalents at End of Year	**$15,437**	**$18,880**	**$10,804**

The accompanying notes are an integral part of these consolidated financial statements

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 and importing and selling western and work boots.

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)		
	2015	**2014**	**2013**
Total Assets:			
Western/Work Boots	$ 36,441	$ 36,033	$ 36,650
Military Boots	13,060	7,167	8,450
Other	55	54	78

	(In thousands)		
	2015	**2014**	**2013**
Total Net Revenues:			
Western/Work Boots	$ 79,483	$ 78,391	$ 75,368
Military Boots	29,001	25,009	20,780
Other	189	229	923

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 demand deposits with banks and 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 the allowance for doubtful accounts 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 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.

Our western and work boot business records an allowance for sales returns which is calculated by applying historical return data to sales subject to potential returns. The allowance for sales returns, which is different from the allowance noted in the preceding paragraph, is included as a component of the allowance presented on the balance sheet. This component totaled approximately $925,000 and $586,000 for fiscal 2015 and fiscal 2014, respectively.

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 our FIFO basis 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 one percentage point error in our inventory allowances would approximate $5,300 and $6,500 for the fiscal years ended August 1, 2015, and August 2, 2014, respectively.

Marketable Securities

The Company determines the appropriate classification of its investments in debt and equity securities at the time of purchase and reevaluates such determinations at each balance sheet date. Debt securities are classified as held to maturity when the Company has the positive intent and ability to hold securities to their maturity. Held-to-maturity securities are recorded as either short term or long term on the consolidated balance sheets, based on their contractual maturity date and are stated at amortized cost. Investments in debt or equity securities that are not classified as held-to-maturity are carried at fair value and classified as available-for-sale. Realized and unrealized gains and losses on available-for-sale securities are included in net income. Refer to Note 10 for additional information related to the Company's available-for-sale securities.

Long-Lived Assets and Other Intangibles

The Company reviews long-lived assets with estimable useful lives for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less cost to sell.

The Company tests identifiable intangible assets with an indefinite life for impairment annually. Furthermore, such assets are required to be tested for impairment on an interim basis if an event or circumstance indicates that it is more likely than not an impairment loss has been incurred. An impairment loss shall be recognized to the extent that the carrying amount of such assets exceeds its implied fair value. Impairment losses shall be recognized in operations. The Company's valuation methodology for assessing impairment requires management to make judgments and assumptions based on historical experience and projections of future operating performance. If these assumptions differ materially from future results, the Company may record impairment charges in the future. Based on its most recent analysis, the Company believes that no impairment exists as of August 1, 2015 and August 2, 2014, 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 contracts are recognized as revenues when the goods are received at their designated depot.

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.

The Company follows the applicable authoritative guidance related to accounting for uncertainty in income tax reporting. This guidance clarifies the accounting for uncertainty in income taxes recognized in the Company's financial statements. It also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

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 the accounting guidance related to accounting for uncertainty in income taxes.

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 fiscal years ending before 2012. 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 carry forward 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 the applicable authoritative guidance. 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 the applicable guidance, 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, 2015.

Advertising

The Company charges advertising costs when incurred as a component of selling, general and administrative expenses. Advertising expense amounted to approximately $970,000, $878,000, and $701,000 for fiscal years 2015, 2014, and 2013, 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.

2. INVENTORIES

Current costs exceeded the LIFO value of inventories by approximately $847,000 and $1,000,000 at August 1, 2015 and August 2, 2014, respectively. Year-end inventories valued under the LIFO method were approximately $7,381,000 and $3,558,000 at August 1, 2015 and August 2, 2014, respectively. For fiscal 2015, lower FIFO pricing resulted in a decreased LIFO reserve, which increased net earnings by approximately $96,000, as compared to higher FIFO pricing for fiscal 2014 resulting in an increased LIFO reserve, which decreased net earnings by approximately $152,000.

Inventory reserves applicable to the FIFO inventories totaled approximately $530,000 and $650,000 for fiscal 2015 and fiscal 2014, respectively.

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

	(In thousands)	
	2015	**2014**
Raw materials	$ 3,692	$ 1,566
Work-in-process	1,805	868
Finished goods	20,260	19,854
	$ 25,757	$ 22,288

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. 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, 2015 and August 2, 2014 consisted of the following:

	(In thousands)	
	2015	**2014**
Land and improvements	$ 501	$ 491
Buildings	4,252	4,128
Machinery and equipment	5,907	5,566
Furniture and fixtures	2,130	1,858
Construction in progress	2,693	102
	15,483	12,145
Less: Accumulated depreciation	(9,666)	(8,923)
	$ 5,817	$ 3,222

Depreciation expense for fiscal years ended 2015, 2014, and 2013 was approximately $785,000, $748,000, and $686,000, respectively.

4. MARKETABLE SECURITIES

The components of our marketable securities as of August 1, 2015 and August 2, 2014 are as follows:

	(In thousands)	
	2015	**2014**
Available-for-sale:		
Short term equity securities	$ 500	$ -
Long term equity securities	3,553	-
Held-to-maturity:		
Short term debt securities	-	76
Long term debt securities	-	872
	$ 4,053	$ 948

During fiscal 2015, the Company liquidated all held to maturity securities and reinvested in available for sale securities. Refer to Note 10.

5. NOTES PAYABLE AND LINES OF CREDIT

Lines of Credit

The Company has a $5,000,000 revolving line of credit with a bank. The Company had no outstanding borrowings under this line of credit as of August 1, 2015 and August 2, 2014. This line of credit provides for interest on outstanding balances to be paid monthly at the prime rate less 1.0%. This line of credit expires in January 2016 and is secured by the inventory and accounts receivable of the Company's western and work boot subsidiary.

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, 2015 and August 2, 2014. The line of credit expires in January 2016 and provides for interest on outstanding balances to be paid monthly at the prime rate.

6. 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 2015, 2014 or 2013.

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 contributions were approximately $295,000, $270,000, and $229,000, for the fiscal years ended 2015, 2014, and 2013, respectively.

Employee benefit program expense amounted to approximately $1,903,000, $2,057,000, and $1,931,000, for the fiscal years ended 2015, 2014 and 2013, respectively.

7. INCOME TAXES

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

	2015	2014	2013
Current expense			
Federal	$ 3,699	$ 3,777	$ 4,323
State	358	377	349
	4,057	4,154	4,672
Deferred expense			
Federal	(64)	74	(375)
State	(11)	13	(66)
	$ 3,982	$ 4,241	$ 4,231

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

	2015	2014	2013
Depreciation	$ (76)	$ 49	$ (84)
Accrued employee benefits	64	(34)	(208)
Allowances for doubtful accounts	(19)	(9)	(105)
Allowance for sales returns	(129)	(15)	(29)
Inventory	52	0	(49)
State net operating loss carry forward	(19)	17	13
Amortization	72	71	72
Prepaid Expenses	5	8	(51)
Self Insurance Reserve	(25)	0	0
Provision for deferred income taxes	$ (75)	$ 87	$ (441)

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

	2015	2014
Noncurrent deferred assets (liabilities)		
Amortization	$ (815)	$ (743)
Gain on Like Kind Exchange	(391)	(391)
Depreciation	(464)	(540)
State net operating loss carry forward	157	138
Net noncurrent deferred tax liabilities	(1,513)	(1,536)
Current deferred tax assets (liabilities)		
Self Insurance	101	76
Accrued employee benefits	618	682
Allowances for doubtful accounts	399	380
Allowance for sales returns	352	223
Inventory	830	882
Economic Price Adjustment Claim	68	68
Prepaid Expenses	(98)	(93)
Net current deferred tax assets	2,270	2,218
Net deferred tax assets	$ 757	$ 682

State net operating loss carry forwards of $6 million will expire through fiscal 2024.

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

	2015		2014		2013	
	Amount	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**
Tax at U.S. statutory rate	$3,612	34.0 %	$4,008	34.0 %	$4,106	35.0 %
State income taxes, net of federal tax benefit	229	2.2 %	257	2.2 %	184	1.6 %
Tax adjustments	150	1.4 %	149	1.3 %	(96)	(0.8) %
Other – net	(9)	(0.1) %	(173)	(1.5)%	37	0.3 %
	$3,982	37.5 %	$4,241	36.0 %	$4,231	36.1 %

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

Total income tax payments during fiscal years 2015, 2014 and 2013 were approximately $3,363,000, $5,278,000, and $4,511,000, respectively.

The Company follows the applicable authoritative guidance related to accounting for uncertainty in income tax reporting. As of August 1, 2015, management has concluded no related liability is necessary.

8. COMMITMENTS AND CONTINGENCIES

Lease Agreements

The Company leases certain offices and equipment under non-cancelable operating leases. Rental expenses on all operating leases were $555,000, $534,000, and $539,000, for fiscal years ended 2015, 2014, and 2013, respectively. The future non-cancelable lease payments as of August 1, 2015 are as follows:

	2016	**2017**	**2018**	**2019**	**2020**
Lease Payments	$521,000	$523,000	$533,000	$536,000	$536,000

The Company leases approximately 34,000 square feet of office and warehouse space to Toshiba Business Solutions, Inc. The original lease covered a base year period and two one-year option periods. In July 2011, the lease was amended to cover a five-year period beginning on September 1, 2011. 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:

	2016
Lease Payments	$50,000
Facility Charges	$68,504

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, which totaled approximately $15 million, $19 million, and $11 million, for fiscal 2015, 2014, and 2013, respectively. 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, 2015, and August 2, 2014 twenty-one customers accounted for 61% and 52% of accounts receivable, respectively.

Synthetic rubber used in our vulcanizing military boot operation is currently available and purchased from the only domestic supplier known to us. Synthetic rubber is available from foreign suppliers; however, an exemption would be required from the U.S. Government to purchase synthetic rubber in the foreign market. The Vibram rubber specified outsoles are a registered product available only from Vibram USA and we depend on their ability to supply our needs. This supplier provided Vibram rubber outsoles for approximately $3.0 million and $2.5 million at August 1, 2015 and August 2, 2014 respectively.

Sales to the U.S. Government amounted to 19%, 19%, and 19%, of total consolidated net revenues for fiscal years ended 2015, 2014, and 2013, respectively. 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.

9. 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.

The Company has 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, 2015, 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.

10. FAIR VALUE OF FINANCIAL INSTRUMENTS

FASB ASC 820 "Fair Value Measurements and Disclosures" defines fair value as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date (that is, an exit price). The exit price is based on the amount that the holder of the asset or liability would receive or need to pay in an actual transaction (or in a hypothetical transaction if an actual transaction does not exist) at the measurement date. In some circumstances, the entry and exit price may be the same; however, they are conceptually different. The accounting standards also establish a three-level hierarchy that prioritizes the inputs used in fair value measurements. The hierarchy consists of three broad levels as follows:

Level 1 – Quoted market prices in active markets for identical assets or liabilities;
Level 2 – Observable inputs other than quoted prices within Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data; and
Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. These include certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The fair values of the Company's available for sale securities are determined using quoted market prices in active markets for identical assets or liabilities which are classified as Level 1 inputs.

The following table presents those assets and liabilities that are measured at fair value as of August 1, 2015 (in thousands):

	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
Mutual Funds	$ 4,053	-	-	$ 4,053

There were no available for sale securities held by the Company during the year ended August 2, 2014.

The fair value of our cash and cash equivalents, accounts and notes receivable, accounts payable, and accrued liabilities approximate their carrying values due to their liquid nature.

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.

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 approximately $105,000.

12. SUBSEQUENT EVENTS

On September 2, 2015, the Company declared a cash dividend of $.13 per share on its Class A and Class B Common Stock payable on October 5, 2015 to shareholders of record on September 21, 2015.

Subsequent events have been evaluated through November 4, 2015, which is the date the financial statements were available to be issued.

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EXECUTIVE OFFICERS & DIRECTORS

Executive Officers

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

James W. McRae
Vice-President and Secretary

Charles E. Covatch
President, McRae Footwear

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

Directors

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

James W. McRae
Vice-President and Secretary

Victor A. Karam
Former President, McRae Footwear

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

Hilton J. Cochran, Jr.*
Executive Director,
Peacehaven Community Farm

Brady W. Dickson*
Consultant

William H. Swan*
Retired President,
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

Stock

McRae's common stock is traded on the Pink Sheets (MCRAA and MCRAB).

Transfer Agent, Registrar, and Dividend Disbursing Agent

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

Annual Meeting

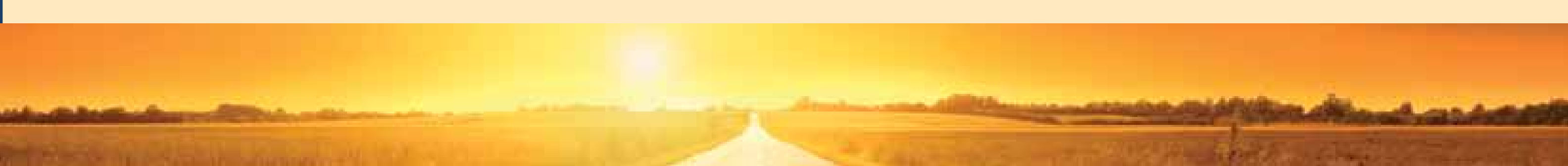
Thursday, December 17, 2015
Corporate Offices
400 North Main Street
Mount Gilead, North Carolina 27306

Independent Auditors

Grant Thornton LLP
201 South College St.
Suite 2500
Charlotte, North Carolina 28244

General Counsel

K&L Gates LLP
Hearst Tower
Suite 4700
214 North Tryon Street
Charlotte, North Carolina 28202



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