FORTITUDINE

McRae Industries

ANNUAL REPORT 2016

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	7/30/16	8/1/15	8/2/14	8/3/13	7/28/12
(In thousands, except per share data)					
INCOME STATEMENT DATA:					
Net revenues	$ 108,758	$ 108,673	$ 103,629	97,071	$ 75,684
Net earnings (loss)	4,692	6,641	7,548	7,498	4,842
Net earnings per common share					
Basic Earnings per share[a]:					
Class A	2.82	3.77	4.18	4.54	2.73
Class B	0.52	0.52	0.48	0.77	0
Diluted Earnings per share[b]:					
Class A	2.36	3.17	3.51	3.79	2.27
Class B	NA	NA	NA	NA	NA
BALANCE SHEET DATA:					
Total assets	$ 80,839	$ 78,344	$ 71,186	$ 64,909	$ 58,763
Long-term liabilities	2,288	1,513	1,536	1,399	1,702
Working capital	52,753	51,251	51,181	44,451	40,582
Shareholders' equity	70,860	67,828	62,450	56,067	50,781
Weighted average number of common shares outstanding:					
Class A	2,035,906	2,038,645	2,038,469	2,035,034	2,038,902
Class B	389,271	391,879	392,055	399,878	414,853
Weighted average number of common shares outstanding[c]:	2,425,177	2,430,524	2,430,524	2,434,912	2,453,755
Cash dividends per Class A common share:	$ 0.52	$ 0.52	$ 0.48	0.36	$ 0.36
Cash dividends per Class B common share:	$ 0.52	$ 0.52	$ 0.48	0.27	$ 0
Special Cash dividend per Class A and Class B common share	$ 0.00	$ 0.00	$ 0.00	0.50	$ 0

(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:

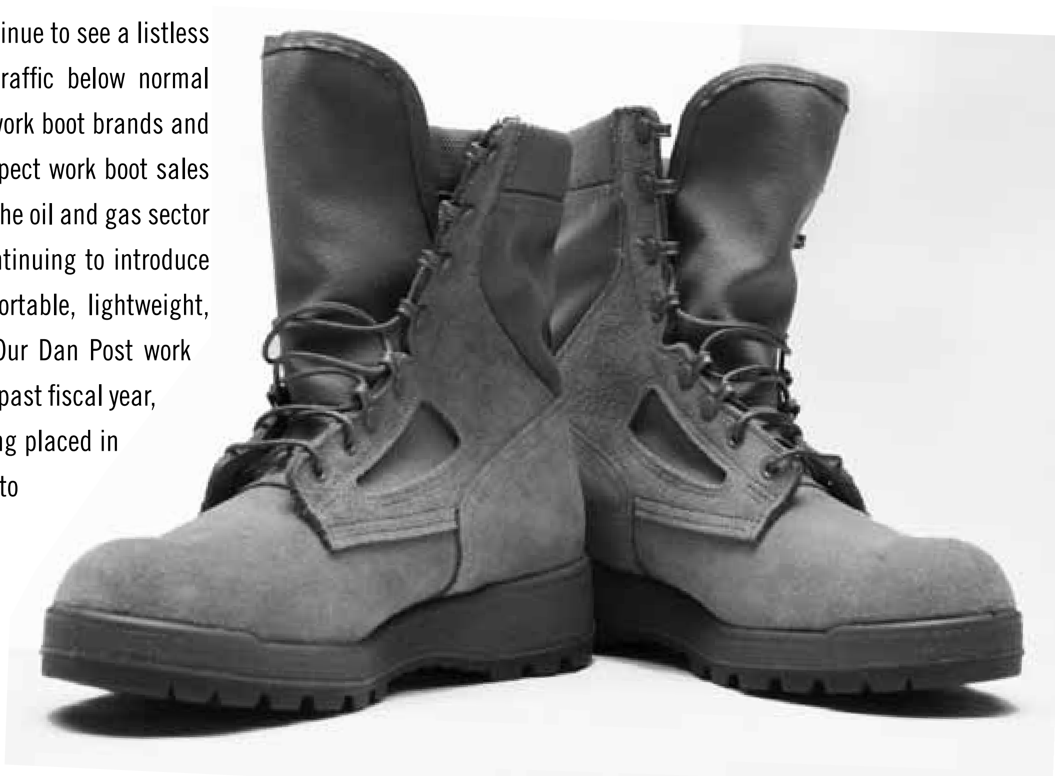
It is my privilege to provide this Annual Report on the activities of McRae Industries for fiscal 2016.

Your company completed another successful year in fiscal 2016. Revenues increased slightly from $108.7 million for fiscal 2015 to $108.8 million for fiscal 2016. Net earnings decreased from $6.6 million in 2015 to $4.7 million in 2016. This decrease in earnings was primarily the result of a change in the mix of our product sales. Our United States Government military business, which carries considerably less gross margin than our work and western/lifestyle products, increased by 36%, while our work and western/lifestyle product sales decreased by 12%. In addition, our group health insurance cost increased over $1.6 million from fiscal 2015 to fiscal 2016. We hope health insurance claims will return to more normal levels in fiscal 2017.

Net revenue for our work boot segment, which includes Dan Post, Laredo, John Deere, and McRae Industrial work boot products along with our Military boots, increased by 20% with sales increasing from $41.3 million in fiscal 2015 to $49.7 million in fiscal 2016. The Military boot sales increased by 36% from $29.0 million in fiscal 2015 to $39.6 million in fiscal 2016, while all other work boot brand sales decreased by 18% from $12.3 million in fiscal 2015 to $10.1 million in fiscal 2016. The work boot brand sales decreased primarily due to softening demand, brought about by the decreased activity in the oil and gas energy sector of our economy. Gross margins on our work boot brands decreased slightly from 34.7% in fiscal 2015 to 33.7% in fiscal 2016.

Our western/lifestyle boot segment, which includes western wear, ladies fashion, and children footwear products under the Dan Post, Laredo, Dingo, El Dorado, and John Deere kid's brand names, experienced a decrease in revenue of 12% from $67.1 million in fiscal 2015 to $58.8 million in fiscal 2016. This sales decrease was primarily the result of a softening in higher priced ladies fashion boots and premium kid's boots. Gross margin in this segment decreased from 35.7% in fiscal 2015 to 35.0% in fiscal 2016.

Looking ahead to fiscal 2017, we continue to see a listless retail environment with store foot traffic below normal levels. This is affecting sales of our work boot brands and western/lifestyle brands. While we expect work boot sales to remain somewhat depressed until the oil and gas sector of our economy improves, we are continuing to introduce new work boot styles that are comfortable, lightweight, and functional on and off the job. Our Dan Post work certified boots, introduced during the past fiscal year, have been well accepted and are being placed in many retail establishments. We hope to



gain market share with these innovative products and marketing programs to supplement our retailers' sales efforts. Our western/lifestyle segment continues to be in a state of change with sales of ladies western boots declining to more historical levels especially in the higher priced Dan Post ladies fashion boots. We have also experienced softness in the sale of higher priced men's exotic boots, because of the decrease in the activity in the oil and gas business. We have begun introducing new innovative western/lifestyle products three times a year and are improving product development lead times to increase retailer and consumer excitement in our offerings and help increase our market share. We are hopeful that retail inventories are lowered during the holiday selling season and that our order flow will return to more normal levels. In addition, we have plans to reduce expenses so that they will be more aligned with current and projected sales.

With respect to our business, we have completed our factory expansion and the hiring and training of the employees needed to meet our military boot contract obligations with the United States Government. This should enable us to increase production and efficiency during the 2017 fiscal year. We currently have four contracts with the United States Government that will keep us operating at full capacity through fiscal 2017. The largest two of these contracts, one for Hot Weather Army boots and the other for Temperature Weather Army boots, will be complete in October 2017. We will be bidding on solicitations to replace those contracts during the second quarter of this fiscal year. There is a large demand for military boots as the Government, in addition to supplying boots for our armed forces, is supplying the Afghanistan Army through the Department of Defense bidding process. Several years ago, we created a commercial boot program and have seen sales in this sector grow each year with sales increasing 44% in fiscal 2016. This is primarily the result of McRae designed and manufactured styles, that are being sold through the Army & Air Force Exchange Stores (AAFES), being well accepted by our armed forces. We currently have two boot styles being sold at AAFES and anticipate getting several more boot styles on their website. We are also marketing our commercial boot offering to military product retailers throughout the country.

With an increased working capital of $52.8 million, the Company continues to enhance its financial position. Our cash and cash equivalents remain relatively consistent, increasing from $15.4 million for fiscal 2015 to $15.6 million for fiscal 2016. While operating activities provided $5.2 million in cash, the majority of this was consumed through investments made in our manufacturing facility and ERP system, along with dividends paid. We believe that the Company's current cash position will be sufficient to support our 2017 fiscal year.

We enter fiscal 2017 full of excitement and enthusiasm as we face a retail business climate that continues to evolve as consumers' choices for products and delivery models continue to change. Your management team is dedicated to producing acceptable results for all of our company stakeholders.

The Board of Directors and I would like to express our sincere gratitude to each of our team members for their contribution to the success of our company, and to our shareholders, business partners, vendors, and customers for their continued support.

Sincerely,

D. Gary McRae

D. Gary McRae
President

FINANCIAL STATEMENTS
TABLE OF CONTENTS

Grant Thornton LLP
201 South College Street
Suite 2500
Charlotte, NC 28244-0100

T 704.632.3500
F 704.331.7701
www.GrantThornton.com

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 July 30, 2016 and August 1, 2015, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended July 30, 2016, 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 July 30, 2016 and August 1, 2015, and the results of their operations and their cash flows for each of the three years in the period ended July 30, 2016, in accordance with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Charlotte, North Carolina
November 1, 2016

CONSOLIDATED BALANCE SHEETS

McRae Industries, Inc. and Subsidiaries

(In thousands, except share data)	July 30, 2016	August 1, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$15,673	$15,437
Short term securities	501	500
Accounts and notes receivable, less allowances of $1,625 and $1,975, respectively	12,708	15,636
Inventories, net	27,944	25,757
Income tax receivable	1,055	122
Prepaid expenses and other current assets	433	532
Deferred tax assets	2,130	2,270
Total current assets	60,444	60,254
Property and equipment, net	8,147	5,817
Other assets:		
Deposits	14	14
Long term securities	3,520	3,553
Real estate held for investment	3,602	3,594
Amounts due from split-dollar life insurance	2,288	2,288
Trademarks	2,824	2,824
Total other assets	12,248	12,273
Total assets	$80,839	$78,344

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)	**July 30, 2016**	**August 1, 2015**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$4,696	$5,599
Accrued employee benefits	1,090	1,627
Accrued payroll and payroll taxes	1,207	1,225
Other	698	552
Total current liabilities	7,691	9,003
Deferred tax liabilities	2,288	1,513
Total liabilities	9,979	10,516
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Common Stock:		
Class A, $1 par value; authorized 5,000,000 shares issued and outstanding, 2,030,658 and 2,039,335 shares, respectively	2,031	2,040
Class B, $1 par value; authorized 2,500,000 shares; issued and outstanding, 387,629 and 391,189 shares, respectively	388	391
Unrealized losses on investments, net of tax	(59)	-
Retained earnings	68,500	65,397
Total shareholders' equity	70,860	67,828
Total liabilities and shareholders' equity	$80,839	$78,344

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	**July 30, 2016**	**August 1, 2015**	**August 2, 2014**
Net revenues	$108,758	$108,673	$103,629
Cost of revenues	81,837	79,347	73,488
Gross profit	26,921	29,326	30,141
Selling, general and administrative expenses	19,782	19,025	18,660
Operating profit	7,139	10,301	11,481
Other income	366	324	311
Interest expense	-	(2)	(3)
Earnings before income taxes	7,505	10,623	11,789
Provision for income taxes	2,813	3,982	4,241
Net earnings	$4,692	$6,641	$7,548
Earnings per common share:			
Earnings per common share:			
Basic earnings per share:			
Class A	$2.82	$3.77	$4.18
Class B	0.52	0.52	0.48
Diluted earnings per share:			
Class A	2.36	3.17	3.51
Class B	NA	NA	NA
Weighted average number of common shares outstanding:			
Class A	2,035,906	2,038,645	2,038,469
Class B	389,271	391,879	392,055
Total	2,425,177	2,430,524	2,430,524

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**		**Accumulated Other**	
	Shares	**Amount**	**Shares**	**Amount**	**Comprehensive Income (Loss)**	**Retained Earnings**
Balance, August 3, 2013	2,037,605	$2,038	392,919	$393	$ -	$53,636
Conversion of Class B to Class A Stock	938	1	(938)	(1)		-
Cash Dividend ($.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	$ -	$60,019
Conversion of Class B to Class A Stock	792	1	(792)	(1)		-
Cash Dividend ($.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	$ -	$65,397
Purchase of ESOP distribution shares	(9,164)	(9)	(3,073)	(3)		(330)
Unrealized losses on investments, net of tax					(59)	
Conversion of Class B to Class A Stock	487	-	(487)	-		-
Cash Dividend ($.52 per Class A common stock)						(1,057)
Cash Dividend ($.52 per Class B common stock)						(202)
Net earnings						4,692
Balance, July 30, 2016	2,030,658	$2,031	387,629	$388	($59)	$68,500

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	**July 30, 2016**	**August 1, 2015**	**August 2, 2014**
Cash Flows from Operating Activities:			
Net earnings	$4,692	$6,641	$7,548
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation	907	785	748
Amortization of bond premiums	-	3	10
(Gain) loss on sale of assets	(6)	-	(40)
Loss on sale of securities	62	-	-
Deferred income taxes	951	(75)	87
Changes in operating assets and liabilities:			
Accounts receivable, net	2,928	(2,208)	1,966
Inventories	(2,187)	(3,469)	758
Prepaid expenses and other assets	99	21	(85)
Accounts payable	(903)	1,821	(276)
Accrued employee benefits	(537)	(171)	91
Accrued payroll and payroll taxes	(18)	64	(48)
Income tax receivable/payable	(933)	816	(1,012)
Other	146	89	64
Net cash provided by operating activities	**5,201**	**4,317**	**9,811**
Cash Flows from Investing Activities:			
Proceeds from sale of assets	15	-	87
Purchase of land for investment	(17)	(9)	(7)
Capital expenditures	(3,237)	(3,380)	(650)
Proceeds from sale of securities	484	75	-
Purchase of securities	(609)	(3,183)	-
Net cash used in investing activities	**(3,364)**	**(6,497)**	**(570)**
Cash Flows from Financing Activities:			
Purchase of common stock	(342)	-	-
Issuance of common stock	-	-	-
Dividends paid	(1,259)	(1,263)	(1,165)
Net cash used in financing activities	**(1,601)**	**(1,263)**	**(1,165)**
Net Increase (Decrease) in Cash and Cash equivalents	236	(3,443)	8,076
Cash and Cash Equivalents at Beginning of Year	15,437	18,880	10,804
Cash and Cash Equivalents at End of Year	**$15,673**	**$15,437**	**$18,880**

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
McRae Industries, Inc. and Subsidiaries
As of and for the Years Ended July 30, 2016, August 1, 2015, and August 2, 2014

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)		
	2016	**2015**	**2014**
Total Assets:			
Western/Work Boots	$ 35,131	$ 36,441	$ 36,033
Military Boots	17,698	13,060	7,167
Other	50	55	54

	(In thousands)		
	2016	**2015**	**2014**
Total Net Revenues:			
Western/Work Boots	$ 68,912	$ 79,483	$ 78,391
Military Boots	39,628	29,001	25,009
Other	218	189	229

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 $875,000 and $925,000 for fiscal 2016 and fiscal 2015, 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 $6,561 and $5,300 for the fiscal years ended July 30, 2016, and August 1, 2015, 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 July 30, 2016 and August 1, 2015, 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 2013. 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 July 30, 2016.

Advertising

The Company charges advertising costs when incurred as a component of selling, general and administrative expenses. Advertising expense amounted to approximately $1,029,000, $970,000, and $878,000 for fiscal years 2016, 2015, and 2014, 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 $715,000 and $847,000 at July 30, 2016 and August 1, 2015, respectively. Year-end inventories valued under the LIFO method were approximately $10,861,000 and $7,381,000 at July 30, 2016 and August 1, 2015, respectively. For fiscal 2016 and fiscal 2015, lower FIFO pricing resulted in a decreased LIFO reserve, which increased net earnings by approximately $83,000 and $96,000, respectively.

Inventory reserves applicable to the FIFO inventories totaled approximately $656,000 and $530,000 for fiscal 2016 and fiscal 2015, respectively.

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

	(In thousands)	
	2016	**2015**
Raw materials	$ 4,817	$ 3,692
Work-in-process	3,297	1,805
Finished goods	19,830	20,260
	$ 27,944	$ 25,757

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 July 30, 2016 and August 1, 2015 consisted of the following:

	(In thousands)	
	2016	**2015**
Land and improvements	$ 604	$ 501
Buildings	6,760	4,252
Machinery and equipment	6,084	5,907
Furniture and fixtures	5,241	2,130
Construction in progress	31	2,693
	18,720	15,483
Less: Accumulated depreciation	(10,573)	(9,666)
	$ 8,147	$ 5,817

Depreciation expense for fiscal years ended 2016, 2015, and 2014 was approximately $907,000, $785,000, and $748,000, respectively.

4. MARKETABLE SECURITIES

The components of our marketable securities as of July 30, 2016 and August 1, 2015 are as follows:

	(In thousands)	
	2016	**2015**
Available-for-sale:		
Short term equity securities	$ 501	$ 500
Long term equity securities	3,520	3,553
	$ 4,021	$ 4,053

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 July 30, 2016 and August 1, 2015. 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 2017 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 July 30, 2016 and August 1, 2015. The line of credit expires in January 2017 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 2016, 2015 or 2014.

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 $292,000, $295,000, and $270,000, for the fiscal years ended 2016, 2015, and 2014, respectively.

Employee benefit program expense amounted to approximately $1,369,000, $1,903,000, and $2,057,000, for the fiscal years ended 2016, 2015 and 2014, respectively.

7. INCOME TAXES

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

	2016	2015	2014
Current expense			
Federal	$ 1,706	$ 3,699	$ 3,777
State	156	358	377
	1,862	4,057	4,154
Deferred expense			
Federal	808	(64)	74
State	143	(11)	13
	$ 2,813	$ 3,982	$ 4,241

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

	2016	2015	2014
Depreciation	$ 758	$ (76)	$ 49
Accrued employee benefits	204	64	(34)
Allowances for doubtful accounts	114	(19)	(9)
Allowance for sales returns	20	(129)	(15)
Inventory	6	52	–
State net operating loss carry forward	(54)	(19)	17
Amortization	71	72	71
Prepaid Expenses	(98)	5	8
Self Insurance Reserve	(70)	(25)	–
Provision for deferred income taxes	$ 951	$ (75)	$ 87

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

	2016	2015
Noncurrent deferred assets (liabilities)		
Amortization	$ (886)	$ (815)
Gain on Like Kind Exchange	(391)	(391)
Depreciation	(1,222)	(464)
State net operating loss carry forward	211	157
Net noncurrent deferred tax liabilities	(2,288)	(1,513)
Current deferred tax assets (liabilities)		
Self Insurance	171	101
Accrued employee benefits	414	618
Allowances for doubtful accounts	285	399
Allowance for sales returns	332	352
Inventory	824	830
Economic Price Adjustment Claim	68	68
Prepaid Expenses	–	(98)
Unrealized (Gain)/Loss	36	–
Net current deferred tax assets	2,130	2,270
Net deferred tax assets	$ (158)	$ 757

State net operating loss carry forwards of $5 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):

	2016		2015		2014	
	Amount	Percent	Amount	Percent	Amount	Percent
Tax at U.S. statutory rate	$2,552	34.0 %	$3,612	34.0 %	$4,008	34.0 %
State income taxes, net of federal tax benefit	197	2.6 %	229	2.2 %	257	2.2 %
Tax adjustments	154	2.1 %	150	1.4 %	149	1.3 %
Other – net	(90)	(1.2) %	(9)	(.1) %	(173)	(1.5)%
	$2,813	37.5 %	$3,982	37.5 %	$4,241	36.0 %

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 2016, 2015 and 2014 were approximately $2,918,000, $3,363,000, and $5,278,000, respectively.

The Company follows the applicable authoritative guidance related to accounting for uncertainty in income tax reporting. As of July 30, 2016, 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 $559,000, $555,000, and $534,000, for fiscal years ended 2016, 2015, and 2014, respectively. The future non-cancelable lease payments as of July 30, 2016 are as follows:

	2017	2018	2019	2020	2021
Lease Payments	$522,000	$538,000	$538,000	$538,000	$536,000

The Company leases approximately 34,000 square feet of office and warehouse space to Toshiba Business Solutions, Inc. The original lease and subsequent amendments covered a base year period and additional periods through August 31, 2016. In February 2016, the lease was amended to cover a three-year period beginning on September 1, 2016. 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:

	2017	2018	2019
Lease Payments	$50,000	$50,000	$50,000
Facility Charges	$69,870	$71,271	$72,697

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 $16 million, $15 million, and $19 million, for fiscal 2016, 2015, and 2014, 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 July 30, 2016 and August 1, 2015, twenty-one customers accounted for 65% and 61% 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 $4.5 million and $3.0 million at July 30, 2016 and August 1, 2015, respectively.

Sales to the U.S. Government amounted to 28%, 19%, and 19% of total consolidated net revenues for fiscal years ended 2016, 2015, and 2014, 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 July 30, 2016, 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 July 30, 2016 (in thousands):

	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
Mutual Funds	$ 4,021	–	–	$ 4,021

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

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 7, 2016, the Company declared a cash dividend of $.13 per share on its Class A and Class B Common Stock payable on October 5, 2016 to shareholders of record on September 21, 2016.

Subsequent events have been evaluated through November 1, 2016, which is the date the financial statements were available to be issued.

This page intentionally left blank.

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

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.
Former Vice-President of Finance

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

Brady W. Dickson*
Consultant

Branson B. McRae
Compliance and Operations Manager,
Dan Post Boot Co.

**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, LLC
6201 15th Avenue
Brooklyn, New York 11219

ANNUAL MEETING

Thursday, December 15, 2016
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
214 North Tryon Street
Suite 4700
Charlotte, North Carolina 28202

McRAE INDUSTRIES, INC. P.O. Box 1239 | Mount Gilead, NC 27306 | www.mcraeindustries.com