McRae Industries

FORTITUDINIE

2019 ANNUAL REPORT

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	8/3/19	7/28/18	7/29/17	7/30/16	8/1/15
(In thousands, except per share data)					
INCOME STATEMENT DATA:					
Net revenues	$ 82,154	$ 73,892	$ 104,316	$ 108,758	$ 108,673
Net earnings (loss)	2,118	2,190	5,083	4,692	6,641
Net earnings per common share					
Diluted Earnings per share[(a)]:					
Class A	0.89	0.91	2.11	1.93	2.73
Class B	NA	NA	NA	NA	NA
BALANCE SHEET DATA:					
Total assets	$ 79,354	$ 80,364	$ 81,641	$ 80,839	$ 78,344
Long-term liabilities	704	621	2,263	2,288	1,513
Working capital	54,457	55,435	56,542	52,753	51,251
Shareholders' equity	73,323	74,989	74,201	70,860	67,828
Weighted average number of common shares outstanding:					
Class A	2,018,940	2,018,701	2,024,470	2,035,906	2,038,645
Class B	374,064	378,020	385,830	389,271	391,879
Weighted average number of common shares outstanding[(b)]:	2,393,004	2,396,721	2,410,300	2,425,177	2,430,524
Cash dividends per Class A common share:	$ 0.52	$ 0.52	$ 0.52	$ 0.52	$ 0.52
Cash dividends per Class B common share:	$ 0.52	$ 0.52	$ 0.52	$ 0.52	$ 0.52
Special Cash dividend per Class A and Class B common share	$ 0.50	$ 0.00	$ 0.00	$ 0.00	$ 0.00

(a) 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.

(b) Includes both Class A and Class B Common Stock.

Dear Valued Shareholders,

I am pleased to present to you the McRae Industries, Inc. 2019 Annual Report.

For fiscal 2019, net revenues increased from $73.9 million for fiscal 2018 to $82.2 million for fiscal 2019. The increase in revenue was primarily the result of increases in our United States Government military contract business offset by decreases in our John Deere business as we exit this brand. Net income decreased slightly from $2.2 million in fiscal 2018 to $2.1 million in fiscal 2019.

Our western/lifestyle boot segment, which includes western, ladies fashion, and children's footwear products under the Dan Post, Dingo, El Dorado, Laredo, and John Deere brand names, experienced a slight increase in revenue from $46.1 million in fiscal 2018 to $46.2 million dollars in fiscal 2019. Dan Post, Laredo, and Dingo revenue was essentially flat while El Dorado had a double digit increase that was offset by decreases in the John Deere children's business. Gross margin for the western/lifestyle segment decreased from 34.5% in fiscal 2018 to 32.2% in fiscal 2019.

In fiscal 2019, we continued to see growth in e-commerce sales through major e-commerce retailers. We have employed an industry veteran to lead our e-commerce effort and build a team dedicated to the continued growth of e-commerce sales in existing and new accounts. We have also experienced growth in the farm and ranch retail sector and have targeted this area for continued growth. While continuing to develop new styles in Laredo and Dan Post core categories, we also introduced a line of Dan Post faux exotic prints and Dingo 1969 fashion footwear that were both well received by retailers.

Our work boot segment, which includes Dan Post, Laredo, McRae Industrial, and John Deere work boots along with our military boots, increased revenues from $27.4 million in fiscal 2018 to $35.6 million in fiscal 2019. Most of this increase was in the military sector with John Deere having a significant decrease as we began to exit this brand. Gross margin for the work boot segment increased from 9.5% in fiscal 2018 to 11.7% for fiscal 2019. This was primarily the result of increased margins in the military boot operation. Our military boot revenue is expected to increase slightly in fiscal 2020 as we continue to pursue additional United States Government and commercial military boot business.

One of our goals for fiscal 2019 was to develop a line of Dan Post Work Certified boots that would be differentiated from other western work boots in the marketplace. We accomplished this with the introduction of our Hurricane series. These Work Certified waterproof boots are available in both composite and soft toe, as well as several different color combinations. They have been well received by our retail partners with promising initial orders for delivery beginning in January 2020.

We enter fiscal 2020 with cautious optimism that the western boot market will become more robust and that the new products we have introduced will continue to resonate well with the retailer and the consumer. We were not affected by the tariffs until September of this year when a 15% tariff was applied to items we import from China. We have established plans to mitigate the tariff impact on earnings as much as possible by working with our vendors in China and retail partners here in the United States. Over the past several years, we began moving products from China to other countries and will continue this movement in fiscal 2020.

The Company's financial position remains strong with working capital of $54.5 million at the end of fiscal 2019. Although cash on hand decreased significantly this year from $27.6 million in 2018 to $12.8 million, this was mainly a result of approximately $11.4 million being used to purchase short term securities. In addition, spending on financing activities amounted to approximately $3.8 million, as a special dividend was issued and common stock was repurchased. We believe that the Company's current cash position will be sufficient to support our 2020 operating activities.

On behalf of the Board of Directors, we thank you for your continued goodwill and 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 consolidate financial statements of McRae Industries, Inc. (a Delaware corporation) and Subsidiaries, which comprise the consolidated balance sheets as of August 3, 2019 and July 28, 2018, and the related consolidated statements of operations and comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended August 3, 2019 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.

Grant Thornton

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 3, 2019 and July 28, 2018, and the results of their operations and their cash flows for each of the three years in the period ended August 3, 2019, accordance with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Charlotte, North Carolina
October 30, 2019

CONSOLIDATED BALANCE SHEETS

McRae Industries, Inc. and Subsidiaries

(Dollars in thousands)	August 3, 2019	July 28, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$12,799	$27,605
Short term securities	13,209	2,211
Accounts and notes receivable, less allowances of $1,017 and $1,221, respectively	12,975	10,665
Inventories, net	19,761	18,427
Income tax receivable	406	1,127
Prepaid expenses and other current assets	634	154
Total current assets	59,784	60,189
Property and equipment, net	6,612	7,375
Other assets:		
Deposits	14	14
Long term securities	4,032	3,899
Real estate held for investment	3,800	3,775
Amounts due from split-dollar life insurance	2,288	2,288
Trademarks	2,824	2,824
Total other assets	12,958	12,800
Total assets	$79,354	$80,364

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

CONSOLIDATED BALANCE SHEETS
McRae Industries, Inc. and Subsidiaries

(Dollars in thousands)	**August 3, 2019**	**July 28, 2018**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$3,403	$2,968
Accrued employee benefits	460	423
Accrued payroll and payroll taxes	713	630
Other	751	733
Total current liabilities	5,327	4,754
Deferred tax liabilities	704	621
Total liabilities	6,031	5,375
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Common Stock:		
Class A, $1 par value; authorized 5,000,000 shares issued and outstanding, 1,967,559 and 2,019,974 shares, respectively	1,967	2,020
Class B, $1 par value; authorized 2,500,000 shares; issued and outstanding, 373,675 and 374,272 shares, respectively	374	375
Unrealized losses on investments, net of tax	(12)	(28)
Retained earnings	70,994	72,622
Total shareholders' equity	73,323	74,989
Total liabilities and shareholders' equity	$79,354	$80,364

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

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
McRae Industries, Inc. and Subsidiaries

(Dollars in thousands)

For Years Ended	**August 3, 2019**	**July 28, 2018**	**July 29, 2017**
Net revenues	$82,154	$73,892	$104,316
Cost of revenues	62,851	55,182	78,739
Gross profit	19,303	18,710	25,577
Selling, general and administrative expenses	17,005	16,431	17,755
Operating profit	2,298	2,279	7,822
Other income	654	443	357
Interest expense	(3)	(1)	-
Earnings before income taxes	2,949	2,721	8,179
Provision for income taxes	831	531	3,096
Net earnings	$2,118	$2,190	$5,083
Other comprehensive income, net of tax:			
Unrealized gains (losses) on investments	16	(23)	54
Total comprehensive income	$2,134	$2,167	$5,137
Earnings per common share:			
Diluted earnings per share:			
Class A	$ 0.89	$ 0.91	$ 2.11
Class B	NA	NA	NA
Weighted average number of common shares outstanding:			
Class A	2,018,940	2,018,701	2,024,470
Class B	374,064	378,020	385,830
Total	2,393,004	2,396,721	2,410,300

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

McRae Industries, Inc and Subsidiaries

(Dollars in thousands)	Common Stock, $1 par value				Accumulated Other	
	Class A		Class B		Comprehensive	Retained
	Shares	Amount	Shares	Amount	Income (Loss)	Earnings
Balance, July 30, 2016	2,030,658	$2,031	387,629	$388	($59)	$68,500
Purchase of ESOP distribution shares	(16,346)	(16)	(3,845)	(4)		(525)
Unrealized losses on investments, net of tax					54	
Conversion of Class B to Class A Stock	530	-	(530)	-		-
Cash Dividend ($.52 per Class A common stock)						(1,051)
Cash Dividend ($.52 per Class B common stock)						(200)
Net earnings						5,083
Balance, July 29, 2017	2,014,842	$2,015	383,254	$384	($5)	$71,807
Stock Buyback	(3,116)	(3)	(734)	(1)		(129)
Unrealized losses on investments, net of tax					(23)	
Conversion of Class B to Class A Stock	8,248	8	(8,248)	(8)		-
Cash Dividend ($.52 per Class A common stock)						(1,050)
Cash Dividend ($.52 per Class B common stock)						(196)
Net earnings						2,190
Balance, July 28, 2018	2,019,974	$2,020	374,272	$375	($28)	$72,622
Stock Buyback	(52,627)	(53)	(385)	(1)		(1,307)
Unrealized gains on investments, net of tax					16	
Conversion of Class B to Class A Stock	212	-	(212)	-		-
Cash Dividend ($1.02 per Class A common stock)						(2,059)
Cash Dividend ($1.02 per Class B common stock)						(380)
Net earnings						2,118
Balance, August 3, 2019	1,967,559	$1,967	373,675	$374	($12)	$70,994

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

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

(Dollars in thousands)

For Years Ended	**August 3, 2019**	**July 28, 2018**	**July 29, 2017**
Cash Flows from Operating Activities:			
Net earnings	$2,118	$2,190	$5,083
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation	1,158	1,234	1,211
Gain on sale of assets	-	-	(2)
Gain on sale of land	(134)	(37)	-
Loss on sale of securities	-	2	6
Deferred income taxes	83	32	398
Changes in operating assets and liabilities:			
Accounts receivable, net	(2,310)	1,666	377
Inventories	(1,334)	(154)	9,671
Prepaid expenses and other assets	(480)	396	(117)
Accounts payable	435	458	(2,186)
Accrued employee benefits	37	(721)	54
Accrued payroll and payroll taxes	83	(179)	(398)
Income tax receivable/payable	721	(798)	726
Other	18	20	16
Net cash provided by operating activities	**395**	**4,109**	**14,839**
Cash Flows from Investing Activities:			
Proceeds from sale of assets	-	-	13
Proceeds from sale of land	153	46	-
Purchase of land for investment	(44)	(180)	-
Capital expenditures	(396)	(1,217)	(465)
Proceeds from sale of securities	274	1,194	833
Purchase of securities	(11,389)	(3,025)	(1,040)
Net cash used in investing activities	**(11,402)**	**(3,182)**	**(659)**
Cash Flows from Financing Activities:			
Purchase of common stock	(1,360)	(133)	(545)
Dividends paid	(2,439)	(1,246)	(1,251)
Net cash used in financing activities	**(3,799)**	**(1,379)**	**(1,796)**
Net Increase (Decrease) in Cash and Cash equivalents	(14,806)	(452)	12,384
Cash and Cash Equivalents at Beginning of Year	27,605	28,057	15,673
Cash and Cash Equivalents at End of Year	**$12,799**	**$27,605**	**$28,057**

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)		
	2019	**2018**	**2017**
Total Assets:			
Western/Work Boots	$ 31,016	$ 27,833	$ 30,443
Military Boots	12,666	11,286	12,037
Other	36	39	41

	(In thousands)		
	2019	**2018**	**2017**
Total Net Revenues:			
Western/Work Boots	$ 53,183	$ 53,479	$ 58,312
Military Boots	28,680	20,180	45,621
Other	291	233	383

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 $625,000 and $505,000 for fiscal 2019 and fiscal 2018, 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.

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 other comprehensive 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 3, 2019 and July 28, 2018, 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 or state income tax examinations for fiscal years ending before 2016. 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 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. Furthermore, for Class A shares, distributed earnings with respect to Class A and all undistributed earnings are used to calculate diluted earnings per share.

Earnings per share has been presented 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, and that our calculation best expresses economic reality.

The Company had no common stock equivalents issued or outstanding for the three-year period ended August 3, 2019.

Advertising

The Company charges advertising costs when incurred as a component of selling, general and administrative expenses. Advertising expense amounted to approximately $1,090,000, $1,018,000, and $487,000 for fiscal years 2019, 2018, and 2017, 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 $546,000 and $748,000 at August 3, 2019 and July 28, 2018, respectively. Year-end inventories valued under the LIFO method were approximately $5,951,000 and $5,254,000 at August 3, 2019 and July 28, 2018, respectively. For fiscal 2019 and fiscal 2018, lower FIFO pricing resulted in a decreased LIFO reserve, which increased net earnings by approximately $156,000 and $47,000, respectively.

Inventory reserves applicable to the FIFO inventories totaled approximately $335,000 and $320,000 for fiscal 2019 and fiscal 2018, respectively.

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

	(In thousands)	
	2019	**2018**
Raw materials	$ 2,889	$ 2,174
Work-in-process	1,333	712
Finished goods	15,539	15,541
	$ 19,761	$ 18,427

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 3, 2019 and July 28, 2018 consisted of the following:

	(In thousands)	
	2019	**2018**
Land and improvements	$ 612	$ 612
Buildings	7,135	6,948
Machinery and equipment	7,611	7,433
Furniture and fixtures	5,399	5,369
	20,757	20,362
Less: Accumulated depreciation	(14,145)	(12,987)
	$ 6,612	$ 7,375

Depreciation expense for fiscal years ended 2019, 2018, and 2017 was approximately $1,158,000, $1,234,000, and $1,211,000, respectively.

4. MARKETABLE SECURITIES

The components of our marketable securities as of August 3, 2019 and July 28, 2018 are as follows:

	(In thousands) 2019	2018
Available-for-sale:		
Short term equity securities	$ 13,209	$ 2,211
Long term equity securities	4,032	3,899
	$ 17,241	$ 6,110

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 3, 2019 and July 28, 2018. 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 2020 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 3, 2019 and July 28, 2018. The line of credit expires in January 2020 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 2019, 2018 or 2017.

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 $276,000, $266,000, and $308,000, for the fiscal years ended 2019, 2018, and 2017, respectively.

Employee benefit program expense, which includes 401-K, amounted to approximately $689,000, $679,000, and $1,439,000, for the fiscal years ended 2019, 2018 and 2017, respectively.

7. INCOME TAXES

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

	2019	2018	2017
Current expense			
Federal	$ 695	$ 383	$ 2,549
State	59	110	149
	754	493	2,698
Deferred expense			
Federal	68	33	338
State	9	5	60
	$ 831	$ 531	$ 3,096

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

	2019	2018	2017
Depreciation	$ (12)	$ (266)	$ (109)
Accrued employee benefits	(8)	313	2
Allowances for doubtful accounts	76	54	64
Allowance for sales returns	(28)	89	125
Inventory	(18)	230	166
State net operating loss carry forward	(2)	5	106
Economic Price Adjustment Claim	42	22	4
Amortization	28	(283)	(1)
Prepaid Expenses	-	(53)	53
Self Insurance Reserve	-	57	9
Like Kind Exchange	-	(130)	-
Other	(1)	-	(21)
Provision for deferred income taxes	$ 77	$ 38	$ 398

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

	2019	2018
Amortization	$ (630)	$ (602)
Gain on Like Kind Exchange	(240)	(240)
Depreciation	(835)	(847)
Prepaid Expenses	-	-
Noncurrent deferred tax liabilities	(1,705)	(1,689)
State net operating loss carry forward	102	100
Self Insurance	105	105
Accrued employee benefits	107	99
Allowances for doubtful accounts	91	167
Allowance for sales returns	146	118
Inventory	446	428
Economic Price Adjustment Claim	-	42
Unrealized (Gain)/Loss	4	9
Noncurrent deferred tax assets	1,001	1,068
Net noncurrent deferred tax liabilities	$ (704)	$ (621)

State net operating loss carry forwards of $4.0 million will begin to expire in fiscal 2024.

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

	2019		2018		2017	
	Amount	Percent	Amount	Percent	Amount	Percent
Tax at U.S. statutory rate	$ 619	21.0 %	$ 722	26.5 %	$2,781	34.0 %
State income taxes, net of federal tax benefit	45	1.5 %	76	2.8 %	138	1.7 %
Tax adjustments	141	4.8 %	160	5.9 %	139	1.7 %
Impact of tax reform	-		(390)	(14.3) %	-	
Other – net	26	0.9 %	(37)	(1.4) %	38	0.5 %
	$ 831	28.2 %	$ 531	19.5 %	$3,096	37.9 %

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

On December 22, 2017, the United States enacted tax reform legislation commonly known as the H.R.1, ("the Act"), resulting in significant modifications to existing law. The legislation reduced the U.S. corporate income tax rate from 35% to 21%. The Company completed the accounting for the effects of the Act during the year ending July 28, 2018. As a result, our financial statements for the year ended July 28, 2018, include a one-time tax benefit of $390. This impact was primarily due to the remeasurement of deferred tax assets and liabilities from 35% to 21% totaling $390.

Total income tax payments during fiscal years 2019, 2018 and 2017 were approximately $165,000, $1,410,000, and $2,104,000, respectively.

The Company follows the applicable authoritative guidance related to accounting for uncertainty in income tax reporting. As of August 3, 2019, 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 $660,000, $664,000, and $725,000, for fiscal years ended 2019, 2018, and 2017, respectively. The future non-cancelable lease payments as of August 3, 2019 are as follows:

	2020	2021	2022	2023	2024
Lease Payments	$575,000	$563,000	$583,000	$587,000	$588,000

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 September 1, 2019. In August 2019, the lease was amended to cover a three-year period beginning on September 1, 2019. 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:

	2020	2021	2022
Lease Payments	$51,000	$52,020	$53,060
Facility Charges	$61,631	$62,863	$64,120

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 $13 million, $28 million, and $28 million, for fiscal 2019, 2018, and 2017, 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 3, 2019 and July 28, 2018, twenty-one customers accounted for 82% and 60% 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 $3.1 million and $2.0 million at August 3, 2019 and July 28, 2018 respectively.

Sales to the U.S. Government amounted to 28%, 24%, and 38%, of total consolidated net revenues for fiscal years ended 2019, 2018, and 2017, 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 3, 2019, 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 3, 2019 (in thousands):

	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
Mutual Funds	$ 17,241	–	–	$ 17,241

The following table presents those assets and liabilities that are measured at fair value as of July 28, 2018 (in thousands):

	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
Mutual Funds	$ 6,110	–	–	$ 6,110

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 August 29, 2019, the Company declared a cash dividend of $.13 per share on its Class A and Class B Common Stock payable on September 25, 2019 to shareholders of record on September 11, 2019.

Subsequent events have been evaluated through October 30, 2019, 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

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 info@mcraeindustries.com.

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
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Brooklyn, NY 11219

Annual Meeting

Thursday, December 19, 2019
Corporate Office
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Independent Auditors

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General Counsel

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