McRae Industries
2010 ANNUAL REPORT

Corporate Overview

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 *(In thousands, except for per share data)*	**7/31/10**	**8/1/09**	**8/2/08**	**7/28/07**	**7/29/06**
INCOME STATEMENT DATA:					
Net revenues	**$ 62,571**	$ 62,213	$ 80,021	$ 68,271	$ 68,852
Net earnings (loss)	**2,952**	(514)	5,041	3,818	3,390
Net earnings per common share					
Basic Earnings per share (a):					
Class A	**1.79**	0.11	2.75	2.13	1.90
Class B	**0**	0	0	0	0
Diluted Earnings per share (b):					
Class A	**1.47**	0.11	2.27	1.75	1.54
Class B	**NA**	NA	NA	NA	NA
BALANCE SHEET DATA:					
Total assets	**$ 51,348**	$ 49,763	$ 51,536	$ 45,973	$ 42,355
Long-term liabilities	**1,134**	2,139	698	0	0
Working capital	**33,892**	32,822	34,321	29,413	27,868
Shareholders' equity	**44,154**	42,318	43,783	39,808	36,931
Weighted average number of common shares outstanding:					
Class A	**2,068,866**	2,089,686	2,098,714	2,111,633	2,147,827
Class B	**432,518**	438,915	446,262	454,645	492,323
Weighted average number of common shares outstanding (c)	**2,501,384**	2,528,601	2,544,976	2,566,278	2,640,150
Cash dividends declared per common share (d)	**$ 0.36**	$ 0.36	$ 0.3525	$ 0.325	$ 0.32

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

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

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

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

Letter to Shareholders

Dear Fellow Shareholders,

I am delighted to report to you that the operating results for McRae Industries for fiscal 2010 showed marked improvement over the results for our previous year and that your Company returned to profitability. Consolidated net earnings for fiscal 2010 totaled $2,952,000 as compared to the net loss of $514,000 reported for fiscal 2009. Consolidated net revenues for fiscal 2010 amounted to $62,571,000 as compared to $62,213,000 for fiscal 2009.

The western/lifestyle segment of our business, which includes our western/lifestyle boots and children shoes, showed strong growth as net revenues for this category grew 21%, from $33.0 million for fiscal 2009 to $40.2 million for fiscal 2010. The majority of this revenue growth was primarily attributable to our Dan Post and Laredo women's boot products, which posted increases of 57% and 84%, respectively. Sales of our Dan Post and Laredo men's boot products also contributed double digit increases in net revenues. Gross profit margins for our western/ lifestyle offerings totaled 35% for fiscal 2010 as compared to 30.1% for fiscal 2009. This increase in gross profit margin, however, is primarily attributable to the negative impact associated with the supply chain inventory interruption we experienced in fiscal 2009. Over the past two years, we have introduced many new designs and styles that have been well accepted in the market place. This strategy has contributed greatly to the growth we have experienced.

Our work boot products consist of our Dan Post, Laredo, John Deere and McRae Industrial work boots and our military boots. Net revenues for our work boot product line decreased slightly from $22.1 million for fiscal 2009 to $21.8 for fiscal 2010, primarily the result of our depressed economy and reduced military boot requirements for the U. S. Government. Gross profit margins in this category were 16.9% for fiscal 2010 as compared to 15.7% for fiscal 2009. Gross profit margins for both years were adversely affected by low margins associated with military boots made under contract for

Letter to Shareholders

the United States Government and a depressed construction economic environment. The low military boot margins were the result of significantly reduced production levels, which were governed by the "minimum" level set in the government contract. There are no assurances that the government will increase their requirement over the remaining contract period.

The Company's financial position at the end of fiscal 2010 remained strong. Our cash and cash equivalents totaled approximately $10.0 million and our working capital increased from $32.8 million at the end of fiscal 2009 to $33.4 million at the end of fiscal 2010. Inventory levels increased year over year as a result of material requirements related to our new military boot contract, and the normal western and work boot buildup as we enter our fall selling season. We believe that we are well positioned to adequately finance our operations for fiscal 2011.

As we move into fiscal 2011, we are optimistic about our prospects for continued success while, at the same time, we are aware of the challenges that we must face and overcome to achieve acceptable results.

We believe that the western/ lifestyle business will stay strong throughout at least the first half of fiscal 2011 and that the work boot business will grow slowly as the economy continues to recover. The success of our military business will be determined by the quantity of boots the U.S. Government orders from our current contracts, and how successful we are in procuring additional contracts in the future. The military business will also be affected by our success in growing our fledging commercial military boot business. Our plans are to continue to grow our business by introducing new products into our existing brands and by extending these brands into new market segments. In addition, we will also continue to bid aggressively on military combat boots for our Armed Services.

On behalf of the Board of Directors, I would like to express our sincere gratitude to all of our employees, customers, vendors 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 balance sheets of **McRae Industries, Inc.** (a Delaware corporation) and Subsidiaries as of July 31, 2010, and August 1, 2009, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended July 31, 2010. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of McRae Industries, Inc. and Subsidiaries as of July 31, 2010, and August 1, 2009, and the results of their operations and their cash flows for each of the three years in the period ended July 31, 2010, in conformity with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Charlotte, North Carolina
November 1, 2010

CONSOLIDATED BALANCE SHEETS

McRae Industries, Inc. and Subsidiaries

(In thousands, except share data)	July 31, 2010	August 1, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 9,948	$ 11,310
Accounts and notes receivable,less allowances of $782 and $844, respectively	10,471	9,891
Inventories, net	17,175	12,856
Income tax receivable	544	2,363
Prepaid expenses and other current assets	165	120
Deferred tax assets	1,649	1,588
Total current assets	39,952	38,128
Property and equipment, net	2,849	3,156
Other assets:		
Real estate held for investment	3,435	3,367
Amounts due from split-dollar life insurance	2,288	2,288
Trademarks	2,824	2,824
Total other assets	8,547	8,479
Total assets	$ 51,348	$ 49,763

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 31, 2010	August 1, 2009
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Bank note payable-current portion	$ 0	$ 184
Accounts payable	3,576	3,373
Accrued employee benefits	674	160
Accrued payroll and payroll taxes	1,111	861
Other	699	728
Total current liabilities	6,060	5,306
Bank note payable net of current portion	0	1,126
Deferred tax liabilities	1,134	1,013
Total liabilities	7,194	7,445
Commitments and contingencies (Note 7)		
Shareholders' equity:		
Common Stock:		
Class A, $1 par value; authorized 5,000,000 shares issued and outstanding, 2,054,282 and 2,083,854 shares, respectively	2,054	2,084
Class B, $1 par value; authorized 2,500,000 Shares; issued and outstanding, 428,979 and 436,384 shares, respectively	429	436
Retained earnings	41,671	39,798
Total shareholders' equity	44,154	42,318
Total liabilities and shareholders' equity	$ 51,348	$ 49,763

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

CONSOLIDATED STATEMENTS OF OPERATIONS

McRae Industries, Inc. and Subsidiaries

(In thousands, except for share and per share data)

For Years Ended	**July 31, 2010**	**August 1, 2009**	**August 2, 2008**
Net revenues	$ 62,571	$ 62,213	$ 80,021
Cost of revenues	44,278	47,771	56,810
Gross profit	18,293	14,442	23,211
Selling, general and administrative expenses	13,705	14,926	15,533
Operating profit (loss)	4,588	(484)	7,678
Other income	206	276	487
Interest expense	(34)	(15)	(29)
Earnings (loss)before income taxes	4,760	(223)	8,136
Provision for income taxes	1,808	291	3,095
Net earnings (loss)	$ 2,952	$ (514)	$ 5,041

Earnings (loss)per common share:			
Earnings (loss)per common share:			
Basic earnings per share:			
Class A	$ 1.79	$ .11	$ 2.75
Class B	0	0	0
Diluted earnings per share:			
Class A	1.47	.11	2.27
Class B	NA	NA	NA
Weighted average number of common shares outstanding:			
Class A	2,068,866	2,089,686	2,098,714
Class B	432,518	438,915	446,262
Total	2,501,384	2,528,601	2,544,976

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, 2007	2,104,924	$2,105	449,155	$ 449	$37,254
Purchase of ESOP distribution shares	(14,689)	(15)	(3,721)	(4)	(286)
Purchase of other shares	(521)		(853)	(1)	(22)
Conversion of Class B to Class A Stock	3,329	3	(3,329)	(3)	
Cash Dividend ($.3525 per Class A common stock)					(738)
Net earnings					5,041
Balance, August 2, 2008	2,093,043	$2,093	441,252	$ 441	$ 41,249
Purchase of ESOP distribution shares	(10,816)	(11)	(2,741)	(3)	(178)
Purchase of other shares			(500)		(7)
Conversion of Class B to Class A Stock	1,627	2	(1,627)	(2)	
Cash Dividend ($.36 per Class A common stock)					(752)
Net loss					(514)
Balance, August 1, 2009	2,083,854	$2,084	436,384	$436	$ 39,798
Purchase of ESOP distribution shares	(19,242)	(20)	(4,879)	(4)	(224)
Purchase of other shares	(12,856)	(13)			(110)
Conversion of Class B to Class A Stock	2,526	3	(2,526)	(3)	0
Cash Dividend ($.36 per Class A common stock)					(745)
Net earnings					2,952
Balance, July 31, 2010	2,054,282	$2,054	428,979	$429	$ 41,671

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 31, 2010**	**August 1, 2009**	**August 2, 2008**
Cash Flows from Operating Activities:			
Net earnings (loss)	$ 2,952	$ (514)	$ 5,041
Adjustments to reconcile net earnings(loss) to net cash provided by (used in) operating activities:			
Depreciation	568	564	485
Gain on sale of assets	(25)	(51)	(383)
Deferred income taxes	60	415	(485)
Changes in operating assets and liabilities:			
Accounts receivable, net	(1,178)	(622)	(332)
Inventories	(4,320)	2,617	587
Prepaid expenses and other current assets	(44)	285	(219)
Accounts payable	203	108	(18)
Accrued employee benefits	514	(832)	516
Accrued payroll and payroll taxes	250	(157)	50
Income taxes	1,820	(2,363)	240
Other	(30)	(525)	(62)
Net cash provided by (used in) operating activities	**770**	**(1,075)**	**5,420**
Cash Flows from Investing Activities:			
Proceeds from sale of bar code business	0	194	0
Proceeds from sale of fixed assets	157	102	449
Purchase of land for investment	(92)	(36)	(56)
Capital expenditures	(369)	(2,056)	(188)
Collections on notes receivable	598	0	20
Net cash provided by (used in) investing activities	**294**	**(1,796)**	**225**
Cash Flows from Financing Activities:			
Bank loan proceeds	0	1,400	0
Purchase of common stock	(371)	(199)	(328)
Principal repayments of bank notes payable	(1,310)	(90)	0
Dividends paid	(745)	(752)	(738)
Net cash (used in) provided by financing activities	**(2,426)**	**359**	**(1,066)**
Net (Decrease) Increase in Cash and Cash equivalents	(1,362)	(2,512)	4,579
Cash and Cash Equivalents at Beginning of Year	11,310	13,822	9,243
Cash and Cash Equivalents at End of Year	**$ 9,948**	**$ 11,310**	**$ 13,822**

Note: During fiscal 2009, the Company's sale of Compsee was financed with a note receivable of $598.

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.

On March 31, 2009, the Company sold substantially all of the assets of the bar code business for approximately $792,000, which did not result in a gain or loss. The assets sold included accounts receivables, various demonstration equipment, certain office furniture and fixtures, the Compsee trade name, domain names, and other registered trademarks. The buyer also assumed all of the accounts payable and specific accrued liabilities. The Company received $194,000 at closing and a promissory note for $598,000 due on September 30, 2009. For fiscal 2010, the Company operated under a supply agreement with the buyer to manufacture and exclusively sell a variety of our proprietary bar code products. The name of this business was changed and now operates under the name of McRae Technologies, Inc.

Principles of Consolidation

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

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

	(In thousands)		
	2010	2009	2008
Total Assets:			
Western/Work Boots	$ 28,419	$ 23,298	$ 24,251
Military Boots	4,949	4,082	3,597
Bar Code	268	1,178	4,154

	(In thousands)		
	2010	2009	2008
Total Net Revenues:			
Western/Work Boots	$ 51,702	$ 43,452	$ 44,761
Military Boots	10,210	11,675	22,575
Bar Code	478	6,837	12,102
Other	182	249	583

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 valuation allowance and a credit to accounts receivable. The Company performs on-going credit evaluations of its customers' financial condition and establishes an allowance for losses on trade receivables based upon factors surrounding the credit risk of specific customers, historical trends, and other information.

Our western and work boot business records an allowance for sales returns. This is calculated applying historical return data to sales subject to potential returns. The allowance for sales returns totaled $138,000 and $144,000 for fiscal 2010 and fiscal 2009, 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 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 $5,600 for the fiscal year ended July 31, 2010.

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 31, 2010 and August 1, 2009, respectively.

Revenue Recognition

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

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

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'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 2007. However, to the extent allowed by law, the tax authorities may have the right to examine prior periods where net operating losses were generated and carried forward, and make adjustments up to the amount of the net operating loss carryforward amount.

Earnings per Share

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

For our primary or basic earnings per share calculation, we use the two-class method, which implies a different dividend rate for our Class B Common Stock.

Consequently, all undistributed earnings are allocated to Class A Common Stock in the earnings per share calculation. The result of this calculation allocates no earnings per share to the holders of Class B Common Stock.

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

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

The Company had no common stock equivalents issued or outstanding for the three-year period ended July 31, 2010.

Recently Issued Accounting Standards

In June 2009, the Financial Accounting Standards Board (FASB) issued the FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles (the Codification or ASC). The Codification became the single source of authoritative nongovernmental United States Generally Accepted Accounting Principles (US GAAP), superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF) and related literature. The Codification eliminates the previous US GAAP hierarchy and establishes one level of authoritative US GAAP. All other literature is considered non-authoritative. The Company has adopted the Codification which became effective for interim and annual periods ended after September 15, 2009. These financial statements contain references to accounting standards issued prior to the adoption of the Codification in order to assist with the transition.

In February 2008, the FASB issued "Effective Date of FASB Statement No. 157," which defers the effective date of FASB ASC 820 for nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years and interim periods within those fiscal years, beginning after November 15, 2008. Adoption of this standard did not materially affect the Company's fiscal 2010 financial statements.

In February 2007, the FASB issued "The Fair Value Option for Financial Assets and Liabilities" (FASB ASC 825; formerly SFAS 159). FASB ASC 825 permitted entities to choose to measure many financial instruments and certain other items at fair value. The provisions of FASB ASC 825 were effective for fiscal years beginning after November 15, 2007. The Company has adopted this standard for our fiscal year beginning August 2008 and it did not have a material impact on the financial statements.

In December 2009, the FASB issued FASB Accounting Standards Update ("ASU") 2010-06 "Improving Disclosures about Fair value Measurements". The ASU requires the disclosure of transfers in and out of Level 1 and 2 fair value measurements. Purchases, sales, issuances, and settlements on the reconciliation of Level 3 inputs should also be disclosed on a gross basis. Fair value measurement disclosures are also required for each class of assets and liabilities on the statement of financial position, and additional disclosures regarding the inputs and valuation techniques of Level 2 and 3 measurements. The clarification of existing disclosures was effective for interim and annual periods beginning after December 15, 2009, except for the disclosures of the rollforward of Level 3 inputs, which is effective for interim and annual periods beginning after December 15, 2010. This standard is applicable to our fiscal year beginning August 2010.

In May 2009, the FASB issued "Subsequent Events" (FASB ASC 855, formerly SFAS 165), which established standards of accounting for events that occur after the balance sheet date and disclosures of events that occur after the balance sheet date but before the financial statements are issued. The Company complies with this standard.

In June 2009, the Financial Accounting Standards Board issued FASB Statement 167, *Amendments to FASB Interpretation No. 46(R),* to improve how enterprises account for and disclose their involvement with variable interest entities (VIE's), which are special-purpose entities, and other entities whose equity at risk is insufficient or lack certain characteristics. Among other things, Statement 167 changes how an entity determines whether it is the primary beneficiary of a variable interest entity (VIE) and whether that VIE should be consolidated. The new Statement requires an entity to provide significantly more disclosures about its involvement with VIEs. As a result, the Company must comprehensively review its involvements with VIEs and potential VIEs, including entities previous considered to be qualifying special purpose entities, to determine the effect on its consolidated financial statements and related disclosures. Statement 167 is effective as of the beginning of a reporting entity's first annual reporting period that begins after November 15, 2009 and for interim periods within the first annual reporting period. Earlier application is prohibited. The Company does not believe that the adoption of Statement 167 will have a significant effect on its consolidated financial statements.

Advertising

The Company charges advertising costs when incurred as a component of SG&A expenses. Advertising expense amounted to $623,000, $542,000, and $600,000 for fiscal years 2010, 2009, and 2008, respectively.

Shipping and Handling

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

Split-Dollar Life Insurance

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

Real Estate Held for Investment

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

Reclassifications

Certain 2009 amounts have been restated to conform to the 2010 presentation.

2. INVENTORIES

Current costs exceeded the LIFO value of inventories by approximately $670,000 and $647,000 at July 31, 2010 and August 1, 2009, respectively. Year-end inventories valued under the LIFO method were $2,418,000 and $1,254,000 at July 31, 2010 and August 1, 2009, respectively. For fiscal 2010, higher FIFO pricing increased the LIFO reserve, which decreased net earnings by approximately $14,000 as compared to a decline in the LIFO reserve for fiscal 2009, which decreased the net loss by approximately $2,600.

Inventory reserves applicable to the FIFO inventories totaled $555,000 and $578,000 for fiscal 2010 and fiscal 2009, respectively.

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

	(In thousands) Fiscal Year Ended	
	2010	**2009**
Raw materials	$ 1,081	$ 803
Work-in-process	600	331
Finished goods	15,494	11,722
	$ 17,175	$ 12,856

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 31, 2010 and August 1, 2009, consisted of the following:

	(In thousands) Fiscal Year Ended	
	2010	**2009**
Land and improvements	$ 385	$ 385
Buildings	4,021	4,003
Machinery and equipment	4,194	4,290
Furniture and fixtures	1,603	1,275
Construction in progress	39	263
	10,242	10,216
Less: Accumulated depreciation	(7,393)	(7,060)
	$ 2,849	$ 3,156

Depreciation expense for fiscal 2010, 2009 and 2008 was $568,000, $564,000, and $485,000, respectively.

4. NOTES PAYABLE AND LINES OF CREDIT

Notes Payable

	(In thousands) Fiscal Year Ended 2010	2009
Note payable- bank	$ 0	$ 1,310
Less current portion		(184)
Note payable less current portion	$ 0	$ 1,126

The note payable-bank was paid in full in March 2010. Interest charges for this note totaled approximately $26,000 and $22,000 for fiscal 2010 and 2009, respectively.

Lines of Credit

The Company has a $3,000,000 revolving line of credit with a bank. The Company had no outstanding borrowings under this line of credit as of July 31, 2010 and August 1, 2009. This line of credit provides for interest on outstanding balances to be paid monthly at the prime rate less 0.5%. This line of credit expires in November 2010 and is secured by the inventory and accounts receivable of the Company’s western and work boot subsidiary. There were no borrowings under this line of credit for fiscal 2010.

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 31, 2010 and August 1, 2009. The line of credit expires in January 2011 and provides for interest on outstanding balances to be paid monthly at the prime rate. There were no borrowings under this line of credit for fiscal 2010.

Total net interest charges for fiscal 2010, 2009 and 2008 were approximately $34,000, $15,000, and $29,000, respectively.

5. EMPLOYEE BENEFIT PLANS

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

The employee stock ownership plan (ESOP) covers substantially all employees. Its principal investments include shares of Class A Common Stock and Class B Common Stock of the Company and collective funds consisting of short-term cash, fixed-income, and equity investments. There have been no contributions to the ESOP in fiscal years 2010, 2009 or 2008.

The Company has a 401-K retirement plan, which covers substantially all employees. Employees can contribute up to 25% of their annual salary to the plan. At its sole discretion, the Board of Directors determines the amount and timing of any Company matching contribution. The Company’s contribution was $143,000, $179,000, and $178,000, for the fiscal years ended 2010, 2009, and 2008, respectively.

Employee benefit program expense amounted to $819,000, $339,000, and $1,187,000 in 2010, 2009 and 2008, respectively.

6. INCOME TAXES

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

	2010	2009	2008
Current expense			
Federal	$ 1,628	$ (146)	$ 3,210
State	120	22	370
	1,748	(124)	3,580
Deferred expense (benefit)			
Federal	51	353	(412)
State	9	62	(73)
	$ 1,808	$ 291	$ 3,095

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

	2010	2009	2008
Depreciation	$ 44	$ 277	$ 27
Accrued employee benefits	(195)	316	(196)
Allowances for doubtful accounts	29	127	(133)
Allowance for sales returns	(5)	(8)	(33)
Inventory	(21)	(79)	(293)
State net operating loss carry forward	(11)	(4)	87
Economic Price Adjustment Claim	(47)	0	0
ERP System write-off	195	(287)	0
Other	71	73	56
Deferred income taxes, expense (benefit)	$ 60	$ 415	$ (485)

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

	2010	2009
Deferred tax liabilities		
Amortization	$ (457)	$ (380)
Gain on Like Kind Exchange	(391)	(391)
Depreciation	(286)	(242)
Total deferred tax liabilities	(1,134)	(1,013)
Deferred tax assets		
Self Insurance	76	76
Accrued employee benefits	256	61
Allowances for doubtful accounts	162	190
Allowance for sales returns	136	131
Inventory	756	712
State net operating loss carry forward	142	132
Economic Price Adjustment Claim	121	0
ERP System write-off	0	287
Other	0	(1)
Total deferred tax assets	1,649	1,588
Net deferred tax assets	$ 515	$ 575

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

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

	2010		2009		2008	
	Amount	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**
Tax at U.S. statutory rate	$1,638	34.0 %	$ (21)	34.0 %	$1,903	34.0 %
State income taxes, net of federal tax benefit	303	6.3 %	(4)	6.3 %	353	6.3 %
Tax adjustments	102	2.1 %	249	(111.7)	0	0
Other – net	(235)	(4.9)%	67	(30.1)%	(471)	(8.9)%
	$1,808	37.5 %	$ 291	(101.4)%	$1,785	31.9 %

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

Total income tax payments during fiscal years 2010, 2009 and 2008 were approximately $1,812,000, $448,000, and $3,426,000, respectively.

7. COMMITMENTS AND CONTINGENCIES

Lease Agreements

The Company leases certain offices and equipment under non-cancelable operating leases. Rental expenses on all operating leases were $434,000, $448,000, and $451,000 for fiscal 2010, 2009, and 2008, respectively. The future non-cancelable lease payments as of July 31, 2010 are as follows:

	2011	2012	2013
Lease Payments	$250,000	$86,000	$2,000

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

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

Concentrations

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash investments and receivables. The Company maintains substantially all of its cash and certificates of deposits with a financial institution in amounts that are in excess of the federally insured limits, which totaled approximately $9 million, $11 million, and $13 million for fiscal 2010, 2009, and 2008, 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 31, 2010 and August 1, 2009, 21 customers accounted for 42% and 34% 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 Government to purchase synthetic rubber in the foreign market. The Vibram rubber specified outsoles is a registered product available only from Quabaug Corporation and we are dependent on their ability to supply our needs. This supplier provided Vibram rubber outsoles for approximately $1.4 million and $1.7 million at July 31, 2010 and August 1, 2009, respectively.

Sales to the U.S. Government amounted to 16%, 19% and 28% of total consolidated net revenues for fiscal 2010, 2009, and 2008, 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.

8. SHAREHOLDERS' EQUITY

Common Stock

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

During fiscal 1999, the Company adopted the McRae Industries, Inc. 1998 Incentive Equity Plan (the Plan). Under the Plan, 100,000 shares of the Company's Class A Common Stock are reserved for issuance to certain key employees of the Company. At July 31, 2010, there were 100,000 shares available for future grants under the Plan.

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

9. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

The fair value of our cash and cash equivalents, accounts and notes receivable, accounts payable, 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.

10. RELATED PARTY TRANSACTIONS

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

11. SUBSEQUENT EVENTS

On September 9, 2010, the Company declared a cash dividend of $.09 per share on its Class A Common Stock payable on October 8, 2010 to shareholders of record on September 24, 2010.

Subsequent events have been evaluated through November 1, 2010, which is the date the financial statements were available to be issued.

Corporate Data

Executive Officers and Directors

EXECUTIVE OFFICERS

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

James W. McRae
Vice-President and Secretary

Victor A. Karam
President, McRae Footwear

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

DIRECTORS

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

James W. McRae
Vice-President and Secretary

Victor A. Karam
President, McRae Footwear

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

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

Brady W. Dickson*
Consultant

William H. Swan*
Retired President of Bob Swan Company

**Members of Audit and Compensation Committees*

Shareholder Information

SHAREHOLDERS

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

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

TRANSFER AGENT, REGISTRAR, AND DIVIDEND DISBURSING AGENT

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

STOCK

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

ANNUAL MEETING

December 16, 2010
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400 North Main Street
Mount Gilead, North Carolina 27306

INDEPENDENT AUDITORS

Grant Thornton LLP
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GENERAL COUNSEL

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214 North Tryon Street
Charlotte, North Carolina 28202

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