McRae Industries

Annual Report 2014

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	8/2/14	8/3/13	7/28/12	7/30/11	7/31/10
(In thousands, except per share data)					
Income Statement Data:					
Net revenues	$ 103,629	$ 97,071	$ 75,684	$ 74,748	$ 62,571
Net earnings (loss)	7,548	7,498	4,842	3,829	2,952
Net earnings per common share					
Basic Earnings per share(a):					
Class A	4.18	4.54	2.73	2.22	1.79
Class B	0.48	0.77	0	0	0
Diluted Earnings per share(b):					
Class A	3.51	3.79	2.27	1.84	1.47
Class B	NA	NA	NA	NA	NA
Balance Sheet Data:					
Total assets	$ 71,186	$ 64,909	$ 58,763	$ 53,811	$ 51,348
Long-term liabilities	1,536	1,399	1,702	1,334	1,134
Working capital	51,181	44,451	40,582	36,559	33,892
Shareholders' equity	62,450	56,067	50,781	47,029	44,154
Weighted average number of common shares outstanding:					
Class A	2,038,469	2,035,034	2,038,902	2,053,042	2,068,866
Class B	392,055	399,878	414,853	423,697	432,518
Weighted average number of common shares outstanding(c):	2,430,524	2,434,912	2,453,755	2,476,739	2,501,384
Cash dividends per Class A common share:	$ 0.48	$ 0.36	$ 0.36	$ 0.36	$ 0.36
Cash dividends per Class B common share	$ 0.48	$ 0.27	$ 0	$ 0	$ 0
Special Cash dividend per Class A and Class B common share	$ 0	$ 0.50	$ 0	$ 0	$ 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,

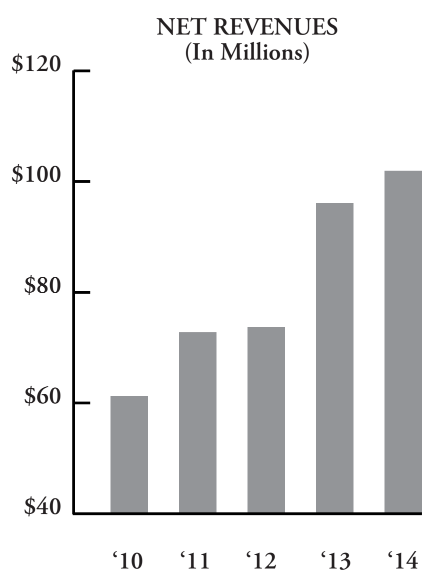
I am delighted to report that your company attained record revenues and earnings for fiscal 2014. Net revenues grew 7% to $103.6 million for fiscal 2014, up from $97.1 million for fiscal 2013. Net earnings increased 0.7% from $7.50 million for fiscal 2013 to $7.55 million for fiscal 2014. The increases in revenue and net profit were primarily attributable to significant increases in demand for our military boot products.

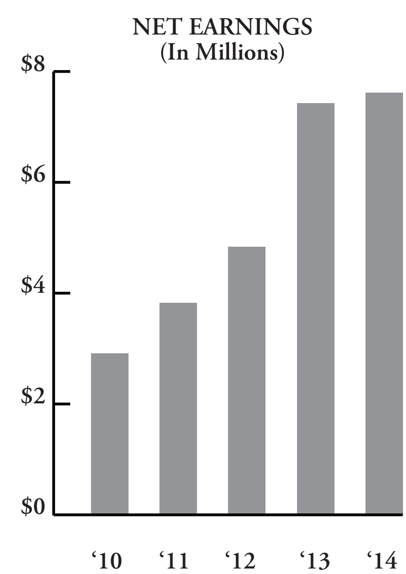
Net revenues for our work boot segment, which includes Dan Post, Laredo, John Deere and McRae Industrial branded work boot products along with our military boots, increased by 11.1% as net revenues increased from $33.3 million for fiscal 2013 to $37.0 million for fiscal 2014. Our military boot revenue increased by 20% to $25 million for fiscal 2014. This increase in revenue was the result of the new contracts received from the U.S. and Israeli governments in 2012, coupled with a contract we received in September 2013 to manufacture boots for the U.S. Marines. Gross margins for the work boot segment decreased slightly as the lower margin military boot business increased its contribution to the overall work boot sales mix.

Our western/lifestyle boot segment, which includes western wear, ladies fashion and children footwear products, experienced a 5.6% increase in net revenues, up from $62.8 million in fiscal 2013 to $66.3 million for fiscal 2014. This increase in revenues was primarily the result of increased demand for our Laredo branded products as consumers moved toward our popular priced boots. Gross margin in this segment of our business decreased slightly as lower margin products had an impact on the overall sales mix.

We have maintained our position of financial strength by managing our risks and capitalizing on growth opportunities. With $51.2 million in working capital, which is up from $44.5 million in the prior year, we believe this is an indication of the Company's financial health. As a result, management continues to look for ways to grow the business and invest excess capital. The company generated significant operating cash flow as cash and cash equivalents increased from $10.8 million in 2013 to $18.9 million in 2014, which we believe will provide sufficient funds to support fiscal 2015.

Net revenues grew 7% to $103.6 million for fiscal 2014, up from $97.1 million for fiscal 2013. Net earnings increased 0.7% from $7.50 million for fiscal 2013 to $7.55 million for fiscal 2014. The increases in revenue and net profit were primarily attributable to significant increases in demand for our military boot products.





Looking ahead to fiscal 2015, we are encouraged about the prospect of continued growth in our work boot segment. Our branded work boot products are expected to do well and we are targeting millennial workers who demand comfortable, lightweight and functional boots that can be worn on or off the job. We are also encouraged by the potential business associated with our military boot products. This additional business could come in a variety of ways: additional solicitations from the U. S. Government, solicitations from foreign governments, and expansion of our commercial boot business. Our product development, marketing and sales teams are working hard to meet the needs of these customers. However, all of this is said with caution as the military boot requirements for the U.S. Government are predicated to a large part on unpredictable world events.

We see our western/lifestyle segment in a state of change. The women fashion consumers who have driven the market in this business over the past few years are becoming more price conscious. Because of this, we see more of these consumers moving from the Dan Post brand to the popular priced Laredo brand boots. We will be introducing our new line of men's, women's and children boots at the Denver WESA show in January 2015 and are excited about the designs we have to offer. To some extent, we expect the revenues in this segment to be down from previous years as the market adjusts to these changing boot preferences.

In fiscal 2015, the management of your company will continue to dedicate itself to making strategic decisions that will enhance the long term interest of Dan Post Boot Company and McRae Footwear.

In fiscal 2015, the management of your company will continue to dedicate itself to making strategic decisions that will enhance the long term interest of Dan Post Boot Company and McRae Footwear. One of these decisions is the implementation of a new ERP system at Dan Post Boot Company. This new system will enable us to have visibility throughout the entire supply chain leading to improved customer service, enhanced decision making capabilities and improved efficiency in all areas.

We want to express our appreciation to all of our team members for their contributions toward our achievement during the past year.

On behalf of the Board of Directors, we thank you for your continued goodwill and support.

Sincerely,

D. Gary McRae

D. Gary McRae
President

FINANCIAL STATEMENTS
TABLE OF CONTENTS

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

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

We have audited the accompanying consolidated financial statements of **McRae Industries, Inc.** (a Delaware corporation) **and Subsidiaries** (the Company), which comprise the consolidated balance sheets as of August 2, 2014 and August 3, 2013, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended August 2, 2014, and the related notes to the financial statements.

Management's responsibility for the financial statements

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

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of McRae Industries, Inc. and Subsidiaries as of August 2, 2014 and August 3, 2013, and the results of their operations and their cash flows for each of the three years in the period ended August 2, 2014, in accordance with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Charlotte, North Carolina
November 5, 2014

CONSOLIDATED BALANCE SHEETS

McRae Industries, Inc. and Subsidiaries

(In thousands, except share data)	**August 2, 2014**	**August 3, 2013**
ASSETS		
Current assets:		
Cash and cash equivalents	$18,880	$10,804
Short term securities	76	0
Accounts and notes receivable, less allowances of $1,586 and $1,521, respectively	13,428	15,394
Inventories, net	22,288	23,046
Income tax receivable	938	0
Prepaid expenses and other current assets	553	482
Deferred tax assets	2,218	2,168
Total current assets	58,381	51,894
Property and equipment, net	3,222	3,319
Other assets:		
Deposits	14	0
Long term securities	872	958
Real estate held for investment	3,585	3,626
Amounts due from split-dollar life insurance	2,288	2,288
Trademarks	2,824	2,824
Total other assets	9,583	9,696
Total assets	$71,186	$64,909

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

CONSOLIDATED BALANCE SHEETS
McRae Industries, Inc. and Subsidiaries

(In thousands, except share data)	August 2, 2014	August 3, 2013
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$3,778	$4,054
Accrued employee benefits	1,798	1,707
Accrued payroll and payroll taxes	1,161	1,209
Income tax payable	0	74
Other	463	399
Total current liabilities	7,200	7,443
Deferred tax liabilities	1,536	1,399
Total liabilities	8,736	8,842
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Common Stock:		
Class A, $1 par value; authorized 5,000,000 shares issued and outstanding, 2,038,543 and 2,037,605 shares, respectively	2,039	2,038
Class B, $1 par value; authorized 2,500,000 shares; issued and outstanding, 391,981 and 392,919 shares, respectively	392	393
Retained earnings	60,019	53,636
Total shareholders' equity	62,450	56,067
Total liabilities and shareholders' equity	$71,186	$64,909

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

CONSOLIDATED STATEMENTS OF OPERATIONS
McRae Industries, Inc. and Subsidiaries

(In thousands, except share data)

For Years Ended	**August 2, 2014**	**August 3, 2013**	**July 28, 2012**
Net revenues	$103,629	$97,071	$75,684
Cost of revenues	73,488	67,539	52,329
Gross profit	30,141	29,532	23,355
Selling, general and administrative expenses	18,660	18,005	15,671
Operating profit	11,481	11,527	7,684
Other income	311	204	249
Interest expense	(3)	(2)	(1)
Earnings before income taxes	11,789	11,729	7,932
Provision for income taxes	4,241	4,231	3,090
Net earnings	$7,548	$7,498	$4,842

Earnings per common share:			
Earnings per common share:			
Basic earnings per share:			
Class A	$4.18	$4.54	$2.73
Class B	0.48	0.77	0
Diluted earnings per share:			
Class A	3.51	3.79	2.27
Class B	NA	NA	NA
Weighted average number of common shares outstanding:			
Class A	2,038,469	2,035,034	2,038,902
Class B	392,055	399,878	414,853
Total	2,430,524	2,434,912	2,453,755

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 30, 2011	2,046,337	$2,046	420,593	$421	$44,562
Purchase of ESOP distribution shares	(21,843)	(22)	(5,143)	(6)	(319)
Purchase of other shares	(488)	0	(200)	0	(9)
Conversion of Class B to Class A Stock	6,874	7	(6,874)	(7)	0
Cash Dividend ($.36 per Class A common stock)					(734)
Net earnings					4,842
Balance, July 28, 2012	2,030,880	$2,031	408,376	$408	$48,342
Purchase of ESOP distribution shares	(6,315)	(6)	(1,486)	(1)	(135)
Purchase of other shares	(1,231)	(1)			(18)
Issuance of Class A Shares	300	0			5
Conversion of Class B to Class A Stock	13,971	14	(13,971)	(14)	0
Cash Dividend ($.36 per Class A common stock)					(732)
Cash Dividend ($.27 per Class B common stock)					(107)
Special Cash Dividend ($.50 per Class A and B common stock)					(1,217)
Net earnings					7,498
Balance, August 3, 2013	2,037,605	$2,038	392,919	$393	$53,636
Conversion of Class B to Class A Stock	938	1	(938)	(1)	0
Cash Dividend ($.48 per Class A common stock)					(978)
Cash Dividend ($.48 per Class B common stock)					(187)
Net earnings					7,548
Balance, August 2, 2014	2,038,543	$2,039	391,981	$392	$60,019

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

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

(In thousands)

For Years Ended	**August 2, 2014**	**August 3, 2013**	**July 28, 2012**
Cash Flows from Operating Activities:			
Net earnings	$7,548	$7,498	$4,842
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation	748	686	640
Amortization of bond premiums	10	11	0
(Gain) loss on sale of assets	(40)	(282)	45
Deferred income taxes	87	(441)	26
Changes in operating assets and liabilities:			
Accounts receivable, net	1,966	(3,612)	(801)
Inventories	758	(3,474)	(961)
Prepaid expenses and other assets	(85)	(87)	(219)
Accounts payable	(276)	681	618
Accrued employee benefits	91	549	307
Accrued payroll and payroll taxes	(48)	206	(84)
Income tax receivable/payable	(1,012)	283	68
Other	64	(347)	(9)
Net cash provided by operating activities	**9,811**	**1,671**	**4,472**
Cash Flows from Investing Activities:			
Proceeds from sale of assets	87	390	8
Proceeds from maturing bond	0	75	0
Purchase of land for investment	(7)	(59)	(23)
Capital expenditures	(650)	(891)	(767)
Purchase of securities	0	(1,044)	0
Net cash used in investing activities	**(570)**	**(1,529)**	**(782)**
Cash Flows from Financing Activities:			
Purchase of common stock	0	(161)	(356)
Issuance of common stock	0	5	0
Dividends paid	(1,165)	(2,056)	(734)
Net cash used in financing activities	**(1,165)**	**(2,212)**	**(1,090)**
Net (Decrease) Increase in Cash and Cash equivalents	8,076	(2,070)	2,600
Cash and Cash Equivalents at Beginning of Year	10,804	12,874	10,274
Cash and Cash Equivalents at End of Year	**$18,880**	**$10,804**	**$12,874**

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)		
	2014	**2013**	**2012**
Total Assets:			
Western/Work Boots	$ 36,033	$ 36,650	$ 33,371
Military Boots	7,167	8,450	4,049
Bar Code	54	78	87

	(In thousands)		
	2014	**2013**	**2012**
Total Net Revenues:			
Western/Work Boots	$ 78,391	$ 75,368	$ 64,454
Military Boots	25,009	20,780	11,067
Bar Code	17	15	31
Other	212	908	132

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 $586,000 and $546,000 for fiscal 2014 and fiscal 2013, 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 $6,500 and $6,300 for the fiscal years ended August 2, 2014, and August 3, 2013 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 Balance Sheet, based on their contractual maturity date and are stated at amortization cost. Our held to maturity securities totaled $948,000 and $958,000 as of August 2, 2014 and August 3, 2013, respectively.

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 2, 2014 and August 3, 2013, 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.

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 guidance of Accounting Standards Codification (ASC) 740.10, "Income Taxes" related to accounting for uncertainty in income tax reporting. ASC 740.10 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 2011. 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 ASC 260, "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 ASC 260, we believe that the holders of Class A and Class B Common Stock have equal rights to the Company's undistributed earnings. Consequently, we believe that the calculation that best expresses economic reality is to calculate earnings per share using the total Class A and Class B Common Stock outstanding.

The Company had no common stock equivalents issued or outstanding for the three-year period ended August 2, 2014.

Advertising

The Company charges advertising costs when incurred as a component of selling, general and administrative expenses. Advertising expense amounted to approximately $878,000, $701,000, and $656,000 for fiscal years 2014, 2013, and 2012, 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 $1,000,000 and $762,000 at August 2, 2014 and August 3, 2013, respectively. Year-end inventories valued under the LIFO method were approximately $3,558,000 and $3,513,000 at August 2, 2014 and August 3, 2013, respectively. For fiscal 2014, higher FIFO pricing resulted in an increased LIFO reserve, which decreased net earnings by approximately $152,000, as compared to lower FIFO pricing for fiscal 2013 resulting in a decreased LIFO reserve, which increased net earnings by approximately $23,000.

Inventory reserves applicable to the FIFO inventories totaled approximately $650,000 and $627,000 for fiscal 2014 and fiscal 2013, respectively.

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

	(In thousands)	
	2014	**2013**
Raw materials	$ 1,566	$ 2,053
Work-in-process	868	864
Finished goods	19,854	20,129
	$ 22,288	$ 23,046

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 2, 2014 and August 3, 2013 consisted of the following:

	(In thousands)	
	2014	**2013**
Land and improvements	$ 491	$ 393
Buildings	4,128	4,125
Machinery and equipment	5,566	5,168
Furniture and fixtures	1,858	1,818
Construction in progress	102	7
	12,145	11,511
Less: Accumulated depreciation	(8,923)	(8,192)
	$ 3,222	$ 3,319

Depreciation expense for fiscal 2014, 2013, and 2012 was approximately $748,000, $686,000, and $640,000, respectively.

4. MARKETABLE SECURITIES

The components of our held to maturity securities are as follows:

	(In thousands)	
	2014	**2013**
Short term corporate notes	$ 76	$ 0
Long term corporate notes	872	958
Total held-to-maturity securities	$ 948	$ 958

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 2, 2014 and August 3, 2013. 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 2015 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 2, 2014 and August 3, 2013. The line of credit expires in January 2015 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 2014, 2013 or 2012.

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 approximately $270,000, $229,000, and $195,000, for the fiscal years ended 2014, 2013, and 2012, respectively.

Employee benefit program expense amounted to approximately $2,057,000, $1,931,000, and $1,348,000, for the fiscal years ended 2014, 2013 and 2012, respectively.

7. INCOME TAXES

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

	2014	2013	2012
Current expense			
Federal	$ 3,777	$ 4,323	$ 2,784
State	377	349	280
	4,154	4,672	3,064
Deferred expense			
Federal	74	(375)	22
State	13	(66)	4
	$ 4,241	$ 4,231	$ 3,090

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

	2014	2013	2012
Depreciation	$ 49	$ (84)	$ 160
Accrued employee benefits	(34)	(208)	(117)
Allowances for doubtful accounts	(9)	(105)	(38)
Allowance for sales returns	(15)	(29)	(31)
Inventory	0	(49)	(182)
State net operating loss carry forward	17	13	(34)
Economic Price Adjustment Claim	0	0	60
Amortization	71	72	72
Prepaid Expenses	8	(51)	136
Provision for deferred income taxes	$ 87	$ (441)	$ 26

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

	2014	2013
Noncurrent deferred assets (liabilities)		
Amortization	$ (743)	$ (672)
Gain on Like Kind Exchange	(391)	(391)
Depreciation	(540)	(491)
State net operating loss carry forward	138	155
Net noncurrent deferred tax liabilities	(1,536)	(1,399)
Current deferred tax assets (liabilities)		
Self Insurance	76	76
Accrued employee benefits	682	648
Allowances for doubtful accounts	380	371
Allowance for sales returns	223	208
Inventory	882	882
Economic Price Adjustment Claim	68	68
Prepaid Expenses	(93)	(85)
Net current deferred tax assets	2,218	2,168
Net deferred tax assets	$ 682	$ 769

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

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

	2014		2013		2012	
	Amount	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**
Tax at U.S. statutory rate	$4,008	34.0 %	$4,106	35.0 %	$2,697	34.0 %
State income taxes, net of federal tax benefit	257	2.2 %	184	1.6 %	188	2.4 %
Tax adjustments	149	1.3 %	(96)	-0.8 %	143	1.8 %
Other – net	(173)	-1.5 %	37	0.3 %	62	0.7%
	$4,241	36.0 %	$4,231	36.2 %	$3,090	38.9 %

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

Total income tax payments during fiscal years 2014, 2013 and 2012 were approximately $5,278,000, $4,511,000, and $3,116,000, respectively.

The Company follows the guidance of ASC 740.10, "Income Taxes" formerly referenced as FASB Interpretation No. 48, "Accounting for Uncertainty of Income Taxes" (FIN 48), related to accounting for uncertainty in income tax reporting. As of August 2, 2014, 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 $534,000, $539,000, and $597,000, for fiscal 2014, 2013, and 2012, respectively. The future non-cancelable lease payments as of August 2, 2014 are as follows:

	2015	**2016**	**2017**	**2018**
Lease Payments	$510,000	$521,000	$526,000	$530,000

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 2011, the lease was amended to cover a five-year period beginning on September 1, 2011. These lease and facility charge payments are reported as a component of "Other Income". The future minimum lease and facility charge payments are as follows:

	2015	**2016**
Lease Payments	$50,000	$50,000
Facility Charges	$67,162	$68,504

Concentrations

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash investments and receivables. The Company maintains substantially all of its cash and certificates of deposits with a financial institution in amounts that are in excess of the federally insured limits, which totaled approximately $19 million, $11 million, and $13 million, for fiscal 2014, 2013, and 2012, 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 2, 2014, and August 3, 2013 twenty-one customers accounted for 52% and 49% 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 are dependent on their ability to supply our needs. This supplier provided Vibram rubber outsoles for approximately $2.5 million and $2.2 million at August 2, 2014 and August 3, 2013 respectively.

Sales to the U.S. Government amounted to 19%, 19%, and 13%, of total consolidated net revenues for fiscal 2014, 2013, and 2012, 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 2, 2014, 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

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.

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 $108,000.

12. SUBSEQUENT EVENTS

On September 5, 2014, the Company declared a cash dividend of $.13 per share on its Class A and Class B Common Stock payable on October 3, 2014 to shareholders of record on September 19, 2014.

Subsequent events have been evaluated through November 5, 2014, 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

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, Jr.*
Executive Director,
Peacehaven Community Farm

Brady W. Dickson*
Consultant

William H. Swan*
Retired President,
Bob Swan Company

**Members of Audit and Compensation Committees*

Shareholder Information

Shareholders

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

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

Stock

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

Transfer Agent, Registrar, and Dividend Disbursing Agent

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

Annual Meeting

Thursday, December 18, 2014
Corporate Offices
400 North Main Street
Mount Gilead, North Carolina 27306

Independent Auditors

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

General Counsel

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

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