McRae Industries

2021 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	7/31/21	8/1/20	8/3/19	7/28/18	7/29/17
(In thousands, except per share data)					
INCOME STATEMENT DATA:					
Net revenues	$ 82,191	$ 69,311	$ 82,154	$ 73,892	$ 104,316
Net earnings (loss)	3,352	(77)	2,118	2,190	5,083
Net earnings per common share					
Diluted Earnings per share[(a)]					
Class A	1.46	(0.03)	0.89	0.91	2.11
Class B	NA	NA	NA	NA	NA
BALANCE SHEET DATA:					
Total assets	$ 77,885	$ 77,929	$ 79,354	$ 80,364	$ 81,641
Long-term liabilities	534	692	704	621	2,263
Working capital[(b)]	58,036	57,539	54,457	55,435	56,542
Shareholders' equity	72,246	71,817	73,323	74,989	74,201
Weighted average number of common shares outstanding:					
Class A	1,927,381	1,965,652	2,018,940	2,018,701	2,024,470
Class B	367,401	373,517	374,064	378,020	385,830
Weighted average number of common shares outstanding[(c)]:	2,294,782	2,339,169	2,393,004	2,396,721	2,410,300
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	$ 0.00	$ 0.00	$ 0.50	$ 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) Working capital increased $4.1 million from 2019 to 2020 due to the adoption of a new accounting standard and long term securities being reclassified to short term. See Note 4 to the consolidated financial statements included in this report.

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

McRae Industries

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Dear Valued Shareholders,

I am pleased to present to you the McRae Industries, Inc. fiscal 2021 Annual Report.

For fiscal 2021, net revenues increased from $69.3 million for fiscal 2020 to $82.2 million for fiscal 2021. This increase in revenue was primarily the result of increases in our western/lifestyle products and Dan Post work boots offset by decreases in our United States military contract business. Net income increased from a loss of $77.2 thousand in fiscal 2020 to a net income of $3.3 million in fiscal 2021.

Our western/lifestyle boot segment which includes western, ladies' fashion, and children's footwear products under the Dan Post, Dingo, Eldorado, and Laredo brand names experienced an increase in revenues from $40.1 million in fiscal 2020 to $55.8 million in fiscal 2021. The fiscal 2021 revenue for this segment is also greater than the revenue for non-Covid-19 fiscal 2019, which was $46.2 million. Dan Post, Dingo, and Laredo had significant revenue increases from fiscal 2019 to fiscal 2021.

Our work boot segment which includes Dan Post, Laredo, and McRae Industrial work boots along with our military combat boots had a decrease in revenue from $28.9 million in fiscal 2020 to $26.4 million in fiscal 2021. This decrease in revenue was primarily driven by lower military boot sales due to a decrease in demand for military combat boots by the United States Government and work force challenges due to Covid-19. The decrease in military boot sales was partially offset by an increase in work boot revenue.

Dan Post Boot Company orders continued to increase in the fourth quarter of fiscal 2021 and into the first quarter of fiscal 2022. As demand for western boots has surged during calendar 2021, most western boot companies are having issues with the supply chain and getting boots from suppliers in a timely fashion. Dan Post Boot Company is no exception. Our revenue should begin to increase as additional shipments from our vendors begin arriving in the first and second quarter of fiscal 2022. Our success in fiscal 2022 will be determined largely by our vendors ability to meet the increased demand for western boots, how soon the supply chain returns to a more normal operation, and how efficient we are at shipping boots to our retail partners.

McRae Footwear is working hard to increase revenues and profitability. There are numerous headwinds with an increase in labor cost brought about by competition for available workers and an inadequate supply of applicants being our biggest challenges going forward. While fiscal 2022 is going to be a challenge, we believe we are positioned well for additional United States Government military boot solicitations in the coming 12-18-month period. We also see commercial military boot opportunities.

The two properties that we mentioned in our third quarter press release, in which we have purchase sales agreements totaling $3,250,000, remain in the due diligence periods at this time.

The Company's financial position remains strong with working capital of $58.0 million. Cash and cash equivalents increased from $21.0 million in fiscal 2020 to $23.5 million in fiscal 2021. While cash from operations provided only $0.8 million, investing activities provided $4.7 million as we scaled back our investments in debt securities. Furthermore, cash used in financing activities amounted to approximately $2.9 million. We believe that the Company's current cash position will be sufficient to support our fiscal 2022 operating activities.

I would like to thank each of our associates for their hard work during the past two years as Covid-19 has interrupted their lives and our business operations. Your contributions to our success are greatly appreciated. Our hearts go out to our associates at our Waverly, Tennessee distribution center who lost loved ones and valuable possessions during the flood in August of this year.

On behalf of our Board of Directors, Officers, Managers, and our team members, we also thank our shareholders, business partners, vendors, and customers for their continued 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, which comprise the consolidated balance sheets as of July 31, 2021 and August 1, 2020, and the related consolidated statements of operations and comprehensive income, shareholders' equity, and cash flows each of the three years in the period ended July 31, 2021 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 July 31, 2021 and August 1, 2020, and the results of their operations and their cash flows for each of the three years in the period ended July 31, 2021, in accordance with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Charlotte, North Carolina
October 29, 2021

CONSOLIDATED BALANCE SHEETS
McRae Industries, Inc. and Subsidiaries

(Dollars in thousands)	July 31, 2021	August 1, 2020
ASSETS		
Current assets:		
Cash and cash equivalents	$23,489	$20,959
Equity investments with readily determinable fair values	6,207	4,131
Debt securities	2,414	9,750
Accounts and notes receivable, less allowances of $1,050 and $745, respectively	16,382	8,027
Inventories, net	14,326	18,255
Income tax receivable	-	979
Prepaid expenses and other current assets	323	858
Total current assets	63,141	62,959
Property and equipment, net	5,363	6,060
Other assets:		
Deposits	14	14
Notes receivable	1,017	-
Real estate held for investment	3,238	3,784
Amounts due from split-dollar life insurance	2,288	2,288
Trademarks	2,824	2,824
Total other assets	9,381	8,910
Total assets	$77,885	$77,929

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

CONSOLIDATED BALANCE SHEETS
McRae Industries, Inc. and Subsidiaries

(Dollars in thousands)	**July 31, 2021**	**August 1, 2020**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$2,714	$3,871
Accrued employee benefits	660	400
Accrued payroll and payroll taxes	700	457
Income tax payable	236	-
Other	795	692
Total current liabilities	5,105	5,420
Deferred tax liabilities	534	692
Total liabilities	5,639	6,112
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Common Stock:		
Class A, $1 par value; authorized 5,000,000 shares issued and outstanding, 1,893,423 and 1,957,142 shares, respectively	1,893	1,957
Class B, $1 par value; authorized 2,500,000 shares; issued and outstanding, 366,737 and 373,233 shares, respectively	367	373
Retained earnings	69,986	69,487
Total shareholders' equity	72,246	71,817
Total liabilities and shareholders' equity	$77,885	$77,929

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	**July 31, 2021**	**August 1, 2020**	**August 3, 2019**
Net revenues	$82,191	$69,311	$82,154
Cost of revenues	60,187	53,763	62,851
Gross profit	22,004	15,548	19,303
Selling, general and administrative expenses	18,165	15,973	17,005
Operating profit (loss)	3,839	(425)	2,298
Other income	203	562	654
Interest expense	-	-	(3)
Investment income (loss)	395	(59)	-
Earnings before income taxes	4,437	78	2,949
Provision for income taxes	1,085	155	831
Net earnings (loss)	$3,352	($77)	$2,118
Other comprehensive income, net of tax:			
Unrealized gains (losses) on investments	-	-	16
Total comprehensive income	$3,352	($77)	$2,134
Earnings per common share:			
Diluted earnings per share:			
Class A	$1.46	$(0.03)	$0.89
Class B	NA	NA	NA
Weighted average number of common shares outstanding:			
Class A	1,927,381	1,965,652	2,018,940
Class B	367,401	373,517	374,064
Total	2,294,782	2,339,169	2,393,004

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				Accumulated Other	
	Class A		Class B		Comprehensive	Retained
	Shares	Amount	Shares	Amount	Income (Loss)	Earnings
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
Stock Buyback	(10,417)	(10)	(442)	(1)		(202)
Adoption of accounting standards[1]					12	(13)
Cash Dividend ($0.52 per Class A common stock)						(1,021)
Cash Dividend ($0.52 per Class B common stock)						(194)
Net earnings						(77)
Balance, August 1, 2020	1,957,142	$1,957	373,233	$373	$0	$69,487
Stock Buyback	(66,019)	(66)	(4,196)	(4)		(1,659)
Conversion of Class B to Class A Stock	2,300	2	(2,300)	(2)		
Cash Dividend ($0.52 per Class A common stock)						(1,004)
Cash Dividend ($0.52 per Class B common stock)						(190)
Net earnings						3,352
Balance, July 31, 2021	1,893,423	$1,893	366,737	$367	$0	$69,986

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	July 31, 2021	August 1, 2020	August 3, 2019
Cash Flows from Operating Activities:			
Net earnings	$3,352	($77)	$2,118
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation	1,052	1,078	1,158
(Gain) loss on sale of land	70	(11)	(134)
Amortization of premiums on debt securities	74	6	-
Unrealized change in equity securities	(395)	59	-
(Gain) loss on sale of securities	(2)	(94)	0
Deferred income taxes	(158)	(12)	83
Changes in operating assets and liabilities:			
Accounts receivable, net	(8,355)	4,948	(2,310)
Inventories	3,929	1,506	(1,334)
Prepaid expenses and other assets	535	(224)	(480)
Accounts payable	(1,157)	468	435
Accrued employee benefits	260	(60)	37
Accrued payroll and payroll taxes	243	(256)	83
Income tax receivable/payable	1,215	(573)	721
Other	103	(59)	18
Net cash provided by operating activities	**766**	**6,699**	**395**
Cash Flows from Investing Activities:			
Proceeds from sale of land	635	31	153
Purchase of land for investment	(160)	(4)	(44)
Capital expenditures	(355)	(526)	(396)
Proceeds from sale of securities	12,762	13,465	274
Purchase of securities	(7,178)	(10,077)	(11,389)
Notes receivable	(1,017)	-	-
Net cash provided in investing activities	**4,687**	**2,889**	**(11,402)**
Cash Flows from Financing Activities:			
Purchase of common stock	(1,729)	(213)	(1,360)
Dividends paid	(1,194)	(1,215)	(2,439)
Net cash used in financing activities	**(2,923)**	**(1,428)**	**(3,799)**
Net Increase (Decrease) in Cash and Cash equivalents	2,530	8,160	(14,806)
Cash and Cash Equivalents at Beginning of Year	20,959	12,799	27,605
Cash and Cash Equivalents at End of Year	**$23,489**	**$20,959**	**$12,799**

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
McRae Industries, Inc. and Subsidiaries
As of and for the Years Ended July 31, 2021, August 1, 2020, and August 3, 2019

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)		
	2021	**2020**	**2019**
Total Assets:			
Western/Work Boots	$ 30,606	$ 26,377	$ 31,016
Military Boots	9,593	10,092	12,666
Corporate/Other	37,686	41,460	35,672

	(In thousands)		
	2021	**2020**	**2019**
Total Net Revenues:			
Western/Work Boots	$ 62,772	$ 46,498	$ 53,183
Military Boots	19,191	22,652	28,680
Corporate/Other	228	161	291

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

The Company defines cash and cash equivalents as cash and short-term investments with original maturities of three months or less. The Company maintains cash balances with financial institutions, which are insured by the Federal Deposit Insurance Corporation (FDIC) up to $250,000. Although the Company maintains balances that exceed the federally insured limit, the Company has not experienced any losses related to this balance and the Company believes credit risk to be minimal.

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 $750,000 and $584,000 for fiscal 2021 and fiscal 2020, 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.

Investments

Effective August 4, 2019, we adopted Accounting Standards Update ("ASU") 2016-01 Financial Instruments — Overall: Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"), which requires us to measure all equity investments that do not result in consolidation and are not accounted for under the equity method at fair value and recognize any changes in earnings. Prior to the adoption of ASU 2016-01, marketable equity securities not accounted for under the equity method were classified as available-for-sale and recorded on the consolidated balance sheet within short-term and long-term securities. For equity securities classified as available-for-sale, realized gains and losses were included in net income. Unrealized gains and losses on equity securities classified as available-for-sale were recognized in accumulated other comprehensive income (loss) ("AOCI"), net of tax. Amounts previously included in short-term and long-term securities on the consolidated balance sheet have been reclassified to conform to current year's presentation and are now included within Equity investments with readily determinable fair values on the consolidated balance sheet.

Our investments in debt securities are carried at either amortized cost or fair value. Investments in debt securities that the Company has the positive intent and ability to hold to maturity are carried at amortized cost and classified as held-to-maturity. Investments in debt securities that are not classified as held-to-maturity are carried at fair value and classified as either trading or available-for-sale. Realized and unrealized gains and losses on trading debt securities as well as realized gains and losses on available-for-sale debt securities are included in net income. Unrealized gains and losses, net of tax, on available-for-sale debt securities are included in our consolidated balance sheet as a component of AOCI, except for the change in fair value attributable to the currency risk being hedged, if applicable, which is included in net income. Refer to Note 4 for additional information related to the Company's available-for-sale securities.

Long-Lived Assets and Other Intangibles

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

The Company tests identifiable intangible assets with an indefinite life for impairment annually. Furthermore, such assets are required to be tested for impairment on an interim basis if an event or circumstance indicates that it is more likely than not an impairment loss has been incurred. An impairment loss shall be recognized to the extent that the carrying amount of such assets exceeds its implied fair value. Impairment losses shall be recognized in operations. The Company's valuation methodology for assessing impairment requires management to make judgments and assumptions based on historical experience and projections of future operating performance. If these assumptions differ materially from future results, the Company may record impairment charges in the future. Based on its most recent analysis, the Company believes that no impairment exists as of July 31, 2021 and August 1, 2020, respectively.

Revenue Recognition

Revenue is recognized upon the transfer of control of promised products or services to customers in an amount that reflects the consideration the Company expects to receive in exchange for those products or services. Where a formal contract does not exist, the Company determined that customer purchase orders primarily represent contracts. The

Company's contracts generally include promises to sell boots. Customers also have the ability to receive shipments directly from the Company's vendors. Revenue associated with the sales of the Company's products are recognized at a point in time, which occurs when control of a good promised in a contract is transferred to a customer. Control is obtained when the customer has the ability to direct the use of and obtain substantially all of the remaining benefits from that good, which generally occurs either on shipment or delivery based on the contractual terms.

Revenue is measured as the amount of consideration the Company expects to receive in exchange for the transfer of the promised products and services. The amount of consideration the Company expects to receive changes due to variable consideration is associated with allowances due to promotional programs, discounts, and rebates that we offer to customers. The amount of variable consideration which is included in the transaction price is only included in net sales to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur in a future period.

Costs of Goods Sold

Costs of goods sold consist of costs associated with procuring materials from suppliers. Sales discounts received from suppliers are recorded as a reduction of the cost of inventory.

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 2018. 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 July 31, 2021.

Advertising

The Company charges advertising costs when incurred as a component of selling, general and administrative expenses. Advertising expense amounted to approximately $595,000, $1,097,000, and $1,090,000 for fiscal years 2021, 2020, and 2019, respectively.

Shipping and Handling

The Company incurs shipping and handling costs when delivering products to customers. All amounts billed to a customer in a sales transaction related to shipping and handling are recognized as revenue for the goods provided. Shipping and handling costs are classified as part of operating expenses in the accompanying consolidated statement 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.

COVID-19

In March 2020, the World Health Organization declared the outbreak of a novel coronavirus (COVID-19) as a pandemic, which continued to spread throughout the United States. The spread of COVID-19 has caused significant volatility in U.S. and international markets. There is significant uncertainty around the breadth and duration of business disruptions related to COVID-19, as well as its impact on the U.S. and international economies. The Company's business, results of operations, financial conditions, and prospects could be adversely affected to the extent that the coronavirus or any other epidemic harms the U.S. and international economies in general.

Recent Accounting Pronouncements

The Company has considered all new accounting pronouncements issued by the FASB and concluded the following accounting pronouncements may have a material impact on its consolidated financial statements or represent accounting pronouncements for which the Company has not yet completed its assessment.

In February 2016, the FASB issued ASU No. 2016-02, which amended the Leases topic of the ASC to require all leases with lease terms over 12 months to be capitalized as a right-of-use asset and lease liability on the balance sheet at the date of lease commencement. Leases will be classified as either finance leases or operating leases. This distinction will be relevant for the pattern of expense recognition in the income statement. The amendments will be effective for the Company for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. Early adoption is permitted. The Company is currently in the process of evaluating the impact of adoption of this guidance on the consolidated financial statements.

2. INVENTORIES

Current costs exceeded the LIFO value of inventories by approximately $930,000 and $739,000 at July 31, 2021 and August 1, 2020, respectively. Year-end inventories valued under the LIFO method were approximately $4,183,000 and $5,178,000 at July 31, 2021 and August 1, 2020, respectively. For fiscal 2021 and fiscal 2020, higher FIFO pricing resulted in an increased LIFO reserve, which decreased net earnings by approximately $147,000 and $148,000, respectively.

Inventory reserves applicable to the FIFO inventories totaled approximately $400,000 and $700,000 for fiscal 2021 and fiscal 2020, respectively.

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

	(In thousands)	
	2021	**2020**
Raw materials	$ 1,918	$ 2,526
Work-in-process	554	825
Finished goods	11,854	14,904
	$ 14,326	$ 18,255

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, 2021 and August 1, 2020 consisted of the following:

	(In thousands)	
	2021	**2020**
Land and improvements	$ 612	$ 612
Buildings	7,287	7,217
Machinery and equipment	7,904	7,814
Furniture and fixtures	5,489	5,445
	21,292	21,088
Less: Accumulated depreciation	(15,929)	(15,028)
	$ 5,363	$ 6,060

Depreciation expense for fiscal years ended 2021, 2020, and 2019 was approximately $1,052,000, $1,078,000, and $1,158,000, respectively.

4. INVESTMENTS

Effective August 4, 2019 we adopted ASU 2016-01, which requires us to measure all equity investments that do not result in consolidation and are not accounted for under the equity method at fair value and recognize any changes in earnings. We use quoted market prices to determine the fair value of equity securities with readily determinable fair values. Prior to the adoption of ASU 2016-01, marketable equity securities not accounted for under the equity method were classified as available-for-sale. Equity securities with readily determinable fair values are not assessed for impairment, since they are carried at fair value with the change included in net income. For debt securities classified as available-for-sale, realized gains and losses were included in net income. Unrealized gains and losses on debt securities classified as available-for-sale were recognized in AOCI, net of tax.

As of July 31, 2021, the carrying values of our equity securities were included in the following line items in our consolidated balance sheet (in thousands):

	Fair Value with Changes Recognized in Income
Equity securities with readily determinable fair values	$ 6,207
Cash and cash equivalents	15,859
Total equity investments	$ 22,066

The calculation of net unrealized gains and losses recognized during the year related to equity securities still held at July 31, 2021 is as follows (in thousands):

	2021
Net gains (losses) recognized during the year related to equity securities	$ 397
Less: Net gains (losses) recognized during the year related to equity securities sold during the year	(2)
Net unrealized gains (losses) recognized during the year related to equity securities still held at the end of the year	$ 395

Our debt securities consisted of the following (in thousands):

	2021	**2020**
Available-for-sale securities	$ 2,414	$ 9,750
Total debt securities	$ 2,414	$ 9,750

5. NOTES PAYABLE AND LINES OF CREDIT

Lines of Credit

The Company has a $5,000,000 revolving line of credit with a bank. The Company had no outstanding borrowings under this line of credit as of July 31, 2021 and August 1, 2020. 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 2022 and is secured by the inventory and accounts receivable of the Company's western and work boot subsidiary.

The Company has an additional $1,750,000 line of credit with a bank. This line is restricted to 100% of the outstanding accounts receivable due from the U.S. Government. There were no outstanding borrowings under this line of credit as of July 31, 2021 and August 1, 2020. The line of credit expires in January 2022 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 2021, 2020 or 2019.

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 $265,000, $202,000, and $276,000, for the fiscal years ended 2021, 2020, and 2019, respectively.

Employee benefit program expense, which includes 401-K, amounted to approximately $943,000, $546,000, and $689,000, for the fiscal years ended 2021, 2020 and 2019, respectively.

7. INCOME TAXES

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

	2021	2020	2019
Current expense			
Federal	$ 1,084	$ 118	$ 695
State	160	49	59
	1,244	167	754
Deferred expense			
Federal	(139)	(11)	68
State	(19)	(1)	9
	$ 1,086	$ 155	$ 831

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

	2021	2020	2019
Depreciation	$ (56)	$ (126)	$ (12)
Accrued employee benefits	(60)	13	(8)
Allowances for doubtful accounts	(33)	54	76
Allowance for sales returns	(38)	9	(28)
Inventory	125	(65)	(18)
State net operating loss carry forward	12	-	(2)
Economic Price Adjustment Claim	-	-	42
Amortization	-	23	28
Prepaid Expenses	(94)	94	-
Like Kind Exchange	(106)	-	-
Other	92	(14)	(1)
Provision for deferred income taxes	$ (158)	$ (12)	$ 77

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

	2021	2020
Amortization	$ (653)	$ (653)
Gain on Like Kind Exchange	(134)	(240)
Depreciation	(653)	(709)
Prepaid Expenses	-	(94)
Noncurrent deferred tax liabilities	(1,440)	(1,696)
State net operating loss carry forward	90	102
Self Insurance	105	105
Accrued employee benefits	154	94
Allowances for doubtful accounts	70	37
Allowance for sales returns	175	137
Inventory	386	511
Economic Price Adjustment Claim	-	-
Unrealized (Gain)/Loss	(75)	17
Other	1	1
Noncurrent deferred tax assets	906	1,004
Net noncurrent deferred tax liabilities	$ (534)	$ (692)

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):

	2021		2020		2019	
	Amount	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**
Tax at U.S. statutory rate	$ 922	21.0 %	$ 16	21.0 %	$ 619	21.0 %
State income taxes, net of federal tax benefit	93	2.1 %	32	41.0 %	45	1.5 %
Tax adjustments	143	3.3 %	143	183.3 %	141	4.8 %
Other – net	(72)	(1.6) %	(36)	(46.1) %	26	0.9 %
	$ 1,086	24.7 %	$ 155	198.7 %	$ 831	28.2 %

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 2021, 2020, and 2019 were approximately $158,000, $870,000, and $165,000, respectively.

The Company follows the applicable authoritative guidance related to accounting for uncertainty in income tax reporting. As of July 31, 2021, 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 $639,000, $611,000, and $660,000, for fiscal years ended 2021, 2020, and 2019, respectively. The future non-cancelable lease payments as of July 31, 2021 are as follows:

	2022	**2023**	**2024**	**2025**	**2026**
Lease Payments	$616,000	$619,000	$621,000	$592,000	$592,000

The Company leases approximately 37,000 square feet of office and warehouse space to Toshiba Business Solutions, Inc. The original lease and subsequent amendments cover a base year period and additional periods through August 31, 2022. 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:

	2021	**2022**
Lease Payments	$53,315	$54,381
Facility Charges	$63,868	$65,145

Concentrations

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, 2021 and August 1, 2020, twenty-one customers accounted for 77% and 66% of accounts receivable, respectively.

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 $1.6 million and $2.5 million at July 31, 2021 and August 1, 2020 respectively.

Sales to the U.S. Government amounted to 13%, 24%, and 28%, of total consolidated net revenues for fiscal years ended 2021, 2020, and 2019, respectively. Under the terms of sale to the U.S. Government, the negotiated contract prices of combat boots are subject to renegotiation if certain conditions are present. Management does not currently expect renegotiation, if any, to have a material adverse effect on the Company's consolidated financial position or results of operations.

9. SHAREHOLDERS' EQUITY

Common Stock

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

The Company has adopted the McRae Industries, Inc. 1998 Incentive Equity Plan (the Plan). Under the Plan, 100,000 shares of the Company's Class A Common Stock are reserved for issuance to certain key employees of the Company. At July 31, 2021, 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 equity and debt investments are determined using quoted market prices in active markets for identical assets or liabilities which are classified as Level 1 inputs.

The following table presents those assets and liabilities that are measured at fair value as of July 31, 2021 (in thousands):

	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
Equity Investments	$ 22,066	–	–	$ 22,066
Debt Securities	$ 2,414	–	–	$ 2,414

The following table presents those assets and liabilities that are measured at fair value as of August 1, 2020 (in thousands):

	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
Equity Investments	$ 17,035	–	–	$ 17,035
Debt Securities	$ 9,750	–	–	$ 9,750

Refer to Note 4 for additional information related to the composition of our equity and debt securities. 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.

On March 24, 2021, the Company entered into a note receivable agreement with a related party in the amount of $1,005,000. The note receivable is in relation to a split dollar insurance arrangement between the Company and a related party. All outstanding principal and interest shall be due and payable upon the earlier of (i) demand of payee and (ii) payment of death benefits under the policies. The outstanding note receivable bears interest at the prime rate in effect. Interest on the outstanding principal amount shall be due and payable annually, in arrears, beginning in March 2022, with subsequent installments of interest being due and payable each year thereafter until the maturity date. As of July 31, 2021, the Company has recorded the principal and interest of $1,017,000 within other assets in the accompanying consolidated balance sheets.

12. SUBSEQUENT EVENTS

On August 31, 2021, the Company declared a cash dividend of $.13 per share on its Class A and Class B Common Stock payable on September 28, 2021 to shareholders of record on September 14, 2021.

Subsequent events have been evaluated through October 29, 2021, which is the date the financial statements were available to be issued.

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 16, 2021
Corporate Office
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Independent Auditors

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General Counsel

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