McRae Industries 2022 ANNUAL REPORT

FORTITUDINIE

Corporate Profile

McRae Industries, Inc. was founded in 1959 as a manufacturer and distributor of children's shoes. Today, McRae Industries is involved in manufacturing, sales and distribution of high quality, reasonably priced boot products targeted to the western/lifestyle and work boot markets. In addition, we continue to take pride in manufacturing military combat boots for the U.S. Government. The company also operates other smaller businesses.

McRae Industries, Inc. corporate headquarters is located in Mount Gilead, North Carolina.

Selected Consolidated Financial Data

The following Selected Consolidated Financial Data of the Company presented below for each of the five years in the periods indicated has been derived from our audited and consolidated financial statements.

FISCAL YEARS ENDED	7/30/2022	7/31/2021	8/1/2020	8/3/2019	7/28/2018
INCOME STATEMENT DATA:					
Net revenues	$ 124,833	$ 82,191	$ 69,311	$ 82,154	$ 73,892
Net earnings (loss)	10,199	3,352	(77)	2,118	2,190
Net earnings per common share					
Diluted Earnings per share[(a)]:					
Class A	4.51	1.46	(0.03)	0.89	0.91
Class B	NA	NA	NA	NA	NA
BALANCE SHEET DATA:					
Total assets	$ 91,044	$ 77,885	$ 77,929	$ 79,354	$ 80,364
Long-term liabilities	25	534	692	704	621
Working capital[(b)]	66,984	58,036	57,539	54,457	55,435
Shareholders' equity	81,249	72,246	71,817	73,323	74,989
Weighted average number of common shares outstanding:					
Class A	1,893,860	1,927,381	1,965,652	2,018,940	2,018,701
Class B	366,300	367,401	373,517	374,064	378,020
Weighted average number of common shares outstanding[(c)]:	2,260,160	2,294,782	2,339,169	2,393,004	2,396,721
Cash dividends per Class A common share:	$ 0.53	$ 0.52	$ 0.52	$ 0.52	$ 0.52
Cash dividends per Class B common share:	$ 0.53	$ 0.52	$ 0.52	$ 0.52	$ 0.52
Special Cash dividend per Class A and Class B common share	$ 0.00	$ 0.00	$ 0.00	$ 0.50	$ 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,

It is with great pleasure that I present to you the McRae Industries, Inc. fiscal 2022 Annual Report.

For fiscal 2022, net revenues increased from $82.2 million for fiscal 2021 to $124.8 million for fiscal 2022. This increase in revenue was attributable to increases in our western/lifestyle products, Dan Post work boots, and in our United States military contract business. Net income increased from $3.3 million in fiscal 2021 to $10.2 million in fiscal 2022.

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 $55.8 million in fiscal 2021 to $92.8 million in fiscal 2022. The significant revenue increases were seen across all brands in this segment.

Our work boot segment which consists of Dan Post and Laredo work boots, as well as our military combat boots, had an increase in revenue from $26.4 million in fiscal 2021 to $29.9 million in fiscal 2022. This increase in revenue was the result of double digit increases across the board.

The demand for all of our western/lifestyle products remained strong throughout fiscal 2022 and into the first quarter of fiscal 2023. We are, however, beginning to see more order cancellations than normal and some order deliveries pushed out as most retailers are flush with inventory. This heavy inventory position is driven by most of the western brands being caught up with demand and now able to ship orders to retailers that were placed months ago. We are not yet sure how this will affect our revenue and inventory in fiscal 2023; although many western retailers have expressed optimism about the coming year.

The McRae Footwear division continues to struggle to increase revenues and profitability. Our most troublesome headwinds are the increased cost of materials brought about by persistent inflation, inadequate supply of qualified applicants for our manufacturing facility, and increased labor cost due to competition for available workers. We are working through these issues and hope to have some improvement in fiscal 2023.

While the Company's financial position remains strong with working capital of $67.0 million, cash and cash equivalents has decreased from $23.5 million to $15.3 million. As the business has grown, so has the need to build inventory. This makes up a significant portion of our operational spending, along with the increase in accounts receivable associated with increased sales. As a result, cash from operations used approximately $4.2 million in this fiscal year. Cash used in investing and financing activities amounted to approximately $2.8 million and $1.2 million, respectively. We will continue to monitor our cash needs, but believe that the Company's current cash position will be sufficient to support our fiscal 2023 operating activities.

I would like to thank each of our team members for all their hard work during the past year which enabled our company to have the most profitable year in its history. There were many challenges that had to be overcome with the supply chain, rising material cost, rising labor cost, and remaining Covid issues, just to name a few. We are hopeful that some of these will not be as severe in fiscal 2023.

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

Sincerely,

D. Gary McRae
President

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

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

Opinion

We have audited the consolidated financial statements of McRae Industries, Inc. (a Delaware corporation) and subsidiaries, (the "Company"), which comprise the consolidated balance sheets as of July 30, 2022 and July 31, 2021, 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 30, 2022 and the related notes to the financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Company as of July 30, 2022 and July 31, 2021, and the results of its operations and its cash flows for each of the three years in the period ended July 30, 2022, in accordance with accounting principles generally accepted in the United States of America.

Basis for opinion

We conducted our audits of the consolidated financial statements in accordance with auditing standards generally accepted in the United States of America (US GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of management for the financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for one year after the date the financial statements are available to be issued.

Grant Thornton

Auditor's responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with US GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with US GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

Grant Thornton LLP

Charlotte, North Carolina
October 31, 2022

CONSOLIDATED BALANCE SHEETS
McRae Industries, Inc. and Subsidiaries

(Dollars in thousands)	July 30, 2022	July 31, 2021
ASSETS		
Current assets:		
Cash and cash equivalents	$15,315	$23,489
Equity investments with readily determinable fair values	6,088	6,207
Debt securities	4,458	2,414
Accounts and notes receivable, less allowances of $1,290 and $1,050, respectively	26,092	16,382
Inventories, net	24,484	14,326
Prepaid expenses and other current assets	317	323
Total current assets	76,754	63,141
Property and equipment, net	5,151	5,363
Other assets:		
Deposits	14	14
Notes receivable	977	1,017
Real estate held for investment	3,036	3,238
Amounts due from split-dollar life insurance	2,288	2,288
Trademarks	2,824	2,824
Total other assets	9,139	9,381
Total assets	$91,044	$77,885

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

CONSOLIDATED BALANCE SHEETS
McRae Industries, Inc. and Subsidiaries

(Dollars in thousands)	July 30, 2022	July 31, 2021
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$5,168	$2,714
Accrued employee benefits	2,172	660
Accrued payroll and payroll taxes	1,188	700
Income tax payable	284	236
Other	958	795
Total current liabilities	9,770	5,105
Deferred tax liabilities	25	534
Total liabilities	9,795	5,639
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Common Stock:		
Class A, $1 par value; authorized 5,000,000 shares issued and outstanding, 1,895,035 and 1,893,423 shares, respectively	1,895	1,893
Class B, $1 par value; authorized 2,500,000 shares; issued and outstanding, 365,125 and 366,737 shares, respectively	365	367
Retained earnings	78,989	69,986
Total shareholders' equity	81,249	72,246
Total liabilities and shareholders' equity	$91,044	$77,885

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

CONSOLIDATED STATEMENTS OF OPERATIONS

McRae Industries, Inc. and Subsidiaries

(Dollars in thousands) **For Years Ended**	**July 30,** **2022**	**July 31,** **2021**	**August 1,** **2020**
Net revenues	$124,833	$82,191	$69,311
Cost of revenues	88,376	60,187	53,763
Gross profit	36,457	22,004	15,548
Selling, general and administrative expenses	22,924	18,165	15,973
Operating profit (loss)	13,533	3,839	(425)
Other income	449	203	562
Investment income (loss)	(572)	395	(59)
Earnings before income taxes	13,410	4,437	78
Provision for income taxes	3,211	1,085	155
Net earnings (loss)	$10,199	$3,352	($77)
Earnings per common share:			
Diluted earnings per share:			
Class A	$4.51	$1.46	$(0.03)
Class B	NA	NA	NA
Weighted average number of common shares outstanding:			
Class A	1,893,860	1,927,381	1,965,652
Class B	366,300	367,401	373,517
Total	2,260,160	2,294,782	2,339,169

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 Comprehensive Income (Loss)	Retained Earnings
	Class A		Class B			
	Shares	Amount	Shares	Amount		
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
Conversion of Class B to Class A Stock	1,612	2	(1,612)	(2)		
Cash Dividend ($0.53 per Class A common stock)						(1,003)
Cash Dividend ($0.53 per Class B common stock)						(193)
Net earnings						10,199
Balance, July 30, 2022	1,895,035	$1,895	365,125	$365	$0	$78,989

[1]Refer to note 4

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 30,** **2022**	**July 31,** **2021**	**August 1,** **2020**
Cash Flows from Operating Activities:			
Net earnings	$10,199	$3,352	($77)
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation	1,017	1,052	1,078
(Gain) loss on sale of land	(363)	70	(11)
Amortization of premiums on debt securities	14	74	6
Unrealized change in equity securities	572	(395)	59
(Gain) loss on sale of securities	102	(2)	(94)
Deferred income taxes	(509)	(158)	(12)
Changes in operating assets and liabilities:			
Accounts receivable, net	(9,710)	(8,355)	4,948
Inventories	(10,158)	3,929	1,506
Prepaid expenses and other assets	6	535	(224)
Accounts payable	2,454	(1,157)	468
Accrued employee benefits	1,512	260	(60)
Accrued payroll and payroll taxes	488	243	(256)
Income tax receivable/payable	48	1,215	(573)
Other	163	103	(59)
Net cash provided by operating activities	**(4,165)**	**766**	**6,699**
Cash Flows from Investing Activities:			
Proceeds from sale of land	566	635	31
Purchase of land for investment	-	(160)	(4)
Capital expenditures	(806)	(355)	(526)
Proceeds from sale of securities	3,551	12,762	13,465
Purchase of securities	(6,164)	(7,178)	(10,077)
Notes receivable	40	(1,017)	-
Net cash provided in investing activities	**(2,813)**	**4,687**	**2,889**
Cash Flows from Financing Activities:			
Purchase of common stock	-	(1,729)	(213)
Dividends paid	(1,196)	(1,194)	(1,215)
Net cash used in financing activities	**(1,196)**	**(2,923)**	**(1,428)**
Net Increase (Decrease) in Cash and Cash equivalents	(8,174)	2,530	8,160
Cash and Cash Equivalents at Beginning of Year	23,489	20,959	12,799
Cash and Cash Equivalents at End of Year	**$15,315**	**$23,489**	**$20,959**

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
McRae Industries, Inc. and Subsidiaries
As of and for the Years Ended July 30, 2022, July 31, 2021, and August 1, 2020

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)		
	2022	**2021**	**2020**
Total Assets:			
Western/Work Boots	$ 49,374	$ 30,606	$ 26,377
Military Boots	10,093	9,593	10,092
Corporate/Other	31,577	37,686	41,460
	$ 91,044	$ 77,885	$ 77,929

	(In thousands)		
	2022	**2021**	**2020**
Total Net Revenues:			
Western/Work Boots	$ 102,135	$ 62,772	$ 46,498
Military Boots	21,943	19,191	22,652
Corporate/Other	755	228	161
	$ 124,833	$ 82,191	$ 69,311

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 $730,000 and $750,000 for fiscal 2022 and fiscal 2021, 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

The Company measures all equity investments that do not result in consolidation and are not accounted for under the equity method at fair value with the change in fair value included in net income. We use quoted market prices to determine the fair value of equity securities with readily determinable fair values. For equity securities without readily determinable fair values, we have elected the measurement alternative under which we measure these investments at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. Management assesses each of these investments on an individual basis.

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 30, 2022 and July 31, 2021, 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 30, 2022.

Advertising

The Company charges advertising costs when incurred as a component of selling, general and administrative expenses. Advertising expense amounted to approximately $1,059,000, $595,000, and $1,097,000 for fiscal years 2022, 2021, and 2020, 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.

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 $1,362,000 and $930,000 at July 30, 2022 and July 31, 2021, respectively. Year-end inventories valued under the LIFO method were approximately $4,988,000 and $4,183,000 at July 30, 2022 and July 31, 2021, respectively. For fiscal 2022 and fiscal 2021, higher FIFO pricing resulted in an increased LIFO reserve, which decreased net earnings by approximately $333,000 and $147,000, respectively.

Inventory reserves applicable to the FIFO inventories totaled approximately $200,000 and $400,000 for fiscal 2022 and fiscal 2021, respectively.

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

	(In thousands)	
	2022	2021
Raw materials	$ 2,263	$ 1,918
Work-in-process	977	554
Finished goods	21,244	11,854
	$ 24,484	$ 14,326

3. PROPERTY AND EQUIPMENT

Property and equipment are recorded at cost. Depreciation for financial reporting purposes is provided using the straight-line method over the estimated useful lives of the assets. Estimated useful lives range from three years for computer equipment to thirty-one and one-half years for buildings. Expenditures for routine maintenance and repairs are charged to expense as incurred.

Property and equipment at July 30, 2022 and July 31, 2021 consisted of the following:

	(In thousands)	
	2022	2021
Land and improvements	$ 612	$ 612
Buildings	7,299	7,287
Machinery and equipment	8,581	7,904
Furniture and fixtures	5,594	5,489
	22,086	21,292
Less: Accumulated depreciation	(16,935)	(15,929)
	$ 5,151	$ 5,363

Depreciation expense for fiscal years ended 2022, 2021, and 2020 was approximately $1,017,000, $1,052,000, and $1,078,000, respectively.

4. INVESTMENTS

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. Debt securities classified as available-for-sale or held-to-maturity are reviewed each reporting period to determine whether a significant event or change in circumstances has occurred that may have an adverse effect on the fair value of each investment. When such events or changes occur, we evaluate the fair value compared to our cost basis in the investment. In the event the fair value of an investment declines below our cost basis, management is required to determine if the decline in fair value is other than temporary. If management determines the decline is other than temporary, an impairment charge is recorded.

As of July 30, 2022, 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	$ 6,088
Cash and cash equivalents	10,512
Total equity investments	$ 16,600

The calculation of net unrealized gains and losses recognized during the year related to equity securities still held at July 30, 2022 is as follows (in thousands):

	2022
Net gains (losses) recognized during the year related to equity securities	$ (674)
Less: Net gains (losses) recognized during the year related to equity securities sold during the year	102
Net unrealized gains (losses) recognized during the year related to equity securities still held at the end of the year	$ (572)

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

	2022	2021
Held-to-maturity securities	$ 4,458	$ 2,414
Total debt securities	$ 4,458	$ 2,414

5. NOTES PAYABLE AND LINES OF CREDIT

Lines of Credit

The Company has a $5,000,000 revolving line of credit with a bank. The Company had no outstanding borrowings under this line of credit as of July 30, 2022 and July 31, 2021. 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 2023 and is secured by the inventory and accounts receivable of the Company's western and work boot subsidiary.

The Company has an additional $1,750,000 line of credit with a bank. This line is restricted to 100% of the outstanding accounts receivable due from the U.S. Government. There were no outstanding borrowings under this line of credit as of July 30, 2022 and July 31, 2021. The line of credit expires in January 2023 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 2022, 2021 or 2020.

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 $290,000, $265,000, and $202,000, for the fiscal years ended 2022, 2021, and 2020, respectively.

Employee benefit program expense, which includes 401-K, amounted to approximately $2,427,000, $943,000, and $546,000, for the fiscal years ended 2022, 2021 and 2020, respectively.

7. INCOME TAXES

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

	2022	2021	2020
Current expense			
Federal	$ 3,236	$ 1,084	$ 118
State	484	160	49
	3,720	1,244	167
Deferred expense			
Federal	(448)	(139)	(11)
State	(61)	(19)	(1)
	$ (509)	$ (158)	$ (12)
Total tax expense	$ 3,211	$ 1,086	$ 155

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

	2022	2021	2020
Depreciation	$ (61)	$ (56)	$ (126)
Accrued employee benefits	(354)	(60)	13
Allowances for doubtful accounts	(61)	(33)	54
Allowance for sales returns	4	(38)	9
Inventory	71	125	(65)
State net operating loss carry forward	24	12	-
Unrealized Gain or Loss	(134)	-	-
Amortization	-	-	23
Prepaid Expenses	-	(94)	94
Like Kind Exchange	-	(106)	-
Other	2	92	(14)
Provision for deferred income taxes	$ 509	$ (158)	$ (12)

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

	2022	2021
Amortization	$ (653)	$ (653)
Gain on Like Kind Exchange	(134)	(134)
Depreciation	(593)	(653)
Prepaid Expenses	-	-
Noncurrent deferred tax liabilities	(1,380)	(1,440)
State net operating loss carry forward	66	90
Self Insurance	105	105
Accrued employee benefits	508	154
Allowances for doubtful accounts	131	70
Allowance for sales returns	171	175
Inventory	315	386
Unrealized (Gain)/Loss	59	(75)
Other	-	1
Noncurrent deferred tax assets	1,355	906
Net noncurrent deferred tax liabilities	$ (25)	$ (534)

State net operating loss carry forwards of $2.6 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):

	2022		2021		2020	
	Amount	Percent	Amount	Percent	Amount	Percent
Tax at U.S. statutory rate	$ 2,816	21.0 %	$ 922	21.0 %	$ 16	21.0 %
State income taxes, net of federal tax benefit	334	2.5 %	93	2.1 %	32	41.0 %
Tax adjustments	81	0.6 %	143	3.3 %	143	183.3 %
Other – net	(20)	(0.1) %	(72)	(1.6) %	(36)	(46.1) %
	$ 3,211	23.9 %	$ 1,086	24.7 %	$ 155	198.7 %

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 2022, 2021, and 2020 were approximately $3,593,000, $158,000, and $870,000, respectively.

The Company follows the applicable authoritative guidance related to accounting for uncertainty in income tax reporting. As of July 30, 2022, 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 $640,000, $639,000, and $611,000, for fiscal years ended 2022, 2021, and 2020, respectively. The future non-cancelable lease payments as of July 30, 2022 are as follows:

	2023	2024	2025	2026	2027
Lease Payments	$683,990	$606,908	$577,748	$577,748	$577,748

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, 2023. 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:

	2023
Lease Payments	$54,829
Facility Charges	$66,885

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 30, 2022 and July 31, 2021, twenty-one customers accounted for 76% and 77% of accounts receivable, respectively.

Synthetic rubber used in our vulcanizing military boot operation is currently available and purchased from the only domestic supplier known to us. Synthetic rubber is available from foreign suppliers; however, an exemption would be required from the U.S. Government to purchase synthetic rubber in the foreign market. The Vibram rubber specified outsoles are a registered product available only from Vibram USA and we depend on their ability to supply our needs. This supplier provided Vibram rubber outsoles for approximately $2.2 million and $1.6 million at July 30, 2022 and July 31, 2021 respectively.

Sales to the U.S. Government amounted to 12%, 13%, and 24%, of total consolidated net revenues for fiscal years ended 2022, 2021, and 2020, respectively. Under the terms of sale to the U.S. Government, the negotiated contract prices of combat boots are subject to renegotiation if certain conditions are present. Management does not currently expect renegotiation, if any, to have a material adverse effect on the Company's consolidated financial position or results of operations.

9. SHAREHOLDERS' EQUITY

Common Stock

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

The Company has adopted the McRae Industries, Inc. 1998 Incentive Equity Plan (the Plan). Under the Plan, 100,000 shares of the Company's Class A Common Stock are reserved for issuance to certain key employees of the Company. At July 30, 2022, 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 30, 2022 (in thousands):

	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
Equity Investments	$ 16,600	–	–	$ 16,600
Debt Securities	$ 4,458	–	–	$ 4,458

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

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 leased administrative and sales office space in Clarksville, Tennessee for the western boot business from the President of Dan Post Boot Company. The annual rent was approximately $105,000 and the lease ended on November 30, 2021.

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. The Company has recorded the principal and interest of $977,000 and $1,017,000 within other assets in the accompanying consolidated balance sheets as of July 30, 2022 and July 31, 2021, respectively.

12. SUBSEQUENT EVENTS

On September 8, 2022, the Company declared a cash dividend of $.14 per share on its Class A and Class B Common Stock payable on October 6, 2022 to shareholders of record on September 22, 2022.

Subsequent events have been evaluated through October 28, 2022, 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.*
Consultant

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 15, 2022
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Independent Auditors

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General Counsel

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