FORTITUDINIE

2023 Annual Report

McRae Industries, Inc.

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	7/29/2023	7/30/2022	7/31/2021	8/1/2020	8/3/2019
(In thousands, except per share data)					
INCOME STATEMENT DATA:					
Net revenues	$ 124,702	$ 124,833	$ 82,191	$ 69,311	$ 82,154
Net earnings (loss)	8,061	10,199	3,352	(77)	2,118
Net earnings per common share					
Diluted Earnings per share[(a)]:					
Class A	3.57	4.51	1.46	(0.03)	0.89
Class B	NA	NA	NA	NA	NA
BALANCE SHEET DATA:					
Total assets	$ 95,469	$ 91,044	$ 77,885	$ 77,929	$ 79,354
Long-term liabilities	2,047	25	534	692	704
Working capital	75,811	66,984	58,036	57,539	54,457
Shareholders' equity	86,917	81,249	72,246	71,817	73,323
Weighted average number of common shares outstanding:					
Class A	1,895,422	1,893,860	1,927,381	1,965,652	2,018,940
Class B	364,737	366,300	367,401	373,517	374,064
Weighted average number of common shares outstanding[(b)]:	2,260,159	2,260,160	2,294,782	2,339,169	2,393,004
Cash dividends per Class A common share:	$ 0.56	$ 0.53	$ 0.52	$ 0.52	$ 0.52
Cash dividends per Class B common share:	$ 0.56	$ 0.53	$ 0.52	$ 0.52	$ 0.52
Special Cash dividend per Class A and Class B common share	$ 0.50	$ 0.00	$ 0.00	$ 0.00	$ 0.50

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

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

McRae Industries

Dear Valued Shareholders,

I am pleased to present to you the McRae Industries, Inc. Annual Report for fiscal 2023.

Consolidated net revenues for fiscal 2023 totaled $124.7 million as compared to $124.8 million for fiscal 2022. This decrease in net revenues is primarily the result of decreases in our western/lifestyle products and Dan Post work boots offset by an increase in our military boot business. Net earnings for fiscal 2023 amounted to $8.1 million or $3.57 per diluted Class A common share as compared to net earnings of $10.2 million or $4.51 per diluted Class A common share for fiscal 2022.

Sales related to our western/lifestyle segment which includes western, ladies' fashion, and children's footwear under the Dan Post, Dingo, Laredo, and Eldorado brand names totaled $92.4 million for fiscal 2023 as compared to $92.8 million for fiscal 2022. This slight decrease in revenue for this segment was primarily the result of a decrease in Dan Post sales offset by an increase in Eldorado sales. Gross margin for this segment was 35.1% in fiscal 2023 as compared to 35.6% for fiscal 2022.

Sales for our work boot segment which includes Dan Post and Laredo work boots as well as our military combat boots totaled $32.9 million for fiscal 2023 as compared to $29.9 million for fiscal 2022. This increase in revenue was primarily the result of an increase in our military boot business of approximately 22% and offset by a decrease of approximately 23% in our Dan Post and Laredo work boot business.

The demand for our western/lifestyle brands remained strong throughout fiscal 2023 and this demand continued for the beginning of fiscal 2024. However, we are now starting to see a slowdown in demand. Most retailers have a substantial inventory of boots from all western brands as supply has finally caught up with demand. Hopefully these inventories will be back to normal after the holiday season and the retailers will be looking to restock their shelves. We are encouraged that most retail stores continue to have good to moderate foot traffic.

In our work boot segment, Dan Post and Laredo work boots, as previously noted, experienced a significant decrease in sales. This was the result of a softness in the work category as well as the need to freshen our product mix and pricing to become more competitive in the marketplace. In fiscal 2024, we will be introducing new work boot models with improved features and pricing.

Even though our military boot business increased sales significantly, it was another disappointing year from a profitability standpoint as we continue to be under the weight of contracts that were bid three to five years ago. This was, of course, before the significant increase in labor and material cost that we have experienced over the past two years. Although the labor market has freed up some, we continue to have challenges hiring competent associates in our manufacturing facilities. We have been the successful awardee on two U.S. Government contracts over the past 18 months which enabled us, on these contracts, to align our pricing more with the current labor and material cost. By the end of fiscal 2024, we should have only one contract remaining that was bid before the dramatic increase in labor and material cost.

The Company's financial position remains strong, as cash and cash equivalents increased from $15.3 million at the end of Fiscal 2022 to $18.3 million at the end of Fiscal 2023. With accounts receivable and inventory balances at lower levels, cash provided by operations was $16.7 million. This was offset by investing activities using approximately $11.3 million, as the Company continues to invest in short-term debt securities providing high returns. An additional $2.4 million was spent on dividends.

On September 20, 2023, the Company, through our affiliate American Mortgage and Investment Company (AMIC), completed the sale of 78 acres of undeveloped land in Berkeley County, South Carolina to Lennar Carolinas, LLC for $1,650,000. This sale was under a signed purchase sales agreement dated February 12, 2020. A second property remains under a May 2021 purchase sales agreement between Levi Grantham, LLC and AMIC. This agreement provides for Levi Grantham's purchase of approximately 168 acres of undeveloped land in Berkeley County, South Carolina for $1,600,000. This property remains under due diligence at this time.

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

Sincerely,

D. Gary McRae

D. Gary McRae
President

FINANCIAL STATEMENTS
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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors and Shareholder 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 29, 2023, and July 30, 2022, and the related consolidated statements of operations and comprehensive, shareholders' equity, and cash flows for each of the three years in the period ended July 29, 2023, 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 29, 2023, and July 30, 2022, and the results of its operations and its cash flows for each of the three years in the period ended July 29, 2023, 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.

Emphasis of matter

As discussed in Note 11 to the consolidated financial statements, the Company has changed its method of accounting for leases in 2023 due to the adoption of Accounting Standards Update No. 2016-02, *Leases (Topic 842).* Our opinion is not modified with respect to this matter.

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.

Grant Thornton

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.

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
November 3, 2023

CONSOLIDATED BALANCE SHEETS
McRae Industries, Inc. and Subsidiaries

(Dollars in thousands)	July 29, 2023	July 30, 2022
ASSETS		
Current assets:		
Cash and cash equivalents	$18,329	$15,315
Equity investments with readily determinable fair values	6,459	6,088
Debt securities	15,047	4,458
Accounts and notes receivable, less allowances of $1,365 and $1,290, respectively	19,880	26,092
Inventories, net	21,914	24,484
Income tax receivable	370	–
Prepaid expenses and other current assets	317	317
Total current assets	82,316	76,754
Property and equipment, net	4,917	5,151
Other assets:		
Deposits	14	14
Notes receivable	–	977
Right to Use Asset	2,362	–
Real estate held for investment	3,036	3,036
Amounts due from split-dollar life insurance	–	2,288
Trademarks	2,824	2,824
Total other assets	8,236	9,139
Total assets	$95,469	$91,044

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

CONSOLIDATED BALANCE SHEETS
McRae Industries, Inc. and Subsidiaries

(Dollars in thousands)	July 29, 2023	July 30, 2022
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$2,122	$5,168
Accrued employee benefits	1,783	2,172
Accrued payroll and payroll taxes	1,293	1,188
Lease Liability	429	–
Income tax payable	–	284
Other	878	958
Total current liabilities	6,505	9,770
Lease Liability	1,933	–
Deferred tax liabilities	114	25
Total liabilities	8,552	9,795
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Common Stock:		
Class A, $1 par value; authorized 5,000,000 shares issued and outstanding, 1,895,949 and 1,895,035 shares, respectively	1,896	1,895
Class B, $1 par value; authorized 2,500,000 shares; issued and outstanding, 364,211 and 365,125 shares, respectively	364	365
Retained earnings	84,657	78,989
Total shareholders' equity	86,917	81,249
Total liabilities and shareholders' equity	$95,469	$91,044

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 29, 2023	July 30, 2022	July 31, 2021
Net revenues	$124,702	$124,833	$82,191
Cost of revenues	90,808	88,376	60,187
Gross profit	33,894	36,457	22,004
Selling, general and administrative expenses	23,628	22,924	18,165
Operating profit (loss)	10,266	13,533	3,839
Other income	707	449	203
Investment income (loss)	83	(572)	395
Earnings before income taxes	11,056	13,410	4,437
Provision for income taxes	2,995	3,211	1,085
Net earnings (loss)	$8,061	$10,199	$3,352
Earnings per common share:			
Diluted earnings per share:			
Class A	$3.57	$4.51	$1.46
Class B	NA	NA	NA
Weighted average number of common shares outstanding:			
Class A	1,895,422	1,893,860	1,927,381
Class B	364,737	366,300	367,401
Total	2,260,159	2,260,160	2,294,782

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 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
Conversion of Class B to Class A Stock	914	1	(914)	(1)		
Cash Dividend ($1.06 per Class A common stock)						(2,008)
Cash Dividend ($1.06 per Class B common stock)						(385)
Net earnings						8,061
Balance, July 29, 2023	1,895,949	$1,896	364,211	$364	$0	$84,657

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 29, 2023**	**July 30, 2022**	**July 31, 2021**
Cash Flows from Operating Activities:			
Net earnings	$8,061	$10,199	$3,352
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation	985	1,017	1,052
(Gain) loss on sale of land	–	(363)	70
Amortization of ROU assets	517	–	–
Amortization of premiums on debt securities	–	14	74
Unrealized change in equity securities	(83)	572	(395)
(Gain) loss on sale of securities	102	102	(2)
Deferred income taxes	89	(509)	(158)
Changes in operating assets and liabilities:			
Accounts receivable, net	6,212	(9,710)	(8,355)
Inventories	2,570	(10,158)	3,929
Prepaid expenses and other assets	2,289	6	535
Accounts payable	(3,046)	2,454	(1,157)
Accrued employee benefits	(389)	1,512	260
Accrued payroll and payroll taxes	105	488	243
Income tax receivable/payable	(654)	48	1,215
Other	(80)	163	103
Net cash provided by operating activities	**16,678**	**(4,165)**	**766**
Cash Flows from Investing Activities:			
Proceeds from sale of land	–	566	635
Purchase of land for investment	–	–	(160)
Capital expenditures	(751)	(806)	(355)
Proceeds from sale of securities	4,816	3,551	12,762
Purchase of securities	(15,796)	(6,164)	(7,178)
Notes receivable	977	40	(1,017.00)
Lease liability - operating	(517)	–	–
Net cash provided in investing activities	**(11,271)**	**(2,813)**	**4,687**
Cash Flows from Financing Activities:			
Purchase of common stock	–	–	(1,729)
Dividends paid	(2,393)	(1,196)	(1,194)
Net cash used in financing activities	**(2,393)**	**(1,196)**	**(2,923)**
Net Increase (Decrease) in Cash and Cash equivalents	**3,014**	**(8,174)**	**2,530**
Cash and Cash Equivalents at Beginning of Year	**15,315**	**23,489**	**20,959**
Cash and Cash Equivalents at End of Year	**$18,329**	**$15,315**	**$23,489**
Supplemental schedule of noncash financing activites:			
Operating ROU asset and lease liability recognized upon adoption of ASC 842	2,879	–	–

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 29, 2023, July 30, 2022, and July 31, 2021

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)		
	2023	**2022**	**2021**
Total Assets:			
Western/Work Boots	$ 43,610	$ 49,374	$ 30,606
Military Boots	10,736	10,093	9,593
Corporate/Other	41,123	31,577	37,686
	$ 95,469	$ 91,044	$ 77,885

	(In thousands)		
	2023	**2022**	**2021**
Total Net Revenues:			
Western/Work Boots	$ 97,710	$ 102,135	$ 62,772
Military Boots	26,808	21,943	19,191
Corporate/Other	184	755	228
	$ 124,702	$ 124,833	$ 82,191

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 $710,000 and $730,000 for fiscal 2023 and fiscal 2022, 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 29, 2023 and July 30, 2022, respectively.

Leases

The Company adopted Accounting Standards Update (ASU) 2016-02, Leases (Topic 842) as of July 31, 2022. After the adoption of this standard, the Company determines if an arrangement contains a lease at inception based on whether there is an identified asset and whether the Company controls the use of the identified asset throughout the period of use. The Company classifies leases as either financing or operating. Right-of-use (ROU) assets are recognized at the lease commencement date and represent the Company's right to use an underlying asset for the lease term and lease liabilities represent the Company's obligation to make lease payments arising from the lease. Lease liabilities are recognized at the lease commencement date based on the present value of future lease payments over the remaining lease term. Present value of lease payments are discounted based upon the risk-free rate.

The Company’s operating lease ROU assets are measured based on the corresponding operating lease liability adjusted for (i) payments made to the lessor at or before the commencement date, (ii) initial direct costs incurred and (iii) lease incentives under the lease. Options to renew or terminate the lease are recognized as part of our ROU assets and lease liabilities when it is reasonably certain the options will be exercised. ROU assets are also assessed for impairments consistent with the long-lived asset guidance.

The Company does not allocate consideration between lease and non-lease components, such as operating costs, as the Company has elected to not separate lease and non-lease components for any leases within its existing classes of assets. Operating lease expense for fixed lease payments is recognized on a straight-line basis over the lease term. Operating leases are presented separately as operating lease ROU assets and operating lease liabilities in the accompanying consolidated balance sheets.

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 2019. 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 29, 2023.

Advertising

The Company charges advertising costs when incurred as a component of selling, general and administrative expenses. Advertising expense amounted to approximately $1,258,000, $1,059,000, and $595,000 for fiscal years 2023, 2022, and 2021, 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.

Recently Adopted 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 2016-02, Leases (Topic 842). This standard requires the recognition of a right-of-use asset and lease liability on the balance sheet for substantially all leases. The standard retained a dual model for lease classification, requiring leases to be classified as finance or operating lease to determine recognition in the statement of operations and cash flows. Additionally, in July 2018, the FASB issued ASU 2018-11, Leases, Targeted Improvements, which provided entities with a transition method option to not restate comparative periods presented, but to recognize a cumulative effect adjustment to beginning retained earnings in the period of adoption. The Company elected the current period adjustment method and did not restate prior comparative periods. The standards also provide additional transition relief, of which the Company has elected to (1) not reassess whether any expired or existing contracts are or contain leases, (2) retain the classification of leases (e.g., operating or finance lease) existing as of the date of adoption, (3) not reassess initial direct costs for any existing leases, and (4) not utilize hindsight when assessing lease term and ROU asset impairment. The standards require more detailed disclosures to enable users of financial statements to understand the amount, timing and uncertainty of cash flows arising from leases. The guidance is effective for public companies beginning after December 15, 2018 and nonpublic companies beginning after December 15, 2021. The Company adopted this standard as of July 31, 2022. See Note 11.

2. INVENTORIES

Current costs exceeded the LIFO value of inventories by approximately $1,717,000 and $1,362,000 at July 29, 2023 and July 30, 2022, respectively. Year-end inventories valued under the LIFO method were approximately $5,284,000 and $4,988,000 at July 29, 2023 and July 30, 2022, respectively. For fiscal 2023 and fiscal 2022, higher FIFO pricing resulted in an increased LIFO reserve, which decreased net earnings by approximately $273,000 and $333,000, respectively.

Inventory reserves applicable to the FIFO inventories totaled approximately $415,000 and $200,000 for fiscal 2023 and fiscal 2022, respectively.

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

	(In thousands)	
	2023	**2022**
Raw materials	$ 2,297	$ 2,263
Work-in-process	1,236	977
Finished goods	18,381	21,244
	$ 21,914	$ 24,484

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 29, 2023 and July 30, 2022 consisted of the following:

	(In thousands)	
	2023	**2022**
Land and improvements	$ 612	$ 612
Buildings	7,410	7,299
Machinery and equipment	9,191	8,581
Furniture and fixtures	5,624	5,594
	22,837	22,086
Less: Accumulated depreciation	(17,920)	(16,935)
	$ 4,917	$ 5,151

Depreciation expense for fiscal years ended 2023, 2022, and 2021 was approximately $991,000, $1,017,000, and $1,052,000, 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 29, 2023, 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	$ 6,459
Cash and cash equivalents	7,405
Total equity investments	$ 13,864

The calculation of net unrealized gains and losses recognized during the year related to equity securities still held at July 29, 2023 is as follows (in thousands):

	2023
Net gains (losses) recognized during the year related to equity securities	$ (19)
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	$ 83

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

	2023	2022
Held-to-maturity securities	$ 15,047	$ 4,458
Total debt securities	$ 15,047	$ 4,458

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 29, 2023 and July 30, 2022. 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 2024 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 29, 2023 and July 30, 2022. The line of credit expires in January 2024 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 2023, 2022 or 2021.

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 $355,000, $290,000, and $265,000, for the fiscal years ended 2023, 2022, and 2021, respectively.

Employee benefit program expense, which includes 401-K, amounted to approximately $1,945,000, $2,427,000, and $943,000, for the fiscal years ended 2023, 2022 and 2021, respectively.

7. INCOME TAXES

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

	2023	2022	2021
Current expense			
Federal	$ 2,564	$ 3,236	$ 1,084
State	342	484	160
	2,906	3,720	1,244
Deferred expense			
Federal	78	(448)	(139)
State	11	(61)	(19)
	$ 89	$ (509)	$ (158)
Total tax expense	$ 2,995	$ 3,211	$ 1,086

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

	2023	2022	2021
Depreciation	$ 18	$ (61)	$ (56)
Accrued employee benefits	91	(354)	(60)
Allowances for doubtful accounts	(22)	(61)	(33)
Allowance for sales returns	5	4	(38)
Inventory	(22)	71	125
State net operating loss carry forward	-	24	12
Unrealized gain or loss	20	(134)	-
Prepaid expenses	-	-	(94)
Like kind exchange	-	-	(106)
Other	(1)	2	92
Provision for deferred income taxes	$ 89	$ 509	$ (158)

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

	2023	2022
Amortization	$ (653)	$ (653)
Gain on like kind exchange	(134)	(134)
Depreciation	(611)	(593)
Right of use asset	(552)	-
Noncurrent deferred tax liabilities	(1,950)	(1,380)
State net operating loss carry forward	66	66
Self Insurance	105	105
Accrued employee benefits	417	508
Allowances for doubtful accounts	153	131
Allowance for sales returns	166	171
Inventory	337	315
Operating lease liability	552	-
Unrealized (gain)/loss	39	59
Noncurrent deferred tax assets	1,835	1,355
Net noncurrent deferred tax liabilities	$ (115)	$ (25)

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):

	2023		2022		2021	
	Amount	Percent	Amount	Percent	Amount	Percent
Tax at U.S. statutory rate	$ 2,322	21.0 %	$ 2,816	21.0 %	$ 922	21.0 %
State income taxes, net of federal tax benefit	279	2.5 %	334	2.5 %	93	2.1 %
Tax adjustments	219	2.0 %	81	0.6 %	143	3.3 %
Other – net	175	1.6 %	(20)	(0.1) %	(72)	(1.6) %
	$ 2,995	27.1 %	$ 3,211	23.9 %	$ 1,086	24.7 %

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 2023, 2022, and 2021 were approximately $3,795,000, $3,593,000, and $158,000, respectively.

The Company follows the applicable authoritative guidance related to accounting for uncertainty in income tax reporting. As of July 29, 2023, management has concluded no related liability is necessary.

8. COMMITMENTS AND CONTINGENCIES

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 29, 2023, and July 30, 2022, twenty-one customers accounted for 81% and 76% of accounts receivable, respectively.

Synthetic rubber used in our vulcanizing military boot operation is currently available and purchased from the only domestic supplier known to us. Synthetic rubber is available from foreign suppliers; however, an exemption would be required from the U.S. Government to purchase synthetic rubber in the foreign market. The Vibram rubber specified outsoles are a registered product available only from Vibram USA and we depend on their ability to supply our needs. This supplier provided Vibram rubber outsoles for approximately $3.0 million and $2.2 million at July 29, 2023 and July 30, 2022 respectively.

Sales to the U.S. Government amounted to 18%, 12%, and 13%, of total consolidated net revenues for fiscal years ended 2023, 2022, and 2021, 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 29, 2023, 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 29, 2023 (in thousands):

	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
Equity Investments	$ 13,864	–	–	$ 13,864
Debt Securities	$ 15,047	–	–	$ 15,047

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

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. The amount due was paid in full during Fiscal 2023.

11. LEASES

Upon adoption, ASC 842 Leases had an impact in the Company's consolidated balance sheet. As part of the transition, the Company elected the following practical expedients:

Package of practical expedients which eliminates the need to reassess (1) whether any expired or existing contracts are or contain leases; (2) the lease classification for any expired or existing leases; and (3) the initial direct costs for any existing leases.

The practical expedient whereby the lease and non-lease components will not be separated for all classes of assets.

Not to recognize ROU assets and corresponding lease liabilities with a lease term of 12 months or less from the lease commencement date.

Elected to use the risk-free rate as the discount rate in circumstances where the implicit lease rate is not determinable.

For existing leases, the Company elected the use of hindsight and reassessed lease term upon adoption. Short-term leases are leases having a term of twelve months or less. The Company recognizes short term leases on a straight-line basis and does not record a related lease asset or liability for such leases. Operating lease ROU assets consist of distribution centers and office facilities with terms of 3 to 17 years.

The following table presents the lease related assets and liabilities recorded on the consolidated balance sheets as of July 29, 2023 and July 31, 2022.

	7/29/23	7/31/22[a]
Assets		
Right-of-use operating assets	2,362	2,879
Liabilities		
Right-of-use operating liabilities	2,362	2,879

[a]ASC 842 adoption date

The lease costs are reflected on the consolidated statement of operations in the operating expenses.

Future undiscounted lease payments for the Company's operating lease liabilities are as follows as of July 29, 2023:

	Operating
2024	$ 491
2025	287
2026	170
2027	170
2028	170
Thereafter	1,506
Total future lease payments	2,794
Less: imputed interest	(432)
Present value of lease liabilities	$ 2,362

The weighted-average remaining lease term for operating leases is 10.95 years and the weighted average discount rate is 2.92% as of July 29, 2023.

The following disclosures primarily relate to the requirements of ASC 840 for the prior year:

Operating Leases

Under ASC 840, the Company had facility and equipment leases expiring at various dates through November 2038. Some of the agreements required the Company to pay certain operating and other expenses. Also, the leases provided for increases in future minimum rental payments based on various factors including prevailing lease rates in the local real estate markets.

Rental expenses on all operating leases were $779,000, $640,000, and $639,000, for fiscal years ended 2023, 2022, and 2021, respectively, and is included within operating expenses in the consolidated statements of operations.

The Company leases approximately 31,000 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 March 31, 2026. 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:

	2024	**2025**	**2026**
Lease Payments	$48,595	$49,838	$33,778
Facility Charges	$25,696	$26,421	$18,029

12. 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 recorded the principal and interest of $977,000 within other assets in the accompanying consolidated balance sheets as of July 30, 2022. The note was paid in full during Fiscal 2023, thus, no balance remains as of July 29, 2023.

13. SUBSEQUENT EVENTS

On September 7, 2023, the Company declared a cash dividend of $.14 per share on its Class A and Class B Common Stock payable on October 5, 2023 to shareholders of record on September 21, 2023.

Subsequent events have been evaluated through November 3, 2023, 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

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Annual Meeting

Thursday, December 21, 2023
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General Counsel

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