

FINANCIAL STATEMENTS
INDEPENDENT AUDITOR'S REPORT
AND SUPPLEMENTAL INFORMATION
HANOVER CONSUMER COOPERATIVE SOCIETY, INC.
JANUARY 3, 2015 AND DECEMBER 28, 2013

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

JANUARY 3, 2015 AND DECEMBER 28, 2013

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Independent Auditor's Report

To the Members and
Board of Directors of
Hanover Consumer Cooperative Society, Inc.

Report on the Financial Statements

We have audited the accompanying financial statements of Hanover Consumer Cooperative Society, Inc., (the Cooperative) which comprise the balance sheets as of January 3, 2015 and December 28, 2013, and the related statements of earnings, members' equity and cash flows for the fifty-three and fifty-two week periods then ended, respectively, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Cooperative as of January 3, 2015 and December 28, 2013, and the results of its operations and its cash flows for the fifty-three and fifty-two week periods then ended, respectively, in conformity with accounting principles generally accepted in the United States of America.

Other Matter

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying supplementary information is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Gallagher, Flynn & Company, LLP

March 2, 2015

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

BALANCE SHEETS

JANUARY 3, 2015 AND DECEMBER 28, 2013

A S S E T S

| | January 3, <u>2015</u> | December 28, <u>2013</u> |
|--|---------------------------|-----------------------------|
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 516,117 | \$ 959,242 |
| Certificates of indebtedness, current portion | 62,010 | 97,897 |
| Accounts receivable | 394,829 | 345,876 |
| Inventories | 1,960,228 | 2,295,164 |
| Other current assets | 369,729 | 178,129 |
| Deferred income taxes | - | 66,200 |
| Total current assets | <u>3,302,913</u> | <u>3,942,508</u> |
| PROPERTY AND EQUIPMENT, at cost | | |
| Land and improvements | 342,189 | 299,138 |
| Buildings and improvements | 8,096,116 | 8,013,192 |
| Machinery and equipment | <u>9,264,823</u> | <u>9,855,670</u> |
| | 17,703,128 | 18,168,000 |
| Less accumulated depreciation and amortization | <u>12,367,112</u> | <u>12,312,903</u> |
| | 5,336,016 | 5,855,097 |
| Construction in progress | <u>1,523,971</u> | <u>257,660</u> |
| | <u>6,859,987</u> | <u>6,112,757</u> |
| OTHER ASSETS | | |
| Investments in other cooperative associations | 1,150,453 | 1,075,817 |
| Certificates of indebtedness, less current portion | 397,215 | 376,536 |
| Other | <u>43,655</u> | <u>38,492</u> |
| | <u>1,591,323</u> | <u>1,490,845</u> |
| | <u>\$ 11,754,223</u> | <u>\$ 11,546,110</u> |

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

BALANCE SHEETS

JANUARY 3, 2015 AND DECEMBER 28, 2013

LIABILITIES AND MEMBERS' EQUITY

| | <u>January 3,</u> <u>2015</u> | <u>December 28,</u> <u>2013</u> |
|--|----------------------------------|------------------------------------|
| CURRENT LIABILITIES | | |
| Current maturities of long-term debt | \$ 325,914 | \$ 302,043 |
| Accounts payable | 2,111,632 | 2,012,399 |
| Accrued payroll and benefits | 1,013,808 | 940,365 |
| Accrued expenses | 592,549 | 525,275 |
| Patronage refunds payable | 100,235 | 248,084 |
| Income taxes payable | 122 | 44,047 |
| Total current liabilities | <u>4,144,260</u> | <u>4,072,213</u> |
| OTHER NON-CURRENT PAYABLES | <u>243,468</u> | <u>-</u> |
| LONG-TERM DEBT, less current maturities | <u>37,769</u> | <u>647,564</u> |
| DEFERRED INCOME TAXES | <u>428,200</u> | <u>523,500</u> |
| MEMBERS' EQUITY | | |
| Capital stock | 3,365,766 | 2,938,107 |
| Donated capital | 42,966 | 42,966 |
| Retained earnings | <u>3,491,794</u> | <u>3,321,760</u> |
| | <u>6,900,526</u> | <u>6,302,833</u> |
| | <u>\$ 11,754,223</u> | <u>\$ 11,546,110</u> |

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF EARNINGS

**FIFTY-THREE WEEK PERIOD ENDED JANUARY 3, 2015 AND
FIFTY-TWO WEEK PERIOD ENDED DECEMBER 28, 2013**

| | January 3, <u>2015</u> | December 28, <u>2013</u> |
|--|---------------------------|-----------------------------|
| NET REVENUES | \$ 74,867,478 | \$ 74,109,483 |
| COST OF SALES | <u>50,864,374</u> | <u>50,173,018</u> |
| GROSS PROFIT | 24,003,104 | 23,936,465 |
| OPERATING EXPENSES | <u>23,165,006</u> | <u>23,163,470</u> |
| EARNINGS FROM OPERATIONS | <u>838,098</u> | <u>772,995</u> |
| OTHER (INCOME) EXPENSE | | |
| Interest income | (26,604) | (29,953) |
| Interest expense | 23,753 | 45,685 |
| Miscellaneous income | <u>(2,634)</u> | <u>(48,135)</u> |
| | <u>(5,485)</u> | <u>(32,403)</u> |
| EARNINGS BEFORE PATRONAGE REFUND AND INCOME TAXES | 843,583 | 805,398 |
| PATRONAGE REFUND | <u>501,178</u> | <u>496,168</u> |
| EARNINGS BEFORE INCOME TAXES | 342,405 | 309,230 |
| PROVISION FOR INCOME TAXES | <u>172,371</u> | <u>174,853</u> |
| NET EARNINGS | <u>\$ 170,034</u> | <u>\$ 134,377</u> |

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF MEMBERS' EQUITY

**FIFTY-THREE WEEK PERIOD ENDED JANUARY 3, 2015 AND
FIFTY-TWO WEEK PERIOD ENDED DECEMBER 28, 2013**

| | Capital Stock | Donated Capital | Retained Earnings | Total |
|--|----------------------|----------------------------|------------------------------|--------------|
| BALANCE, December 30, 2012 | \$ 2,667,370 | \$ 42,966 | \$ 3,187,383 | \$ 5,897,719 |
| Net earnings | - | - | 134,377 | 134,377 |
| Shares issued, net of cancellations | 22,653 | - | - | 22,653 |
| Allocation of patronage refund to be issued as capital stock | 248,084 | - | - | 248,084 |
| BALANCE, December 28, 2013 | 2,938,107 | 42,966 | 3,321,760 | 6,302,833 |
| Net earnings | - | - | 170,034 | 170,034 |
| Shares issued, net of cancellations | 26,716 | - | - | 26,716 |
| Allocation of patronage refund to be issued as capital stock | 400,943 | - | - | 400,943 |
| BALANCE, January 3, 2015 | \$ 3,365,766 | \$ 42,966 | \$ 3,491,794 | \$ 6,900,526 |

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF CASH FLOWS

**FIFTY-THREE WEEK PERIOD ENDED JANUARY 3, 2015 AND
FIFTY-TWO WEEK PERIOD ENDED DECEMBER 28, 2013**

| | January 3, <u>2015</u> | December 28, <u>2013</u> |
|--|---------------------------|-----------------------------|
| DECREASE IN CASH AND CASH EQUIVALENTS | | |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net earnings | \$ 170,034 | \$ 134,377 |
| Noncash items included in net earnings: | | |
| Depreciation and amortization | 957,567 | 943,297 |
| Patronage refund declared | 501,178 | 496,168 |
| Patronage certificates of indebtedness received | (82,689) | (74,523) |
| Patronage investments in cooperatives received | (65,706) | (26,580) |
| Deferred income taxes | (29,100) | (26,300) |
| Changes in assets and liabilities: | | |
| Accounts receivable | (48,953) | 182,290 |
| Inventory | 334,936 | 33,723 |
| Income taxes receivable | - | 64,976 |
| Other current assets | (196,763) | (68,574) |
| Accounts payable | 99,233 | (468,118) |
| Accrued expenses and other current liabilities | 140,717 | (284,726) |
| Income taxes payable | (43,925) | 44,047 |
| | <u>1,566,495</u> | <u>815,680</u> |
| Net cash provided by operating activities | <u>1,736,529</u> | <u>950,057</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Capital expenditures | (1,461,329) | (1,240,262) |
| Purchase of investments | (8,930) | (9,551) |
| Proceeds from repayments of certificates of indebtedness | 97,897 | 35,910 |
| Net cash used in investing activities | <u>(1,372,362)</u> | <u>(1,213,903)</u> |
| Subtotal (forward) | <u>\$ 364,167</u> | <u>\$ (263,846)</u> |

(CONTINUED)

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF CASH FLOWS

**FIFTY-THREE WEEK PERIOD ENDED JANUARY 3, 2015 AND
FIFTY-TWO WEEK PERIOD ENDED DECEMBER 28, 2013**

| | January 3, <u>2015</u> | December 28, <u>2013</u> |
|---|---------------------------|-----------------------------|
| Subtotal (forwarded) | \$ 364,167 | \$ (263,846) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Principal payments on long-term debt | (585,924) | (289,623) |
| Patronage refund liability paid | (248,084) | (334,646) |
| Proceeds from issuance (payments for repurchase) of capital stock, net | <u>26,716</u> | <u>22,653</u> |
| Net cash used in financing activities | <u>(807,292)</u> | <u>(601,616)</u> |
| Net decrease in cash and cash equivalents | (443,125) | (865,462) |
| CASH AND CASH EQUIVALENTS, beginning of period | <u>959,242</u> | <u>1,824,704</u> |
| CASH AND CASH EQUIVALENTS, end of period | <u>\$ 516,117</u> | <u>\$ 959,242</u> |
| <u>Supplemental Disclosures of Cash Flows Information</u> | | |
| Cash paid during the period for: | | |
| Interest expense | <u>\$ 17,379</u> | <u>\$ 39,311</u> |
| Income taxes | <u>\$ 157,546</u> | <u>\$ 180,224</u> |

Noncash investing and financing activities:

The Cooperative incurred approximately \$243,000 of construction in progress, which is included in other non-current payables at January 3, 2015.

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 3, 2015 AND DECEMBER 28, 2013

A) SUMMARY OF OPERATIONS AND ACCOUNTING POLICIES

Operations:

The Hanover Consumer Cooperative Society, Inc., (the Cooperative) was incorporated in New Hampshire in 1937. The Cooperative operates member-owned food stores in Hanover and Lebanon, New Hampshire, and White River Junction, Vermont, a community market in Hanover, New Hampshire, and an automobile service center in Hanover, New Hampshire, which are open to its members and the general public. In addition, the Cooperative leases and operates a commissary kitchen in Wilder, Vermont, which prepares food products for resale through the Cooperative's food stores. The majority of sales are to members of the Cooperative. Sales to members were approximately 74% of total sales for the periods ending January 3, 2015 and December 28, 2013. Sales of grocery-related items were 93% of total sales in 2014 and 2013, and sales of automobile fuel and repair services were 7% of total sales in 2014 and 2013.

Accounting policies:

A summary of the Cooperative's significant accounting policies applied in the preparation of the accompanying financial statements follows:

1. Fiscal year end

The Cooperative's fiscal year ends on the Saturday nearest to December 31. The fiscal periods ended January 3, 2015 and December 28, 2013 included fifty-three and fifty-two weeks, respectively.

2. Cash and cash equivalents

For purpose of the statement of cash flows, the Cooperative considers all highly liquid instruments purchased with a maturity of three months or less to be cash equivalents.

3. Accounts receivables

Trade accounts are stated at the amount the Cooperative expects to collect from sales of products. The Cooperative maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Management considers the following factors when determining the collectibility of these receivables: customer creditworthiness, programmatic discounts and allowances, past transaction history, current economic industry trends, and changes in payment terms. If the financial condition of the Cooperative's customers was to deteriorate, adversely affecting their ability to make payments, additional allowances would be required. Based on management's assessment, the Cooperative provides for estimated uncollectible amounts through a charge to earnings and a credit to a valuation allowance. At January 3, 2015 and December 28, 2013, no allowance was required.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 3, 2015 AND DECEMBER 28, 2013

A) SUMMARY OF OPERATIONS AND ACCOUNTING POLICIES (continued)

4. Inventory and cost of goods sold

Inventory is stated at the lower of cost or market. Cost is determined principally by the first-in-first out (FIFO) method.

5. Property and equipment

Depreciation and amortization are provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives. Leasehold improvements are amortized over the lives of the respective leases or the service lives of the improvements, whichever are shorter. The straight-line method of depreciation is followed for substantially all assets for financial reporting purposes, but accelerated methods are used for tax purposes.

6. Impairment of long-lived assets

Long-lived assets, such as property and equipment, and purchased intangibles subject to amortization, are reviewed 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 estimated undiscounted future cash flows. An impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. During 2015 and 2013, no significant impairment loss was required to be recognized.

7. Investment in other cooperative associations

Nonmarketable investments in cooperative associations are carried at cost and are evaluated for impairment annually to adjust the investments to their net realizable value. During 2015 and 2013, no impairment loss was required to be recognized.

8. Income taxes

Temporary differences giving rise to deferred income taxes consist primarily of the excess of depreciation for tax purposes over the amount for financial reporting purposes, an impairment write-down recognized for financial reporting purposes not for tax purposes, accrued compensation, patronage refunds earned on investments in other cooperatives, and certain expenses, which are reported differently for financial reporting and tax purposes.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 3, 2015 AND DECEMBER 28, 2013

A) SUMMARY OF OPERATIONS AND ACCOUNTING POLICIES (continued)

8. Income taxes (continued)

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50% likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Interest and penalties associated with unrecognized tax benefits are classified as additional income taxes in the statements of earnings.

9. Advertising expenses

Advertising costs are charged to operations when incurred. Advertising expense was approximately \$219,000 and \$231,000 for the periods ended January 3, 2015 and December 28, 2013, respectively.

10. Use of estimates

In preparing financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates.

11. Evaluation of subsequent events

In preparing these financial statements, the Cooperative has evaluated events and transactions for potential recognition or disclosure through March 2, 2015, the date the financial statements were available to be issued.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 3, 2015 AND DECEMBER 28, 2013

B) CONCENTRATION OF CREDIT RISK

The Cooperative maintains bank account balances which, at times, may exceed federally insured limits. The Cooperative has mitigated its concentration of credit risk relative to its cash balances by entering into an overnight repurchase agreement with its financial institution. The Cooperative has not experienced any losses with these accounts. Management believes the Cooperative is not exposed to any significant credit risk on cash.

C) CERTIFICATES OF INDEBTEDNESS

Certificates of indebtedness primarily consist of amounts due from Associated Grocers of New England, Inc., (AG) with interest rates ranging from 3.25% to 4.5%, maturing at various times through June 2020. The Cooperative is issued certificates of indebtedness to satisfy patronage rebates declared by AG (see Note D). Amounts due under these agreements totaled \$459,225 and \$474,433 at January 3, 2015 and December 28, 2013, respectively. The Cooperative evaluates collectability by evaluating the financial condition of AG and provides for estimated uncollectible amounts through a charge to earnings and a credit to a valuation allowance, if warranted. At January 3, 2015 and December 28, 2013, no valuation allowance was required.

At January 3, 2015 certificates of indebtedness mature as follows:

| Fiscal Periods Ending on or Around <u>December 31,</u> | <u>Amount</u> |
|---|-------------------|
| 2015 | \$ 62,010 |
| 2016 | 56,201 |
| 2017 | 93,449 |
| 2018 | 90,353 |
| 2019 | 74,523 |
| Thereafter | <u>82,689</u> |
| | <u>\$ 459,225</u> |

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 3, 2015 AND DECEMBER 28, 2013

D) INVESTMENTS IN OTHER COOPERATIVE ASSOCIATIONS

The investments in cooperative associations are nonmarketable investments, which consist of the following at:

| | <u>January 3, 2015</u> | <u>December 28, 2013</u> |
|--|----------------------------|------------------------------|
| National Consumer Cooperative Bank (NCCB): | | |
| A cooperative financial services Cooperative that provides members with patronage rebates in cash and shares of Class B2 and C2 stock. The Cooperative recognizes patronage rebates earned in Class C2 stock, which is nonredeemable, eligible to pay cash dividends, transferable to eligible members, subject to approval. The Cooperative also receives and holds Class B2 stock in connection with its patronage-based loans from NCCB (see Note F). Class B2 stock does not pay dividends, is nontransferable and nonredeemable; therefore, the Cooperative does not recognize any value for Class B2 stock received. There were no patronage rebates issued during 2015 or 2013. At January 3, 2015 and December 28, 2013, the Cooperative owned 2,027 shares of Class C2 stock. | \$ 202,701 | \$ 202,701 |
| Associated Grocers of New England, Inc. (AG): | | |
| A membership organization that provides members with discounted purchase pricing and annual patronage rebates in cash, certificates of indebtedness (see Note C), and patronage shares. Members initially purchase one share of Class A stock at \$5,000 and annually purchase additional shares of Class B stock based on total merchandise purchases. Class A and B stock are nonredeemable and eligible to pay cash dividends. At January 3, 2015 and December 28, 2013, the Cooperative owns three shares of Class A stock. At January 3, 2015 and December 28, 2013, the Cooperative owned 5,435 and 5,167 shares of Class B stock, respectively. | 784,059 | 768,143 |
| Other | <u>163,693</u> | <u>104,973</u> |
| | <u>\$1,150,453</u> | <u>\$1,075,817</u> |

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 3, 2015 AND DECEMBER 28, 2013

E) NOTE PAYABLE

At January 3, 2015, the Cooperative had available a \$1,000,000 revolving line of credit with Mascoma Savings Bank, due October 2015. Interest was payable monthly and carried an interest rate at *The Wall Street Journal* prime rate (3.25% at January 3, 2015). The note was secured by substantially all assets of the Cooperative. There were no borrowings related to this agreement outstanding at January 3, 2015 and December 28, 2013. The line of credit was refinanced in February 2015 to a \$1,000,000 line of credit with NCCB (see Note M).

F) LONG-TERM DEBT

Long-term debt consists of a patronage-based note payable with NCB, FSB, a federally chartered subsidiary of National Consumer Cooperative Bank (NCCB). The note is payable in monthly installments of \$27,877, including interest at 4%, due March 2016. The note is secured by a building, equipment and the assignment of a lease (see Note I) and is subject to certain financial ratios, as defined.

As of January 3, 2015 long-term debt matures as follows:

| Fiscal Periods Ending on or Around <u>December 31,</u> | <u>Amount</u> |
|---|-------------------|
| 2015 | \$ 325,914 |
| 2016 | <u>37,769</u> |
| | <u>\$ 363,683</u> |

G) INCOME TAXES

The provision for income taxes consists of the following:

| | <u>January 3, 2015</u> | <u>December 28, 2013</u> |
|-------------------|----------------------------|------------------------------|
| Currently payable | \$ 201,471 | \$ 201,153 |
| Deferred | <u>(29,100)</u> | <u>(26,300)</u> |
| | <u>\$ 172,371</u> | <u>\$ 174,853</u> |

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 3, 2015 AND DECEMBER 28, 2013

G) INCOME TAXES (continued)

Deferred tax assets and liabilities consist of the following at:

| | January 3, <u>2015</u> | December 28, <u>2013</u> |
|---|---------------------------|-----------------------------|
| Deferred tax assets: | | |
| Inventory valuation | \$ 10,700 | \$ 13,900 |
| Investment valuation | - | 22,600 |
| Accrued compensation | 96,100 | 93,900 |
| Unclaimed patronage refund | 46,800 | 46,800 |
| State of New Hampshire Business Enterprise tax credit carryforward | 292,000 | 236,500 |
| Other | <u>15,700</u> | <u>14,000</u> |
| | 461,300 | 427,700 |
| Valuation allowance | <u>(292,000)</u> | <u>(236,500)</u> |
| | <u>\$ 169,300</u> | <u>\$ 191,200</u> |
| Deferred tax liabilities: | | |
| Depreciation and impairment write down | \$ 339,300 | \$ 442,900 |
| Patronage refunds on investments in other cooperatives | 124,500 | 148,700 |
| Prepaid expenses | <u>133,700</u> | <u>56,900</u> |
| | <u>\$ 597,500</u> | <u>\$ 648,500</u> |

The valuation allowance increased by \$55,500 and \$42,800 during 2014 and 2013, respectively. The valuation allowance consists of an allowance against the New Hampshire Business Enterprise tax credit carried forward, which is unlikely to be realized.

The Cooperative's effective income tax rate in the periods ended January 3, 2015 and December 28, 2013 is higher than would be expected if the federal statutory rate was applied to earnings primarily because the State of New Hampshire Business Enterprise tax is accounted for as an income tax.

The Cooperative files income tax returns in the U.S. federal jurisdiction and two state jurisdictions. With few exceptions, the Cooperative is no longer subject to U.S. federal, state or local income tax examinations by tax authorities for fiscal periods before January 1, 2011.

During the periods ended January 3, 2015 and December 28, 2013, the Cooperative recognized no interest or penalties related to unrecognized tax benefits.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 3, 2015 AND DECEMBER 28, 2013

H) MEMBERS' EQUITY

The Cooperative's legal organization is determined by federal and state laws and by its Bylaws and Certificate of Organization.

On October 28, 2013, the Cooperative's membership approved amendments to the Cooperative's bylaws. Certain amendments to the adopted bylaws became effective upon the membership's approval of the amendment of the Certificate of Organization on April 30, 2014.

Revised Bylaws

Capital stock: The adopted Bylaw and Certificate of Organization amendments authorized 2,000,000 shares of stock, which is established in two classes of capital stock: voting Class A shares, which have a \$5 par value and are issued in consideration of becoming a member of the cooperative, and non-voting Class B shares, which have a \$5 par value and are issued to members as patronage refunds in lieu of cash payments. Dividends are not paid on Class A or Class B stock. All shares issued prior to the amendment date were converted to Class A shares. After October 28, 2013 an individual or organization may become a voting member of the Cooperative by owning ten shares of Class A stock. Prior to October 28, 2013, three shares of stock were required to become a voting member. Individuals and organizations owning three or more shares, but less than ten shares as of October 28, 2013, maintain their status as voting members, provided they own ten Class A shares by October 28, 2016. If a member decides to discontinue membership and request a refund, the Cooperative, at the discretion of the Board, may repurchase all shares from a member. Any person owning fewer than ten shares is referred to as "a subscriber."

Prior to the revision, the value of partial share credits were recorded when the noncash portion of a patronage refund for an individual patron was less than the par value required to purchase a share of stock. The amount remained until it accumulated to the value of a full share. If there was no activity for eight years, the shares were transferred to donated capital. According to the revised bylaws, the partial shares are retained and are allowable credits toward the purchase of additional shares of Class A stock.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 3, 2015 AND DECEMBER 28, 2013

H) MEMBERS' EQUITY (continued)

Revised Bylaws (continued)

Patronage refunds: Patronage refunds are determined under a formula by applying the percentage of sales to members and non-member patrons to calculate member net earnings and non-member net earnings (also known as "savings"). Member net earnings, before the provision for federal income taxes, is then allocated as patronage refunds to each member based on the percentage of that member's purchases to total member purchases. Per the revised bylaws, the Board may issue patronage refunds in the form of cash, written notices of allocation, credit towards purchases at the Cooperative, or credit towards payment of Class A or Class B stock. Up to 80% of the refund may be distributed in the form of additional shares or written notices of allocation. A subscriber patron shall receive patronage refunds in the form of credit to the patron's account until the amount of capital subscribed has been fully paid. Non-member patrons may receive patronage refunds only in the form of Class A shares in order to obtain the ten share membership requirement and is responsible for providing satisfactory evidence of applicable purchases.

Original Bylaws

Capital stock: A person or organization could have become a voting member of the Cooperative by owning three shares of stock. If a member decided to discontinue membership and request a refund, the Cooperative, at the discretion of the Board, could have repurchased shares from a member and refunded all amounts received toward the purchase of a membership share.

Patronage refunds: The Board could have issued patronage refunds in the form of cash, certificates of indebtedness, credit toward purchases at the Cooperative, or up to 50% of the distribution could have been made in the form of credits towards the purchase of capital stock. Members with less than ten shares of stock received 80% of the amount allocated in credits toward additional shares of capital stock. Non-members were credited with payments towards stock subscriptions in individual subscription accounts until the account accumulated to fifteen dollars in order to meet the three-share membership requirement. The patronage refund rate could not have exceeded the amount of net earnings before provision for income taxes allocable to members based upon the percentage of sales to members. In addition, the amount retained was required to be the greater of the amount of net savings for the year multiplied by the 10% or the net savings before provision for income taxes at the percent of non-member sales plus the related income taxes. The Board could have approved a higher refund rate in the event that the retained patronage ("reserve fund") exceeded 30% of paid-in and subscribed capital as of the end of the fiscal year.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 3, 2015 AND DECEMBER 28, 2013

H) MEMBERS' EQUITY (continued)

Patronage refunds declared and issued

Total patronage refunds were \$501,178 and \$496,168 for the periods ended January 3, 2015 and December 28, 2013, respectively. For the period ended January 3, 2015, the Board authorized issuance of \$100,235 of the refund in cash and \$400,943 in credits to be redeemed for additional common stock in the future. For the period ended December 28, 2013, the Board authorized issuance of \$248,084 of the refund in cash and \$248,084 in credits, which were redeemed for common stock in 2014. The cash portion is reflected as a current liability and the credits for additional common stock portion as an allocation to equity.

Capital stock

Capital stock is comprised of the following at:

| | January 3, <u>2015</u> | December 28, <u>2013</u> |
|--|---------------------------|-----------------------------|
| Common stock, 2,000,000 shares authorized | | |
| Class A, \$5 per share par value authorized; 582,832 shares issued and outstanding at January 3, 2015 and 527,993 shares issued and outstanding at December 28, 2013 | \$2,914,160 | \$2,639,965 |
| Class B \$5 per share par value authorized; 0 shares issued and outstanding at January 3, 2015 and December 28, 2013 | - | - |
| Allocation of value of partial share credits | 50,663 | 50,058 |
| Allocation of patronage refund to be issued in equity in the following year | <u>400,943</u> | <u>248,084</u> |
| Total | <u>\$3,365,766</u> | <u>\$2,938,107</u> |

I) COMMITMENTS AND CONTINGENCIES

Operating leases

The Cooperative leases facilities in Lebanon, New Hampshire, for the operation of one of its food stores. Base rent currently approximates \$60,000 per month, plus an allocation of common area maintenance costs, through June 2017, with an option to extend an additional five years. The base rent is adjusted annually based on the Consumer Price Index (CPI), as defined.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 3, 2015 AND DECEMBER 28, 2013

I) COMMITMENTS AND CONTINGENCIES (continued)

Operating leases (continued)

The Cooperative leases facilities in White River Junction, Vermont, for the operation of another of its food stores. Base rent currently approximates \$14,000 per month. In September 2014, the Cooperative exercised an option to extend the lease term through May 2025. Effective May 2015 the base rent will be approximately \$17,000 per month, with an annual 2.5% increase, through May 2025.

The Cooperative has a lease for land upon which the community market in Hanover, New Hampshire, is operated in a building built and owned by the Cooperative from the proceeds of long-term debt (see Note F). Base rent is approximately \$4,000 per month through February 2034, with an option to extend an additional ten years. The base rent is adjusted annually based on the CPI, as defined. At the end of the lease term, the lessor shall acquire all rights, title and interest in the building.

The Cooperative leases facilities in Wilder, Vermont, on a triple-net basis, for the operation of a commissary kitchen. Base rent currently approximates \$3,000 per month, adjusted annually based on the CPI, as defined. The lease is in effect through November 2019. The Cooperative has the option to renew the lease for two additional two-year terms.

The Cooperative leases administrative offices in in Hanover, New Hampshire. Base rent is approximately \$9,000 per month adjusted annually based on the CPI, as defined, with a minimum increase of 1% each year, expiring in February 2018.

Future minimum lease payments in the aggregate and for each of the next five fiscal years are approximately as follows:

| <u>Fiscal Periods</u> <u>Ending on or</u> <u>Around</u> <u>December 31,</u> | <u>Amount</u> |
|--|--------------------|
| 2015 | \$1,113,000 |
| 2016 | 1,131,000 |
| 2017 | 774,000 |
| 2018 | 325,000 |
| 2019 | 309,000 |
| Thereafter | <u>2,009,000</u> |
| | <u>\$5,661,000</u> |

The Cooperative had rental expense under operating leases of approximately \$1,366,000 and \$1,354,000 for the periods ended January 3, 2015 and December 28, 2013, respectively.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 3, 2015 AND DECEMBER 28, 2013

I) COMMITMENTS AND CONTINGENCIES (continued)

Guarantee of debt

The Cooperative guarantees debt held by the Littleton Consumer Cooperative Society, Inc., with Cooperative Fund of New England, Inc. (CFNE), up to \$150,000. In the event of default, the Cooperative will satisfy this guarantee through the purchase of sellable inventory from CFNE in the amount owed at 50% of the invoice price. This guarantee shall remain in effect until full extinguishment of the debt.

Other commitments

In September 2014, the Cooperative commenced renovations of its food store in Hanover, New Hampshire. In connection with these renovations, the Cooperative entered into a construction contract of approximately \$3,200,000 and has remaining commitments under this contract of approximately \$2,500,000 at January 3, 2015. The Cooperative also entered into various other agreements related to the renovation, with additional commitments totaling approximately \$1,200,000 for machinery and equipment and \$337,000 for services as of January 3, 2015.

J) PROGRESS SHARING PLAN

The Cooperative is an “authorized employer” in the multi-employer Associated Grocers 401(k) Savings Plan (AG Plan) and maintains all employee accounts in the AG Plan. The AG Plan covers all employees who met the eligibility requirements and provides for a guaranteed safe harbor non-elective contribution equal to 3% of compensation. The AG Plan also provides for a discretionary Cooperative contribution.

The Cooperative reported pension expense with respect to the Plans of approximately \$342,000 and \$339,000 at January 3, 2015 and December 28, 2013, respectively. There were no discretionary amounts provided for the periods ended January 3, 2015 and December 28, 2013.

K) MAJOR SUPPLIERS

During the period ended January 3, 2015, the Cooperative purchased approximately \$21,113,000 (42% of total purchases) of its goods from an unrelated party and AG, a related party (see Note D). At January 3, 2015, amounts due to these suppliers, included in accounts payable, totaled approximately \$572,000.

During the period ended December 28, 2013, the Cooperative purchased approximately \$20,254,000 (40% of total purchases) of its goods from an unrelated party and AG, a related party (see Note D). At December 28, 2013, amounts due to these suppliers, included in accounts payable, totaled approximately \$664,000.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 3, 2015 AND DECEMBER 28, 2013

L) RELATED-PARTY TRANSACTIONS

The Cooperative is a member of AG (see Note D). The Cooperative purchased goods and groceries from AG of approximately \$12,384,000 and \$12,472,000 during the periods ended January 3, 2015 and December 28, 2013, respectively. Amounts due to AG, included in accounts payable, were approximately \$188,000 and \$234,600 at January 3, 2015 and December 28, 2013, respectively. Patronage refunds due from AG, included in accounts receivable, were approximately \$125,500 and \$130,000 at January 3, 2015 and December 28, 2013, respectively.

The Cooperative offers a 20% discount on purchases made by employees and board members. Total gross sales to employees and board members for the periods ended January 3, 2015 and December 28, 2013 were approximately \$1,500,000 and \$1,537,600, respectively. The discounts on these sales were netted against the gross sales in the statement of earnings and approximated \$326,400 and \$307,500, for the periods ended January 3, 2015 and December 28, 2013, respectively.

Amounts due from members of approximately \$128,500 and \$132,700 are included in accounts receivable at January 3, 2015 and December 28, 2013, respectively.

M) SUBSEQUENT EVENTS

In February 2015, the Cooperative entered into a construction loan agreement with NCCB to fund renovations of its Hanover food store (see Note I). Additionally, the Cooperative refinanced the Mascoma Bank line of credit agreement (see Note E) with an agreement with NCCB. The \$3,840,000 NCCB construction loan agreement is payable in interest-only payments at the greater of *The Wall Street Journal* prime rate plus 0.5% or 4%, until January 1, 2016. Beginning February 1, 2016, the note is payable in monthly equal installments through February 1, 2026, including interest at the greater of the Ten-Year U.S. Treasury Note Yield on January 1, 2016, plus 0.25% or 5%. The note is secured by a first mortgage on certain real estate and substantially all assets of the Cooperative. The line of credit agreement provides a \$1,000,000 revolving line of credit, with interest payable monthly at *The Wall Street Journal* prime rate, due March 2016, secured by a first mortgage on certain real estate and substantially all assets of the Cooperative.

At January 3, 2015, the Cooperative had amounts due of approximately \$243,000 for costs related to the renovation of its Hanover food store that will be refinanced on a long-term basis with the aforementioned note payable with NCCB and, as a result, the amounts are presented as "other non-current payables" at January 3, 2015.

SUPPLEMENTAL INFORMATION

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

SCHEDULE OF OPERATING EXPENSES

**FIFTY-THREE WEEK PERIOD ENDED JANUARY 3, 2015 AND
FIFTY-TWO WEEK PERIOD ENDED DECEMBER 28, 2013**

| | January 3, <u>2015</u> | December 28, <u>2013</u> |
|--------------------------------------|---------------------------|-----------------------------|
| Store operations expenses: | | |
| Store wages and benefits | \$ 12,008,575 | \$ 11,931,403 |
| Facilities cost | 2,883,522 | 2,756,472 |
| Equipment costs | 792,882 | 789,184 |
| Credit card expenses | 986,617 | 964,067 |
| Selling and other costs | <u>1,051,326</u> | <u>1,041,216</u> |
| | <u>17,722,922</u> | <u>17,482,342</u> |
| General and administrative expenses: | | |
| Education expenses | 583,046 | 588,689 |
| Gain sharing expense | 16,583 | 223,328 |
| Administrative expenses | 1,010,663 | 1,019,590 |
| Board of director's expenses | 103,296 | 100,342 |
| Human resources department | 425,692 | 391,570 |
| Finance department | 678,418 | 665,873 |
| Merchandising expenses | 850,653 | 942,649 |
| Marketing expenses | 482,597 | 459,804 |
| Information technology department | 907,031 | 895,367 |
| Facilities maintenance department | <u>384,105</u> | <u>393,916</u> |
| | <u>5,442,084</u> | <u>5,681,128</u> |
| | <u>\$ 23,165,006</u> | <u>\$ 23,163,470</u> |

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

SCHEDULE OF GENERAL AND ADMINISTRATIVE EXPENSES

**FIFTY-THREE WEEK PERIOD ENDED JANUARY 3, 2015 AND
FIFTY-TWO WEEK PERIOD ENDED DECEMBER 28, 2013**

| | January 3, <u>2015</u> | December 28, <u>2013</u> |
|--|---------------------------|-----------------------------|
| Salaries and benefits | \$ 3,610,952 | \$ 3,694,673 |
| Equipment expenses | 332,102 | 269,264 |
| Professional fees | 308,798 | 212,697 |
| Advertising | 219,095 | 220,206 |
| Building leases | 177,316 | 222,444 |
| Telephone | 148,465 | 182,788 |
| Equipment depreciation | 121,422 | 67,275 |
| Education and training | 88,217 | 50,428 |
| Dues and subscriptions | 72,833 | 81,272 |
| Consulting fees | 50,736 | 46,390 |
| Supplies | 44,547 | 82,132 |
| Occupancy costs | 36,180 | 29,733 |
| Meals, entertainment and vehicle reimbursement | 35,304 | 39,919 |
| Graphics and promotional expenses | 28,340 | 14,467 |
| Gain sharing expense | 16,583 | 223,328 |
| Demo expenses | 16,263 | 25,291 |
| Printing | 16,197 | 11,310 |
| Employee relations and programs | 15,525 | 27,739 |
| Insurance | 14,844 | 14,844 |
| Co-op News | 14,807 | 30,846 |
| Postage | 14,027 | 17,284 |
| Technical maintenance contracts | 13,461 | 23,188 |
| Bank charges | 12,989 | 14,802 |
| Contributions | 8,203 | 11,694 |
| Software licenses | 6,750 | 19,525 |
| Membership meeting | 683 | 14,035 |
| Other | <u>17,445</u> | <u>33,554</u> |
| | <u>\$ 5,442,084</u> | <u>\$ 5,681,128</u> |