

FINANCIAL STATEMENTS
INDEPENDENT AUDITOR'S REPORT
AND SUPPLEMENTAL INFORMATION
HANOVER CONSUMER COOPERATIVE SOCIETY, INC.
DECEMBER 31, 2016 AND JANUARY 2, 2016

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

DECEMBER 31, 2016 AND JANUARY 2, 2016

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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 December 31, 2016 and January 2, 2016, and the related statements of operations, members' equity and cash flows for the fifty-two week periods then ended, 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 December 31, 2016 and January 2, 2016, and the results of its operations and its cash flows for the fifty-two week periods then ended, 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 included in the Schedule of Operating Expenses for the fifty-two week periods ended December 31, 2016 and January 2, 2016 and the Schedule of General and Administrative Expenses for the fifty-two week periods ended December 31, 2016 and January 2, 2016 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management. The information has not been subjected to the auditing procedures applied in the audit of the financial statements. Accordingly, it is inappropriate to and we do not express an opinion on the supplementary information referred to above.

Gallagher, Flynn & Company, LLP

March 17, 2017

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

BALANCE SHEETS

DECEMBER 31, 2016 AND JANUARY 2, 2016

A S S E T S

	December 31, <u>2016</u>	January 2, <u>2016</u>
CURRENT ASSETS		
Cash and cash equivalents	\$ 1,336,288	\$ 528,017
Certificates of indebtedness, current portion	93,449	56,201
Accounts receivable	363,188	369,838
Inventories	2,072,413	2,000,069
Refundable income tax prepayments	226,654	232,162
Other current assets	276,754	330,718
Deferred income taxes	48,800	105,700
Total current assets	<u>4,417,546</u>	<u>3,622,705</u>
 PROPERTY AND EQUIPMENT, at cost		
Land and improvements	342,189	342,189
Buildings and improvements	11,840,557	11,840,557
Machinery and equipment	10,853,963	10,711,130
	<u>23,036,709</u>	<u>22,893,876</u>
Less accumulated depreciation and amortization	13,778,772	12,555,192
	9,257,937	10,338,684
Construction in progress	10,415	4,527
	<u>9,268,352</u>	<u>10,343,211</u>
 OTHER ASSETS		
Investments in other cooperative associations	1,313,934	1,240,509
Certificates of indebtedness, less current portion	247,565	341,014
Other	62,527	68,842
	<u>1,624,026</u>	<u>1,650,365</u>
	<u>\$ 15,309,924</u>	<u>\$ 15,616,281</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

BALANCE SHEETS

DECEMBER 31, 2016 AND JANUARY 2, 2016

LIABILITIES AND MEMBERS' EQUITY

	December 31, <u>2016</u>	January 2, <u>2016</u>
CURRENT LIABILITIES		
Current maturities of long-term debt	\$ 324,993	\$ 315,823
Accounts payable	2,548,802	2,410,892
Accrued payroll and benefits	760,153	872,664
Accrued expenses	616,252	427,963
Income taxes payable	15,299	-
Total current liabilities	<u>4,265,499</u>	<u>4,027,342</u>
 OTHER NON-CURRENT LIABILITY	 <u>282,131</u>	 <u>282,131</u>
 LONG-TERM DEBT, less current maturities	 <u>3,280,234</u>	 <u>3,562,038</u>
 DEFERRED INCOME TAXES	 <u>605,200</u>	 <u>742,900</u>
 MEMBERS' EQUITY		
Capital stock	3,106,799	3,378,341
Donated capital	315,500	50,693
Retained earnings	<u>3,454,561</u>	<u>3,572,836</u>
	<u>6,876,860</u>	<u>7,001,870</u>
	 <u>\$ 15,309,924</u>	 <u>\$ 15,616,281</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF OPERATIONS

FIFTY-TWO WEEK PERIODS ENDED DECEMBER 31, 2016 AND JANUARY 2, 2016

	December 31, <u>2016</u>	January 2, <u>2016</u>
NET REVENUES	\$ 71,555,883	\$ 69,993,775
COST OF SALES	<u>48,117,615</u>	<u>46,891,161</u>
GROSS PROFIT	23,438,268	23,102,614
OPERATING EXPENSES	<u>23,463,516</u>	<u>22,804,781</u>
EARNINGS (LOSS) FROM OPERATIONS	<u>(25,248)</u>	<u>297,833</u>
OTHER (INCOME) EXPENSE		
Interest expense	186,952	86,622
Interest income	(13,302)	(17,644)
Other (income) expense	<u>(74,596)</u>	<u>25,128</u>
	<u>99,054</u>	<u>94,106</u>
EARNINGS (LOSS) BEFORE INCOME TAXES	(124,302)	203,727
PROVISION FOR (BENEFIT FROM) INCOME TAXES	<u>(6,027)</u>	<u>122,685</u>
NET EARNINGS (LOSS)	<u>\$ (118,275)</u>	<u>\$ 81,042</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF MEMBERS' EQUITY

FIFTY-TWO WEEK PERIODS ENDED DECEMBER 31, 2016 AND JANUARY 2, 2016

	<u>Class A Common Stock</u>		<u>Class B Common Stock</u>		<u>Partial</u>	<u>Allocated</u>	<u>Donated</u>	<u>Retained</u>	<u>Total</u>
	<u>Shares</u>	<u>Value</u>	<u>Shares</u>	<u>Value</u>	<u>Share</u> <u>Credits</u>	<u>Capital</u>	<u>Capital</u>	<u>Earnings</u>	
BALANCE, January 3, 2015	582,832	\$ 2,914,160	-	\$ -	\$ 50,663	\$ 400,943	\$ 42,966	\$ 3,491,794	\$ 6,900,526
Net earnings	-	-	-	-	-	-	-	81,042	81,042
Shares issued in satisfaction of allocated capital	1,906	9,530	68,474	342,370	49,043	(400,943)	-	-	-
Shares sold, net of redemptions	<u>3,382</u>	<u>16,910</u>	<u>-</u>	<u>-</u>	<u>(4,335)</u>	<u>-</u>	<u>7,727</u>	<u>-</u>	<u>20,302</u>
BALANCE, January 2, 2016	588,120	2,940,600	68,474	342,370	95,371	-	50,693	3,572,836	7,001,870
Net loss	-	-	-	-	-	-	-	(118,275)	(118,275)
Shares cancelled	(52,611)	(263,055)	-	-	(1,752)	-	264,807	-	-
Shares sold, net of redemptions	<u>(1,855)</u>	<u>(9,274)</u>	<u>-</u>	<u>-</u>	<u>2,539</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(6,735)</u>
BALANCE, December 31, 2016	<u>533,654</u>	<u>\$ 2,668,271</u>	<u>68,474</u>	<u>\$ 342,370</u>	<u>\$ 96,158</u>	<u>\$ -</u>	<u>\$ 315,500</u>	<u>\$ 3,454,561</u>	<u>\$ 6,876,860</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF CASH FLOWS

FIFTY-TWO WEEK PERIODS ENDED DECEMBER 31, 2016 AND JANUARY 2, 2016

	December 31, <u>2016</u>	January 2, <u>2016</u>
INCREASE IN CASH AND CASH EQUIVALENTS		
CASH FLOWS FROM OPERATING ACTIVITIES		
Net earnings (loss)	\$ (118,275)	\$ 81,042
Noncash items included in net earnings (loss):		
Depreciation and amortization	1,223,584	1,097,341
Patronage investments in cooperatives	(73,425)	(45,393)
Deferred income taxes	(80,800)	209,000
Changes in assets and liabilities:		
Accounts receivable	6,650	24,991
Inventory	(72,344)	(39,841)
Income taxes receivable	5,508	(232,162)
Other current assets	60,279	13,824
Accounts payable	137,910	299,260
Accrued expenses and other current liabilities	75,778	(549,320)
Income taxes payable	15,299	-
	<u>1,298,439</u>	<u>777,700</u>
Net cash provided by operating activities	<u>1,180,164</u>	<u>858,742</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(148,725)	(4,298,434)
Purchase of investments	-	(44,663)
Proceeds from repayments of certificates of indebtedness	56,201	62,010
Net cash used in investing activities	<u>(92,524)</u>	<u>(4,281,087)</u>
Subtotal (forward)	<u>\$ 1,087,640</u>	<u>\$ (3,422,345)</u>

(CONTINUED)

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF CASH FLOWS

FIFTY-TWO WEEK PERIODS ENDED DECEMBER 31, 2016 AND JANUARY 2, 2016

	December 31, <u>2016</u>	January 2, <u>2016</u>
Subtotal (forwarded)	\$ 1,087,640	\$ (3,422,345)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term debt	45,253	3,840,000
Principal payments on long-term debt	(317,887)	(325,822)
Patronage refund liability paid	-	(100,235)
Proceeds from issuance (payments for repurchase) of capital stock, net	<u>(6,735)</u>	<u>20,302</u>
Net cash provided by (used in) financing activities	<u>(279,369)</u>	<u>3,434,245</u>
Net increase in cash and cash equivalents	808,271	11,900
CASH AND CASH EQUIVALENTS, beginning of period	<u>528,017</u>	<u>516,117</u>
CASH AND CASH EQUIVALENTS, end of period	<u>\$ 1,336,288</u>	<u>\$ 528,017</u>
<u>Supplemental Disclosures of Cash Flows Information</u>		
Cash paid during the period for:		
Interest expense	<u>\$ 185,425</u>	<u>\$ 7,038</u>
Income taxes	<u>\$ 42,023</u>	<u>\$ 145,847</u>

Noncash investing and financing activities:

The Cooperative acquired \$282,131 of equipment, which is included in other non-current liabilities at January 2, 2016 (see Note I).

During the period ended January 2, 2016, the Cooperative issued \$9,530 of Class A shares, \$342,370 of Class B shares, and \$49,043 of share credits in satisfaction of the patronage refund declared as payable at January 3, 2015.

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND JANUARY 2, 2016

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 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 75% and 73% of total sales for the fifty-two week periods ending December 31, 2016 and January 2, 2016, respectively. Sales of grocery-related items were 95% of total sales in 2016 and 2015, and sales of automobile fuel and repair services were 5% of total sales in 2016 and 2015.

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 December 31, 2016 and January 2, 2016 included fifty-two weeks.

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 collectability 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 December 31, 2016 and January 2, 2016, no allowance was required.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND JANUARY 2, 2016

A) SUMMARY OF OPERATIONS AND ACCOUNTING POLICIES (continued)

4. Inventory

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 2016 and 2015, 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 2016 and 2015, 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

DECEMBER 31, 2016 AND JANUARY 2, 2016

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 \$105,700 and \$184,800 for the periods ended December 31, 2016 and January 2, 2016, 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.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND JANUARY 2, 2016

A) SUMMARY OF OPERATIONS AND ACCOUNTING POLICIES (continued)

11. Recently issued accounting pronouncements

The Cooperative is currently evaluating the impact of adopting the following recently issued accounting pronouncements:

Balance Sheet Classification of Deferred Taxes

In November 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*. Per the ASU, deferred income tax assets and liabilities will no longer be separated into current and noncurrent amounts in a classified balance sheet. The recognition and measurement guidance for deferred income taxes are not affected by the new guidance. This ASU is effective for years beginning after December 15, 2017, and may be implemented on a prospective or retrospective basis.

Revenue recognition

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which provides a robust framework for addressing revenue recognition issues and, upon its effective date, replaces almost all existing revenue recognition guidance, including industry-specific guidance, in current U.S. generally accepted accounting principles. The revenue recognition policies of almost all entities will be affected by the new guidance in the ASU. The degree to which an entity's revenue recognition policies will change upon the adoption of the ASU, and the effects the changes will have on the entity's financial statements, will vary depending on the nature and terms of the entity's revenue-generating transactions. In addition, entities in some industries likely will be affected by the new guidance in the ASU more than entities in other industries. Given the broad applicability and potentially significant ramifications of the guidance in the ASU, the FASB provided significantly delayed effective dates for its guidance. The ASU is effective for years beginning after December 15, 2018.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND JANUARY 2, 2016

A) SUMMARY OF OPERATIONS AND ACCOUNTING POLICIES (continued)

11. Recently issued accounting pronouncements (continued)

Leases

In February 2016, the FASB issued ASU 2016-02 *Leases (Topic 842)*. This ASU was issued in three parts: (a) Section A, *Leases: Amendments to the FASB Accounting Standards Codification*, (b) Section B, *Conforming Amendments Related to Leases: Amendments to the FASB Accounting Standards Codification*, and (c) Section C, *Background Information and Basis for Conclusions*. While both lessees and lessors are affected by the new guidance which includes many changes, the effects on lessees are much more significant. The most significant change for lessees is the requirement to recognize right-of-use assets and lease liabilities for all leases not considered short-term leases, affecting leases which previously were accounted for as operating leases. This ASU is effective for years beginning after December 15, 2019, and must be implemented using a modified retrospective approach.

12. Evaluation of subsequent events

In preparing these financial statements, the Cooperative has evaluated events and transactions for potential recognition or disclosure through March 17, 2017, the date the financial statements were available to be issued.

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.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND JANUARY 2, 2016

C) CERTIFICATES OF INDEBTEDNESS

Certificates of indebtedness primarily consist of amounts due from Associated Grocers of New England, Inc., (AGNE), a cooperative in which the Cooperative is a member (see Note D). The Cooperative receives certificates of indebtedness from AGNE to satisfy patronage rebates. Interest rates range from 3.25% to 3.5%, maturing at various times through June 2020. Amounts receivable under these agreements totalled \$341,014 and \$397,215 at December 31, 2016 and January 2, 2016, respectively. The Cooperative evaluates collectability by evaluating the financial condition of AGNE and provides for estimated uncollectible amounts through a charge to operations and a credit to a valuation allowance, if warranted. At December 31, 2016 and January 2, 2016, no valuation allowance was required.

At December 31, 2016 certificates of indebtedness mature as follows:

<u>Fiscal Periods</u> <u>Ending on or</u> <u>Around</u> <u>December 31,</u>	<u>Amount</u>
2017	\$ 93,449
2018	90,353
2019	74,523
2020	82,689
	<u>\$ 341,014</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND JANUARY 2, 2016

D) INVESTMENTS IN OTHER COOPERATIVE ASSOCIATIONS

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

	December 31, <u>2016</u>	January 2, <u>2016</u>
National Consumer Cooperative Bank (NCCB):		
NCCB is a financial services cooperative, the parent company of its wholly-owned subsidiary, National Cooperative Bank, N.A. (Note F). At December 31, 2016 and January 2, 2016, the Cooperative owned 2,027 shares of Class C stock, which represent the cumulative amount of shares issued as patronage refunds over the course of its financing agreements with NCCB (Note F). NCCB provides members with patronage rebates in cash and shares of Class B2 and C stock in connection with its patronage-based loans from NCCB. The Cooperative recognizes patronage rebates earned in Class C stock, which is eligible to pay cash dividends, nonredeemable, and transferable to other eligible members, subject to approval. The Cooperative also receives and holds Class B2 stock, which does not pay dividends, is nonredeemable, and is nontransferable; therefore, the Cooperative does not recognize any value for Class B2 stock received. There were no patronage rebates issued during 2016 or 2015.	\$ 202,701	\$ 202,701
Associated Grocers of New England, Inc. (AGNE):		
AGNE is a consumer goods membership cooperative 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 purchase additional shares of Class B stock annually based on total merchandise purchases. Class A and B stock are eligible to pay cash dividends and are redeemable in the event that the Cooperative terminates membership, as defined. The Cooperative owns three shares of Class A stock at December 31, 2016 and January 2, 2016. The Cooperative owns 5,435 shares of Class B stock at December 31, 2016 and January 2, 2016.	<u>784,059</u>	<u>784,059</u>
Subtotal (forward)	<u>\$ 986,760</u>	<u>\$ 986,760</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND JANUARY 2, 2016

D) INVESTMENTS IN OTHER COOPERATIVE ASSOCIATIONS (continued)

	December 31, <u>2016</u>	January 2, <u>2016</u>
Subtotal (forwarded)	\$ 986,760	\$ 986,760
National Cooperative Grocers Association (NCGA):		
NCGA is a consumer goods cooperative that requires members to purchase one share of voting stock at \$500, plus a base equity investment of 0.1% of annual purchases, and provides members with discounted purchase pricing and annual patronage rebates, a percentage of which is retained as equity and is redeemable at the discretion of the NCGA board of directors.	320,209	246,784
Other	<u>6,965</u>	<u>6,965</u>
	<u>\$ 1,313,934</u>	<u>\$ 1,240,509</u>

E) NOTES PAYABLE

The Cooperative has a \$1,000,000 revolving line of credit with the Ledyard Bank due December 2019. Interest is payable monthly at *The Wall Street Journal* prime rate (3.75% at December 31, 2016). The note is secured by a first mortgage on certain real property and substantially all business assets of the Cooperative. There were no borrowings related to this agreement outstanding at December 31, 2016.

At January 2, 2016, the Cooperative had available a \$1,000,000 revolving line of credit with NCCB, terminated in December 2016. Interest was payable monthly and carried an interest rate at *The Wall Street Journal* prime rate. The note was secured by substantially all assets of the Cooperative. There were no borrowings related to this agreement outstanding at January 2, 2016.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND JANUARY 2, 2016

F) LONG-TERM DEBT

Long-term debt consists of the following at:

	December 31, <u>2016</u>	January 2, <u>2016</u>
National Cooperative Bank, N.A. (formerly NCB, FSB) - Payable in monthly installments of \$40,727 including interest at the greater of 5% or the Ten-Year U.S. Treasury Note Yield, plus .25% due February 2026. The note is secured by a first mortgage on certain property and certain personal property, and a second security interest in substantially all other assets of the Cooperative, and subject to certain financial ratios, as defined.	\$ 3,564,011	\$ 3,840,000
Payable in monthly installments of \$27,877, including interest at 4%, paid in full during 2016. Secured by real estate.	-	37,861
Ally Bank - Payable in monthly installments of \$730, with a 4.99% interest rate, due June 2022. Secured by a vehicle.	<u>41,216</u> 3,605,227	<u>-</u> 3,877,861
Principal payments due within one year	<u>324,993</u>	<u>315,823</u>
	<u>\$ 3,280,234</u>	<u>\$ 3,562,038</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND JANUARY 2, 2016

F) LONG-TERM DEBT (continued)

As of December 31, 2016, long-term debt matures as follows:

Fiscal Periods Ending on or Around <u>December 31,</u>	<u>Amount</u>
2017	\$ 324,993
2018	341,187
2019	358,642
2020	376,990
2021	396,277
Thereafter	<u>1,807,138</u>
	<u>\$ 3,605,227</u>

G) INCOME TAXES

The provision for (benefit from) income taxes consists of the following:

	<u>December 31,</u> <u>2016</u>	<u>January 2,</u> <u>2016</u>
Currently payable (refundable), net of benefit of net operating loss carryback of \$181,600 in the period ending January 2, 2016	\$ 74,773	\$ (86,315)
Deferred	<u>(80,800)</u>	<u>209,000</u>
	<u>\$ (6,027)</u>	<u>\$ 122,685</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND JANUARY 2, 2016

G) INCOME TAXES (continued)

Deferred tax assets and liabilities consist of the following at:

	December 31, <u>2016</u>	January 2, <u>2016</u>
Deferred tax assets:		
Inventory valuation	\$ 11,900	\$ 11,600
Accrued compensation	41,800	77,900
Unclaimed patronage refund	46,800	46,800
Federal net operating loss carryforward	99,600	103,200
Other	<u>55,900</u>	<u>35,900</u>
	<u>\$ 256,000</u>	<u>\$ 275,400</u>
Deferred tax liabilities:		
Depreciation and impairment write down	\$ 597,200	\$ 673,900
Patronage refunds on investments in other cooperatives	113,800	121,500
Prepaid expenses	<u>101,400</u>	<u>117,200</u>
	<u>\$ 812,400</u>	<u>\$ 912,600</u>

There was no recorded valuation allowance at December 31, 2016. The valuation allowance decreased by \$292,000 during the period ended January 2, 2016, as the Cooperative concluded that the State of New Hampshire Business Enterprise tax credit had no value under state law and was written off. There was no impact on net earnings or retained earnings.

The Cooperative has net operating losses of approximately \$297,000 to offset future federal taxable income through 2036.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND JANUARY 2, 2016

G) INCOME TAXES (continued)

The Cooperative's effective income tax rate in the periods ended December 31, 2016 and January 2, 2016, 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 December 31, 2013.

During the periods ended December 31, 2016 and January 2, 2016, the Cooperative recognized no interest or penalties related to unrecognized tax benefits.

H) MEMBERS' EQUITY AND CONTINGENCY

The Cooperative's legal organization is determined by federal and state laws and by its Bylaws (pursuant to the revision adopted effective October 28, 2013) and Certificate of Organization.

Bylaws

Capital stock: The Bylaw and Certificate of Organization authorizes 2,000,000 shares of stock, which includes two classes: Class A shares are voting, have a \$5 par value, and are issued in consideration of becoming a member of the cooperative. Class B shares are non-voting, have a \$5 par value, and may be issued to members as patronage refunds in lieu of cash payments. Dividends are not paid on either Class A or Class B stock. Partial share credits are comprised of amounts credited to patron's capital accounts until such amounts are sufficient to purchase the minimum number of shares required to be a member.

Membership: Until October 28, 2016, individuals and organizations owning three or more, but less than ten Class A shares, are voting members. Thereafter, individuals and corporations are required to own at least 10 Class A shares in order to be a member. Any person owning fewer than ten shares is considered to be "a subscriber."

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND JANUARY 2, 2016

H) MEMBERS' EQUITY AND CONTINGENCY (continued)

Bylaws (continued)

Termination of membership: Members who discontinue membership may request a refund, which may be issued at the discretion of the Board. The Cooperative's By-Laws, in concert with the state of New Hampshire statutes, provide that if a member has not claimed their outstanding patronage or corresponded with the Cooperative over a five-year period, the Cooperative shall make a good faith effort to contact the member and then, having satisfied the regulations, as defined, terminate such membership and that member's associated capital shall revert to the Cooperative. During 2016, the Cooperative cancelled 52,611 member shares, resulting in a reduction of \$263,055 to Class A common stock and \$1,752 of share credits and an increase in donated capital of \$264,807.

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, are then allocated as patronage refunds to each member based on the percentage of that member's purchases to total member purchases. The Board may issue patronage refunds in the form of cash, written notices of allocation, credit towards purchases at the Cooperative, credit towards payment of Class A, or Class B stock, up to 80% of which 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 is sufficient to acquire ten shares of Class A stock. Non-member patrons may receive patronage refunds in the form of Class A shares in order to obtain the ten share membership requirement and are responsible for providing satisfactory evidence of applicable purchases.

Patronage refunds declared and issued

There were no patronage refunds for the periods ended December 31, 2016 and January 2, 2016.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND JANUARY 2, 2016

H) MEMBERS' EQUITY AND CONTINGENCY (continued)

Contingency

During 2015, the Cooperative was notified by the State of New Hampshire Bureau of Securities Regulation ("Bureau") that the Bureau was investigating a complaint regarding the issuance of Class B stock issued as patronage refund. In November 2016, the Cooperative entered into a consent agreement with the Bureau pursuant to which the Cooperative agrees to propose a Bylaw amendment to its members that would allow and call for the offer of new Class B shares with a fixed maturity date ("new Class B shares") to members in exchange for outstanding Class B shares ("current Class B shares"), which have no fixed maturity date. In addition, the proposed Bylaw amendment provides any member with current Class B shares with a five-year period to elect to exchange current Class B shares for new Class B shares from the date that the shares are available to be exchanged; if the member with current Class B shares does not respond to elect to exchange the current Class B shares for new Class B shares within this five-year period, the member will have their current Class B shares cancelled and the associated capital will revert to the Cooperative. The Bylaw amendment is subject to approval by the membership. The Cooperative's Board of Directors has approved the proposal of an amendment to the By-Laws to the members in accordance with the consent agreement, which amendment will be considered by the membership in 2017. If the members approve the amendment and the new Class B shares are issued in exchange for the current Class B shares, the effect will be to decrease members' equity and increase new Class B stock liability by \$342,370. If the membership does not approve the amendment, the Bureau may reopen the matter. Due to the uncertainty of the outcome of this matter, the financial statements at December 31, 2016 do not reflect any adjustments that might be required as a result of the members' consideration of the proposed Bylaw amendment in 2017 or subsequent action by the Bureau.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND JANUARY 2, 2016

I) COMMITMENTS

Operating leases

The Cooperative leases facilities in Lebanon, New Hampshire, for the operation of a food store through June 2022. Base rent currently approximates \$61,000 per month, plus an allocation of common area maintenance costs. The base rent is adjusted annually based on the Consumer Price Index (CPI), as defined.

The Cooperative leases facilities in White River Junction, Vermont, for the operation of a food store through May 2025. Base rent currently approximates \$17,000 per month, with an annual 2.5% increase.

The Cooperative leases land upon which the community market in Hanover, New Hampshire, is operated in a building built and owned by the Cooperative. The lease expires February 2034 and contains an option to extend an additional ten years. Base rent is approximately \$4,200 per month. 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 for the operation of a commissary kitchen through November 2019, with an option to renew the lease for two additional two-year terms. Base rent currently approximates \$4,000 per month, adjusted annually based on the CPI, as defined.

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

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

Fiscal Periods Ending on or Around <u>December 31,</u>	<u>Amount</u>
2017	\$ 1,163,000
2018	1,077,000
2019	1,064,000
2020	1,065,000
2021	1,026,000
Thereafter	<u>1,821,000</u>
	<u>\$ 7,216,000</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND JANUARY 2, 2016

I) COMMITMENTS (continued)

Operating leases (continued)

The Cooperative had rental expense of approximately \$1,510,000 and \$1,414,000 for the periods ended December 31, 2016 and January 2, 2016, respectively.

Other commitments

In April 2015, the Cooperative entered into an agreement expiring in 2025 with a supplier to purchase a minimum of 1,300,000 gallons per year of liquid petroleum products and to acquire certain equipment valued at \$282,000 used in its distribution of petroleum operations. In the event that the Cooperative terminates the supplier agreement prior to June 2020, the Cooperative must pay the supplier full purchase price. Thereafter, the Cooperative's obligation decreases by 20% annually until the agreement expires in 2025, at which time the Cooperative has no further obligation. If the Cooperative retains its supplier agreement, the Cooperative will recognize other income on a straight-line basis over the five-year period beginning June 2020. Accordingly, the Cooperative has recognized amounts of approximately \$282,000, related to this agreement in equipment and other non-current liabilities at December 31, 2016 and January 2, 2016.

J) DEFINED CONTRIBUTION PLAN

The Cooperative has a defined contribution plan that covers all eligible employees. The Cooperative participates as 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 Plan provides for a guaranteed safe harbor non-elective contribution by the Cooperative equal to 3% of eligible compensation and additional contributions may be made at the discretion of the Cooperative.

The Cooperative recognized pension expense with respect to the Plans of approximately \$320,000 and \$324,000 in the periods ended December 31, 2016 and January 2, 2016, respectively. There were no discretionary contributions made in the periods ended December 31, 2016 and January 2, 2016.

K) SELF-INSURANCE HEALTH PLAN

In 2016, the Cooperative entered into a self-funded insurance program to provide group health insurance benefits to active employees. The Cooperative incurred charges to operations of approximately \$2,788,000 in 2016 in connection with this plan. The financial statements include a liability for claims incurred but not yet reported in the amount of approximately \$226,000 as of December 31, 2016.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND JANUARY 2, 2016

L) MAJOR SUPPLIERS

During the period ended December 31, 2016, the Cooperative purchased approximately \$20,337,000 (42% of total purchases) of its goods from an unrelated party and AGNE, a related party (see Note D). At December 31, 2016, amounts due to these suppliers, included in accounts payable, totalled approximately \$645,000.

During the period ended January 2, 2016, the Cooperative purchased approximately \$20,880,000 (44% of total purchases) of its goods from an unrelated party and AGNE, a related party (see Note D). January 2, 2016, amounts due to these suppliers, included in accounts payable, totalled approximately \$590,000.

M) RELATED-PARTY TRANSACTIONS

The Cooperative is a member of AGNE (see Note D). The Cooperative purchased goods and groceries from AGNE of approximately \$11,592,000 and \$12,523,000 during the periods ended December 31, 2016 and January 2, 2016, respectively. Amounts due to AGNE, included in accounts payable, were approximately \$204,000 and \$185,000 at December 31, 2016 and January 2, 2016, respectively. Patronage refunds due from AGNE, included in accounts receivable, were approximately \$95,000 and \$117,000 at December 31, 2016 and January 2, 2016, 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 December 31, 2016 and January 2, 2016, were approximately \$1,438,000 and \$1,427,000, respectively. The discounts on these sales were netted against the gross sales in the statement of operations and approximated \$294,000 and \$308,800, for the periods ended December 31, 2016 and January 2, 2016, respectively.

Amounts due from members of approximately \$140,000 and \$131,000 are included in accounts receivable at December 31, 2016 and January 2, 2016, respectively.

SUPPLEMENTAL INFORMATION

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

SCHEDULE OF OPERATING EXPENSES

FIFTY-TWO WEEK PERIODS ENDED DECEMBER 31, 2016 AND JANUARY 2, 2016

	(Unaudited) December 31, <u>2016</u>	(Unaudited) January 2, <u>2016</u>
Store operations expenses:		
Store wages and benefits	\$ 12,018,497	\$ 11,591,090
Facilities cost	3,132,712	3,149,305
Equipment costs	936,634	849,380
Credit card expenses	1,009,727	1,019,117
Selling and other costs	<u>1,054,316</u>	<u>1,076,407</u>
	<u>18,151,886</u>	<u>17,685,299</u>
General and administrative expenses:		
Education expenses	501,390	468,333
Administrative expenses	925,958	872,286
Board of directors' expenses	128,052	113,303
Human resources department	529,432	510,917
Finance department	642,354	587,654
Merchandising expenses	834,590	817,341
Marketing expenses	345,270	495,421
Information technology department	932,058	901,751
Facilities maintenance department	<u>472,526</u>	<u>352,476</u>
	<u>5,311,630</u>	<u>5,119,482</u>
	<u>\$ 23,463,516</u>	<u>\$ 22,804,781</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

SCHEDULE OF GENERAL AND ADMINISTRATIVE EXPENSES

FIFTY-TWO WEEK PERIODS ENDED DECEMBER 31, 2016 AND JANUARY 2, 2016

	(Unaudited) December 31, <u>2016</u>	(Unaudited) January 2, <u>2016</u>
Salaries and benefits	\$ 3,582,563	\$ 3,417,719
Equipment expenses	243,918	301,350
Professional fees	264,369	250,219
Advertising	105,679	184,833
Building leases	189,886	183,122
Equipment depreciation	196,373	175,046
Telephone	129,013	137,006
Education and training	104,282	84,923
Dues and subscriptions	84,485	57,031
Consulting fees	66,931	55,419
Meals, entertainment and vehicle reimbursement	37,291	45,172
Occupancy costs	29,662	38,479
Supplies	35,662	27,685
Graphics and promotional expenses	25,416	25,439
Technical maintenance contracts	75,623	20,431
Printing	30,358	16,850
Insurance	18,518	14,844
Bank charges	16,256	13,262
Postage	21,445	13,134
Employee relations and programs	9,421	12,097
Contributions	8,481	8,068
Membership meeting	5,788	3,039
Demo expenses	7,608	2,227
Co-op News	1,867	1,908
Software licenses	8,377	658
Other	<u>12,358</u>	<u>29,521</u>
	<u>\$ 5,311,630</u>	<u>\$ 5,119,482</u>