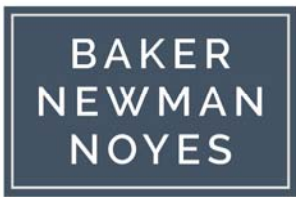


Hanover Consumer Cooperative Society, Inc.

Financial Statements and Supplemental Information

*Years Ended December 29, 2018 and December 30, 2017
With Independent Auditors' Report*



INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of Hanover Consumer Cooperative Society, Inc., (the Cooperative) which comprise the balance sheet as of December 29, 2018, the related statements of operations, members' equity and cash flows for the year 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 auditors' 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.

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

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 29, 2018, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matter – 2017 Financial Statements

The financial statements of the Cooperative as of and for the year ended December 30, 2017 were audited by other auditors, whose report, dated March 7, 2018, expressed an opinion on those statements.

Other Matter – Supplemental Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as of and for the year ended December 29, 2018, as a whole. The accompanying supplementary information is presented for the purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information for the year ended December 29, 2018 has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information for the year ended December 29, 2018 is fairly stated in all material respects in relation to the financial statements as a whole. The supplementary information for the year ended December 30, 2017 was audited by other auditors, whose report, dated March 7, 2018, expressed an unmodified opinion on such information in relation to the financial statements as a whole.

Behr Neuman & Noyes LLC

Manchester, New Hampshire
February 28, 2019

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

BALANCE SHEETS

December 29, 2018 and December 30, 2017

ASSETS

	<u>2018</u>	<u>2017</u>
Current assets:		
Cash and cash equivalents	\$ 2,141,671	\$ 1,798,424
Certificates of indebtedness, current portion	74,523	90,353
Accounts receivable – trade and other	518,371	535,564
Inventories	2,297,643	2,121,772
Refundable income tax	30,038	44,892
Other current assets	<u>157,612</u>	<u>205,188</u>
Total current assets	5,219,858	4,796,193
Property and equipment, at cost:		
Land and improvements	342,189	342,189
Buildings and improvements	11,846,259	11,840,557
Machinery and equipment	11,825,836	11,504,965
Construction in process	<u>293,732</u>	<u>58,966</u>
	24,308,016	23,746,677
Less accumulated depreciation and amortization	<u>15,931,859</u>	<u>14,909,125</u>
Property and equipment, net	8,376,157	8,837,552
Other assets:		
Investments in other cooperative associations	1,515,946	1,502,678
Certificates of indebtedness, less current portion	111,861	157,212
Other	<u>12,452</u>	<u>13,527</u>
Total other assets	<u>1,640,259</u>	<u>1,673,417</u>
Total assets	<u>\$15,236,274</u>	<u>\$15,307,162</u>

LIABILITIES AND MEMBERS' EQUITY

	<u>2018</u>	<u>2017</u>
Current liabilities:		
Current maturities of long-term debt	\$ 430,765	\$ 408,316
Accounts payable	2,813,575	2,827,405
Accrued payroll and benefits	786,451	778,124
Accrued expenses	508,655	567,749
Patronage refunds payable	<u>108,222</u>	<u>—</u>
Total current liabilities	4,647,668	4,581,594
Long-term liabilities:		
Other non-current liability	282,131	282,131
Long-term debt, less current maturities	2,716,125	3,122,623
Deferred rent	193,640	—
Deferred income taxes	285,534	262,800
Mandatorily redeemable stock	<u>47,971</u>	<u>36,836</u>
Total liabilities	<u>3,525,401</u>	<u>3,704,390</u>
Total liabilities	8,173,069	8,285,984
Members' equity:		
Capital stock	3,093,002	3,078,893
Donated capital	315,500	315,500
Retained earnings	<u>3,654,703</u>	<u>3,626,785</u>
Total members' equity	<u>7,063,205</u>	<u>7,021,178</u>
Total liabilities and members' equity	<u>\$15,236,274</u>	<u>\$15,307,162</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF OPERATIONS

Years Ended December 29, 2018 and December 30, 2017

	<u>2018</u>	<u>2017</u>
Net revenues	\$74,653,586	\$72,013,580
Cost of sales	<u>50,703,120</u>	<u>48,748,971</u>
Gross profit	23,950,466	23,264,609
Operating expenses	<u>23,506,580</u>	<u>23,300,719</u>
Income (loss) from operations	443,886	(36,110)
Other (income) expense:		
Interest expense	167,978	178,943
Interest income	(9,942)	(11,014)
Other expense (income)	<u>45,535</u>	<u>(161,722)</u>
	<u>203,571</u>	<u>6,207</u>
Income (loss) before patronage refund and income taxes	240,315	(42,317)
Patronage refunds	<u>108,222</u>	<u>—</u>
Income (loss) before income taxes	132,093	(42,317)
Provision (benefit) from income taxes	<u>104,175</u>	<u>(214,541)</u>
Net income	<u>\$ 27,918</u>	<u>\$ 172,224</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF MEMBERS' EQUITY

Years Ended December 29, 2018 and December 30, 2017

	<u>Class A</u>		<u>Class B</u>		<u>Partial</u> <u>Share</u> <u>Credits</u>	<u>Total</u> <u>Capital</u> <u>Stock</u>	<u>Donated</u> <u>Capital</u>	<u>Retained</u> <u>Earnings</u>	<u>Total</u>
	<u>Common Stock</u> <u>Shares</u>	<u>Values</u>	<u>Common Stock</u> <u>Shares</u>	<u>Value</u>					
Balance, December 31, 2016	533,654	\$2,668,271	68,474	\$342,370	\$96,158	\$3,106,799	\$315,500	\$3,454,561	\$6,876,860
Net income	-	-	-	-	-	-	-	172,224	172,224
Class B shares exchanged (note 9)	-	-	(6,942)	(34,710)	(2,126)	(36,836)	-	-	(36,836)
Shares issued, net of redemptions	<u>3,347</u>	<u>16,735</u>	<u>(1,378)</u>	<u>(6,890)</u>	<u>(915)</u>	<u>8,930</u>	<u>-</u>	<u>-</u>	<u>8,930</u>
Balance, December 30, 2017	537,001	2,685,006	60,154	300,770	93,117	3,078,893	315,500	3,626,785	7,021,178
Net income	-	-	-	-	-	-	-	27,918	27,918
Class B shares exchanged (note 9)	-	-	(2,227)	(11,135)	-	(11,135)	-	-	(11,135)
Shares issued, net of redemptions	<u>5,416</u>	<u>27,080</u>	<u>(309)</u>	<u>(1,535)</u>	<u>(301)</u>	<u>25,244</u>	<u>-</u>	<u>-</u>	<u>25,244</u>
Balance, December 29, 2018	<u>542,417</u>	<u>\$2,712,086</u>	<u>57,618</u>	<u>\$288,100</u>	<u>\$92,816</u>	<u>\$3,093,002</u>	<u>\$315,500</u>	<u>\$3,654,703</u>	<u>\$7,063,205</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF CASH FLOWS

Years Ended December 29, 2018 and December 30, 2017

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities:		
Net income	\$ 27,918	\$ 172,224
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	1,050,077	1,136,376
Deferred rent	193,640	-
Gain on disposal of equipment	(7,901)	-
Patronage certificates of indebtedness received	(29,172)	-
Patronage investments in cooperatives	(13,268)	(188,744)
Deferred income taxes	22,734	(293,600)
Changes in operating assets and liabilities:		
Accounts receivable	17,193	(172,376)
Inventory	(175,871)	(49,359)
Refundable income taxes	14,854	181,762
Other current assets	47,576	71,566
Accounts payable	(13,830)	278,603
Accrued payroll and benefits	8,327	-
Accrued expenses	(59,094)	(30,532)
Income taxes payable	-	(15,299)
Patronage refunds payable	<u>108,222</u>	<u>-</u>
Net cash provided by operating activities	<u>1,191,405</u>	<u>1,090,621</u>
Cash flows from investing activities:		
Acquisition of property and equipment	(606,592)	(699,277)
Proceeds from disposal of equipment	32,110	-
Proceeds from repayments of certificates of indebtedness	<u>90,353</u>	<u>93,449</u>
Net cash used in investing activities	<u>(484,129)</u>	<u>(605,828)</u>
Cash flows from financing activities:		
Proceeds from long-term debt	45,244	350,000
Principal payments on long-term debt	(434,517)	(381,587)
Proceeds from issuance (payments for repurchase) of capital stock, net	<u>25,244</u>	<u>8,930</u>
Net cash used in financing activities	<u>(364,029)</u>	<u>(22,657)</u>
Net increase in cash and cash equivalents	343,247	462,136
Cash and cash equivalents, beginning of year	<u>1,798,424</u>	<u>1,336,288</u>
Cash and cash equivalents, end of year	<u>\$2,141,671</u>	<u>\$1,798,424</u>
Supplemental disclosures of cash flows information:		
Cash paid (received) during the period for:		
Interest expense	<u>\$ 162,754</u>	<u>\$ 177,868</u>
Income taxes	<u>\$ 119,029</u>	<u>\$ (87,404)</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 29, 2018 and December 30, 2017

1. Nature of 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, an automobile service center in Hanover, New Hampshire and beginning in January 2019, Norwich, Vermont, 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 74% of total sales for the years ending December 29, 2018 and December 30, 2017. Sales of grocery-related items were 94% and 95% of total sales in 2018 and 2017, respectively, and sales of automobile fuel and repair services were 6% and 5% of total sales in 2018 and 2017, respectively.

2. Summary of Accounting Policies

Fiscal Year End

The Cooperative's fiscal year ends on the Saturday nearest to December 31. The fiscal periods ended December 29, 2018 and December 30, 2017.

Cash and Cash Equivalents

The Cooperative considers all highly liquid instruments purchased with an original maturity of three months or less to be cash equivalents.

Accounts Receivable

Trade accounts are stated at the amount the Cooperative expects to collect from sales of products. Other receivables primarily consist of volume rebates due from various suppliers. 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. Management determined that no allowance was required at December 29, 2018 and December 30, 2017.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 29, 2018 and December 30, 2017

2. Summary of Accounting Policies (Continued)

Accounts receivable – trade and other consists of the following at December 29, 2018 and December 30, 2017:

	<u>2018</u>	<u>2017</u>
Trade receivables	\$179,526	\$185,487
Other receivables	<u>338,845</u>	<u>350,077</u>
	<u>\$518,371</u>	<u>\$535,564</u>

Inventory

Inventory consists of consumer products for resale and is stated at the lower of cost or net realizable value. Cost is determined using the first-in first-out (FIFO) method.

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. Depreciation expense was \$1,043,778 and \$1,130,077 for the years ended December 29, 2018 and December 30, 2017, respectively.

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 2018 and 2017, management determined that no impairment loss was required to be recognized.

Investment in Other Cooperative Associations

Nonmarketable investments in cooperative associations are carried at cost, less any impairment, plus or minus changes from observable price changes in orderly transactions for an identical or similar investment of the same issuer.

Mandatorily Redeemable Stock

Mandatorily redeemable stock (note 9), is recorded as a liability at its estimated fair value upon issuance and is remeasured annually to its redemption amount through charges to interest expense.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 29, 2018 and December 30, 2017

2. Summary of Accounting Policies (Continued)

Debt Issuance Costs

Debt issuance costs are amortized on the straight-line method, which approximates the effective interest method, over the term of the related agreements. The debt issuance costs are presented as a component of long-term debt.

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, any impairment write-down recognized for financial reporting purposes not for tax purposes, accrued compensation, patronage refunds earned on investments in other cooperative associations, and certain expenses which are reported differently for financial reporting and tax purposes.

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.

The Cooperative has evaluated the positions taken on its corporate tax returns filed and the potential impact on its tax status as of December 29, 2018 and December 30, 2017. The Cooperative has concluded no uncertain income tax positions existed at December 29, 2018 and December 30, 2017.

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

Advertising Expense

Advertising costs are charged to operations when incurred. Advertising expense was approximately \$109,400 and \$109,200 for the periods ended December 29, 2018 and December 30, 2017, respectively.

Revenue Recognition

The Cooperative recognizes sales revenue when goods are sold to customers. Revenue related to gift cards sold is deferred until the gift cards are redeemed. Sales taxes collected and remitted are not reflected in revenue or expenses.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 29, 2018 and December 30, 2017

2. Summary of Accounting Policies (Continued)

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.

Reclassifications

Certain 2017 amounts have been reclassified to permit comparison with the 2018 financial statements presentation format.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The ASU supersedes the revenue recognition requirements in *Topic 605 (Revenue Recognition)* and most industry-specific guidance throughout the Industry Topics of the Accounting Standards Codification. The core principal of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. The guidance is effective for the Cooperative on December 30, 2018. Management is currently evaluating the impact this guidance will have on the Cooperative's financial statements and related disclosures. The standard is not expected to have a material impact on the Cooperative's current revenue recognition policies.

In November 2015, the FASB issued ASU No. 2015-17, *Balance Sheet Classification of Deferred Taxes (Topic 740)*. ASU 2015-17 simplifies the presentation of deferred taxes by requiring deferred tax assets and liabilities be classified as noncurrent on the balance sheets. The guidance is effective for annual reporting periods beginning after December 15, 2017. The guidance may be adopted prospectively or retrospectively, and early adoption is permitted. The Cooperative adopted this guidance in 2018. The impact was the reclassification of deferred tax liabilities from current to noncurrent on the balance sheets.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. The amendments in this ASU address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments and makes targeted improvements to GAAP as follows:

1. Require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values 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.
2. Simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 29, 2018 and December 30, 2017

2. Summary of Accounting Policies (Continued)

3. Eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost.
4. Require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.
5. Require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the consolidated financial statements.
6. Clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, with early adoption permitted for fiscal years beginning after December 15, 2017. The Cooperative adopted ASU 2016-01 during the year ended December 29, 2018. The adoption of this pronouncement did not materially impact the Cooperative's financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. Under ASU 2016-02, at the commencement of a long-term lease, lessees will recognize a liability equivalent to the discounted payments due under the lease agreement, as well as an offsetting right-of-use asset. ASU 2016-02 is effective for the Cooperative on December 29, 2019, with early adoption permitted. Lessees (for capital and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. An entity that elects to apply the practical expedients will, in effect, continue to account for leases that start before the effective date in accordance with previous methodology unless the lease is modified, except that lessees are required to recognize a right-of-use asset and a lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous lease accounting rules. The Cooperative is currently evaluating the impact of the pending adoption of ASU 2016-02 on the Cooperative's financial statements.

Subsequent Events

In preparing these financial statements, the Cooperative has evaluated events and transactions for potential recognition or disclosure through February 28, 2019, the date the financial statements were available to be issued.

On January 11, 2019, the Cooperative entered into a lease agreement for new office space in White River Junction, Vermont, with the lease commencing as of the move in date. The Cooperative plans to move into this new location by July 1, 2019. The initial term of the lease is five years, with two additional five year renewal options. Base rent is approximately \$20,400 per month, with an annual 2% increase.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 29, 2018 and December 30, 2017

3. 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 repurchase agreement is secured by a U.S. government-backed security. The Cooperative has not experienced any losses with these accounts. Management believes the Cooperative is not exposed to any significant credit risk on cash.

4. 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 5). The Cooperative receives certificates of indebtedness from AGNE to satisfy patronage rebates. Interest rates range from 3.25% to 4.0%, maturing at various times through June 2024. Amounts receivable under these agreements totaled \$186,384 and \$247,565 at December 29, 2018 and December 30, 2017, 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 29, 2018 and December 30, 2017, management determined that no valuation allowance was required.

At December 29, 2018 certificates of indebtedness mature as follows:

Fiscal Periods Ending on or Around <u>December 31</u>	<u>Amount</u>
2019	\$ 74,523
2020	82,689
2021	—
2022	—
2023	—
Thereafter	<u>29,172</u>
	<u>\$186,384</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 29, 2018 and December 30, 2017

5. Investments in Other Cooperative Associations

The investments in cooperative associations are nonmarketable investments, which consist of the following at December 29, 2018 and December 30, 2017:

	<u>2018</u>	<u>2017</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 7). At December 29, 2018 and December 30, 2017, 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 7). 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 2018 or 2017.	\$ 202,701	\$ 202,701
Associated Grocers of New England, Inc. (AGNE):		
AGNE is a consumer goods membership cooperative that provides members with annual patronage rebates in cash, certificates of indebtedness (see note 4), 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 29, 2018 and December 30, 2017. The Cooperative owns 5,435 shares of Class B stock at December 29, 2018 and December 30, 2017.	784,059	784,059
National Coop Grocers (NCG):		
NCG 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 NCG board of directors.	513,080	499,812
Other	<u>16,106</u>	<u>16,106</u>
	<u>\$1,515,946</u>	<u>\$1,502,678</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 29, 2018 and December 30, 2017

6. Notes Payable

The Cooperative has a \$1,000,000 revolving line of credit with the Ledyard Bank which matures December 22, 2019. Interest is payable monthly at The Wall Street Journal prime rate (5.50% at December 29, 2018). The note is secured by a first mortgage on certain real property and substantially all business assets of the Cooperative. The Cooperative is also required to meet certain minimum debt service coverage ratios, among other requirements. The Cooperative was in compliance with these covenants as of December 29, 2018. There were no borrowings related to this agreement outstanding at December 29, 2018 or December 30, 2017.

7. Long-Term Debt

Long-term debt consisted of the following at December 29, 2018 and December 31, 2017:

	<u>2018</u>	<u>2017</u>
National Cooperative Bank, N.A.:		
Payable in monthly installments of \$40,727 including interest at 5.00% through 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. The Cooperative is required to meet certain minimum debt service coverage ratios, among other requirements. The Cooperative was in compliance with these covenants as of December 29, 2018. The note is subject to a prepayment penalty.	\$2,914,106	\$3,247,692
Ledyard National Bank:		
Payable in monthly installments of \$6,525 including interest at 4.50% due January 2022. The note is secured by equipment and a second security interest in substantially all other assets. The Cooperative is required to meet certain minimum debt service coverage ratios, among other requirements. The Cooperative was in compliance with these covenants as of December 29, 2018.	225,017	291,554
Ally Bank:		
Payable in monthly installments of \$730, with a 4.99% interest rate, due June 2022. Secured by a vehicle. This note was paid in full during 2018	—	34,394
Great America Financial Services:		
Payable in monthly installments of \$1,169, including interest at a 10.70% interest rate through January 1, 2023. Secured by certain equipment.	<u>45,244</u>	<u>—</u>
	3,184,367	3,573,640
Less current maturities of long-term debt	430,765	408,316
Less unamortized deferred financing fees	<u>37,477</u>	<u>42,701</u>
	<u>\$2,716,125</u>	<u>\$3,122,623</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 29, 2018 and December 30, 2017

7. Long-Term Debt (Continued)

As of December 29, 2018, long-term debt matures as follows:

Fiscal Periods Ending on or Around <u>December 31</u>	<u>Amount</u>
2019	\$ 430,765
2020	453,727
2021	477,564
2022	429,173
2023	431,665
Thereafter	<u>961,473</u>
	<u>\$3,184,367</u>

8. Income Taxes

The provision (benefit) from federal and state income taxes consists of the following at December 29, 2018 and December 30, 2017:

	<u>2018</u>	<u>2017</u>
Currently payable:		
Federal	\$ 13,975	\$ —
State	<u>67,466</u>	<u>79,059</u>
	81,441	79,059
Deferred:		
Federal	13,824	(287,178)
State	<u>8,910</u>	<u>(6,422)</u>
	<u>22,734</u>	<u>(293,600)</u>
	<u>\$ 104,175</u>	<u>\$(214,541)</u>

Deferred tax assets and liabilities consist of the following at December 29, 2018 and December 30, 2017:

	<u>2018</u>	<u>2017</u>
Deferred tax assets:		
Inventory valuation	\$ 8,479	\$ 7,600
Accrued compensation	21,470	11,700
Unclaimed patronage refund	29,644	29,700
Federal net operating loss carryforward	6,347	125,800
Other	<u>48,688</u>	<u>45,800</u>
	114,628	220,600

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 29, 2018 and December 30, 2017

8. Income Taxes (Continued)

	<u>2018</u>	<u>2017</u>
Deferred tax liabilities:		
Depreciation	\$342,572	\$420,300
Patronage refunds on investments in other cooperative	19,737	16,900
Prepaid expenses	<u>37,853</u>	<u>46,200</u>
	<u>400,162</u>	<u>483,400</u>
Net deferred tax liability	<u>\$285,534</u>	<u>\$262,800</u>

On December 22, 2017, the United States enacted the *Tax Cuts and Jobs Act*. Effects of tax law changes are accounted for in the period of enactment and deferred tax assets and liabilities are required to be adjusted to reflect the effect of a change in enacted tax rates in the period in which the law is enacted. The U.S. federal corporate tax rate was reduced to 21%, which became effective as of January 1, 2018. The impact of applying the new tax rate to deferred taxes is reflected in 2017 as a deferred tax benefit of approximately \$175,000. The impact of other tax law changes did not have a material impact on the Cooperative.

At December 29, 2018, the Cooperative has net operating losses of approximately \$30,225 available to reduce future federal taxable income through 2037. The Company has net operating loss carryforwards for which deferred tax assets have been provided for in previous years. The newly enacted tax law has limited the use of carryforwards to 80% of taxable income in a given year, which is not expected to impact the Cooperative's ability to be able to utilize its carryforwards. The Company utilized approximately \$387,000 of federal net operating losses carryforwards in 2018 to reduce federal taxable income.

The Cooperative's effective income tax rate in the period ended December 29, 2018, 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's effective income tax rate in the period ended December 30, 2017 is higher than would be expected if the federal statutory rate was applied to earnings primarily because of the derecognition of deferred tax liabilities related to certain income determined to not be taxable in the future, the impact of the change in the federal tax rates, and the State of New Hampshire Business Enterprise tax being accounted for as an income tax.

The Cooperative files income tax returns in the U.S. federal jurisdiction and two state jurisdictions.

During the periods ended December 29, 2018 and December 30, 2017, the Cooperative recognized no interest or penalties related to unrecognized tax benefits.

9. Members' Equity

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

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 29, 2018 and December 30, 2017

9. Members' Equity (Continued)

Capital Stock

The Bylaws (pursuant to the revision adopted effective May 1, 2017) and Certificate of Organization authorizes 2,000,000 shares of stock, consisting of two classes: Class A are issued in consideration of becoming a member of the cooperative or as patronage refunds in lieu of cash payments, are voting, and have a \$5 par value. Class B shares may be issued to members as patronage refunds in lieu of cash payments, are non-voting, have a \$5 par value, and may or may not have a fixed maturity date. Prior to the Bylaw revision effective May 1, 2017, the Class B shares did not have the option of having fixed maturity dates. 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

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."

Exchange of Class B Shares

On May 24, 2017 and effective May 1, 2017, the Board of Directors approved an exchange of new Class B shares, which have a ten-year maturity from the date of issuance for previously- issued and outstanding Class B shares (current Class B shares), which have no fixed maturity date. The Cooperative is required to redeem the new Class B shares for \$5 per share upon maturity. Members holding current Class B shares have until May 1, 2022 to exchange current Class B shares for new Class B shares, after which date any remaining current Class B shares will be cancelled and the associated capital will revert to the Cooperative.

During 2018 and 2017, members exchanged 2,227 and 6,942, respectively, of current Class B shares for new Class B shares, which resulted in the reclassification of \$11,135 and \$36,836, respectively, from capital stock to mandatorily redeemable stock, which is reported as a non-current liability. As of December 29, 2018, there are 57,618 shares of current Class B shares outstanding, representing \$288,100 of equity that could be reclassified to non-current liabilities upon exchange by members. As of December 30, 2017, there are 60,154 shares of current Class B shares outstanding, representing \$300,770 of equity that could be reclassified to non-current liabilities upon exchange by members.

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. The Cooperative cancelled no shares during the years ended December 29, 2018 and December 30, 2017.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 29, 2018 and December 30, 2017

9. Members' Equity (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, 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.

The Board of Directors authorized total patronage refunds of \$108,222, payable in store credit or cash, for the year ended December 29, 2018, which is reflected as a currently liability on the accompanying balance sheets. There were no patronage refunds for the year ended December 30, 2017.

10. Commitments

Operating Leases

The Cooperative leases facilities in Lebanon, New Hampshire, for the operation of a food store through June 2032 with an option to extend an additional twenty years. Base rent currently approximates \$66,000 per month, plus 2% of annual gross sales from the Lebanon store in excess of \$36,000,000 and an allocation of common area maintenance costs (totaling approximately \$324,000 in 2018 and \$253,000 in 2017). The base rent is adjusted annually based on the Consumer Price Index (CPI), with a minimum monthly base rent of approximately \$73,000 commencing in January 2023 and a minimum monthly base rate of approximately \$82,000 commencing in January 2028, 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 \$18,000 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.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 29, 2018 and December 30, 2017

10. Commitments (Continued)

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 on a month-to-month basis. Base rent is approximately \$9,500 per month adjusted annually based on the CPI, as defined, with a minimum increase of 1% each year, plus an allocation of common area maintenance fees (totaling approximately \$65,000 in 2018 and \$77,000 in 2017).

On October 16, 2018, the Cooperative entered into a lease agreement to open a new service center in Norwich, Vermont through December 2022, with an option to renew the lease for an additional ten year term. Base rent currently approximates \$15,100 per month, with an increase of approximately 3.5% each year, plus an allocation of common area maintenance fees.

Certain operating leases contain a rent escalation clause. The Cooperative recognizes rent expense ratably over the terms of the lease agreements, computed by dividing the total rents payable by the number of months of the lease terms. The incremental rent expense charged to operations under operating lease agreements with escalating payments amounted to approximately \$194,000 for the year ended December 29, 2018. No incremental rent expense was incurred for the year ended December 30, 2017.

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

<u>Fiscal Periods</u> <u>Ending on or</u> <u>Around</u> <u>December 31</u>	<u>Amount</u>
2019	\$ 1,422,948
2020	1,514,678
2021	1,531,867
2022	1,546,911
2023	1,432,675
Thereafter	<u>9,323,082</u>
	<u>\$16,772,161</u>

The Cooperative had rental expense, which is recognized ratably over the period of the related lease, of approximately \$1,850,000 and \$1,530,000 for the periods ended December 29, 2018 and December 30, 2017, respectively, which includes common area maintenance costs of \$389,000 in 2018 and \$330,000 in 2017.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 29, 2018 and December 30, 2017

10. **Commitments (Continued)**

Other Non-Current Liability

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. The obligation is secured by a security interest in the related equipment. 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 29, 2018 and December 30, 2017. The agreement also requires the Cooperative to pay certain liquidation damages, as defined, if the Cooperative terminates the agreement without cause prior to the termination date.

11. **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 contribution expense with respect to the Plan of approximately \$342,000 and \$337,000 in the periods ended December 29, 2018 and December 30, 2017, respectively. There were no discretionary contributions made in the periods ended December 29, 2018 and December 30, 2017.

12. **Self-Insurance Health Plan**

In 2016, the Cooperative entered into a self-funded insurance program to provide group health insurance benefits to active employees that includes self-insured retention (stop loss) levels on individual and aggregate bases. The Cooperative incurred charges to operations of approximately \$2,210,000 and \$2,718,000 in 2018 and 2017, respectively, in connection with this plan. The financial statements include a liability for claims incurred but not yet reported in the amount of approximately \$150,000 and \$154,000 as of December 29, 2018 and December 30, 2017, respectively.

13. **Major Suppliers**

During the period ended December 29, 2018, the Cooperative purchased approximately \$21,633,000 (45% of total purchases) of its goods from an unrelated party and AGNE, a related party (see note 5). At December 29, 2018, amounts due to these suppliers, included in accounts payable, totaled approximately \$720,000.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 29, 2018 and December 30, 2017

13. Major Suppliers (Continued)

During the period ended December 30, 2017, the Cooperative purchased approximately \$20,951,000 (43% of total purchases) of its goods from an unrelated party and AGNE, a related party (see note 5). At December 30, 2017, amounts due to these suppliers, included in accounts payable, totaled approximately \$746,000.

14. Related Party Transactions

The Cooperative is a member of AGNE (see note 5). The Cooperative purchased goods and groceries from AGNE of approximately \$12,264,000 and \$12,014,000 during the periods ended December 29, 2018 and December 30, 2017, respectively. Amounts due to AGNE, included in accounts payable, were approximately \$216,000 and \$186,000 at December 29, 2018 and December 30, 2017, respectively. Patronage refunds due from AGNE, included in accounts receivable, were approximately \$74,000 and \$76,000 at December 29, 2018 and December 30, 2017, 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 29, 2018 and December 30, 2017, were approximately \$1,425,000 and \$1,491,000, respectively. The discounts on these sales were netted against the gross sales in the statement of operations and approximated \$302,000 and \$282,000, for the periods ended December 29, 2018 and December 30, 2017, respectively.

Amounts due from members of approximately \$153,000 and \$156,000 are included in accounts receivable at December 29, 2018 and December 30, 2017, respectively.

See also notes 5 and 7 for additional disclosure related to investments in cooperatives and the outstanding mortgage from National Cooperative Bank, N.A.

15. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. In determining fair value, the use of various valuation approaches, including market, income and cost approaches, is permitted.

A fair value hierarchy has been established based on whether the inputs to valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from sources independent of the reporting entity and unobservable inputs reflect the entity's own assumptions about how market participants would value an asset or liability based on the best information available. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 29, 2018 and December 30, 2017

15. Fair Value Measurements (Continued)

The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used by the Cooperative for financial instruments measured at fair value on a recurring basis. The three levels of inputs are as follows:

Level 1 — Observable inputs such as quoted prices in active markets;

Level 2 — Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

Level 3 — Unobservable inputs in which there is little or no market data.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques. The three valuation techniques are as follows:

- *Market approach* – Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities;
- *Cost approach* – Amount that would be required to replace the service capacity of an asset (i.e., replacement cost); and
- *Income approach* – Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques).

In determining the appropriate levels, the Cooperative performs a detailed analysis of the assets and liabilities.

The following is a description of the valuation methodologies used:

Investments in Other Cooperative Associations

Investments in other cooperative associations totaling \$1,515,946 and \$1,502,678 at December 29, 2018 and 2017, respectively, are not readily marketable and are recorded at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. These investments may be redeemed at face value only at the discretion of the other cooperatives' boards of directors and have been classified as level 2 within the fair value hierarchy.

SUPPLEMENTAL INFORMATION

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

SCHEDULE OF OPERATING EXPENSES

Years Ended December 29, 2018 and December 30, 2017

	<u>2018</u>	<u>2017</u>
Store operations expenses:		
Store wages and benefits	\$11,605,933	\$11,939,766
Facilities cost	3,636,777	3,090,820
Credit card expenses	1,098,558	1,115,631
Selling and other costs	1,150,836	1,032,857
Equipment costs	<u>716,225</u>	<u>770,226</u>
	18,208,329	17,949,300
General and administrative expenses:		
Information technology department expenses	1,060,317	1,043,807
Administrative expenses	893,021	944,223
Merchandising expenses	767,089	821,266
Education expenses	791,044	794,604
Finance department expenses	555,460	650,340
Facilities maintenance department expenses	589,220	514,999
Human resources department expenses	478,376	430,202
Board of directors' expenses	137,825	128,173
Public relations expenses	<u>25,899</u>	<u>23,805</u>
	<u>5,298,251</u>	<u>5,351,419</u>
	<u>\$23,506,580</u>	<u>\$23,300,719</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

SCHEDULE OF GENERAL AND ADMINISTRATIVE EXPENSES

Years Ended December 29, 2018 and December 30, 2017

	<u>2018</u>	<u>2017</u>
Salaries and benefits	\$3,664,226	\$3,784,084
Equipment expenses	130,121	254,240
Equipment depreciation	214,591	230,699
Building leases	184,320	197,702
Professional fees	206,869	185,371
Telephone	113,853	139,338
Advertising	79,252	91,697
Consulting fees	60,487	83,477
Dues and subscriptions	100,998	63,209
Meals, entertainment and vehicle reimbursement	30,691	43,457
Education and training	43,844	37,364
Technical maintenance contracts	122,847	32,266
Supplies	29,090	28,569
Occupancy costs	66,167	28,246
Insurance	22,656	22,506
Postage	6,576	21,713
Printing	15,894	20,787
Graphics and promotional expenses	30,076	17,481
Employee relations and programs	16,797	12,734
Software licenses	104,504	8,820
Bank charges	5,465	7,103
Demo expenses	4,993	5,431
Contributions	7,781	3,453
Membership meeting	727	2,450
Co-op news	5,435	1,961
Other	<u>29,991</u>	<u>27,261</u>
	<u>\$5,298,251</u>	<u>\$5,351,419</u>