

FINANCIAL STATEMENTS
INDEPENDENT AUDITOR'S REPORT
AND SUPPLEMENTAL INFORMATION
HANOVER CONSUMER COOPERATIVE SOCIETY, INC.
JANUARY 2, 2016 AND JANUARY 3, 2015

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

JANUARY 2, 2016 AND JANUARY 3, 2015

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Independent Auditor's Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of Hanover Consumer Cooperative Society, Inc., (the Cooperative) which comprise the balance sheets as of January 2, 2016 and January 3, 2015, and the related statements of earnings, members' equity and cash flows for the fifty-two and fifty-three week periods then ended, respectively, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Cooperative as of January 2, 2016 and January 3, 2015, and the results of its operations and its cash flows for the fifty-two and fifty-three week periods then ended, respectively, in conformity with accounting principles generally accepted in the United States of America.

Other Matter

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

Gallagher, Flynn & Company, LLP

March 15, 2016

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

BALANCE SHEETS

JANUARY 2, 2016 AND JANUARY 3, 2015

A S S E T S

	<u>January 2,</u> <u>2016</u>	<u>January 3,</u> <u>2015</u>
CURRENT ASSETS		
Cash and cash equivalents	\$ 528,017	\$ 516,117
Certificates of indebtedness, current portion	56,201	62,010
Accounts receivable	369,838	394,829
Inventories	2,000,069	1,960,228
Refundable income tax prepayments	232,162	-
Other current assets	330,718	369,729
Deferred income taxes	105,700	-
Total current assets	<u>3,622,705</u>	<u>3,302,913</u>
 PROPERTY AND EQUIPMENT, at cost		
Land and improvements	342,189	342,189
Buildings and improvements	11,840,557	8,096,116
Machinery and equipment	<u>10,711,130</u>	<u>9,264,823</u>
	22,893,876	17,703,128
Less accumulated depreciation and amortization	<u>12,555,192</u>	<u>12,367,112</u>
	10,338,684	5,336,016
Construction in progress	<u>4,527</u>	<u>1,523,971</u>
	<u>10,343,211</u>	<u>6,859,987</u>
 OTHER ASSETS		
Investments in other cooperative associations	1,240,509	1,150,453
Certificates of indebtedness, less current portion	341,014	397,215
Other	<u>68,842</u>	<u>43,655</u>
	<u>1,650,365</u>	<u>1,591,323</u>
	<u>\$ 15,616,281</u>	<u>\$ 11,754,223</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

BALANCE SHEETS

JANUARY 2, 2016 AND JANUARY 3, 2015

LIABILITIES AND MEMBERS' EQUITY

	January 2, <u>2016</u>	January 3, <u>2015</u>
CURRENT LIABILITIES		
Current maturities of long-term debt	\$ 315,823	\$ 325,914
Accounts payable	2,410,892	2,111,632
Accrued payroll and benefits	872,664	1,013,808
Accrued expenses	427,963	592,671
Patronage refunds payable	<u>-</u>	<u>100,235</u>
Total current liabilities	<u>4,027,342</u>	<u>4,144,260</u>
 OTHER NON-CURRENT LIABILITIES	 <u>282,131</u>	 <u>243,468</u>
 LONG-TERM DEBT, less current maturities	 <u>3,562,038</u>	 <u>37,769</u>
 DEFERRED INCOME TAXES	 <u>742,900</u>	 <u>428,200</u>
 MEMBERS' EQUITY		
Capital stock	3,378,341	3,365,766
Donated capital	50,693	42,966
Retained earnings	<u>3,572,836</u>	<u>3,491,794</u>
	<u>7,001,870</u>	<u>6,900,526</u>
	 <u>\$ 15,616,281</u>	 <u>\$ 11,754,223</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF EARNINGS

**FIFTY-TWO WEEK PERIOD ENDED JANUARY 2, 2016 AND
FIFTY-THREE WEEK PERIOD ENDED JANUARY 3, 2015**

	January 2, <u>2016</u>	January 3, <u>2015</u>
NET REVENUES	\$ 69,993,775	\$ 74,867,478
COST OF SALES	<u>46,891,161</u>	<u>50,864,374</u>
GROSS PROFIT	23,102,614	24,003,104
OPERATING EXPENSES	<u>22,804,781</u>	<u>23,165,006</u>
EARNINGS FROM OPERATIONS	<u>297,833</u>	<u>838,098</u>
OTHER (INCOME) EXPENSE		
Interest expense	86,622	23,753
Interest income	(17,644)	(26,604)
Miscellaneous (income) expense	<u>25,128</u>	<u>(2,634)</u>
	<u>94,106</u>	<u>(5,485)</u>
EARNINGS BEFORE PATRONAGE REFUND AND INCOME TAXES	203,727	843,583
PATRONAGE REFUND	<u>-</u>	<u>501,178</u>
EARNINGS BEFORE INCOME TAXES	203,727	342,405
PROVISION FOR INCOME TAXES	<u>122,685</u>	<u>172,371</u>
NET EARNINGS	<u>\$ 81,042</u>	<u>\$ 170,034</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF MEMBERS' EQUITY

**FIFTY-TWO WEEK PERIOD ENDED JANUARY 2, 2016 AND
FIFTY-THREE WEEK PERIOD ENDED JANUARY 3, 2015**

	<u>Class A Common Stock</u>		<u>Class B Common Stock</u>		<u>Share Credits</u>	<u>Allocated Capital</u>	<u>Donated Capital</u>	<u>Retained Earnings</u>	<u>Total</u>
	<u>Shares</u>	<u>Value</u>	<u>Shares</u>	<u>Value</u>					
BALANCE, December 28, 2013	527,993	\$ 2,639,965	-	\$ -	\$ 50,058	\$ 248,084	\$ 42,966	\$ 3,321,760	\$ 6,302,833
Net earnings		-	-	-	-	-	-	170,034	170,034
Shares issued in satisfaction of allocated capital	49,254	246,270	-	-	1,814	(248,084)	-	-	-
Shares sold, net of cancellations	5,585	27,925	-	-	(1,209)	-	-	-	26,716
Allocation of patronage refund to be issued as capital stock	-	-	-	-	-	400,943	-	-	400,943
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 cancellations	3,382	16,910	-	-	(4,335)	-	7,727	-	20,302
BALANCE, January 2, 2016	<u>588,120</u>	<u>\$ 2,940,600</u>	<u>68,474</u>	<u>\$ 342,370</u>	<u>\$ 95,371</u>	<u>\$ -</u>	<u>\$ 50,693</u>	<u>\$ 3,572,836</u>	<u>\$ 7,001,870</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF CASH FLOWS

**FIFTY-TWO WEEK PERIOD ENDED JANUARY 2, 2016 AND
FIFTY-THREE WEEK PERIOD ENDED JANUARY 3, 2015**

	January 2, <u>2016</u>	January 3, <u>2015</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		
CASH FLOWS FROM OPERATING ACTIVITIES		
Net earnings	\$ 81,042	\$ 170,034
Noncash items included in net earnings:		
Depreciation and amortization	1,097,341	957,567
Patronage refund declared	-	501,178
Patronage certificates of indebtedness received	-	(82,689)
Patronage investments in cooperatives received	(45,393)	(65,706)
Deferred income taxes	209,000	(29,100)
Changes in assets and liabilities:		
Accounts receivable	24,991	(48,953)
Inventory	(39,841)	334,936
Income taxes receivable	(232,162)	-
Other current assets	13,824	(196,763)
Accounts payable	299,260	99,233
Accrued expenses and other current liabilities	(549,320)	96,792
	<u>777,700</u>	<u>1,566,495</u>
Net cash provided by operating activities	<u>858,742</u>	<u>1,736,529</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(4,298,434)	(1,461,329)
Purchase of investments	(44,663)	(8,930)
Proceeds from repayments of certificates of indebtedness	62,010	97,897
Net cash used in investing activities	<u>(4,281,087)</u>	<u>(1,372,362)</u>
Subtotal (forward)	<u>\$ (3,422,345)</u>	<u>\$ 364,167</u>

(CONTINUED)

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF CASH FLOWS

**FIFTY-TWO WEEK PERIOD ENDED JANUARY 2, 2016 AND
FIFTY-THREE WEEK PERIOD ENDED JANUARY 3, 2015**

	January 2, <u>2016</u>	January 3, <u>2015</u>
Subtotal (forwarded)	\$ (3,422,345)	\$ 364,167
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term debt	3,840,000	-
Principal payments on long-term debt	(325,822)	(585,924)
Patronage refund liability paid	(100,235)	(248,084)
Proceeds from issuance of capital stock, net	<u>20,302</u>	<u>26,716</u>
Net cash provided by (used in) financing activities	<u>3,434,245</u>	<u>(807,292)</u>
Net increase (decrease) in cash and cash equivalents	11,900	(443,125)
CASH AND CASH EQUIVALENTS, beginning of period	<u>516,117</u>	<u>959,242</u>
CASH AND CASH EQUIVALENTS, end of period	<u>\$ 528,017</u>	<u>\$ 516,117</u>
<u>Supplemental Disclosures of Cash Flows Information</u>		
Cash paid during the period for:		
Interest expense	<u>\$ 70,383</u>	<u>\$ 17,379</u>
Income taxes	<u>\$ 145,847</u>	<u>\$ 157,546</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. During the period ended January 3, 2015 the Cooperative issued \$246,270 of Class A shares, \$0 of Class B shares, and \$1,814 of share credits in satisfaction of the patronage refund declared as payable at December 28, 2013.

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

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 2, 2016 AND JANUARY 3, 2015

A) SUMMARY OF OPERATIONS AND ACCOUNTING POLICIES

Operations:

The Hanover Consumer Cooperative Society, Inc., (the Cooperative) was incorporated in New Hampshire in 1937. The Cooperative operates member-owned food stores in Hanover and Lebanon, New Hampshire, and White River Junction, Vermont, a community market in Hanover, New Hampshire, and an automobile service center in Hanover, New Hampshire, which are open to its members and the general public. In addition, the Cooperative leases and operates a commissary kitchen in Wilder, Vermont, which prepares food products for resale through the Cooperative's food stores. The majority of sales are to members of the Cooperative. Sales to members were approximately 73% and 74% of total sales for the periods ending January 2, 2016 and January 3, 2015, respectively. Sales of grocery-related items were 95% of total sales in 2015 and 93% in 2014, and sales of automobile fuel and repair services were 5% of total sales in 2015 and 7% in 2014.

Accounting policies:

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

1. Fiscal year end

The Cooperative's fiscal year ends on the Saturday nearest to December 31. The fiscal periods ended January 2, 2016 and January 3, 2015 included fifty-two and fifty-three weeks, respectively.

2. Cash and cash equivalents

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

3. Accounts receivables

Trade accounts are stated at the amount the Cooperative expects to collect from sales of products. The Cooperative maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Management considers the following factors when determining the 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 January 2, 2016 and January 3, 2015, no allowance was required.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 2, 2016 AND JANUARY 3, 2015

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 2015 and 2014, no significant impairment loss was required to be recognized.

7. Investment in other cooperative associations

Nonmarketable investments in cooperative associations are carried at cost and are evaluated for impairment annually to adjust the investments to their net realizable value. During 2015 and 2014, no impairment loss was required to be recognized.

8. Income taxes

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

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 2, 2016 AND JANUARY 3, 2015

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 \$184,800 and \$219,000 for the periods ended January 2, 2016 and January 3, 2015, respectively.

10. Use of estimates

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

11. Evaluation of subsequent events

In preparing these financial statements, the Cooperative has evaluated events and transactions for potential recognition or disclosure through March 15, 2016, the date the financial statements were available to be issued.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 2, 2016 AND JANUARY 3, 2015

B) CONCENTRATION OF CREDIT RISK

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

C) CERTIFICATES OF INDEBTEDNESS

Certificates of indebtedness primarily consist of amounts due from Associated Grocers of New England, Inc., (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 4.5%, maturing at various times through June 2020. Amounts receivable under these agreements totaled \$397,215 and \$459,225 at January 2, 2016 and January 3, 2015, respectively. The Cooperative evaluates collectability by evaluating the financial condition of AGNE and provides for estimated uncollectible amounts through a charge to earnings and a credit to a valuation allowance, if warranted. At January 2, 2016 and January 3, 2015, no valuation allowance was required.

At January 2, 2016 certificates of indebtedness mature as follows:

Fiscal Periods Ending on or Around <u>December 31,</u>	<u>Amount</u>
2016	\$ 56,201
2017	93,449
2018	90,353
2019	74,523
2020	<u>82,689</u>
	<u>\$ 397,215</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 2, 2016 AND JANUARY 3, 2015

D) INVESTMENTS IN OTHER COOPERATIVE ASSOCIATIONS

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

	<u>January 2, 2016</u>	<u>January 3, 2015</u>
National Consumer Cooperative Bank (NCCB):		
NCCB is a financial services cooperative. At January 2, 2016 and January 3, 2015, 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 January 2, 2016 and January 3, 2015. The Cooperative owns 5,435 and 5,435 shares of Class B stock at January 2, 2016 and January 3, 2015, respectively.	<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

JANUARY 2, 2016 AND JANUARY 3, 2015

D) INVESTMENTS IN OTHER COOPERATIVE ASSOCIATIONS (continued)

	January 2, <u>2016</u>	January 3, <u>2015</u>
Subtotal (forwarded)	\$ 986,760	\$ 986,760
National Cooperative Grocers Association (NCGA):		
NCGA is a consumer goods cooperative that 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.	246,784	156,728
Other	<u>6,965</u>	<u>6,965</u>
	<u>\$1,240,509</u>	<u>\$1,150,453</u>

E) NOTE PAYABLE

The Cooperative has a \$1,000,000 revolving line of credit with the NCCB due March 2016. Interest is payable monthly at *The Wall Street Journal* prime rate (3.50% at January 2, 2016). The note is secured by substantially all assets of the Cooperative. There were no borrowings related to this agreement outstanding at January 2, 2016.

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

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 2, 2016 AND JANUARY 3, 2015

F) LONG-TERM DEBT

Long-term debt consists of the following at:

	<u>January 2, 2016</u>	<u>January 3, 2015</u>
National Consumer Cooperative Bank (NCCB) - Payable in interest-only payments at the greater of 4% or <i>The Wall Street Journal</i> prime rate (3.50% at January 3, 2016) plus 0.5% through January 1, 2016. Beginning February 1, 2016, the note is payable in monthly installments of \$40,727 including interest at the greater of 5% or the Ten-Year U.S. Treasury Note Yield on, plus .25% February 2026. The note is secured by a first mortgage on certain real estate and substantially all assets of the Cooperative, and subject to certain financial ratios, as defined.	\$ 3,840,000	\$ -
National Cooperative Bank, N.A. (formerly NCB, FSB), a subsidiary of NCCB - Payable in monthly installments of \$27,877, including interest at 4%, due March 2016. Secured by real estate, equipment and the assignment of a lease (see Note I), and subject to certain financial ratios, as defined.	<u>37,861</u> 3,877,861	<u>363,683</u> 363,683
Principal payments due within one year	<u>315,823</u>	<u>325,914</u>
	<u>\$ 3,562,038</u>	<u>\$ 37,769</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 2, 2016 AND JANUARY 3, 2015

F) LONG-TERM DEBT (continued)

As of January 2, 2016, long-term debt matures as follows:

<u>Fiscal Periods Ending on or Around December 31,</u>	<u>Amount</u>
2016	\$ 315,823
2017	317,838
2018	334,100
2019	351,193
2020	369,160
Thereafter	<u>2,189,747</u>
	<u>\$ 3,877,861</u>

G) INCOME TAXES

The provision for income taxes consists of the following:

	<u>January 2, 2016</u>	<u>January 3, 2015</u>
Currently payable (refundable), net of benefit of net operating loss carryback of \$181,600 in the period ending January 2, 2016	\$ (86,315)	\$ 201,471
Deferred	<u>209,000</u>	<u>(29,100)</u>
	<u>\$ 122,685</u>	<u>\$ 172,371</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 2, 2016 AND JANUARY 3, 2015

G) INCOME TAXES (continued)

Deferred tax assets and liabilities consist of the following at:

	January 2, <u>2016</u>	January 3, <u>2015</u>
Deferred tax assets:		
Inventory valuation	\$ 11,600	\$ 10,700
Accrued compensation	77,900	96,100
Unclaimed patronage refund	46,800	46,800
Federal net operating loss carryforward	103,200	-
State of New Hampshire Business Enterprise tax credit carryforward	-	292,000
Other	<u>35,900</u>	<u>15,700</u>
	275,400	461,300
Valuation allowance	<u>-</u>	<u>(292,000)</u>
	<u>\$ 275,400</u>	<u>\$ 169,300</u>
Deferred tax liabilities:		
Depreciation and impairment write down	\$ 673,900	\$ 339,300
Patronage refunds on investments in other cooperatives	121,500	124,500
Prepaid expenses	<u>117,200</u>	<u>133,700</u>
	<u>\$ 912,600</u>	<u>\$ 597,500</u>

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 removed from the books. There was no impact on net earnings or retained earnings. The valuation allowance increased by \$55,500 during the period ended January 3, 2015.

The Cooperative has net operating losses of approximately \$303,000 to offset future federal taxable income through 2036.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 2, 2016 AND JANUARY 3, 2015

G) INCOME TAXES (continued)

The Cooperative's effective income tax rate in the periods ended January 2, 2016 and January 3, 2015 is higher than would be expected if the federal statutory rate was applied to earnings primarily because the State of New Hampshire Business Enterprise tax is accounted for as an income tax.

The Cooperative files income tax returns in the U.S. federal jurisdiction and two state jurisdictions. With few exceptions, the Cooperative is no longer subject to U.S. federal, state or local income tax examinations by tax authorities for fiscal periods before January 1, 2012.

During the periods ended January 2, 2016 and January 3, 2015, 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 will be 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." Members who discontinue membership may request a refund, which may be issued at the discretion of the Board.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 2, 2016 AND JANUARY 3, 2015

H) MEMBERS' EQUITY AND CONTINGENCY (continued)

Bylaws (continued)

Patronage refunds: Patronage refunds are determined under a formula by applying the percentage of sales to members and non-member patrons to calculate member net earnings and non-member net earnings (also known as "savings"). Member net earnings, before the provision for federal income taxes, 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, or 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

Total patronage refunds were \$0 and \$501,178 for the periods ended January 2, 2016 and January 3, 2015, respectively. For the period ended January 3, 2015, the Board authorized issuance of \$100,235 of the refund in cash and \$400,943 in credits, which were redeemed for common stock in 2015. The cash portion is reflected as a current liability and the credits for additional common stock portion as an allocation to equity.

Contingency

The Cooperative has been notified by the State of New Hampshire Bureau of Securities Regulation that the Bureau is evaluating the Cooperative's capital structure for compliance with state law. The issue relates to the redeemability of common stock issued to satisfy patronage refunds declared. The Cooperative is in the early stages of addressing the matter with State authorities. Management believes that the matter is without merit and will be resolved favorably to the Cooperative without any unfavorable impact. Legal counsel for the Cooperative has advised that while they concur with management's opinion, they are unable to conclude the likelihood of unfavorable outcome at this point. Therefore, the financial statements do not reflect any adjustments that might be required as a result of this matter.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 2, 2016 AND JANUARY 3, 2015

I) COMMITMENTS AND CONTINGENCIES

Operating leases

The Cooperative leases facilities in Lebanon, New Hampshire, for the operation of a food store through June 2017, with an option to extend an additional five years. Base rent currently approximates \$60,000 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. In September 2014, the Cooperative exercised an option to extend the lease term through May 2025. Prior to this extension, base rent approximated \$14,000 per month. Effective May 2015 the base rent approximated \$17,000 per month, with an annual 2.5% increase, through May 2025.

The Cooperative leases land upon which the community market in Hanover, New Hampshire, is operated in a building built and owned by the Cooperative from the proceeds of long-term debt (see Note F). The lease expires February 2034 and contains an option to extend an additional ten years. Base rent is approximately \$4,000 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 \$3,000 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.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 2, 2016 AND JANUARY 3, 2015

I) COMMITMENTS AND CONTINGENCIES (continued)

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>
2016	\$1,144,000
2017	784,000
2018	332,000
2019	315,000
2020	277,000
Thereafter	<u>1,732,000</u>
	<u>\$4,584,000</u>

The Cooperative had rental expense of approximately \$1,414,000 and \$1,366,000 for the periods ended January 2, 2016 and January 3, 2015, 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 used in its distribution of petroleum operations. The purchase price of the equipment of approximately \$282,000 is payable on a gradually reducing schedule. In the event that the Cooperative terminates the supplier agreement prior to June 2020, the Cooperative must pay the supplier full purchase price. Therefore, 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 January 2, 2016.

At January 2, 2016 the Cooperative had certain ongoing matters, which, except for deductibles, are covered by insurance. During the period ended January 3, 2015, \$40,000 was charged to earnings related to deductibles for these cases. Amounts included in accounts payable related to these cases were \$40,000 at January 2, 2016 and January 3, 2015.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 2, 2016 AND JANUARY 3, 2015

J) PROGRESS SHARING 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 \$324,000 and \$342,000 in the periods ended January 2, 2016 and January 3, 2015, respectively. There were no discretionary contributions made in the periods ended January 2, 2016 and January 3, 2015.

K) MAJOR SUPPLIERS

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 AG, a related party (see Note D). At January 2, 2016, amounts due to these suppliers, included in accounts payable, totaled approximately \$590,000.

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

L) RELATED-PARTY TRANSACTIONS

The Cooperative is a member of AG (see Note D). The Cooperative purchased goods and groceries from AG of approximately \$12,523,000 and \$12,384,000 during the periods ended January 2, 2016 and January 3, 2015, respectively. Amounts due to AG, included in accounts payable, were approximately \$185,000 and \$188,000 at January 2, 2016 and January 3, 2015, respectively. Patronage refunds due from AG, included in accounts receivable, were approximately \$117,000 and \$125,500 at January 2, 2016 and January 3, 2015, respectively.

The Cooperative offers a 20% discount on purchases made by employees and board members. Total gross sales to employees and board members for the periods ended January 2, 2016 and January 3, 2015 were approximately \$1,427,000 and \$1,500,000, respectively. The discounts on these sales were netted against the gross sales in the statement of earnings and approximated \$308,800 and \$326,400, for the periods ended January 2, 2016 and January 3, 2015, respectively.

Amounts due from members of approximately \$131,000 and \$128,500 are included in accounts receivable at January 2, 2016 and January 3, 2015, respectively.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

JANUARY 2, 2016 AND JANUARY 3, 2015

M) NEW ACCOUNTING PRONOUNCEMENTS

In November 2015, the FASB issued *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 in 2018 and may be implemented on a prospective or retrospective basis. The Company is currently evaluating the impact of adopting the ASU on the presentation of its consolidated financial statements.

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 in 2020 and must be implemented using a modified retrospective approach. The Company is currently evaluating the impact of adopting the ASU on its financial position and results of operations.

SUPPLEMENTAL INFORMATION

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

SCHEDULE OF OPERATING EXPENSES

**FIFTY-TWO WEEK PERIOD ENDED JANUARY 2, 2016 AND
FIFTY-THREE WEEK PERIOD ENDED JANUARY 3, 2015**

	January 2, <u>2016</u>	January 3, <u>2015</u>
Store operations expenses:		
Store wages and benefits	\$ 11,591,090	\$ 12,008,575
Facilities cost	3,149,305	2,883,522
Equipment costs	849,380	792,882
Credit card expenses	1,019,117	986,617
Selling and other costs	<u>1,076,407</u>	<u>1,051,326</u>
	<u>17,685,299</u>	<u>17,722,922</u>
General and administrative expenses:		
Education expenses	468,333	583,046
Gain sharing expense	-	16,583
Administrative expenses	872,286	1,010,663
Board of director's expenses	113,303	103,296
Human resources department	510,917	425,692
Finance department	587,654	678,418
Merchandising expenses	817,341	850,653
Marketing expenses	495,421	482,597
Information technology department	901,751	907,031
Facilities maintenance department	<u>352,476</u>	<u>384,105</u>
	<u>5,119,482</u>	<u>5,442,084</u>
	<u>\$ 22,804,781</u>	<u>\$ 23,165,006</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

SCHEDULE OF GENERAL AND ADMINISTRATIVE EXPENSES

**FIFTY-TWO WEEK PERIOD ENDED JANUARY 2, 2016 AND
FIFTY-THREE WEEK PERIOD ENDED JANUARY 3, 2015**

	January 2, <u>2016</u>	January 3, <u>2015</u>
Salaries and benefits	\$ 3,417,719	\$ 3,610,952
Equipment expenses	301,350	332,102
Professional fees	250,219	308,798
Advertising	184,833	219,095
Building leases	183,122	177,316
Equipment depreciation	175,046	121,422
Telephone	137,006	148,465
Education and training	84,923	88,217
Dues and subscriptions	57,031	72,833
Consulting fees	55,419	50,736
Meals, entertainment and vehicle reimbursement	45,172	35,304
Occupancy costs	38,479	36,180
Supplies	27,685	44,547
Graphics and promotional expenses	25,439	28,340
Technical maintenance contracts	20,431	13,461
Printing	16,850	16,197
Insurance	14,844	14,844
Bank charges	13,262	12,989
Postage	13,134	14,027
Employee relations and programs	12,097	15,525
Contributions	8,068	8,203
Membership meeting	3,039	683
Demo expenses	2,227	16,263
Co-op News	1,908	14,807
Software licenses	658	6,750
Gain sharing expense	-	16,583
Other	29,521	17,445
	<u>\$ 5,119,482</u>	<u>\$ 5,442,084</u>