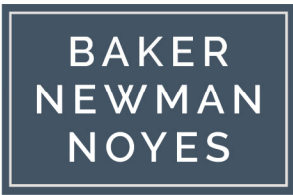


Hanover Consumer Cooperative Society, Inc.

Financial Statements and Supplemental Information

*Years Ended January 1, 2022 and January 2, 2021
With Independent Auditors' Report*



INDEPENDENT AUDITORS' REPORT

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

Opinion

We have audited the financial statements of Hanover Consumer Cooperative Society, Inc. (the Cooperative), which comprise the balance sheets as of January 1, 2022 and January 2, 2021, the related consolidated statements of income, comprehensive income, members' equity and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Cooperative as of January 1, 2022 and January 2, 2021, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Cooperative to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Cooperative's ability to continue as a going concern within one year after the date the financial statements are available to be issued.

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

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Cooperative's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings and certain internal control-related matters that we identified during the audit.

Supplemental Information

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 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 has been subjected to the auditing procedures applied in the audits 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 is fairly stated in all material respects in relation to the financial statements as a whole.

Beck Noyes & Noyes LLC

Manchester, New Hampshire
March 2, 2022

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

BALANCE SHEETS

January 1, 2022 and January 2, 2021

ASSETS

	<u>2021</u>	<u>2020</u>
Current assets:		
Cash and cash equivalents	\$ 4,434,229	\$ 6,929,866
Accounts receivable – trade and other	887,365	747,901
Inventories	2,030,349	2,083,720
Other current assets	<u>501,611</u>	<u>440,042</u>
Total current assets	7,853,554	10,201,529
Property and equipment, at cost:		
Land and improvements	342,189	342,189
Buildings and improvements	11,902,310	11,868,721
Machinery and equipment	14,343,314	13,422,977
Construction in process	<u>2,144,499</u>	<u>330,884</u>
	28,732,312	25,964,771
Less accumulated depreciation and amortization	<u>18,918,989</u>	<u>18,134,617</u>
Property and equipment, net	9,813,323	7,830,154
Other assets:		
Investments in other cooperative associations	1,532,942	1,477,839
Certificates of indebtedness	65,964	65,964
Interest rate swap asset	207,729	–
Other	<u>9,228</u>	<u>10,303</u>
Total other assets	1,815,863	1,554,106
	_____	_____
Total assets	<u>\$19,482,740</u>	<u>\$19,585,789</u>

LIABILITIES AND MEMBERS' EQUITY

	<u>2021</u>	<u>2020</u>
Current liabilities:		
Current maturities of long-term debt	\$ 197,271	\$ 563,675
Accounts payable	1,732,972	2,070,217
Accrued payroll and benefits	504,328	507,332
Accrued expenses	701,906	641,828
Current portion of equipment obligation	<u>56,426</u>	<u>56,426</u>
Total current liabilities	3,192,903	3,839,478
Long-term liabilities:		
Long-term debt, less current maturities	5,552,605	6,039,846
Long-term equipment obligation	112,853	169,279
Interest rate swap liability	-	62,059
Deferred rent	1,015,697	365,045
Deferred income taxes	439,249	230,705
Mandatorily redeemable stock	<u>123,355</u>	<u>97,298</u>
	<u>7,243,759</u>	<u>6,964,232</u>
Total liabilities	10,436,662	10,803,710
Commitments (note 10)		
Members' equity:		
Capital stock	3,059,189	3,079,208
Donated capital	353,013	315,500
Retained earnings	5,472,526	5,435,569
Accumulated other comprehensive income (loss)	<u>161,350</u>	<u>(48,198)</u>
Total members' equity	<u>9,046,078</u>	<u>8,782,079</u>
Total liabilities and members' equity	<u>\$19,482,740</u>	<u>\$19,585,789</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF INCOME

Years Ended January 1, 2022 and January 2, 2021

	<u>2021</u>	<u>2020</u>
Revenues (net of discounts of \$2,260,301 and \$2,012,182 during 2021 and 2020, respectively)	\$84,933,973	\$85,416,539
Cost of sales	<u>57,065,989</u>	<u>57,044,218</u>
Gross profit	27,867,984	28,372,321
Operating expenses	<u>27,518,209</u>	<u>28,557,508</u>
Income (loss) from operations	349,775	(185,187)
Other income (expense):		
Interest expense	(153,393)	(149,215)
Interest income	8,580	14,456
Other income	<u>33,107</u>	<u>18,624</u>
Total other expense	(111,706)	(116,135)
Other income, not available for patronage refund:		
Government grant income	-	2,317,550
Gain on disposal of equipment	16,610	4,400
Loss on prepayment of long-term debt	<u>-</u>	<u>(101,579)</u>
Total other income, not available for patronage refund	<u>16,610</u>	<u>2,220,371</u>
Income before income taxes	254,679	1,919,049
Provision for income taxes	<u>217,722</u>	<u>64,561</u>
Net income	<u>\$ 36,957</u>	<u>\$ 1,854,488</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF COMPREHENSIVE INCOME

Years Ended January 1, 2022 and January 2, 2021

	<u>2021</u>	<u>2020</u>
Net income	\$ 36,957	\$1,854,488
Other comprehensive income (loss) before tax:		
Change in fair value of swap derivative during period	269,788	(62,059)
Income tax effect related to items of other comprehensive loss	<u>(60,240)</u>	<u>13,861</u>
Other comprehensive income (loss), net of tax	<u>209,548</u>	<u>(48,198)</u>
Total comprehensive income	<u>\$246,505</u>	<u>\$1,806,290</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF MEMBERS' EQUITY

Years Ended January 1, 2022 and January 2, 2021

	Class A Common Stock		Class B Common Stock		Partial Share Credits	Total Capital Stock	Donated Capital	Retained Earnings	Other Accumulated Compre- hensive Income (Loss)	Total
	Shares	Values	Shares	Value						
Balance, December 28, 2019	543,465	\$ 2,717,326	50,710	\$ 253,570	\$ 88,778	\$ 3,059,674	\$ 315,500	\$ 3,581,081	\$ —	\$ 6,956,255
Net income	—	—	—	—	—	—	—	1,854,488	—	1,854,488
Other comprehensive loss	—	—	—	—	—	—	—	—	(48,198)	(48,198)
Class B shares exchanged	—	—	(2,390)	(11,950)	(789)	(12,739)	—	—	—	(12,739)
Shares issued, net of redemptions	<u>6,869</u>	<u>34,345</u>	<u>(285)</u>	<u>(1,425)</u>	<u>(647)</u>	<u>32,273</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>32,273</u>
Balance, January 2, 2021	550,334	2,751,671	48,035	240,195	87,342	3,079,208	315,500	5,435,569	(48,198)	8,782,079
Net income	—	—	—	—	—	—	—	36,957	—	36,957
Other comprehensive income	—	—	—	—	—	—	—	—	209,548	209,548
Class B shares exchanged	—	—	(4,988)	(24,940)	(1,117)	(26,057)	—	—	—	(26,057)
Shares issued, net of redemptions	9,083	45,415	(296)	(1,480)	(384)	43,551	—	—	—	43,551
Donated capital	<u>(7,353)</u>	<u>(36,765)</u>	<u>—</u>	<u>—</u>	<u>(748)</u>	<u>(37,513)</u>	<u>37,513</u>	<u>—</u>	<u>—</u>	<u>—</u>
Balance, January 1, 2022	<u>552,064</u>	<u>\$ 2,760,321</u>	<u>42,751</u>	<u>\$ 213,775</u>	<u>\$ 85,093</u>	<u>\$ 3,059,189</u>	<u>\$ 353,013</u>	<u>\$ 5,472,526</u>	<u>\$ 161,350</u>	<u>\$ 9,046,078</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF CASH FLOWS

Years Ended January 1, 2022 and January 2, 2021

	<u>2021</u>	<u>2020</u>
Cash flows from operating activities:		
Net income	\$ 36,957	\$ 1,854,488
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	930,470	1,124,934
Deferred rent	650,652	77,224
Gain on disposal of equipment	(16,610)	(4,400)
Loss on prepayment of long-term debt	-	101,579
Patronage investments in cooperatives	(107,423)	(56,882)
Deferred income taxes	148,304	(7,574)
Changes in operating assets and liabilities:		
Accounts receivable	(139,464)	(88,152)
Inventory	53,371	250,443
Other current and long-term assets	(61,569)	(261,133)
Accounts payable	(337,245)	(123,886)
Accrued payroll and benefits	(3,004)	(163,705)
Accrued expenses	60,078	25,721
Other liabilities	<u>(56,426)</u>	<u>(56,426)</u>
Net cash provided by operating activities	1,158,091	2,672,231
Cash flows from investing activities:		
Acquisition of property and equipment	(2,929,823)	(1,041,781)
Proceeds from disposal of equipment	41,191	4,400
Proceeds from repayments of certificates of indebtedness	-	82,689
Proceeds from investments in cooperatives	<u>52,320</u>	<u>70,996</u>
Net cash used in investing activities	(2,836,312)	(883,696)
Cash flows from financing activities:		
Proceeds from long-term debt	10,473	6,682,450
Principal payments on long-term debt	(871,440)	(2,803,556)
Prepayment penalty on long-term debt	-	(71,445)
Debt issuance costs	-	(54,440)
Proceeds from issuance of capital stock, net	<u>43,551</u>	<u>32,273</u>
Net cash (used) provided by financing activities	<u>(817,416)</u>	<u>3,785,282</u>
Net (decrease) increase in cash and cash equivalents	(2,495,637)	5,573,817
Cash and cash equivalents, beginning of year	<u>6,929,866</u>	<u>1,356,049</u>
Cash and cash equivalents, end of year	<u>\$ 4,434,229</u>	<u>\$ 6,929,866</u>

Continued on next page.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF CASH FLOWS (CONTINUED)

Years Ended January 1, 2022 and January 2, 2021

	<u>2021</u>	<u>2020</u>
Supplemental disclosures of cash flows information:		
Cash paid during the period for:		
Interest expense	\$ <u>146,170</u>	\$ <u>143,938</u>
Income taxes	\$ <u>96,224</u>	\$ <u>51,645</u>
Supplemental disclosure of noncash activities:		
Class B shares exchanged for mandatorily redeemable stock	\$ <u>26,057</u>	\$ <u>12,739</u>
Other comprehensive income (loss) amounts:		
Noncash activity related to interest rate swap:		
Change in fair value of interest rate swap, net of related tax effect	\$ <u>209,548</u>	\$ <u>(48,198)</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

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; as well as automobile service centers in Hanover, New Hampshire and 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 76% and 75% of total sales for the years ending January 1, 2022 and January 2, 2021, respectively. Sales of grocery-related items were 95% and 96% of total sales in 2021 and 2020, respectively, and sales of automobile fuel and repair services were 5% and 4% of total sales in 2021 and 2020, 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 January 1, 2022 and January 2, 2021.

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 as well as a construction allowance reimbursement due to the Cooperative for construction performed at the Lebanon store location as of January 1, 2022. 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 January 1, 2022 and January 2, 2021.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

2. Summary of Accounting Policies (Continued)

Accounts receivable – trade and other consists of the following at January 1, 2022 and January 2, 2021:

	<u>2021</u>	<u>2020</u>
Trade and credit card receivables	\$158,493	\$558,708
Other receivables	<u>728,872</u>	<u>189,193</u>
	<u>\$887,365</u>	<u>\$747,901</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 \$922,073 and \$1,118,582 for the years ended January 1, 2022 and January 2, 2021, 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. As of January 1, 2022 and January 2, 2021, 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

January 1, 2022 and January 2, 2021

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 January 1, 2022 and January 2, 2021. The Cooperative has concluded no uncertain income tax positions existed at January 1, 2022 and January 2, 2021.

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

Advertising Expense

Advertising costs are charged to operations when incurred. Advertising expense was approximately \$116,500 and \$116,300 for the years ended January 1, 2022 and January 2, 2021, respectively.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

2. Summary of Accounting Policies (Continued)

Revenue Recognition

The Cooperative records revenue from the sales of merchandise upon delivery, which is when its performance obligation is satisfied. For sales at retail grocery stores, delivery occurs at the point of sale. Automotive service center revenues are recognized as the agreed-upon services are completed. Payment is generally due at the point of sale. The transaction price is the amount of consideration to which the Cooperative expects to be entitled to in exchange for transfer of goods and services to the customer, adjusted for returns and discounts. Sales discounts totaled \$2,260,301 and \$2,012,182 for the years ended January 1, 2022 and January 2, 2021, respectively. Returns are not significant.

The Cooperative collects and remits sales related taxes on transactions with customers and reports such amounts under the net method in the statement of income. Accordingly, these taxes are not included in revenues.

The Cooperative records a liability in the period in which a gift card is sold. As gift cards are redeemed, the Cooperative recognizes revenue and reduces the related liability. Gift cards do not expire, but typically are redeemed within one year of issuance. When a gift card is not subject to escheatment and it is probable that a portion of the gift card will not be redeemed, this amount is considered to be breakage. Gift card revenues and related breakage are not significant.

The following summarizes revenues between grocery-related sales, sales of automobile fuel and repair sales for the years ended January 1, 2022 and January 2, 2021:

	<u>2021</u>	<u>2020</u>
Grocery-related	\$80,274,502	\$81,960,177
Fuel sales	2,740,586	1,851,940
Repair services	<u>1,918,885</u>	<u>1,604,422</u>
	<u>\$84,933,973</u>	<u>\$85,416,539</u>

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.

Derivative Financial Instruments

Derivatives are required to be recorded on the balance sheet at fair value. In 2020, the Cooperative entered into two interest rate swap agreements with TD Bank, N.A., which have been designated and qualify as cash flow hedges. Accordingly, the change in fair value of the swap was credited to accumulated other comprehensive income (loss), net of the related income tax effect, a component of members' equity, and excluded from net income.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

2. Summary of Accounting Policies (Continued)

Risks and Uncertainties

On March 11, 2020, the World Health Organization classified the coronavirus (COVID-19) outbreak as a pandemic. In response to COVID-19, the *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act) was signed into law on March 27, 2020. The CARES Act provides tax provisions and other stimulus measures to affected companies. The global pandemic of COVID-19 continues to evolve and, while some effects of COVID-19 are reflected in these financial statements, the ultimate impact over time is highly uncertain and subject to change. The extent to which COVID-19 impacts the Cooperative going forward will depend on numerous evolving factors which cannot be reliably predicted, including the duration and scope of the pandemic; governmental, business, and individuals' actions in response to the pandemic; and the impact on the global economic activity including the possibility of recession or financial market instability.

New Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (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 January 2, 2022. Lessees 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 finalizing the impact the adoption of ASU 2016-02 will have on the Cooperative's financial statements.

Reclassifications

Certain 2020 amounts have been reclassified to permit comparison with the 2021 financial statements presentation format.

Subsequent Events

In preparing these financial statements, the Cooperative has evaluated events and transactions for potential recognition or disclosure through March 2, 2022, the date the financial statements were available to be issued.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

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 overnight repurchase agreements with its financial institutions. The repurchase agreements are secured by U.S. government-backed securities. 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 4.0% to 4.5%, maturing at various times through June 2025. Amounts receivable under these agreements totaled \$65,964 at January 1, 2022 and January 2, 2021. 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 January 1, 2022 and January 2, 2021, management determined that no valuation allowance was required.

At January 1, 2022 certificates of indebtedness mature as follows:

Fiscal Years Ending on
or Around December 31

2022	\$ –
2023	–
2024	29,172
2025	<u>36,792</u>
	<u>\$65,964</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

5. Investments in Other Cooperative Associations

The investments in cooperative associations are nonmarketable investments, which consist of the following at January 1, 2022 and January 2, 2021:

	<u>2021</u>	<u>2020</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.		
At January 1, 2022 and January 2, 2021, 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. 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.	\$ 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 may purchase additional shares of Class B stock annually based on total merchandise purchases. Class A and B stock are eligible to receive 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 1, 2022 and January 2, 2021. The Cooperative owns 5,435 shares of Class B stock at January 1, 2022 and January 2, 2021.	784,522	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.	534,962	476,116
Other	10,757	14,963
	<u>\$1,532,942</u>	<u>\$1,477,839</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

6. Lines of Credit

The Cooperative has a \$1,000,000 revolving line of credit with the Ledyard Bank which expires December 22, 2022. Interest is payable monthly at The Wall Street Journal prime rate (3.25% at January 1, 2022). 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 January 1, 2022. There were no borrowings related to this agreement outstanding at January 1, 2022 and January 2, 2021.

On June 25, 2020, the Cooperative entered into a \$1,000,000 revolving line of credit with TD Bank, N.A. that can be used to purchase property and equipment. Interest is payable monthly during the draw period based on the prime rate as published by the Wall Street Journal, subject to a floor of 4.0% (4.0% at January 1, 2022). The Cooperative may receive funds under this agreement through October 31, 2022, at which time any outstanding balances will be converted into a term loan, with principal and interest payable monthly commencing on November 30, 2022 through August 31, 2026, at which time all unpaid principal and interest become due. The term loan will bear a fixed interest rate equal to the TD Bank borrowing rate, plus 1.67%. The note may be paid in advance without penalty. The fixed asset line of credit is secured by substantially all business assets and will also be collateralized by any assets purchased. The Cooperative is also required to meet certain tangible net worth and debt service coverage ratios, among other requirements. The Cooperative was in compliance with these covenants as of January 1, 2022. There were no borrowings related to this agreement outstanding at January 1, 2022 and January 2, 2021.

On June 25, 2020, the Cooperative entered into a \$1,000,000 revolving line of credit with TD Bank, N.A. that can be used for working capital. Interest is payable monthly based on the prime rate as published by the Wall Street Journal, subject to a floor of 4.0%. The working capital line of credit is secured by a third priority mortgage and security agreement on certain property and substantially all business assets. The working capital line of credit is set to expire on October 31, 2022. The Cooperative is also required to meet certain tangible net worth and debt service coverage ratios, among other requirements. In addition, the working capital line of credit must be paid off for 30 consecutive days within a 12 month period. The Cooperative was in compliance with these covenants as of January 1, 2022. There were no borrowings related to this agreement outstanding at January 1, 2022 and January 2, 2021.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

7. Long-Term Debt

Long-term debt consisted of the following at January 1, 2022 and January 2, 2021:

	<u>2021</u>	<u>2020</u>
TD Bank, N.A.:		
Note payable with variable interest equal to LIBOR, plus 1.67% subject to interest rate swap described below and principal payable in monthly installments ranging from \$6,602 to \$8,544 through June 2030 at which time all unpaid interest and principal, including a final balloon payment of \$1,827,844, become due. The note is secured by a first mortgage on certain property and certain personal property, and a security interest in substantially all other assets. The Cooperative is required to meet certain minimum debt service coverage and tangible net worth ratios, among other requirements.	\$2,588,535	\$2,667,753
TD Bank, N.A.:		
Note payable with variable interest equal to LIBOR, plus 2.00% subject to interest rate swap described below and principal payable in monthly installments ranging from \$7,720 to \$10,356 through June 2030, at which time all unpaid interest and principal, including a final balloon payment of \$2,264,719, become due. The note is secured by a second mortgage on certain property and certain personal property, and a security interest in substantially all other assets. The Cooperative is required to meet certain minimum debt service coverage and tangible net worth ratios, among other requirements.	3,169,675	3,262,388
Great America Financial Services:		
Payable in monthly installments of \$1,251, including interest at a 10.99% interest rate through February 7, 2023. Secured by certain equipment.	16,369	28,830
Great America Financial Services:		
Payable in monthly installments of \$496, including interest at a 14.80% interest rate through September 24, 2023. Secured by certain equipment.	9,128	13,382
Great America Financial Services:		
Payable in monthly installments of \$275, including interest at an 11.82% interest rate through October 25, 2025. Secured by certain equipment	10,129	–
Paycheck Protection Program Loan – see below.	<u>–</u>	<u>682,450</u>
	5,793,836	6,654,803
Less current maturities of long-term debt	(197,271)	(563,675)
Less unamortized deferred financing fees	<u>(43,960)</u>	<u>(51,282)</u>
	<u>\$5,552,605</u>	<u>\$6,039,846</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

7. **Long-Term Debt (Continued)**

Paycheck Protection Program Loan

On April 24, 2020, the Cooperative entered into a promissory note for an unsecured loan in the amount of \$3,000,000 through the Paycheck Protection Program (PPP) established by the CARES Act and administered by the U.S. Small Business Administration (SBA). The PPP provides loans to qualifying businesses for amounts up to 2.5 times the average monthly payroll expenses of the qualifying business. The loan and accrued interest had original terms that were forgivable as long as the borrower used the loan proceeds for eligible purposes, including payroll, benefits, rent and utilities, and maintains its payroll levels for an 8 week or 24 week period, as defined. The amount of loan forgiveness would be reduced if the borrower terminated employees or reduced salaries during the covered period. Certain modifications to PPP loan terms were signed into law in June 2020 and October 2020 that changed the forgiveness, covered period, deferral period and forgiveness periods. The PPP loan was made for the purpose of securing funding for salaries and wages of employees that may have otherwise been displaced by the outbreak of COVID-19 and the resulting detrimental impact on the Cooperative's business. Ledyard National Bank (the Lender) processed and funded the PPP loan. The loan bore interest at 1.0%, with principal and interest payments deferred until the date the SBA remitted the Cooperative's loan forgiveness amount to the lender or for ten months following the end of the covered period. After that, the loan and interest would be paid back over a period of two years, if the loan was not forgiven under the loan forgiveness terms of the PPP.

When the Cooperative applied for the loan, management believed it would qualify to have the loan forgiven under the terms of PPP, and therefore considered the loan to be, substantively, a conditional government grant. The Cooperative performed initial calculations for PPP loan forgiveness, and expected that \$2,317,550 of the \$3,000,000 PPP loan would be forgiven because (1) the Cooperative, as of January 2, 2021, utilized the proceeds that were requested for forgiveness to cover payroll and other qualified expenses and (2) the Cooperative believed it would continue to comply with other terms and conditions necessary for forgiveness.

As such, during the year ended January 2, 2021, the Cooperative determined that \$2,317,550 of the \$3,000,000 PPP loan proceeds should be accounted for as a government grant. As accounting principles generally accepted in the United States of America do not contain guidance on the accounting for government grants, the Cooperative is following the guidance in International Accounting Standards No. 20, *Accounting for Government Grants and Disclosure of Government Assistance* (IAS 20). Under the provisions of IAS 20, a forgivable loan from the government is treated as a government grant when there is reasonable assurance that the entity will meet the terms for forgiveness of the loan. As discussed above, the Cooperative believed there was reasonable assurance it met the terms of forgiveness as of January 2, 2021. Under IAS 20, government grants are recognized in income as required activities are undertaken. As the Cooperative believed that it completed the required activities by utilizing PPP proceeds for payroll, and other qualified expenditures, prior to January 2, 2021, it has recognized PPP grant income for \$2,317,550 of the \$3,000,000 PPP loan. The remaining \$682,450, as noted above, was recorded within long-term debt at January 2, 2021.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

7. Long-Term Debt (Continued)

The Cooperative formally submitted an application for forgiveness on September 30, 2020. The application for forgiveness required the approval of the lender, Ledyard National Bank and by the SBA. The SBA approved the Cooperative's forgiveness application for the full amount requested, \$2,317,550, on June 25, 2021. The Cooperative repaid the remaining loan balance of \$682,450, plus accrued interest of \$8,059, on June 28, 2021.

Interest Rate Swap Agreements

The Cooperative entered into two interest rate swap agreements to hedge the cash flow impact and risk of changes in interest rates on certain variable rate notes related to TD Bank, N.A. described above, which each fluctuate with LIBOR rates. The agreements effectively changed the Cooperative's interest rate exposure from a floating rate to a fixed rate. The interest rate swap agreements mature at the time the related notes mature (June 2030) and the variable rate component of the swaps correspond to the index used to set the interest rate on the Cooperative's debt. The interest rate swap agreements outstanding at January 1, 2022 and January 2, 2021 are summarized below:

Outstanding Debt Balance and Notional Amount of Swap		Swap Maturity Date	Variable Rate paid by Counterparty		Fixed Rate Paid by the Cooperative	Fair Value	
2021	2020		2021	2020		2021	2020
\$2,588,535	\$2,667,753	June 25, 2030	1.772%	1.853%	2.503%	\$ 88,549	\$(27,928)
3,169,675	3,262,388	June 25, 2030	2.099	2.146	2.834	110,253	(34,131)

Since the above agreements meet the criteria for designation as a cash flow hedge under applicable accounting standards, the offsetting amounts (net of related deferred income taxes, if appropriate) are recorded as a separate component of members' equity referred to as accumulated other comprehensive income or loss. Since the terms of the derivative agreement match the terms of the related debt, there is no hedge ineffectiveness. On a monthly basis the Cooperative pays or receives the difference between the fixed and variable rates as applied to the notional amount. The resulting difference is charged or credited to interest expense. Such charges for the years ended January 1, 2022 and January 2, 2021 are not material.

As of January 1, 2022, long-term debt matures as follows:

<u>Fiscal Years Ending on or Around December 31</u>	<u>Amount</u>
2022	\$ 197,271
2023	190,277
2024	188,942
2025	193,902
2026	196,603
Thereafter	<u>4,826,841</u>
	<u>\$5,793,836</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

8. Income Taxes

The provision (benefit) from federal and state income taxes consists of the following at January 1, 2022 and January 2, 2021:

	<u>2021</u>	<u>2020</u>
Currently payable:		
Federal	\$ —	\$ —
State	<u>69,418</u>	<u>72,135</u>
	69,418	72,135
Deferred:		
Federal	170,450	(48,367)
State	<u>(22,146)</u>	<u>40,793</u>
	<u>148,304</u>	<u>(7,574)</u>
	<u>\$217,722</u>	<u>\$ 64,561</u>

Deferred tax assets and liabilities consist of the following at January 1, 2022 and January 2, 2021:

	<u>2021</u>	<u>2020</u>
Deferred tax assets:		
Inventory valuation	\$ 7,529	\$ 7,783
Unclaimed patronage refund	29,835	29,845
Federal net operating loss carryforward	102,688	132,020
Interest rate swap agreements	—	13,861
Other	<u>60,944</u>	<u>61,586</u>
	200,996	245,095
Deferred tax liabilities:		
Depreciation and amortization	428,357	319,165
Patronage refunds on investments in other cooperative	64,770	37,854
Prepaid expenses	87,030	65,724
Accrued compensation	13,709	22,123
Interest rate swap agreements	46,379	—
PPP loan	<u>—</u>	<u>30,934</u>
	<u>640,245</u>	<u>475,800</u>
Net deferred tax liability	<u>\$439,249</u>	<u>\$230,705</u>

The Cooperative has federal tax net operating loss carryforwards of \$434,886 at January 1, 2022, of which \$29,807 of net operating loss carryforwards will begin to expire in 2037. The remaining \$405,079 of net operating loss carryforwards are not subject to expiration. These net operating loss carryforwards are subject to review and possible adjustment by the Internal Revenue Service. Section 382 of the Internal Revenue Code also contains provisions that could place annual limitations on the utilization of these net operating loss carryforwards in the event of a change in ownership, as defined.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

8. **Income Taxes (Continued)**

The Cooperative's effective income tax rate at January 2, 2021 is lower than would be expected if the federal statutory rate was applied to earnings primarily because the grant income resulting from the PPP loan is nontaxable for federal purposes. The State of New Hampshire Business Enterprise tax is accounted for as an income tax, which increases the effective income tax rate for the years ended January 1, 2022 and January 2, 2021.

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

During the years ended January 1, 2022 and January 2, 2021, 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.

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 patrons' 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 exchange date 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.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

9. Members' Equity (Continued)

During 2021 and 2020, members exchanged 4,988 and 2,390, respectively, of current Class B shares for new Class B shares, which resulted in the reclassification of \$26,057 and \$12,739, respectively, from capital stock to mandatorily redeemable stock, which is reported as a non-current liability. As of January 1, 2022, there are 42,751 shares of current Class B shares outstanding, representing \$213,775 of equity that could be reclassified to non-current liabilities upon exchange by members. As of January 2, 2021, there are 48,035 shares of current Class B shares outstanding, representing \$240,195 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 canceled 7,353 shares, representing \$37,513 of members' equity during the year ended January 1, 2022. The Cooperative canceled no shares during the year ended January 2, 2021.

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.

There were no patronage refunds for the years ended January 1, 2022 and January 2, 2021. The Cooperative has elected to retain any amount available for patronage during the year ended January 1, 2022, in order to support the long-term benefit of members by using the funds to pay down long-term debt.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

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 approximately \$37,908,000 (adjusted annually) and an allocation of common area maintenance costs (totaling approximately \$301,000 in 2021 and \$318,000 in 2020). 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 \$80,000 commencing in January 2028, as defined. The Cooperative's lease agreement provides for tenant improvement allowances totaling approximately \$568,000, which related improvements were paid for by the lessor. The Cooperative completed renovations during the year ended January 1, 2022, and was entitled to the full tenant improvement allowance. The costs of these improvements have been reflected within property and equipment in the accompanying balance sheet and as a liability for deferred rent as of January 1, 2022. The capitalized tenant improvements are being depreciated over the remaining life of the lease term. The deferred rent liability will be amortized as a reduction of lease expense ratably over the remaining lease term.

The Cooperative leases facilities in White River Junction, Vermont, for the operation of a food store through May 2025. Base rent currently approximates \$19,000 per month, with an annual 2.5% increase.

The Cooperative leases land upon which the community market in Hanover, New Hampshire, is operated in a building built and owned by the Cooperative. The lease expires February 2034 and contains an option to extend an additional ten years. Base rent is approximately \$4,200 per month. The base rent is adjusted annually based on the CPI, as defined. At the end of the lease term, the lessor shall acquire all rights, title and interest in the building.

The Cooperative leases facilities in Wilder, Vermont for the operation of a commissary kitchen through November 2023. Base rent currently approximates \$4,300 per month, adjusted annually based on the CPI, as defined.

The Cooperative leases office space in White River Junction, Vermont, through May 2024, with two additional five year renewal options. Base rent which includes common area fees is approximately \$21,200 per month, with an annual 2% increase.

The Cooperative leases a 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 \$17,300 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 \$65,000 and \$77,000 for the years ended January 1, 2022 and January 2, 2021, respectively.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

10. Commitments (Continued)

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

<u>Fiscal Years Ending on or Around December 31</u>	<u>Amount</u>
2022	\$ 1,613,343
2023	1,483,311
2024	1,288,040
2025	1,032,796
2026	927,402
Thereafter	<u>6,054,157</u>
	<u>\$12,399,049</u>

The Cooperative had rental expense, which is recognized ratably over the period of the related lease, of approximately \$2,021,000 and \$2,057,000 for the years ended January 1, 2022 and January 2, 2021, respectively, which includes common area maintenance costs of \$301,000 in 2021 and \$318,000 in 2020.

As of January 1, 2022 and January 2, 2021, the Cooperative reflected in the accompanying balance sheets a liability for deferred rent and improvements paid for by the lessor of \$1,015,697 and \$365,045, respectively.

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 May 8, 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 recorded \$169,279 and \$225,705 related to this agreement in equipment obligation on the accompanying balance sheets at January 1, 2022 and January 2, 2021, respectively. The obligation decreased by \$56,426 in May 2021 and 2020 based on the agreement and the amount is recorded within other income on the accompanying statement of income. 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.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

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 \$431,000 and \$423,000 in the years ended January 1, 2022 and January 2, 2021, respectively. There were no discretionary contributions made in the years ended January 1, 2022 and January 2, 2021.

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 \$2,518,000 and \$2,522,000 in 2021 and 2020, respectively, in connection with this plan. The financial statements include a liability for claims incurred but not yet reported in the amount of approximately \$225,000 and \$147,000 as of January 1, 2022 and January 2, 2021, respectively.

13. Major Suppliers

During the year ended January 1, 2022, the Cooperative purchased approximately \$26,871,000 (41% of total purchases) of its goods from an unrelated party and AGNE, a related party (see note 5). At January 1, 2022, amounts due to these suppliers, included in accounts payable, totaled approximately \$732,000.

During the year ended January 2, 2021, the Cooperative purchased approximately \$26,544,000 (41% of total purchases) of its goods from an unrelated party and AGNE, a related party (see note 5). At January 2, 2021, amounts due to these suppliers, included in accounts payable, totaled approximately \$708,000.

14. Related Party Transactions

The Cooperative is a member of AGNE (see note 5). The Cooperative purchased goods and groceries from AGNE of approximately \$16,722,000 and \$16,145,000 during the years ended January 1, 2022 and January 2, 2021, respectively. Amounts due to AGNE, included in accounts payable, were approximately \$256,000 at January 1, 2022 and January 2, 2021. Patronage refunds due from AGNE, included in accounts receivable, were approximately \$250,000 and \$150,000 at January 1, 2022 and January 2, 2021, 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 years ended January 1, 2022 and January 2, 2021, were approximately \$2,307,000 and \$2,157,000, respectively. The discounts on these sales were netted against the gross sales in the statement of income and approximated \$404,000 and \$432,000, for the years ended January 1, 2022 and January 2, 2021, respectively.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

14. Related Party Transactions (Continued)

Amounts due from members of approximately \$111,000 and \$166,000 are included in accounts receivable at January 1, 2022 and January 2, 2021, respectively.

See also note 5 for additional disclosure related to investments in cooperatives.

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.

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).

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

January 1, 2022 and January 2, 2021

15. Fair Value Measurements (Continued)

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 \$1,532,942 and \$1,477,839 at January 1, 2022 and January 2, 2021, 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.

Interest Rate Swap Agreements

The fair value of the interest rate swap asset totaling \$207,729 at January 1, 2022 and interest rate swap liability totaling \$62,059 at January 2, 2021 have been classified as level 2 within the fair value hierarchy, as the amounts are estimated using industry standard valuation models. These models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rates.

The methodology described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while management of the Cooperative believes its valuation methodology is appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

SUPPLEMENTAL INFORMATION

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

SCHEDULE OF OPERATING EXPENSES

Years Ended January 1, 2022 and January 2, 2021

	<u>2021</u>	<u>2020</u>
Store operations expenses:		
Store wages and benefits	\$13,579,145	\$14,324,292
Facilities cost	3,932,564	3,963,671
Credit card expenses	1,507,946	1,338,959
Selling and other costs	1,239,886	1,276,802
Equipment costs	<u>532,179</u>	<u>679,796</u>
	20,791,720	21,583,520
General and administrative expenses:		
Information technology department expenses	1,203,814	1,286,895
Administrative expenses	1,712,408	1,506,535
Merchandising expenses	1,006,562	984,542
Education expenses	1,010,038	966,033
Finance department expenses	701,389	954,427
Facilities maintenance department expenses	592,102	590,966
Human resources department expenses	354,700	539,437
Board of directors expenses	111,298	109,727
Public relations expenses	<u>34,178</u>	<u>35,426</u>
	<u>6,726,489</u>	<u>6,973,988</u>
	<u>\$27,518,209</u>	<u>\$28,557,508</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

SCHEDULE OF GENERAL AND ADMINISTRATIVE EXPENSES

Years Ended January 1, 2022 and January 2, 2021

	<u>2021</u>	<u>2020</u>
Salaries and benefits	\$4,836,165	\$4,780,230
Equipment expenses	93,115	225,797
Equipment depreciation	266,327	292,481
Building leases	260,425	256,549
Professional fees	218,997	270,447
Telephone	118,549	149,275
Advertising	54,715	71,108
Consulting fees	21,142	22,924
Dues and subscriptions	150,573	128,627
Meals, entertainment and vehicle reimbursement	18,730	13,286
Education and training	27,387	39,688
Technical maintenance contracts	317,927	241,394
Supplies	52,198	79,827
Occupancy costs	78,906	209,869
Insurance	31,851	31,851
Postage	27,152	21,945
Printing	3,486	12,155
Graphics and promotional expenses	61,819	45,147
Employee relations and programs	27,327	50,728
Software licenses	2,506	6,799
Bank charges	47,002	16,397
Demo expenses	-	467
Contributions	19,224	5,533
Membership meeting	3,710	3,038
Co-op news	100	653
Other	<u>(12,844)</u>	<u>(2,227)</u>
	<u>\$6,726,489</u>	<u>\$6,973,988</u>