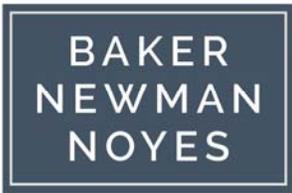


Hanover Consumer Cooperative Society, Inc.

Financial Statements and Supplemental Information

*Years Ended December 28, 2019 and December 29, 2018
With Independent Auditors' Report*



INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of Hanover Consumer Cooperative Society, Inc., (the Cooperative) which comprise the balance sheets as of December 28, 2019 and December 29, 2018, the related statements of operations, members' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Cooperative as of December 28, 2019 and December 29, 2018, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

Other Matter – Supplemental Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as of and for the years ended December 28, 2019 and December 29, 2018, as a whole. The accompanying supplementary information is presented for the purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information 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, Newman & Noyes LLC

Manchester, New Hampshire
February 28, 2020

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

BALANCE SHEETS

December 28, 2019 and December 29, 2018

ASSETS

	<u>2019</u>	<u>2018</u>
Current assets:		
Cash and cash equivalents	\$ 1,356,049	\$ 2,141,671
Certificates of indebtedness, current portion	82,689	74,523
Accounts receivable – trade and other	659,749	518,371
Inventories	2,334,163	2,297,643
Refundable income tax	–	30,038
Other current assets	<u>175,909</u>	<u>157,612</u>
Total current assets	4,608,559	5,219,858
Property and equipment, at cost:		
Land and improvements	342,189	342,189
Buildings and improvements	11,758,235	11,846,259
Machinery and equipment	12,567,991	11,825,836
Construction in process	<u>262,767</u>	<u>293,732</u>
	24,931,182	24,308,016
Less accumulated depreciation and amortization	<u>17,024,227</u>	<u>15,931,859</u>
Property and equipment, net	7,906,955	8,376,157
Other assets:		
Investments in other cooperative associations	1,491,953	1,515,946
Certificates of indebtedness, less current portion	65,964	111,861
Other	<u>14,378</u>	<u>12,452</u>
Total other assets	1,572,295	1,640,259
	_____	_____
Total assets	<u>\$14,087,809</u>	<u>\$15,236,274</u>

LIABILITIES AND MEMBERS' EQUITY

	<u>2019</u>	<u>2018</u>
Current liabilities:		
Current maturities of long-term debt	\$ 457,853	\$ 430,765
Accounts payable	2,194,103	2,813,575
Accrued payroll and benefits	671,037	786,451
Accrued expenses	616,376	508,655
Patronage refunds payable	—	108,222
Current portion of equipment obligation	<u>56,426</u>	<u>—</u>
Total current liabilities	3,995,795	4,647,668
Long-term liabilities:		
Long-term debt, less current maturities	2,285,803	2,716,125
Long-term equipment obligation	225,705	282,131
Deferred rent	287,821	193,640
Deferred income taxes	252,140	285,534
Mandatorily redeemable stock	<u>84,290</u>	<u>47,971</u>
	<u>3,135,759</u>	<u>3,525,401</u>
Total liabilities	7,131,554	8,173,069
Commitments (note 10)		
Members' equity:		
Capital stock	3,059,674	3,093,002
Donated capital	315,500	315,500
Retained earnings	<u>3,581,081</u>	<u>3,654,703</u>
Total members' equity	<u>6,956,255</u>	<u>7,063,205</u>
Total liabilities and members' equity	<u>\$14,087,809</u>	<u>\$15,236,274</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF OPERATIONS

Years Ended December 28, 2019 and December 29, 2018

	<u>2019</u>	<u>2018</u>
Revenues	\$76,977,353	\$74,653,586
Cost of sales	<u>51,718,546</u>	<u>50,703,120</u>
Gross profit	25,258,807	23,950,466
Operating expenses	<u>25,073,206</u>	<u>23,506,580</u>
Income from operations	185,601	443,886
Other (income) expense:		
Interest expense	145,579	167,978
Interest income	(9,043)	(9,942)
Other expense	<u>86,318</u>	<u>45,535</u>
	<u>222,854</u>	<u>203,571</u>
(Loss) income before patronage refund and income taxes	(37,253)	240,315
Patronage refunds	<u>—</u>	<u>108,222</u>
(Loss) income before income taxes	(37,253)	132,093
Provision from income taxes	<u>36,369</u>	<u>104,175</u>
Net (loss) income	\$ <u>(73,622)</u>	\$ <u>27,918</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF MEMBERS' EQUITY

Years Ended December 28, 2019 and December 29, 2018

	Class A		Class B		Partial Share Credits	Total Capital Stock	Donated Capital	Retained Earnings	Total
	<u>Common Stock</u> <u>Shares</u>	<u>Values</u>	<u>Common Stock</u> <u>Shares</u>	<u>Value</u>					
Balance, December 30, 2017	537,001	\$2,685,006	60,154	\$300,770	\$93,117	\$3,078,893	\$315,500	\$3,626,785	\$7,021,178
Net income	-	-	-	-	-	-	-	27,918	27,918
Class B shares exchanged (note 9)	-	-	(2,227)	(11,135)	-	(11,135)	-	-	(11,135)
Shares issued, net of redemptions	<u>5,416</u>	<u>27,080</u>	<u>(309)</u>	<u>(1,535)</u>	<u>(301)</u>	<u>25,244</u>	<u>-</u>	<u>-</u>	<u>25,244</u>
Balance, December 29, 2018	542,417	2,712,086	57,618	288,100	92,816	3,093,002	315,500	3,654,703	7,063,205
Net loss	-	-	-	-	-	-	-	(73,622)	(73,622)
Class B shares exchanged (note 9)	-	-	(6,567)	(32,834)	(3,485)	(36,319)	-	-	(36,319)
Shares issued, net of redemptions	<u>1,048</u>	<u>5,240</u>	<u>(341)</u>	<u>(1,696)</u>	<u>(553)</u>	<u>2,991</u>	<u>-</u>	<u>-</u>	<u>2,991</u>
Balance, December 28, 2019	<u>543,465</u>	<u>\$2,717,326</u>	<u>50,710</u>	<u>\$253,570</u>	<u>\$88,778</u>	<u>\$3,059,674</u>	<u>\$315,500</u>	<u>\$3,581,081</u>	<u>\$6,956,255</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

STATEMENTS OF CASH FLOWS

Years Ended December 28, 2019 and December 29, 2018

	<u>2019</u>	<u>2018</u>
Cash flows from operating activities:		
Net (loss) income	\$ (73,622)	\$ 27,918
Adjustments to reconcile net (loss) income to cash provided by operating activities:		
Depreciation and amortization	1,138,109	1,050,077
Deferred rent	94,181	193,640
Loss (gain) on disposal of equipment	66,668	(7,901)
Patronage certificates of indebtedness received	(36,792)	(29,172)
Patronage investments in cooperatives	(19,586)	(13,268)
Deferred income taxes	(33,394)	22,734
Changes in operating assets and liabilities:		
Accounts receivable	(141,378)	17,193
Inventory	(36,520)	(175,871)
Refundable income taxes	30,038	14,854
Other current and long-term assets	(21,298)	47,576
Accounts payable	(619,472)	(13,830)
Accrued payroll and benefits	(115,414)	8,327
Accrued expenses	107,721	(59,094)
Patronage refunds payable	<u>(108,222)</u>	<u>108,222</u>
Net cash provided by operating activities	231,019	1,191,405
Cash flows from investing activities:		
Acquisition of property and equipment	(731,976)	(606,592)
Proceeds from disposal of equipment	2,700	32,110
Proceeds from repayments of certificates of indebtedness	74,523	90,353
Proceeds from investments in cooperatives	<u>43,579</u>	<u>—</u>
Net cash used in investing activities	(611,174)	(484,129)
Cash flows from financing activities:		
Proceeds from long-term debt	21,062	45,244
Principal payments on long-term debt	(429,520)	(434,517)
Proceeds from issuance (payments for repurchase) of capital stock, net	<u>2,991</u>	<u>25,244</u>
Net cash used in financing activities	<u>(405,467)</u>	<u>(364,029)</u>
Net (decrease) increase in cash and cash equivalents	(785,622)	343,247
Cash and cash equivalents, beginning of year	<u>2,141,671</u>	<u>1,798,424</u>
Cash and cash equivalents, end of year	<u>\$1,356,049</u>	<u>\$2,141,671</u>
Supplemental disclosures of cash flows information:		
Cash paid during the period for:		
Interest expense	<u>\$ 140,355</u>	<u>\$ 162,754</u>
Income taxes	<u>\$ 66,407</u>	<u>\$ 119,029</u>

The accompanying notes are an integral part of these statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 28, 2019 and December 29, 2018

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 beginning in January 2019, Norwich, Vermont, which are open to its members and the general public. In addition, the Cooperative operates a commissary kitchen in Wilder, Vermont, which prepares food products for resale through the Cooperative's food stores. The majority of sales are to members of the Cooperative. Sales to members were approximately 74% of total sales for the years ending December 28, 2019 and December 29, 2018. Sales of grocery-related items were 94% of total sales in 2019 and 2018 and sales of automobile fuel and repair services were 6% of total sales in 2019 and 2018.

2. Summary of Accounting Policies

Fiscal Year End

The Cooperative's fiscal year ends on the Saturday nearest to December 31. The fiscal periods ended December 28, 2019 and December 29, 2018.

Cash and Cash Equivalents

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

Accounts Receivable

Trade accounts are stated at the amount the Cooperative expects to collect from sales of products. Other receivables primarily consist of volume rebates due from various suppliers. The Cooperative maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Management considers the following factors when determining the collectability of these receivables: customer creditworthiness, programmatic discounts and allowances, past transaction history, current economic industry trends, and changes in payment terms. If the financial condition of the Cooperative's customers was to deteriorate, adversely affecting their ability to make payments, additional allowances would be required. Based on management's assessment, the Cooperative provides for estimated uncollectible amounts through a charge to earnings and a credit to a valuation allowance. Management determined that no allowance was required at December 28, 2019 and December 29, 2018.

Accounts receivable – trade and other consists of the following at December 28, 2019 and December 29, 2018:

	<u>2019</u>	<u>2018</u>
Trade receivables	\$222,236	\$179,526
Other receivables	<u>437,513</u>	<u>338,845</u>
	<u>\$659,749</u>	<u>\$518,371</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 28, 2019 and December 29, 2018

2. Summary of Accounting Policies (Continued)

Inventory

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

Property and Equipment

Depreciation and amortization are provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives. Leasehold improvements are amortized over the lives of the respective leases or the service lives of the improvements, whichever are shorter. The straight-line method of depreciation is followed for substantially all assets for financial reporting purposes, but accelerated methods are used for tax purposes. Depreciation expense was \$1,131,810 and \$1,043,778 for the years ended December 28, 2019 and December 29, 2018, respectively.

Impairment of Long-Lived Assets

Long-lived assets, such as property and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows. An impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. During 2019 and 2018, 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.

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.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 28, 2019 and December 29, 2018

2. Summary of Accounting Policies (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.

The Cooperative has evaluated the positions taken on its corporate tax returns filed and the potential impact on its tax status as of December 28, 2019 and December 29, 2018. The Cooperative has concluded no uncertain income tax positions existed at December 28, 2019 and December 29, 2018.

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

Advertising Expense

Advertising costs are charged to operations when incurred. Advertising expense was approximately \$111,100 and \$109,400 for the periods ended December 28, 2019 and December 29, 2018, respectively.

Revenue Recognition

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (Topic 606). ASU No. 2014-09 supersedes virtually all existing revenue guidance. Under this standard, an entity is required to recognize revenue upon transfer of promised goods or services to customers, in an amount that reflects the expected consideration received in exchange for those goods or services. As such, an entity needs to use more judgment and make more estimates than under the previous guidance. On December 30, 2018, the Cooperative adopted the new accounting standard and all related amendments using the modified retrospective method which allows application only to the most current reporting period presented in the financial statements with a cumulative effect adjustment to retained earnings. The Cooperative determined that the new standard required no change in the timing of when revenue is recognized. As a result, no cumulative effect adjustment was required.

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. Returns are not significant.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 28, 2019 and December 29, 2018

2. Summary of Accounting Policies (Continued)

The Cooperative collects and remits sales, food, beverage and alcoholic beverage taxes on transactions with customers and reports such amounts under the net method in the statement of operations. 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 December 28, 2019 and December 29, 2018:

	<u>2019</u>	<u>2018</u>
Grocery-related	\$72,666,962	\$70,509,710
Fuel sales	2,940,382	3,391,171
Repair services	<u>1,370,009</u>	<u>752,705</u>
	<u>\$76,977,353</u>	<u>\$74,653,586</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.

New Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. Under ASU 2016-02, at the commencement of a long-term lease, lessees will recognize a liability equivalent to the discounted payments due under the lease agreement, as well as an offsetting right-of-use asset. ASU 2016-02 is effective for the Cooperative on January 2, 2021, with early adoption permitted. Lessees (for capital and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. An entity that elects to apply the practical expedients will, in effect, continue to account for leases that start before the effective date in accordance with previous methodology unless the lease is modified, except that lessees are required to recognize a right-of-use asset and a lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous lease accounting rules. The Cooperative is currently evaluating the impact of this pending adoption of ASU 2016-02 on the Cooperative's financial statements.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 28, 2019 and December 29, 2018

2. Summary of Accounting Policies (Continued)

Subsequent Events

In preparing these financial statements, the Cooperative has evaluated events and transactions for potential recognition or disclosure through February 28, 2020, the date the financial statements were available to be issued.

3. Concentration of Credit Risk

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

4. Certificates of Indebtedness

Certificates of indebtedness primarily consist of amounts due from Associated Grocers of New England, Inc. (AGNE), a cooperative in which the Cooperative is a member (see note 5). The Cooperative receives certificates of indebtedness from AGNE to satisfy patronage rebates. Interest rates range from 3.25% to 4.5%, maturing at various times through June 2025. Amounts receivable under these agreements totaled \$148,653 and \$186,384 at December 28, 2019 and December 29, 2018, respectively. The Cooperative evaluates collectability by evaluating the financial condition of AGNE and provides for estimated uncollectible amounts through a charge to operations and a credit to a valuation allowance, if warranted. At December 28, 2019 and December 29, 2018, management determined that no valuation allowance was required.

At December 28, 2019 certificates of indebtedness mature as follows:

Fiscal Periods Ending on or Around <u>December 31</u>	
2020	\$ 82,689
2021	—
2022	—
2023	—
2024	29,172
Thereafter	<u>36,792</u>
	<u>\$148,653</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 28, 2019 and December 29, 2018

5. Investments in Other Cooperative Associations

The investments in cooperative associations are nonmarketable investments, which consist of the following at December 28, 2019 and December 29, 2018:

	<u>2019</u>	<u>2018</u>
National Consumer Cooperative Bank (NCCB):		
NCCB is a financial services cooperative, the parent company of its wholly-owned subsidiary, National Cooperative Bank, N.A. (note 7). At December 28, 2019 and December 29, 2018, the Cooperative owned 2,027 shares of Class C stock, which represent the cumulative amount of shares issued as patronage refunds over the course of its financing agreements with NCCB (note 7). NCCB provides members with patronage rebates in cash and shares of Class B2 and C stock in connection with its patronage-based loans from NCCB. The Cooperative recognizes patronage rebates earned in Class C stock, which is eligible to pay cash dividends, nonredeemable, and transferable to other eligible members, subject to approval. The Cooperative also receives and holds Class B2 stock, which does not pay dividends, is nonredeemable, and is nontransferable; therefore, the Cooperative does not recognize any value for Class B2 stock received.	\$ 202,701	\$ 202,701
Associated Grocers of New England, Inc. (AGNE):		
AGNE is a consumer goods membership cooperative that provides members with annual patronage rebates in cash, certificates of indebtedness (see note 4), and patronage shares. Members initially purchase one share of Class A stock at \$5,000 and purchase additional shares of Class B stock annually based on total merchandise purchases. Class A and B stock are eligible to pay cash dividends and are redeemable in the event that the Cooperative terminates membership, as defined. The Cooperative owns three shares of Class A stock at December 28, 2019 and December 29, 2018. The Cooperative owns 5,435 shares of Class B stock at December 28, 2019 and December 29, 2018.	784,059	784,059
National Coop Grocers (NCG):		
NCG is a consumer goods cooperative that requires members to purchase one share of voting stock at \$500, plus a base equity investment of 0.1% of annual purchases, and provides members with discounted purchase pricing and annual patronage rebates, a percentage of which is retained as equity and is redeemable at the discretion of the NCG board of directors.	489,087	513,080
Other	<u>16,106</u>	<u>16,106</u>
	<u>\$1,491,953</u>	<u>\$1,515,946</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 28, 2019 and December 29, 2018

6. Notes Payable

The Cooperative has a \$1,000,000 revolving line of credit with the Ledyard Bank which matures December 22, 2022. Interest is payable monthly at The Wall Street Journal prime rate (4.75% at December 28, 2019). The note is secured by a first mortgage on certain real property and substantially all business assets of the Cooperative. The Cooperative is also required to meet certain minimum debt service coverage ratios, among other requirements. The Cooperative was in compliance with these covenants as of December 28, 2019. There were no borrowings related to this agreement outstanding at December 28, 2019 and December 29, 2018.

7. Long-Term Debt

Long-term debt consisted of the following at December 28, 2019 and December 29, 2018:

	<u>2019</u>	<u>2018</u>
National Cooperative Bank, N.A.:		
Payable in monthly installments of \$40,727 including interest at 5.00% through February 2026. The note is secured by a first mortgage on certain property and certain personal property, and a second security interest in substantially all other assets. The Cooperative is required to meet certain minimum debt service coverage ratios, among other requirements. The Cooperative was in compliance with these covenants as of December 28, 2019. The note is subject to a prepayment penalty.	\$2,563,432	\$2,914,106
Ledyard National Bank:		
Payable in monthly installments of \$6,525 including interest at 4.50% due January 2022. The note is secured by equipment and a second security interest in substantially all other assets. The Cooperative is required to meet certain minimum debt service coverage ratios, among other requirements. The Cooperative was in compliance with these covenants as of December 28, 2019.	155,426	225,017
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.	39,999	45,244
Great America Financial Services:		
Payable in monthly installments of \$496, including interest at a 14.801% interest rate through September 24, 2023. Secured by certain equipment.	<u>17,052</u>	<u>—</u>
	2,775,909	3,184,367
Less current maturities of long-term debt	(457,853)	(430,765)
Less unamortized deferred financing fees	<u>(32,253)</u>	<u>(37,477)</u>
	<u>\$2,285,803</u>	<u>\$2,716,125</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 28, 2019 and December 29, 2018

7. Long-Term Debt (Continued)

As of December 28, 2019, long-term debt matures as follows:

Fiscal Periods Ending on or Around <u>December 31</u>	<u>Amount</u>
2020	\$ 457,853
2021	482,366
2022	434,750
2023	437,061
2024	452,421
Thereafter	<u>511,458</u>
	<u>\$2,775,909</u>

8. Income Taxes

The provision (benefit) from federal and state income taxes consists of the following at December 28, 2019 and December 29, 2018:

	<u>2019</u>	<u>2018</u>
Currently payable:		
Federal	\$ 4,066	\$ 13,975
State	<u>65,697</u>	<u>67,466</u>
	69,763	81,441
Deferred:		
Federal	(32,938)	13,824
State	<u>(456)</u>	<u>8,910</u>
	<u>(33,394)</u>	<u>22,734</u>
	<u>\$ 36,369</u>	<u>\$104,175</u>

Deferred tax assets and liabilities consist of the following at December 28, 2019 and December 29, 2018:

	<u>2019</u>	<u>2018</u>
Deferred tax assets:		
Inventory valuation	\$ 8,925	\$ 8,479
Accrued compensation	(12,995)	21,470
Unclaimed patronage refund	29,808	29,644
Federal net operating loss carryforward	34,231	6,347
Other	<u>59,319</u>	<u>48,688</u>
	119,288	114,628

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 28, 2019 and December 29, 2018

8. Income Taxes (Continued)

	<u>2019</u>	<u>2018</u>
Deferred tax liabilities:		
Depreciation	\$295,657	\$342,572
Patronage refunds on investments in other cooperative	35,404	19,737
Prepaid expenses	<u>40,367</u>	<u>37,853</u>
	<u>371,428</u>	<u>400,162</u>
Net deferred tax liability	<u>\$252,140</u>	<u>\$285,534</u>

At December 28, 2019, the Cooperative has net operating losses of approximately \$163,003 available to reduce future federal taxable income through 2037. The Company has net operating loss carryforwards for which deferred tax assets have been provided for in previous years. The newly enacted tax law has limited the use of carryforwards to 80% of taxable income in a given year, which is not expected to impact the Cooperative's ability to be able to utilize its carryforwards.

The Cooperative's effective income tax rate in the periods ended December 28, 2019 and December 29, 2018, is higher than would be expected if the federal statutory rate was applied to earnings primarily because the State of New Hampshire Business Enterprise tax is accounted for as an income tax.

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

During the periods ended December 28, 2019 and December 29, 2018, 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 patron's capital accounts until such amounts are sufficient to purchase the minimum number of shares required to be a member.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 28, 2019 and December 29, 2018

9. Members' Equity (Continued)

Membership

Individuals and corporations are required to own at least 10 Class A shares in order to be a member. Any person owning fewer than ten shares is considered to be "a subscriber."

Exchange of Class B Shares

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

During 2019 and 2018, members exchanged 6,567 and 2,227, respectively, of current Class B shares for new Class B shares, which resulted in the reclassification of \$36,319 and \$11,135, respectively, from capital stock to mandatorily redeemable stock, which is reported as a non-current liability. As of December 28, 2019, there are 50,710 shares of current Class B shares outstanding, representing \$253,570 of equity that could be reclassified to non-current liabilities upon exchange by members. As of December 29, 2018, there are 57,618 shares of current Class B shares outstanding, representing \$288,100 of equity that could be reclassified to non-current liabilities upon exchange by members.

Termination of Membership

Members who discontinue membership may request a refund, which may be issued at the discretion of the Board. The Cooperative's By-Laws, in concert with the state of New Hampshire statutes, provide that if a member has not claimed their outstanding patronage or corresponded with the Cooperative over a five-year period, the Cooperative shall make a good faith effort to contact the member and then, having satisfied the regulations, as defined, terminate such membership and that member's associated capital shall revert to the Cooperative. The Cooperative cancelled no shares during the years ended December 28, 2019 and December 29, 2018.

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.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 28, 2019 and December 29, 2018

9. Members' Equity (Continued)

There were no patronage refunds for the year ended December 28, 2019. The Board of Directors authorized total patronage refunds of \$108,222, payable in store credit or cash, for the year ended December 29, 2018, which is reflected as a current liability on the accompanying 2018 balance sheet.

10. Commitments

Operating Leases

The Cooperative leases facilities in Lebanon, New Hampshire, for the operation of a food store through June 2032 with an option to extend an additional twenty years. Base rent currently approximates \$66,000 per month, plus 2% of annual gross sales from the Lebanon store in excess of \$36,000,000 (adjusted annually) and an allocation of common area maintenance costs (totaling approximately \$340,000 in 2019 and \$324,000 in 2018). The base rent is adjusted annually based on the Consumer Price Index (CPI), with a minimum monthly base rent of approximately \$73,000 commencing in January 2023 and a minimum monthly base rate of approximately \$82,000 commencing in January 2028, as defined.

The Cooperative leases facilities in White River Junction, Vermont, for the operation of a food store through May 2025. Base rent currently approximates \$18,000 per month, with an annual 2.5% increase.

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

The Cooperative leases facilities in Wilder, Vermont for the operation of a commissary kitchen through November 2021, with an option to renew the lease for an additional two-year term. Base rent currently approximates \$4,000 per month, adjusted annually based on the CPI, as defined.

The Cooperative leased administrative offices in Hanover, New Hampshire on a month-to-month basis through May 2019. Base rent is approximately \$9,500 per month adjusted annually based on the CPI, as defined, with a minimum increase of 1% each year, plus an allocation of common area maintenance fees.

On January 11, 2019, the Cooperative entered into a lease agreement for new office space in White River Junction, Vermont, with the lease commencing May 22, 2019. The initial term of the lease is five years, with two additional five year renewal options. Base rent which includes common area fees is approximately \$20,400 per month, with an annual 2% increase.

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

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 28, 2019 and December 29, 2018

10. Commitments (Continued)

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 \$94,000 and \$194,000 for the years ended December 28, 2019 and December 29, 2018, respectively.

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

<u>Fiscal Periods</u> Ending on or Around <u>December 31</u>	<u>Amount</u>
2020	\$ 1,669,692
2021	1,665,397
2022	1,618,159
2023	1,421,627
2024	1,273,194
Thereafter	<u>7,676,131</u>
	<u>\$15,324,200</u>

The Cooperative had rental expense, which is recognized ratably over the period of the related lease, of approximately \$2,003,000 and \$1,850,000 for the periods ended December 28, 2019 and December 29, 2018, respectively, which includes common area maintenance costs of \$340,000 in 2019 and \$389,000 in 2018.

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 recognized amounts of approximately \$282,000, related to this agreement in equipment and equipment obligation at December 28, 2019 and December 29, 2018. 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

December 28, 2019 and December 29, 2018

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 \$362,000 and \$342,000 in the periods ended December 28, 2019 and December 29, 2018, respectively. There were no discretionary contributions made in the periods ended December 28, 2019 and December 29, 2018.

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 \$2,525,000 and \$2,210,000 in 2019 and 2018, respectively, in connection with this plan. The financial statements include a liability for claims incurred but not yet reported in the amount of approximately \$231,000 and \$150,000 as of December 28, 2019 and December 29, 2018, respectively.

13. Major Suppliers

During the period ended December 28, 2019, the Cooperative purchased approximately \$22,374,000 (39% of total purchases) of its goods from an unrelated party and AGNE, a related party (see note 5). At December 28, 2019, amounts due to these suppliers, included in accounts payable, totaled approximately \$771,000.

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

14. Related Party Transactions

The Cooperative is a member of AGNE (see note 5). The Cooperative purchased goods and groceries from AGNE of approximately \$12,982,000 and \$12,264,000 during the periods ended December 28, 2019 and December 29, 2018, respectively. Amounts due to AGNE, included in accounts payable, were approximately \$234,000 and \$216,000 at December 28, 2019 and December 29, 2018, respectively. Patronage refunds due from AGNE, included in accounts receivable, were approximately \$135,000 and \$74,000 at December 28, 2019 and December 29, 2018, respectively.

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 28, 2019 and December 29, 2018

14. Related Party Transactions (Continued)

The Cooperative offers a 20% discount on purchases made by employees and board members. Total gross sales to employees and board members for the periods ended December 28, 2019 and December 29, 2018, were approximately \$1,749,000 and \$1,425,000, respectively. The discounts on these sales were netted against the gross sales in the statement of operations and approximated \$347,000 and \$302,000, for the periods ended December 28, 2019 and December 29, 2018, respectively.

Amounts due from members of approximately \$172,000 and \$153,000 are included in accounts receivable at December 28, 2019 and December 29, 2018, respectively.

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

15. Fair Value Measurements

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

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

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;

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

NOTES TO FINANCIAL STATEMENTS

December 28, 2019 and December 29, 2018

15. Fair Value Measurements (Continued)

- *Cost approach* – Amount that would be required to replace the service capacity of an asset (i.e., replacement cost); and
- *Income approach* – Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques).

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

The following is a description of the valuation methodologies used:

Investments in Other Cooperative Associations

Investments in other cooperative associations totaling \$1,491,953 and \$1,515,946 at December 28, 2019 and December 29, 2018, respectively, are not readily marketable and are recorded at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. These investments may be redeemed at face value only at the discretion of the other cooperatives' boards of directors and have been classified as level 2 within the fair value hierarchy.

SUPPLEMENTAL INFORMATION

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

SCHEDULE OF OPERATING EXPENSES

Years Ended December 28, 2019 and December 29, 2018

	<u>2019</u>	<u>2018</u>
Store operations expenses:		
Store wages and benefits	\$12,453,421	\$11,605,933
Facilities cost	3,926,081	3,636,777
Credit card expenses	1,142,976	1,098,558
Selling and other costs	1,094,684	1,150,836
Equipment costs	<u>682,605</u>	<u>716,225</u>
	19,299,767	18,208,329
General and administrative expenses:		
Information technology department expenses	1,051,440	1,060,317
Administrative expenses	1,065,829	893,021
Merchandising expenses	871,899	767,089
Education expenses	906,757	791,044
Finance department expenses	577,658	555,460
Facilities maintenance department expenses	609,579	589,220
Human resources department expenses	516,776	478,376
Board of directors expenses	128,773	137,825
Public relations expenses	<u>44,728</u>	<u>25,899</u>
	<u>5,773,439</u>	<u>5,298,251</u>
	<u>\$25,073,206</u>	<u>\$23,506,580</u>

HANOVER CONSUMER COOPERATIVE SOCIETY, INC.

SCHEDULE OF GENERAL AND ADMINISTRATIVE EXPENSES

Years Ended December 28, 2019 and December 29, 2018

	<u>2019</u>	<u>2018</u>
Salaries and benefits	\$3,983,422	\$3,664,226
Equipment expenses	148,227	130,121
Equipment depreciation	250,277	214,591
Building leases	259,256	184,320
Professional fees	186,733	206,869
Telephone	143,472	113,853
Advertising	82,933	79,252
Consulting fees	59,585	60,487
Dues and subscriptions	36,725	100,998
Meals, entertainment and vehicle reimbursement	41,910	30,691
Education and training	46,338	43,844
Technical maintenance contracts	123,170	122,847
Supplies	37,814	29,090
Occupancy costs	191,788	66,167
Insurance	30,098	22,656
Postage	23,469	6,576
Printing	18,814	15,894
Graphics and promotional expenses	28,189	30,076
Employee relations and programs	16,368	16,797
Software licenses	35,369	104,504
Bank charges	19,652	5,465
Demo expenses	4,027	4,993
Contributions	9,326	7,781
Membership meeting	2,929	727
Co-op news	162	5,435
Other	<u>(6,614)</u>	<u>29,991</u>
	<u>\$5,773,439</u>	<u>\$5,298,251</u>