MCRAE INDUSTRIES INC
Form 10-K/A
June 27, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K/A
(Amendment No. 2)

þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended July 31, 2004

Commission file number: 1-8578

McRAE INDUSTRIES, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**56-0706710**
(State of Incorporation)	(I.R.S. Employer Identification No.)

400 North Main Street, Mount Gilead, North Carolina 27306
(Address of Principal Executive Offices)

Registrant s telephone number, including area code: (910) 439-6147

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Class A Common Stock, $1 Par Value	American Stock Exchange
Class B Common Stock, $1 Par Value	American Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K/A or any amendment of this Form 10-K/A. þ

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).

Yes o No þ

The aggregate market value of shares of the Registrant s $1 par value Class A and Class B Common Stock held by non-affiliates as of January 30, 2004 was approximately $10,888,117 and $1,506,134, respectively. On October 27, 2004, 1,943,543 Class A shares and 824,956 Class B shares of the Registrant s Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the proxy statement for the annual shareholders meeting held on December 16, 2004 are incorporated by reference in Part III.

INTRODUCTORY NOTE

McRae Industries, Inc. (the Company, which may be referred to as we , us , or our) is filing this Amendment No. 2 (Amendment No. 2) to the Form 10-K originally filed October 29, 2004, as amended by the Form 10-K/A filed December 23, 2004 (the original filing), to reflect a revised discussion concerning the Company s disclosure controls and procedures and internal control over financial reporting in the *Disclosure Controls and Procedures* and *Management s Discussion and Analysis of Financial Condition and Results of Operations* sections of the original filing. This Amendment No. 2 presents a complete restatement of the original filing. Except as set forth above and for such other changes as required by applicable law, no attempt has been made in this Amendment No. 2 to modify or update the disclosures as presented in the original filing and other than the discussion regarding our internal control over financial reporting contained in Item 9A of Part II, this Amendment No. 2 does not reflect events occurring after the original filing of the Form 10-K on October 29, 2004.

PART I

ITEM 1. BUSINESS

McRae Industries, Inc., (the Company , which may be referred to as we , us or our), is a Delaware corporation organized in 1983 and is the successor to a North Carolina corporation organized in 1959. Our principal lines of business are: manufacturing and selling bar code reading and related printing devices and manufacturing and selling military combat boots, western and work boots. Our office products business was sold in September 2004 and our commercial printing and packaging business was discontinued during fiscal 2001. Additional financial information about these lines of business can be found in Note 14 to the financial statements.

Bar Code Operations

Our bar code unit manufactures and sells bar code reading and printing devices and other items related to optical data collection, including licensing and selling computer software, through Compsee, Inc. (Compsee), a wholly owned subsidiary as of June 2004 and majority owned prior to June 2004. Compsee markets, sells, and services its products directly through sales centers located throughout the United States.

Compsee designs and manufactures QuickReader, QuickLink, Turbowedge stationary bar code readers, and APEX portable bar code scanners. Principal materials used in Compsee s assembly operations consist of various electrical and electronic components that are readily available from a number of sources. Compsee s portable bar code scanner equipment includes the APEX II, APEX III, and APEX IV. The APEX II was introduced in fiscal 1996 and the APEX III was introduced in fiscal 2001. The APEX III provides batch and wireless data collection capability. The APEX IV is a more rugged, pistol grip version of the APEX III product. The APEX products have generally been well received in the market and provided 17%, 15%, and 19% of Compsee sales for fiscal 2004, 2003, and 2002, respectively. QuickReader, QuickLink, and Turbowedge bar code readers developed and marketed by Compsee accounted for 10%, 6%, and 9% of Compsee s net revenues for fiscal 2004, 2003, and 2002, respectively, and for 2%, 2%, and 2% of the Company s consolidated net revenues from continuing operations during fiscal 2004, 2003, and 2002, respectively. Compsee expects to begin shipment of its new state of the art windows ce.net wireless portable data collector in the second quarter of fiscal 2005. Compsee also purchases and re-sells bar code products to compliment their manufactured product lines. Purchased bar code products for resale accounted for 72%, 73%, and 71% of Compsee s net revenues for fiscal 2004, 2003, and 2002, respectively.

The markets in which this business unit operates are generally highly competitive. We are not aware of any reliable statistics that would enable us to determine the relative position of Compsee or its products within the industry. Competition in the industry is principally based on product features, customer service, and price. Our major competitors for our manufactured products in the industry, some of which are larger companies that have greater financial, development, marketing, and distribution resources than we do, include PSC, Intermec, Handheld Products, and Symbol Technologies.

Compsee s backlog of firm orders for bar code products at July 31, 2004 and August 2, 2003 totaled approximately $326,000 and $564,000, respectively. We expect to fill all of the backlog as of July 31, 2004 during the 2005 fiscal year.

Net revenues derived from this unit in fiscal 2004, 2003, and 2002 were 15%, 18%, and 22% of the Company s consolidated net revenues from continuing operations, respectively.

Military Combat Boots

Our footwear manufacturing operations include the manufacture and sale of military combat boots. We have manufactured direct molded sole military combat boots for the United States Government (the Government) since 1966.

Whenever the Government determines a need for combat boots, it solicits bid responses from U.S. boot manufacturers. The solicitation process typically includes the evaluation by the Government of written technical and cost proposals. The Government awards contracts on negotiated per pair contract prices based on actual and estimated allowable costs plus a reasonable profit margin. This profit margin is subject to the Government s determination that the prices are fair and reasonable. From 1965 to 2002, the basic issue combat boots required vulcanized construction. Now, basic issue combat boots allow and accept a variety of footwear constructions. As a result, as many as 12 bidders have responded to military boot solicitations with awards being made to only two or three manufacturers. All recent Government contracts for vulcanized military boots have been awarded to four manufacturers including us.

On September 30, 2003, the Government notified us that we had been awarded a new contract (the Contract) to produce direct molded sole military combat boots. On September 30, 2004, the Government exercised the first year option, which provides for a minimum and a maximum boot requirement of 276,460 pair and 1,077,552 pair, respectively. The second year option ranges from a minimum of 236,460 pair to a maximum of 852,552 pair.

During the third quarter of fiscal 2004, the U.S. Army changed their Type I and Type II Black Desert hot weather boot specification from a single vulcanized outsole to a three-layer outsole design. This three-layer outsole design can be made with our vulcanizing equipment. Our current contract with the Government was modified to incorporate this new three-layer outsole and we have produced boots that meet the new specifications. We have been advised that the future option quantities against this contract, if they are invoked, will require this new design because this new three-layer outsole construction is well liked and accepted by our troops.

No one company dominates the Government military boot industry. Our major competitors in the direct molded sole vulcanized military boot market include Wellco, Inc., Belleville Shoe Manufacturing Company, and Altama Delta Corporation. Price, quality, manufacturing efficiency, and delivery are the areas we emphasize to strengthen our competitive position. We also sell boots to civilian and other military customers including other countries. Military boot sales under the Government contract were $36.0 million, $15.7 million, and $14.3 million, for fiscal 2004, 2003, and 2002, respectively. Such sales constituted 51%, 29%, and 28% of consolidated net revenues from continuing operations in fiscal 2004, 2003, and 2002, respectively. Sales of military boots to foreign countries were $3.1 million, $5.3 million, and $4.9 million for the past three fiscal years, respectively. For the last three fiscal years, all of our foreign country sales were to Israel.

The Company s backlog of firm orders for military combat boots at July 31, 2004 and August 2, 2003 totaled approximately $12.9 million and $6.8 million, respectively. We expect to fill all of the backlog as of July 31, 2004 during the 2005 fiscal year.

Net revenues derived from the military combat boot segment in fiscal 2004, 2003, and 2002 were 57%, 41%, and 39%, respectively, of the Company s consolidated net revenues from continuing operations.

Our contracts with the Government are subject to partial or complete termination under certain specified circumstances including, but not limited to, the following: for the convenience of the Government, for the lack of funding, and for our actual or anticipated failure to perform our contractual obligations. If a contract is partially or completely terminated for its convenience, the Government is required to negotiate a settlement with us to cover costs already incurred. We have never had a contract either partially or completely terminated by the Government.

Leather, synthetic rubber, and the specified rubber Vibram outsoles are the principal material components used in the boot manufacturing process. Pursuant to Government contract requirements for military combat boots, all materials used in manufacturing these boots must be and are produced in the United States and must be certified as conforming to military specifications. The synthetic rubber we use in our military combat boots is available from one domestic supplier, therefore, if this domestic supplier is not able to provide us with synthetic rubber, it would be necessary for us to get an exemption from the Government to purchase this material in the foreign market. There is only one certified domestic supplier that can provide the Vibram rubber outsoles and we are dependent on its ability to supply our needs.

We have a technical assistance agreement with Ro-Search, Inc., a subsidiary of Wellco, Inc., a competitor to whom we pay a fee for each pair of direct molded sole boots we produce.

Western and Work Boots

Dan Post Boot Company (Dan Post), formerly American West, designs, imports, and sells, western and work boots for men, women, and children. Dan Post utilizes seasoned and highly respected independent sales representatives to market and sell its boots nationwide to major retail discount stores, regional specialty chain stores, major western boot distributors, and direct mail catalogs. The boots are marketed primarily under the retailer s private label and under the Dan Post , Dingo , and American West Trading brands.

The Dingo footwear line provides a lifestyle product to supplement our western boot products. The Dan Post brand is a high quality, traditional western product and is well recognized by both retailers and consumers.

In December 2003, our Waverly, Tennessee facility was converted to a military combat boot factory due to the high demand for military production to fight terrorism, and we began importing our western boot products primarily from China, India, Mexico, and Brazil.

During fiscal 2000, we expanded our western boot product line with imported children s boots we purchased from India and China. With the conversion of the Waverly plant in December 2003, all adult products are imported from Brazil, Mexico, and China. During fiscal 2005, we will continue to import from these countries to maintain higher margins. All of our imported boots are produced by contract manufacturers based on specifications that we provide.

The western and work boot markets are highly competitive. We are not aware of any reliable statistics that would enable us to determine Dan Post s or its products relative positions within the industry; however, we believe we have established a solid position in the market for all price ranges.

Dan Post manages its manufacturing and inventory according to the seasonality of its business, which tends to have higher sales occurring generally in the fall and winter months. Dan Post contributed $20.2 million, $22.6 million, and $20.15 million of consolidated net revenues from continuing operations for fiscal 2004, 2003, and 2002, respectively.

The backlog of firm orders for western and work boots at July 31, 2004 and August 2, 2003 totaled approximately $2.0 million and $1.2 million, respectively. We expect to fill all of the backlog as of July 31, 2004 during the 2005 fiscal year.

Net revenues derived from the western and work boot segment in fiscal 2004, 2003, and 2002 were 28%, 41%, and 39%, respectively, of the Company s consolidated net revenues from continuing operations.

Discontinued Operations

In September 2004, our wholly owned subsidiary, McRae Office Solutions, Inc., sold substantially all of its assets to Connected Office Products, Inc., a wholly owned subsidiary of TOPAC U.S.A., Inc., for $11,000,000, subject to adjustment based on the net book value of the acquired assets as of August 28, 2004. As a result, the office products business segment is shown as a disposal of a segment of business. In the first quarter of fiscal 2005, we will recognize a gain of approximately $3.0 million on the sale, subject to purchase price adjustments. Accordingly, the operating results of the office products business segment have been classified as a discontinued operation for all periods presented in the Company s consolidated financial statements included in this Report.

Other Businesses

The Company s Financing and Leasing Division manages our short-term investments and marketable securities. This division is also engaged in equipment leasing and the financing of receivables for other businesses and individuals.

Foreign Sales

Our only business that experiences significant foreign sales is the military boot business. Sales of military boots to foreign countries were $3.1 million (7.7%) of total military boot sales), $5.3 million (23.8%), and $4.9 million (24.5%) during fiscal 2004, 2003, and 2002, respectively. For the last three fiscal years, all of our foreign country sales were to Israel.

Other Investment Interests

We own land in North and South Carolina that is being held for investment purposes.

Regulation

We are subject to various laws and regulations concerning environmental matters and employee safety and health. We believe we are operating in substantial compliance with these laws and regulations.

Employment

As of July 31, 2004, we employed approximately 640 persons in all divisions and subsidiaries. None of our employees are represented by collective bargaining or a labor union. We consider our relations with our employees to be good.

Financial Information about Operating Segments

Financial information for the past three fiscal years with respect to our operating segments are incorporated herein by reference to Note 14 to the consolidated financial statements included in this Report.

Research and Development

Research and development costs related to development of future bar code products amounted to $1,452,000, $914,000, and $646,000 for fiscal 2004, 2003, and 2002, respectively.

ITEM 2. PROPERTIES

The following table describes the location, principal use, and approximate size of the principal facilities used in our business. Except for the Tennessee warehouse, which we lease, we own all of these facilities.

Location	Principal Use	Size
400 North Main Street Mt. Gilead, N.C.	Corporate headquarters, manufacturing, and sales	71,000 square feet
Highway 109 North Mt. Gilead, N.C.	Footwear manufacturing	57,600 square feet
2500 Port Malabar Blvd. Palm Bay, Florida	Compsee bar code sales office	5,250 square feet

Highway 109 North Mt. Gilead, N.C.	Footwear warehouse	3,500 square feet
Highway 109 Richmond County, N.C.	Footwear storage	11,200 square feet

Location	Principal Use	Size
Highway 24-27 Troy, N.C.	Footwear manufacturing and warehousing	60,000 square feet
Highway 109 North Mt. Gilead, N.C.	Footwear storage	4,800 square feet
601 E. Railroad Street Waverly, TN	Footwear manufacturing	71,520 square feet
5576 Highway 70 West Waverly, TN	Footwear warehouse	77,000 square feet

In addition to these principal locations, we lease other sales offices throughout the United States.

Under the terms of a lease agreement entered into in connection with the sale of our office products business, we lease a portion of our corporate headquarters facility to Connected Office Products, Inc.

As of July 31, 2004, our Waverly, Tennessee manufacturing facility was encumbered by a deed of trust in favor of The Fidelity Bank to secure a loan in the amount of approximately $3.1 million. This loan was paid in full in September 2004.

We believe that our current facilities are adequate for current and future operations.

ITEM 3. LEGAL PROCEEDINGS

While from time to time we are engaged in litigation incidental to our business, we are not currently party to any material legal proceedings.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Each of our classes of Common Stock is traded on the American Stock Exchange (ticker symbols MRI.A and MRI.B). As of October 27, 2004, there were approximately 377 record holders of Class A Common Stock and approximately 373 record holders of Class B Common Stock. High and low stock prices and dividends declared per share for the last two fiscal years were:

CLASS A COMMON STOCK:

	Fiscal 2004			Fiscal 2003		
Quarter	Sales High	Price Low	Cash Dividends Declared	Sales High	Price Low	Cash Dividends Declared
First	$ 9.30	$ 6.36	$ .06	$ 8.80	$ 7.02	$ .06
Second	11.00	8.85	.06	9.45	7.15	.06
Third	11.75	9.49	.06	8.20	7.20	.06
Fourth	10.30	9.05	.06	7.38	6.07	.06

CLASS B COMMON STOCK:

	Fiscal 2004		Fiscal 2003	
Quarter	Sales High	Price Low	Sales High	Price Low
First	$ 8.75	$ 6.50	$ 8.90	$ 6.95
Second	10.75	8.80	9.35	7.50
Third	11.50	9.60	8.05	7.20
Fourth	10.15	9.15	7.15	6.20

While we have no formal policy with respect to payment of dividends, we expect to continue paying regular cash dividends on our Class A Common Stock. Dividends paid on Class B Common Stock, if any, must also be paid on Class A Common Stock in an equal amount. Dividends paid on Class A Common Stock, if any, are not also required to be paid on Class B Common Stock. We did not pay any dividends on Class B Common Stock during the prior three fiscal years. There can be no assurance as to future dividends on either class of Common Stock, as the payment of any dividends is dependent on future actions of the Board of Directors, earnings, capital requirements, and financial condition of the Company.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following Selected Consolidated Financial Data of the Company presented below for each of the five years in the period indicated has been derived from our audited and consolidated financial statements as adjusted to reflect the office products business as a discontinued operation. The Selected Consolidated Financial Data should be read in conjunction with the Consolidated Financial Statements and Notes thereto, Management s Discussion and Analysis of Financial Conditions and Results of Operations , and the other financial data included elsewhere herein.

	(In thousands, except for per share data)				
Fiscal Years Ended	**7-31-04**	**8-2-03**	**8-3-02**	**7-28-01**	**7-29-00**
Income Statement Data:					
Net revenues	$ 70,496	$ 54,501	$ 50,745	$ 38,505	$ 36,463
Net earnings from continuing operations	3,206	2,447	2,179	830	958
Net (loss) earnings from discontinued operations	(197)	30	406	(1,527)	399
Net earnings (loss)	3,009	2,477	2,585	(697)	1,357

Net earnings from continuing operations per common share:		1.16		0.88		0.79		0.30		0.35
Balance Sheet Data:										
Total assets	$	49,548	$	46,149	$	41,929	$	38,977	$	42,697
Long-term liabilities		3,082		3,307		3,900		4,598		5,057
Working capital		28,794		27,377		23,829		21,202		22,520
Shareholders equity		34,148		31,602		29,581		27,371		28,589
Weighted average number of common shares outstanding(a)		2,768,499		2,768,499		2,768,499		2,768,499		2,768,499
Cash dividends declared per common share(b)	$	0.24	$	0.24	$	0.21	$	0.28	$	0.36

(a) Includes both Class A and Class B Common Stock

(b) Dividends were paid only on Class A Common Stock

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTERNAL CONTROL OVER FINANCIAL REPORTING

In connection with the audit of our consolidated financial statements for the fiscal year ended July 31, 2004, our independent auditors informed us that they had discovered significant deficiencies in our internal control over financial reporting that in the aggregate constituted material weaknesses under standards established by the Public Company Accounting Oversight Board. These deficiencies, which were noted across all of the Company s operating divisions and which have been present since the Company s inception, are generally the result of incompatible duties, undocumented controls, lack of monitoring controls and the lack of an internal audit function. Additionally, the discovery of compilation errors in the military boot operation s fiscal 2004 year-end inventory required us to restate our financial statements as of July 31, 2004 and for the fiscal year then ended included in our Annual Report on Form 10-K originally filed by us on October 29, 2004. Upon completion by our independent auditors of their review of the accounting for inventory in our financial statements as previously reported for fiscal 2004, our independent auditors informed us that in their view there were material internal control weaknesses related to the compilation of the Company s inventory.

We have performed substantial additional procedures including, but not limited to, documentation of our procedures, identification of key control weaknesses, and initiation of an appropriate remediation process in an effort to ensure that these internal control deficiencies do not lead to further material misstatements in our consolidated financial statements and to enable the completion of the independent auditor s audit of our consolidated financial statements.

CRITICAL ACCOUNTING POLICIES

Our timely preparation of financial reports and related disclosures requires us to use estimates and assumptions that may cause actual results to be materially different from our estimated results. Specifically, we use estimates when accounting for depreciation, amortization, cost per copy contract contingencies, useful lives for intangible assets, and asset valuation allowances (including those for bad debts, inventory, and deferred income tax asset valuation allowances). Our most critical accounting policies include the following:

Contract Contingencies

Our office products business, which we sold in September 2004, leased equipment (usually for a sixty-month period) to countywide education systems and sold the lease to third party leasing companies. Under this program the school system was billed on a monthly, quarterly or annual basis at a specified rate for each copy they make. The cost per copy charged to the school system was designed to cover the equipment cost, supplies (except for paper and staples), service, and a finance charge. Prior to the sale of the office products business, on a quarterly basis, on a program-by-program basis, we projected an expected outcome over the life of the program. We used historical copy usage to predict the number of copies to be made over the remaining life of the program. We adjusted this estimate of the number of expected future copies based on known factors that would influence copy rates in each program. We used historical service and supply costs incurred on each program to estimate future service and supply costs on a per copy basis. We adjusted these estimated costs for known factors that would impact service and supplies in the future. We also estimated any other costs expected to be incurred such as depreciation on rental equipment. On programs where the sum of the estimated future costs exceeded the expected future revenue, we recognized a provision for

100% of the expected losses for these programs.

Intangible Assets

We determine the utility of goodwill and trademarks based on estimated future cash flows and test for impairment in accordance with applicable accounting pronouncements. We estimate future cash flows based on historical performance and our knowledge of known factors likely to impact future cash flows.

Inventories

Inventories are recorded at the lower of cost or market value. We regularly review inventory quantities on hand and record a provision for excess and obsolete inventory based primarily on our estimated forecast and demand requirements for the next twelve months. Actual demand and market conditions may be different from those projected by our management.

Revenue Recognition

We recognize revenue under our current boot contract when the boots are inspected and accepted by the Government s Quality Assurance Representative (QAR), thereby transferring ownership to the Government. Pursuant to the contract, the boots become Government-owned property after inspection and acceptance by the QAR. The boots are transferred and stored in our warehouse, which is a designated storage facility approved by the Government, and accounted for as bill and hold sales in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104, Revenue Recognition in Financial Statements.

Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves us estimating our actual current exposure together with assessing temporary differences resulting from differing treatment of items, such as leasing activity, allowances, and depreciation, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the statement of operations. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities, and any valuation allowance recorded against our net deferred tax assets. In the event that actual results differ from these estimates or we adjust these estimates in future periods, we may need to establish an additional valuation allowance, which could materially impact our financial position and results of operations.

DESCRIPTION OF BUSINESS SEGMENTS

We have three primary business units: our bar code unit operates under the name Compsee, Inc. (Compsee); our military boot unit operates under the name McRae Footwear and our western and work boot unit operates under the name Dan Post Boot Company (Dan Post), formerly American West Trading Company. Our office products business, which we sold in September 2004 to Connected Office Products, Inc. operated under the name McRae Office Solutions, Inc. We also operate other smaller businesses.

A summary of net revenues; gross profits; selling, general and administrative expenses; and operating profits (loss) of our major business units for fiscal years 2002 through 2004 is presented in the following table. Certain reclassifications have been made to the prior year amounts to conform with the current year presentation.

	Fiscal Year 2004	2003 (In thousands)	2002	Percent change over prior period 2004	2003	Fiscal Year 2004	2003	2002
						Percentage of Net Revenues		
Net Revenues								
Bar Code	$ 10,875	$ 9,776	$ 11,034	11.2	(11.4)	15	18	22
Military Boots	40,104	22,272	20,030	80.0	11.2	57	41	39
Western/Work Boots	20,169	22,618	20,153	(10.8)	12.2	28	41	39
Eliminations/Other	(652)	(165)	(472)	NM	NM	0	0	0
Consolidated	$ 70,496	$ 54,501	$ 50,745	29.3	7.4	100	100	100
						Gross Profit Percentage		
Gross Profit								
Bar Code	$ 3,244	$ 2,619	$ 3,124	23.9	(16.2)	30	27	28
Military Boots	6,632	4,772	5,517	39.0	(13.5)	16	21	28
Western/Work Boots	4,961	5,743	4,911	(13.6)	16.9	25	25	25
Eliminations/Other	166	285	3	NM	NM	0	0	0
Consolidated	$ 15,003	$ 13,419	$ 13,555	11.8	(1.0)	21	25	27
						Percentage of Net Revenues		
Selling, General and Administrative Expense								
Bar Code	$ 4,341	$ 4,155	$ 4,971	4.5	(16.4)	40	43	45
Military Boots	1,485	997	800	48.9	24.6	4	4	4
Western/Work Boots	4,612	4,550	3,912	1.4	16.3	23	20	20
Eliminations/Other	194	156	7	NM	NM	0	0	0
Consolidated	$ 10,632	$ 9,858	$ 9,690	7.9	1.7	15	18	19
						Percentage of Net Revenues		
Operating Profit (Loss)								
Bar Code	$ (1,097)	$ (1,536)	$ (1,847)	28.5	16.8	(10)	(16)	(17)
Military Boots	5,147	3,775	4,717	36.3	(20.0)	13	17	24
Western/Work Boots	349	1,193	999	(70.8)	19.4	2	5	5
Eliminations/Other	(28)	129	(4)	NM	NM	0	0	0
Consolidated	$ 4,371	$ 3,561	$ 3,865	22.7	(7.8)	6	7	8

CONSOLIDATED RESULTS OF CONTINUING OPERATIONS, FISCAL 2004 COMPARED TO FISCAL 2003

Consolidated net revenues from continuing operations totaled $70.5 million for fiscal 2004 as compared to $54.5 million for fiscal 2003. This 29% increase in consolidated net revenues from continuing operations was primarily attributable to significant demand for military combat boots by the U.S. Government (Government) to support our troops engaged in the fight against terrorism throughout the world. Weak demand for western and work boots partially offset this surge in net revenues as net revenues for this business declined by approximately $2.4 million over the results posted for fiscal 2003.

Consolidated gross profit from continuing operations for fiscal 2004 amounted to $15.0 million, up 12% from $13.4 million for fiscal 2003. This growth in gross profit was primarily the result of increased net revenues. As a percentage of net revenues, gross profit decreased from 25% for fiscal 2003 to 21% for fiscal 2004 primarily attributable to lower margins in the military boot business, which accounted for approximately 57% of the overall sales mix.

Consolidated selling, general and administrative (SG&A), and research and development (R&D) expenses from continuing operations were $10.6 million for fiscal 2004 as compared to $9.9 million for fiscal 2003. The increase in SG&A expenses was primarily the result of higher expenditures for R&D, group health insurance, professional fees, marketing activities and bad debt charges, which were partially offset by decreased expenditures for sales related compensation, travel, and office rentals. As a percentage of net revenues, SG&A expenses decreased from 18% for fiscal 2003 to 15% for fiscal 2004.

As a result of the above, fiscal 2004 operating profit from continuing operations totaled $4.4 million as compared to $3.6 million for fiscal 2003.

BAR CODE UNIT RESULTS OF OPERATIONS, FISCAL 2004 COMPARED TO FISCAL 2003

Compsee is a manufacturer and distributor of bar code reading and printing devices, other peripheral equipment, and supplies related to optical data collection. Compsee markets, sells, and services its products primarily through sales centers located throughout the United States. Compsee continues to explore new markets throughout the United States and other parts of the world.

Net revenues for the bar code business increased from $9.8 million for fiscal 2003 to $10.9 million for fiscal 2004 primarily as a result of improvement in the market for bar code products. We expect revenues to continue to grow in fiscal 2005 with continued improvement in the bar code market and the introduction of a new bar code product in the second quarter of fiscal 2005.

Gross profit for the bar code business grew from $2.6 million for fiscal 2003 to $3.2 million for fiscal 2004 as a result of increased sales and improved profit margin. Gross profit as a percentage of net revenues was 30% for fiscal 2004 as compared to 27% for fiscal 2003. This improvement in gross profit percentage was primarily the result of increased sales of higher margin manufactured products in the overall bar code sales mix.

SG&A and R&D expenditures amounted to $4.3 million for fiscal 2004 as compared to $4.2 million for fiscal 2003. R&D costs were up approximately $500,000 as efforts to complete development of the new bar code product intensified. SG&A expenses for sales salaries and commissions, marketing activities, travel costs, postage, and depreciation were lower as a result of effective cost containment measures.

As a result of the above, the bar code business operating loss fell from $1.5 million for fiscal 2003 to $1.1 million for fiscal 2004.

MILITARY BOOT UNIT RESULTS OF OPERATIONS, FISCAL 2004 COMPARED TO FISCAL 2003

Our military boot unit manufactures and distributes military combat boots primarily to the U.S. Government (the Government), foreign governments, and selected commercial surplus outlets.

Net revenues for the military boot business for fiscal 2004 totaled $40.1 million as compared to $22.3 million for fiscal 2003. This growth in net revenues was the result of significantly increased demand for military combat boots by the Government. Military boot sales to the Government were $36.0 million for fiscal 2004 as compared to $15.7 million for fiscal 2003. The increase in net revenues for fiscal 2004 was partially offset by reduced foreign and commercial military boot sales.

Gross profit grew from $4.8 million for fiscal 2003 to $6.6 million for fiscal 2004 primarily due to the increase in net revenues. In August 2004, the Government approved an economic price adjustment for increased material costs based on a change in cost estimates from a contract in prior years, which contributed approximately $490,000 to the increase in gross profit. As a percentage of net revenues, gross profit fell from 21% for fiscal 2003 to 16% for fiscal 2004. This decline in gross profit percentage was primarily the result of lower per unit selling prices and higher per unit manufacturing costs associated with training new production workers, higher subcontract costs, and difficulties encountered in producing multiple boot constructions.

SG&A expenses for fiscal 2004 amounted to $1.5 million as compared to $1.0 million for fiscal 2003. This increase in SG&A expenses was primarily the result of higher group health insurance costs, professional fees, and employee benefit expenses.

As a result of the above, operating profit for fiscal 2004 totaled $5.1 million as compared to $3.8 million for fiscal 2003.

On September 30, 2003, the Government notified us that we had been awarded a new contract (the Contract) to produce direct molded sole military combat boots. On September 30, 2004, the Government exercised the first year option, which provides for a minimum and a maximum boot requirement of 276,460 pair and 1,077,552 pair, respectively. The second year option ranges from a minimum of 236,460 pair to a maximum of 852,552 pair.

During the third quarter of fiscal 2004, the U.S. Army changed its Type I and Type II Black Desert hot weather boot specification from a single vulcanized outsole to a three-layer outsole design. This three-layer outsole design can be made with our vulcanizing equipment. Our current contract with the Government was modified to incorporate this new three-layer outsole and we have produced boots that meet the new specifications. We have been advised that the future option quantities against this contract, if they are invoked, will require this new design because this new three-layer outsole construction is well liked and accepted by our troops.

Our contracts with the Government are subject to partial or complete termination under certain specified circumstances including, but not limited to, the following: for the convenience of the Government, for the lack of funding, and for our actual or anticipated failure to perform our contractual obligations. If a contract is partially or completely terminated for its convenience, the Government is required to negotiate a settlement with us to cover costs already incurred. We have never had a contract either partially or completely terminated.

WESTERN AND WORK BOOT UNIT RESULTS OF OPERATIONS, FISCAL 2004 COMPARED TO FISCAL 2003

Our western and work boot business imports and sells various boot styles for men, women, and children for dress and casual wear.

Net revenues for the western and work boot business totaled $20.2 million for fiscal 2004 as compared to $22.6 million for fiscal 2003. This decrease in net revenues resulted primarily from a soft market for western and work boots, partially offset by military boot sales to our military boot unit, which amounted to approximately $836,000 for fiscal 2004 as compared to $563,000 for fiscal 2003.

Gross profit for fiscal 2004 amounted to $5.0 million as compared to $5.7 million for fiscal 2003. This decrease in gross profit resulted primarily from the decline in net revenues. Gross profit as a percentage of net revenues held steady at 25% for both fiscal 2004 and 2003. Manufacturing inefficiencies associated with military boot production for the first six months of fiscal 2004 and inventory write-offs related to discontinuing western boot manufacturing were offset by higher margins on imported western and work boot products.

SG&A expenses were $4.6 million for both fiscal 2004 and 2003. Higher bad debt expenses for fiscal 2004 were offset by lower expenditures for sales commissions, travel, and advertising.

As a result of the above, operating profit totaled $349,000 for fiscal 2004 as compared to $1.2 million for fiscal 2003.

DISCONTINUED OPERATIONS, FISCAL 2004 COMPARED TO FISCAL 2003

McRae Office Solutions distributed Toshiba photocopiers, Toshiba facsimile machines, RISO digital printing equipment, OKI color copiers and printers and provided related service and supplies for these products throughout North Carolina and parts of Virginia and South Carolina.

We sold our office products business in September 2004. As a result, the office products business segment is shown as a disposal of a segment of business. Accordingly, the operating results of the office products business segment have been classified as a discontinued operation for all periods presented in the Company s consolidated financial statements included in this Report.

Net revenues for the discontinued office products business amounted to $23.9 million for fiscal 2004 as compared to $22.5 million for fiscal 2003. The increase was primarily due to the higher service and supply revenues related to the growth of machines in service.

Gross profit totaled approximately $6.0 million for both fiscal 2004 and 2003. As a percentage of net revenues, gross profit declined from 26.7% for fiscal 2003 to 25.1% for fiscal 2004 primarily attributable to lower commercial sales that normally have higher margins and decreased seasonal school billings.

SG&A expenses were $6.1 million for fiscal 2004 as compared to $5.8 million for fiscal 2003 as a result of increased costs for sales and administrative salaries, professional fees and group health insurance, which were partially offset by reduced costs for advertising, equipment rental, property taxes, and bad debt.

As a result of the above, the operating loss for fiscal 2004 amounted to $111,000 as compared to an operating profit of $231,000 for fiscal 2003.

CONSOLIDATED RESULTS OF CONTINUING OPERATIONS, FISCAL 2003 COMPARED TO FISCAL 2002

Consolidated net revenues from continuing operations for fiscal 2003 reached $54.5 million, up 7.4% from $50.7 million for fiscal 2002. This growth in consolidated net revenues was the result of significantly higher requirements for military boots by the U.S. Government (the Government) and increased sales of our branded western boot products. Lower net revenues in the bar code business partially offset the net revenue increase of the footwear businesses.

Consolidated gross profit from continuing operations for fiscal 2003 amounted to $13.4 million as compared to $13.6 million for fiscal 2002. Gross profit as a percentage of net revenues decreased from 27% for fiscal 2002 to 25% for fiscal 2003. These declines in consolidated gross profit were primarily the result of lower product sales prices, higher per unit manufacturing costs, changing product sales mixes, and depressed market conditions.

Consolidated selling, general and administrative (SG&A) expenses from continuing operations were approximately $9.9 million for fiscal 2003, an increase of 1.7% over the $9.7 million reported for fiscal 2002. The additional SG&A costs were primarily attributable to increased research and development costs, advertising and marketing expenditures, group health insurance costs, and professional fees.

As a result of the lower gross profit and higher SG&A costs, consolidated operating profit from continuing operations fell from $3.9 million for fiscal 2002 to $3.6 million for fiscal 2003.

BAR CODE UNIT RESULTS OF OPERATIONS, FISCAL 2003 COMPARED TO FISCAL 2002

Net revenues for the bar code business fell nearly 11.4%, down from $11.0 million for fiscal 2002 to $9.8 million for fiscal 2003. This decline in net revenues was primarily the result of competitive pressures in a depressed bar code market, the maturation of the Apex II and III manufactured products, and the delay in getting the Apex IV product to market.

Gross profit for fiscal 2003 amounted to $2.6 million as compared to $3.1 million for fiscal 2002. Gross profit as a percentage of net revenues dropped from 28% for fiscal 2002 to 27% for fiscal 2003. This decrease in gross profit was primarily attributable to lower net revenues and a reduced proportion of higher margin manufactured products in the sales mix.

SG&A expenses for fiscal 2003 were $4.2 million, down 16.4% from $5.0 million for fiscal 2002. The decrease in SG&A costs were primarily the result of effective cost containment strategies that lowered sales and administrative salaries, advertising expenditures, telephone costs, and amortization charges. These reduced SG&A costs were partially offset by higher research and development expenditures that increased from $646,000 for fiscal 2002 to $914,000 for fiscal 2003.

As a result of the above, the bar code business loss from operations amounted to $1.5 million for fiscal 2003 as compared to a loss from operations of $1.8 million for fiscal 2002.

MILITARY BOOT UNIT RESULTS OF OPERATIONS, FISCAL 2003 COMPARED TO FISCAL 2002

Net revenues for fiscal 2003 totaled $22.3 million, up 11.2% from $20.0 million for fiscal 2002. This growth in net revenues was the result of increased requirements for military combat boots by the Government primarily attributable to various conflicts associated with the war on terrorism. Military boot sales to foreign governments for fiscal 2003 were $5.3 million as compared to $4.9 million for fiscal 2002.

Gross profit amounted to $4.8 million for fiscal 2003 as compared to $5.5 million for fiscal 2002. As a percentage of net revenues, gross profit fell from 28% for fiscal 2002 to 21% for fiscal 2003. This decline in gross profit was primarily the result of lower sales prices, higher levels of lower margin desert boots in the overall sales mix, and increased per unit manufacturing costs.

SG&A expenses for fiscal 2003 were $997,000 as compared to $800,000 for fiscal 2002. This increase in SG&A costs were primarily attributable to higher administrative salaries, group health insurance costs, and professional fees. These higher costs were partially offset by decreased sales salaries and related expenses.

As a result of the above, the operating profit for fiscal 2003 fell to $3.8 million, down from $4.7 million for fiscal 2002.

WESTERN AND WORK BOOT UNIT RESULTS OF OPERATIONS, FISCAL 2003 COMPARED TO FISCAL 2002

Net revenues for fiscal 2003 increased 12.2%, up from $20.15 million for fiscal 2002 to $22.6 million for fiscal 2003. This increase was primarily attributable to strong demand for our Dan Post and Dingo branded products.

Gross profit totaled $5.7 million for fiscal 2003, an increase of 16.9% over the $4.9 million for fiscal 2002. Gross profit as a percentage of net revenues was 25% for both fiscal 2003 and fiscal 2002. The increase in gross profit resulted primarily from the increased revenue for fiscal 2003.

SG&A expenses for fiscal 2003 amounted to $4.6 million as compared to $3.9 million for fiscal 2002. The increase in SG&A costs resulted primarily from higher sales commissions, sales and marketing expenses, group health insurance costs, professional fees, and administrative salaries.

As a result of the above, operating profit increased from $999,000 for fiscal 2002 to $1.2 million for fiscal 2003.

DISCONTINUED OPERATIONS, FISCAL 2003 COMPARED TO FISCAL 2002

Discontinued operations net revenues for fiscal 2003 were $22.5 million, a decline from $24.7 million for fiscal 2002. Net revenue decreased as a result of lower sales to county-wide educational systems, partly as a result of our focus on improving service to existing customers.

Gross profit amounted to $6.0 million for fiscal 2003 as compared to $6.3 million for fiscal 2002. As a percentage of net revenues, gross profit increased from 25% for fiscal 2002 to 27% for fiscal 2003. The decrease in gross profit dollars as a result of lower net revenues was partially offset by increased contributions of higher margin commercial and state contract sales.

SG&A expenses for fiscal 2003 amounted to $5.8 million, up 3.8% from $5.6 million for fiscal 2002. This increase in SG&A expenses was primarily the result of higher sales salaries and commissions, advertising costs, property taxes, group health insurance, and professional fees. These expenses were partially offset by reduced research and development costs.

As a result of the above, the operating profit decreased from $629,000 for fiscal 2002 to $231,000 for fiscal 2003.

FINANCIAL CONDITION AND LIQUIDITY

We measure our liquidity by our ability to generate cash to fund our operations, investment activities, and financing requirements. Our liquidity position is sensitive to and dependent on cash generated from operations, the level of capital expenditures, reductions in debt, payment of quarterly dividends, and our access to bank financing arrangements.

At July 31, 2004, cash and cash equivalents amounted to approximately $2.5 million. Working capital equaled $28.8 million and the current ratio, defined as current assets divided by current liabilities, was 3.3 to 1. Under the terms of the Asset Purchase Agreement pursuant to which we sold our office products business in September 2004, we received $9.9 million on September 9, 2004 and will receive the remainder of the purchase price, subject to adjustments based on the net book value of the acquired assets as of August 28, 2004 and any indemnification claims made by the purchaser, in September 2005. We expect the proceeds from the sale to provide a total of approximately $7.0 million of cash after income taxes. In September 2004, we used approximately $3.1 million to pay off the long-term note related to our western and work boot business.

We have two lines of credit with a bank totaling $4.75 million, all of which was available at July 31, 2004. One credit line totaling $1.75 million (which is restricted to one hundred percent of the outstanding accounts receivable due from the U.S. Government) expires in January 2005. The other credit line totaling $3.0 million expires in November 2004. We believe that current cash and cash equivalents ($2.5 million at July 31, 2004), cash generated from operations and the sale of our office products business, and the available lines of credit will be sufficient to meet our capital requirements for fiscal 2005. We expect to use the proceeds from the sale of the office products business to reduce debt, expand and retool our military and western boot businesses, and provide capital support for our bar code business research and development efforts.

OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off-balance sheet financing arrangements.

CONTRACTUAL OBLIGATIONS

The table below details by fiscal year maturity dates our contractual commitments as of July 31, 2004 (amounts in thousands):

Commitment	2005	2006	2007	2008	2009	Thereafter
Bank loans	$ 3,172	$ 62	$ 64	$ 66	$ 251	$ 88
Operating leases	98	8	4	0	0	0
Total	$ 3,270	$ 70	$ 68	$ 66	$ 251	$ 88

Selected cash flow data is presented below (in thousands):

Source (Use) of Cash	For Years Ended July 31, 2004	August 2, 2003
Operating activities		
Net earnings adjusted for depreciation and amortization	$ 3,736	$ 3,061
Accounts receivable	(3,564)	(583)
Inventories	(1,893)	(1,306)
Net cash provided by operating activities	281	1,195
Investing activities		
Sale of property	142	377
Capital expenditures	(1,370)	(249)
Financing activities		
Proceeds from bank loan	401	
Principal repayment of long-term debt	(582)	(542)

Dividends paid	(463)	(456)

Net cash provided by operating activities during fiscal 2004 totaled approximately $281,000. Net earnings plus depreciation contributed a positive cash flow of approximately $3.7 million. The trade accounts receivable balance increased by almost $3.6 million, which was primarily attributable to expanded sales of military combat boots to the Government, to the timing of higher fourth quarter sales in the bar code business, and to state and federal income tax refunds. Inventory balances increased by approximately $1.9 million as a result of increased demand for military boots, which was offset partially by lower bar code and western boot inventories.

Capital expenditures for fiscal 2004 amounted to approximately $1.4 million primarily for footwear and bar code manufacturing equipment, computer equipment upgrades, and a 25,000 square foot addition to our military boot warehouse.

Our financing activities in fiscal 2004 used approximately $1.0 million of cash to pay dividends and reduce our debt. In addition, during fiscal 2004 we borrowed $401,000 to finance the expansion of our military boot warehouse.

INFLATION

Management does not believe inflation has had a material impact on sales or operating results for the periods covered in this discussion.

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

There were no accounting standards issued for fiscal 2004 that were applicable to us.

FORWARD-LOOKING STATEMENTS

In addition to historical information, this Annual Report includes certain forward-looking statements as such term is defined in Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Important factors that could cause actual results or events to differ materially from those projected, estimated, assumed or anticipated in any such forward-looking statements include: the effect of competitive products and pricing, risks unique to selling goods to the Government (including variation in the Government s requirements for our products and the Government s ability to terminate its contracts with vendors), loss of key customers, acquisitions, supply interruptions, additional financing requirements, our expectations about future Government orders for military boots, loss of key management personnel, our ability to successfully develop new products and services, and the effect of general economic conditions in our markets.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to the impact of interest rate changes related to the aggregate $4.75 million lines of credit and a term loan through our military boot business (the term loan through our wholly owned subsidiary, Dan Post Boot Company was paid off in September 2004). As of July 31, 2004, there was no outstanding indebtedness under the lines of credit and approximately $400,000 was outstanding on the term loan. We do not buy or sell derivative financial instruments for trading purposes. Borrowings under these credit facilities described above bear interest at rates based upon the Prime Rate or the Prime Rate less a margin of one-half percent offered by the applicable lender. We have not entered into any swap agreements or engaged in any other hedging activities with respect to this variable rate indebtedness. A 10% increase in the interest rates under these credit facilities would increase annual interest expense by approximately $2,000 (assuming that our aggregate borrowings under the credit facilities averaged $395,000 during a fiscal year).

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following documents are filed as part of this report:

Schedules other than those listed above have been omitted because they are not applicable or the required information is shown in the financial statements or the notes thereto.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of
McRae Industries, Inc. and Subsidiaries:

We have audited the accompanying consolidated balance sheets of McRae Industries, Inc. (a Delaware corporation) and Subsidiaries as of July 31, 2004 and August 2, 2003, and the related consolidated statements of operations, shareholders equity, and cash flows for each of the three years in the period ended July 31, 2004. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of McRae Industries, Inc. and Subsidiaries as of July 31, 2004 and August 2, 2003, and the results of their operations and their cash flows for each of the three years in the period ended July 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

We have also audited Schedule II for each of the three years in the period ended July 31, 2004. In our opinion, this schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information therein.

As discussed in Note 15, the consolidated financial statements as of July 31, 2004, and for the year then ended have been restated to reflect adjustments related to an overstatement of the Company s inventory, income tax accrual and shareholders equity and an understatement of cost of revenues.

/s/ Grant Thornton LLP

Charlotte, North Carolina
October 26, 2004 (except for Note 15,
as to which the date is December 22, 2004)

CONSOLIDATED BALANCE SHEETS
McRae Industries, Inc. and Subsidiaries

	(In thousands)	
	July 31, 2004 As restated (Note 15)	**August 2, 2003**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,463	$ 3,835
Accounts receivable, less allowances for doubtful accounts of $339,000 and $431,000, respectively	11,245	8,116
Notes receivable, current portion		
Employees	0	2
Other	25	56
Inventories	14,810	12,917
Income tax receivable	676	283
Prepaid expenses and other current assets	271	211
Assets held for sale from discontinued operations	11,622	13,109
Total current assets	41,112	38,529
Property and equipment, net	3,342	2,523
Other assets:		
Notes receivable, net of current portion		
Employees	0	2
Other	36	69
Real estate held for investment	1,422	1,390
Goodwill	362	362
Cash surrender value life insurance	2,220	2,220

Trademarks	1,049	1,049
Other	5	5
Total other assets	5,094	5,097
Total assets	$ 49,548	$ 46,149

See notes to consolidated financial statements

CONSOLIDATED BALANCE SHEETS

McRae Industries, Inc. and Subsidiaries

	(In thousands)	
	July 31, 2004 As restated (Note 15)	**August 2, 2003**
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current portion of notes payable, banks	$ 621	$ 577
Accounts payable	4,672	2,580
Accrued employee benefits	524	427
Accrued payroll and payroll taxes	865	903
Liabilities held for sale from discontinued operations	4,587	5,640
Other	1,049	1,025
Total current liabilities	12,318	11,152
Notes payable, banks, net of current portion	3,082	3,307
Minority interest	0	88
Shareholders equity:		
Common stock:		
Class A, $1 par value; authorized 5,000,000 shares; issued and outstanding, 1,943,543 and 1,914,972 shares, respectively	1,943	1,915
Class B, $1 par value; authorized 2,500,000 shares; issued and outstanding, 824,956 and 853,527 shares, respectively	825	853
Additional paid-in capital	791	791
Retained earnings	30,589	28,043
Total shareholders equity	34,148	31,602

Total liabilities and shareholders equity	$ 49,548	$ 46,149

See notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF OPERATIONS
McRae Industries, Inc. and Subsidiaries

	(In thousands)		
For the years Ended	**July 31, 2004 As restated (Note 15)**	**August 2, 2003**	**August 3, 2002**
Net revenues	$ 70,496	$ 54,501	$ 50,745
Cost of revenues	55,493	41,082	37,190
Gross profit	15,003	13,419	13,555
Selling, general and administrative expenses	10,632	9,858	9,690
Operating profit from continuing operations	4,371	3,561	3,865
Other income, net	329	604	24
Interest expense	(144)	(175)	(239)
Earnings from continuing operations before income taxes and minority interest	4,556	3,990	3,650
Provision for income taxes	1,352	1,552	1,482
Minority interest	2	9	11
Net earnings from continuing operations	3,206	2,447	2,179
Discontinued operations:			
Earnings (loss) from discontinued operations, net of income tax (benefit) provision of $(72,000), $88,000, and $211,000 for 2004, 2003, and 2002.	(197)	30	406
Net earnings	$ 3,009	$ 2,477	$ 2,585
Earnings per common share:			
Earnings from continuing operations	$ 1.16	$ .88	$ .79
Earnings (loss) from discontinued operations	(.07)	.01	.14

Net earnings	$ 1.09	$ .89	$ .93
Weighted average number of common shares outstanding	2,768,499	2,768,499	2,768,499

See notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
McRae Industries, Inc. and Subsidiaries

(Dollars in thousands)

	Common Stock, $1 par value					
	Class A		**Class B**		**Additional Paid-in**	**Retained**
	Shares	**Amount**	**Shares**	**Amount**	**Capital**	**Earnings**
Balance, July 28, 2001	1,861,817	$ 1,862	906,682	$ 907	$ 791	$ 23,811
Conversion of Class B to Class A stock	17,255	17	(17,255)	(18)		
Cash Dividend ($.20 per Class A common stock)						(374)
Net earnings						2,585
Balance, August 3, 2002	1,879,072	1,879	889,427	889	791	26,022
Conversion of Class B to Class A stock	35,900	36	(35,900)	(36)		
Cash Dividend ($.24 per Class A common stock)						(456)
Net earnings						2,477
Balance, August 2, 2003	1,914,972	1,915	853,527	853	791	28,043
Conversion of Class B to Class A stock	28,571	28	(28,571)	(28)		
Cash Dividend ($.24 per Class A common stock)						(463)
Net earnings As restated (Note 15)						3,009
Balance, July 31, 2004	**1,943,543**	**$ 1,943**	**824,956**	**$ 825**	**$ 791**	**$ 30,589**
As restated (Note 15)						

See notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF CASH FLOWS
McRae Industries, Inc. and Subsidiaries

	(In thousands)		
For the Years Ended	**July 31, 2004 As restated (Note 15)**	**August 2, 2003**	**August 3, 2002**
Cash Flows from Operating Activities:			
Net earnings from continuing operations	$ 3,206	$ 2,447	$ 2,179
Adjustments to reconcile net earnings from continuing operations to net cash provided by operating activities:			
Depreciation and amortization	530	614	961
Minority shareholder s interest in earnings (loss) of subsidiary	(2)	(9)	(11)
Loss (gain) on sale of assets	(73)	(326)	122
Changes in operating assets and liabilities:			
Accounts receivable	(3,564)	(583)	(3,459)
Inventories	(1,893)	(1,306)	(2,454)
Prepaid expenses and other current assets	(139)	72	(51)
Accounts payable	2,093	273	780
Accrued employee benefits	97	(48)	235
Deferred revenues			(2)
Accrued payroll and payroll taxes	(38)	160	170
Income taxes	41	(57)	627
Other	23	(42)	246
Net cash provided by (used in) operating activities	**281**	**1,195**	**(657)**
Cash Flows from Investing Activities:			
Proceeds from sale of property	142	377	106
Proceeds from sale of short term investments		18	
Purchase of other assets		(150)	(342)
Purchase of trademarks			(800)
Purchase of minority interest	(85)		
Capital expenditures	(1,370)	(249)	(552)
Collections on notes receivable	68	73	95
Net cash (used in) provided by investing activities	**1,245**	**69**	**1,493**
Cash Flows from Financing Activities:			
Proceeds from bank loan	401		
Principal repayments of long-term debt	(582)	(542)	(579)

Dividends paid	(463)	(456)	(374)
Net cash used in financing activities	**(644)**	**(998)**	**(953)**
Net cash provided by (used in) discontinued operations	236	(26)	2,136
Net (Decrease) Increase in Cash and Cash Equivalents	(1,372)	240	(967)
Cash and Cash Equivalents at Beginning of Year	3,835	3,595	4,562
Cash and Cash Equivalents at End of Year	**$ 2,463**	**$ 3,835**	**$ 3,595**

See notes to consolidated financial statements

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