

NORTH STATE GROCERY, INC.

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FINANCIAL STATEMENTS  
December 27, 2014 and December 28, 2013

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## INDEPENDENT AUDITOR'S REPORT

To The Board of Directors  
North State Grocery, Inc.  
Cottonwood, California

### **Report on the Financial Statements**

We have audited the accompanying financial statements of North State Grocery, Inc., (a California S-Corporation), which comprise the balance sheets as of December 27, 2014 and December 28, 2013, and the related statements of income, retained earnings, 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.

### **Auditor's Responsibility**

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

An audit involves performing procedures to obtain evidence about amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion. 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 North State Grocery, Inc. as of December 27, 2014 and December 28, 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### **Report on Supplementary Information**

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary schedules on pages 16-17 are presented for purposes of additional analysis and are 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 audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

*Neal & Leidholdt*

Redding, California  
July 14, 2015

NORTH STATE GROCERY, INC.  
BALANCE SHEETS  
December 27, 2014 and December 28, 2013

ASSETS

|  | <u>2014</u>           | <u>2013</u>           |
|--|-----------------------|-----------------------|
| CURRENT ASSETS:  |                       |                       |
| Cash   | \$ 3,533,783          | \$ 1,363,700          |
| Trade receivables (net of allowances for doubtful accounts of \$389 and \$47, respectively)        | 55,190                | 59,632                |
| Other receivables (net of allowances for doubtful accounts of \$84,259 and \$60,946, respectively) | 839,851               | 709,761               |
| Merchandise inventory  | 9,895,415             | 9,772,139             |
| Prepaid expenses   | <u>605,455</u>        | <u>454,483</u>        |
| TOTAL CURRENT ASSETS   | <u>14,929,694</u>     | <u>12,359,715</u>     |
| PROPERTY AND EQUIPMENT (Note 2):   | 25,997,885            | 25,507,801            |
| Less accumulated depreciation  | ( <u>15,029,766</u> ) | ( <u>16,254,282</u> ) |
| PROPERTY AND EQUIPMENT, NET  | <u>10,968,119</u>     | <u>9,253,519</u>      |
| OTHER ASSETS:  |                       |                       |
| Off-sale liquor licenses   | 581,014               | 588,754               |
| Investment in real estate (Note 3)   | 1,390,651             | 1,390,651             |
| Goodwill – net (Note 1)  | 1,054,006             | 1,054,006             |
| Loan fees - net of accumulated amortization (Note 4)   | 137,139               | 161,664               |
| Deposits   | 35,635                | 56,930                |
| Cash surrender value of officers' life insurance   | <u>136,906</u>        | <u>86,489</u>         |
| TOTAL OTHER ASSETS   | <u>3,335,351</u>      | <u>3,338,494</u>      |
| TOTAL ASSETS   | \$ <u>29,233,164</u>  | \$ <u>24,951,728</u>  |

# LIABILITIES AND STOCKHOLDERS' EQUITY

|   | <u>2014</u>          | <u>2013</u>          |
|---|----------------------|----------------------|
| <b>CURRENT LIABILITIES:</b>   |                      |                      |
| Current maturities of notes payable (Note 5 and 13)   | \$ 1,625,365         | \$ 1,167,639         |
| Obligations under capital leases, current portion (Note 7)  | 76,084               | 83,501               |
| Trade accounts payable and disbursements outstanding  | 5,417,568            | 7,726,101            |
| Accrued wages, payroll taxes, and employee benefits withheld                                      | 2,023,354            | 2,000,943            |
| Accrued liabilities (Note 13)   | 1,916,629            | 1,675,883            |
| Deferred income taxes (Note 10)   | <u>2,829</u>         | <u>2,080</u>         |
| <b>TOTAL CURRENT LIABILITIES</b>  | <u>11,061,829</u>    | <u>12,656,147</u>    |
| <br><b>LONG-TERM LIABILITIES:</b>   |                      |                      |
| Notes payable, net of current maturities (Note 5 and 13)  | 10,209,473           | 9,254,639            |
| Obligations under capital leases, net of current portion (Note 7)                                 | 107,098              | 66,475               |
| Accrued interest expense  | 0                    | 166,750              |
| Deferred income taxes (Note 10)   | <u>12,048</u>        | <u>12,056</u>        |
| <b>TOTAL LONG-TERM LIABILITIES</b>  | <u>10,328,619</u>    | <u>9,499,920</u>     |
| <b>TOTAL LIABILITIES</b>  | <u>21,390,448</u>    | <u>22,156,067</u>    |
| <br><b>STOCKHOLDERS' EQUITY:</b>  |                      |                      |
| Common stock, no par value, 1,000,000 shares authorized,<br>222,800 shares issued and outstanding | 11,140               | 11,140               |
| Additional paid in capital (Note 12)  | 3,610,768            | 3,271,537            |
| Unearned ESOP shares (Note 9)   | ( 811,258 )          | ( 927,153 )          |
| Retained earnings   | <u>5,032,066</u>     | <u>440,137</u>       |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>   | <u>7,842,716</u>     | <u>2,795,661</u>     |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>   | <u>\$ 29,233,164</u> | <u>\$ 24,951,728</u> |

See accompanying notes and accountant's report.

NORTH STATE GROCERY, INC.  
STATEMENTS OF INCOME  
For The Year Ended December 27, 2014 and December 28, 2013

|  | 2014                |               | 2013                 |               |
|--|---------------------|---------------|----------------------|---------------|
|  | Amount              | %             | Amount               | %             |
| SALES                                  | \$ 191,462,454      | 100.0         | \$ 182,907,653       | 100.0         |
| COST OF SALES                          | <u>140,483,363</u>  | <u>73.4</u>   | <u>134,789,931</u>   | <u>73.7</u>   |
| GROSS PROFIT                           | 50,979,091          | 26.6          | 48,117,722           | 26.3          |
| Lottery income                         | 70,947              | .0            | 81,946               | .0            |
| Money order fees                       | 16,596              | .0            | 18,078               | .0            |
| Miscellaneous income                   | <u>170,568</u>      | <u>.1</u>     | <u>196,151</u>       | <u>.2</u>     |
| TOTAL OPERATING REVENUES               | 51,237,202          | 26.7          | 48,413,897           | 26.5          |
| OPERATING EXPENSES                     | <u>44,261,232</u>   | <u>23.1</u>   | <u>44,224,316</u>    | <u>24.2</u>   |
| INCOME FROM OPERATIONS (Note 14)       | <u>6,975,970</u>    | <u>3.6</u>    | <u>4,189,581</u>     | <u>2.3</u>    |
| OTHER INCOME (EXPENSES):               |                     |               |                      |               |
| Interest expense                       | ( 638,502 )         | ( .3 )        | ( 853,873 )          | ( .5 )        |
| Gain (loss) on disposal of assets      | ( <u>129,833</u> )  | ( <u>.1</u> ) | ( <u>233,240</u> )   | ( <u>.1</u> ) |
| OTHER EXPENSES, NET                    | ( <u>768,335</u> )  | ( <u>.4</u> ) | ( <u>1,087,113</u> ) | ( <u>.6</u> ) |
| INCOME (LOSS) BEFORE TAXES             | 6,207,635           | 3.2           | 3,102,468            | 1.7           |
| Income tax (expense) benefit (Note 10) | ( <u>99,169</u> )   | ( <u>.0</u> ) | ( <u>69,305</u> )    | ( <u>.0</u> ) |
| NET INCOME (LOSS)                      | \$ <u>6,108,466</u> | <u>3.2</u>    | \$ <u>3,033,163</u>  | <u>1.7</u>    |

See accompanying notes and accountant's report.

NORTH STATE GROCERY, INC.  
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
For The Year Ended December 27, 2014 and December 28, 2013

2014

|                              | Common<br>Stock  | Paid In<br>Capital  | Unearned<br>ESOP<br>Share | Retained<br>Earnings | Total               |
|------------------------------|------------------|---------------------|---------------------------|----------------------|---------------------|
| Beginning<br>Balance         | \$ 11,140        | \$ 3,271,537        | \$ ( 927,153 )            | \$ 440,137           | \$ 2,795,661        |
| Current Period<br>Income     | 0                | 0                   | 0                         | 6,108,467            | 6,108,467           |
| Shareholder<br>Distributions | 0                | 0                   | 0                         | ( 1,896,667 )        | ( 1,896,667 )       |
| ESOP Funding                 | 0                | 339,231             | 115,895                   | 380,129              | 835,255             |
| Ending Balance               | \$ <u>11,140</u> | \$ <u>3,610,768</u> | \$ ( <u>811,258</u> )     | \$ <u>5,032,066</u>  | \$ <u>7,842,716</u> |

2013

|                              | Common<br>Stock  | Paid In<br>Capital  | Unearned<br>ESOP<br>Share | Retained<br>Earnings | Total               |
|------------------------------|------------------|---------------------|---------------------------|----------------------|---------------------|
| Beginning<br>Balance         | \$ 11,140        | \$ 3,145,491        | \$ ( 1,043,048 )          | \$ ( 2,238,812 )     | \$ ( 125,229 )      |
| Current Period<br>Inc(Loss)  | 0                | 0                   | 0                         | 3,033,163            | 3,033,163           |
| Shareholder<br>Distributions | 0                | 0                   | 0                         | ( 457,329 )          | ( 457,329 )         |
| ESOP Funding                 | 0                | 126,046             | 115,895                   | 103,115              | 345,056             |
| Ending Balance               | \$ <u>11,140</u> | \$ <u>3,271,537</u> | \$ ( <u>927,153</u> )     | \$ <u>440,137</u>    | \$ <u>2,795,661</u> |

See accompanying notes and accountant's report.



NORTH STATE GROCERY, INC.  
STATEMENTS OF CASH FLOWS  
For The Year Ended December 27, 2014 and December 28, 2013

|  | <u>2014</u>         | <u>2013</u>         |
|--|---------------------|---------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES:  |                     |                     |
| Net income (loss)  | \$ 6,108,467        | \$ 3,033,163        |
| Adjustments to reconcile net income to<br>net cash provided by operating activities: |                     |                     |
| Depreciation and amortization  | 1,296,753           | 1,150,824           |
| Loss on disposition of fixed assets  | 129,833             | 233,240             |
| (Increase) Decrease in cash surrender value of life insurance                        | ( 50,417 )          | ( 47,520 )          |
| Increase (Decrease) in deferred income tax liability                                 | 741                 | 268                 |
| Changes in current assets and liabilities:   |                     |                     |
| Trade accounts receivable  | 4,442               | ( 9,211 )           |
| Other accounts receivable  | ( 130,090 )         | ( 115,219 )         |
| Merchandise inventory  | ( 123,276 )         | ( 75,559 )          |
| Prepaid expenses   | ( 150,972 )         | ( 20,783 )          |
| Deposits   | 21,295              | 3,011               |
| Trade accounts payable   | ( 2,308,533 )       | ( 300,964 )         |
| Accrued salaries and wages, payroll taxes<br>and employee benefits                   | 22,411              | 103,375             |
| Accrued liabilities  | 240,746             | 202,342             |
| Accrued interest   | ( 166,750 )         | 15,000              |
| NET CASH PROVIDED BY OPERATIONS  | <u>4,894,650</u>    | <u>4,171,967</u>    |
| CASH FLOWS FROM INVESTING ACTIVITIES:  |                     |                     |
| Purchase of liquor license   | 0                   | ( 101,830 )         |
| Proceeds from sale of assets   | 46,907              | 16,961              |
| Purchase of property and equipment   | ( 3,113,800 )       | ( 2,705,831 )       |
| NET CASH (USED) BY INVESTING ACTIVITIES  | ( 3,066,893 )       | ( 2,790,700 )       |
| CASH FLOWS FROM FINANCING ACTIVITIES:  |                     |                     |
| Proceeds from borrowings on notes payable  | 10,243,018          | 429,094             |
| Principal payments on notes payable  | ( 8,830,458 )       | ( 2,566,755 )       |
| ESOP Funding   | 455,126             | 345,056             |
| Proceeds from borrowings on capital leases   | 143,621             | 15,667              |
| Shareholder distributions  | ( 1,516,538 )       | ( 457,329 )         |
| Payment of loan fees   | ( 42,028 )          | ( 105,000 )         |
| Payments on capital leases   | ( 110,415 )         | ( 122,039 )         |
| NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES                                     | <u>342,326</u>      | ( 2,461,306 )       |
| NET INCREASE (DECREASE) IN CASH AND CASH<br>EQUIVALENTS                              | 2,170,083           | ( 1,080,039 )       |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR   | <u>1,363,700</u>    | <u>2,443,739</u>    |
| CASH AND CASH EQUIVALENTS, END OF YEAR   | \$ <u>3,533,783</u> | \$ <u>1,363,700</u> |

See accompanying notes and accountant's report.

NORTH STATE GROCERY, INC.  
NOTES TO THE FINANCIAL STATEMENTS  
December 27, 2014 and December 28, 2013

Note 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**BUSINESS ACTIVITY OR NATURE OF BUSINESS** - The Company engages in the business of retail grocery sales. As of the balance sheet date, operations consisted of stores in nineteen locations throughout Northern California.

**ACCOUNTING PERIOD** - The Company has adopted a 52-53 week fiscal year and has elected to end its accounting period on the last Saturday in December.

**ACCOUNTING METHOD** - The financial statements are presented on the accrual basis of accounting in accordance with generally accepted accounting principles, whereby revenues are recognized when earned, and expenses are recognized when incurred.

**CASH AND CASH EQUIVALENTS** - For purposes of the accompanying statement of cash flows, cash equivalents include time deposits, certificates of deposit, and all highly liquid debt instruments purchased with an original maturity of three months or less.

**CONCENTRATION OF CREDIT RISK** - The Company's financial instruments that are potentially exposed to concentration of credit risk consist primarily of cash and cash equivalents. The Company places its cash and temporary cash investments with high credit quality institutions. At times, such investments may be in excess of the FDIC insurance limit; however, the Company believes that the credit risk is nominal. As of December 27, 2014 and December 28, 2013, the Company had cash and cash equivalents in excess of the FDIC insured limit of \$697,899 and \$350,514, respectively.

**ACCOUNTS RECEIVABLE** - Allowances and reserves for doubtful accounts have been recorded at December 27, 2014 and December 28, 2013. The Company's policy is not to accrue interest on accounts receivable. Accounts are written off as uncollectable at the time management determines that collection is unlikely.

**INVENTORIES** - Merchandise inventory is valued at the lower of cost or market, with cost determined using the first-in, first-out method, or an average cost method.

**PROPERTY AND EQUIPMENT** - Additions to property and equipment are recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets; except for leasehold improvements, which are generally amortized over the lesser of the lease term or the estimated useful lives of the improvements.

Estimated useful lives are as follows:

| <u>Description</u>           | <u>Lives<br/>Years</u> |
|------------------------------|------------------------|
| Store fixtures and equipment | 3-15                   |
| Leasehold improvements       | 6-40                   |

**INTANGIBLE ASSETS** - Intangible assets, including liquor licenses, are stated at cost less accumulated amortization. Amortization has been provided for on a straight-line basis for covenants not to compete and leasehold acquisition costs. Covenants not to compete and leasehold acquisition costs are amortized over the lives of the underlying agreements, on the straight-line method.

Note 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continued)

**GOODWILL** – The Company has classified as goodwill the cost in excess of the carrying value of net assets related to the acquisition of several businesses from their former owners. The company tests goodwill annually for impairment. If goodwill is determined to be impaired, it will be adjusted to its fair value. The value of the goodwill at December 27, 2014 and December 28, 2013 is \$1,054,006 and \$1,054,006, respectively.

**EMPLOYEE STOCK OWNERSHIP PLAN (ESOP)** – The Company accounts for its ESOP in accordance with FASB Accounting Standards Codification (ASC) 718-40, *Employee Stock Ownership Plans*. Accordingly, shares pledged as collateral are reported as "Unearned ESOP Shares" in the Balance Sheet. As shares are released from collateral, the Company reports compensation expense equal to the current market price of the shares.

Dividends on unallocated shares are recorded as compensation expense. Dividends on allocated shares are recorded as a reduction in retained earnings.

**USE OF ESTIMATES** - The preparation of financial statements in conformity with generally accepted accounting principals requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**LITIGATION** - Although the Company is involved in certain legal actions and lawsuits, it is the opinion of management, after consultation with counsel, that the resolution of such actions will not have a material adverse effect on the financial statements.

**INCOME TAXES** – The company has elected to be taxed under the provisions of Subchapter S of the Internal Revenue Code and the California Income Tax Code. Under those tax provisions the Company generally does not pay federal corporate income taxes on its taxable income. Instead, the stockholder's are liable for individual income taxes on his share of the Company's taxable income for both federal and California tax purposes.

The Company, however, is required to pay a 1.5% California corporate tax in addition to the taxes paid to California by its stockholders. Accordingly, the Company accounts for income taxes in accordance with Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) 740. Deferred taxes are provided for accumulated temporary differences due to basis differences for assets and liabilities for financial reporting and income tax purposes.

It is the Company's policy to include interest and penalties assessed by income taxing authorities as a component of income tax expense. No such penalties and interest were incurred during the years ended December 27, 2014 and December 28, 2013. The Company's federal and state income tax returns for 2011 through 2014 are subject to examination (generally for the three years after they are filed and four years for California) by the Internal Revenue Service and the State of California.

FASB ASC 740 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements. FASB ASC 740 details how companies should recognize, measure, present, and disclose uncertain tax positions that have been or are expected to be taken. As such, financial statements will reflect expected future tax consequences of uncertain tax positions presuming the taxing authorities' full knowledge of the position and all relevant facts.

The Company did not have unrecognized tax benefits as of December 27, 2014 and December 28, 2013, and does not expect this to change significantly over the next 12 months.

**PRESENTATION OF SALES TAX** – The State of California and counties within the State impose a sales tax on certain products the Company sells to customers. The Company collects that sales tax from customers and remits the entire amount to the State. The Company's accounting policy is to exclude the tax collected and remitted to the State from revenue and cost of sales.

**ADVERTISING** – Advertising costs are expensed as incurred. Advertising expenses for the years ended December 27, 2014 and December 28, 2013 were \$178,789 and \$280,822, respectively.

## Note 2 PROPERTY AND EQUIPMENT

The following is a summary of property and equipment as of December 27, 2014 and December 28, 2013:

|                        | <u>2014</u>                 | <u>2013</u>                 |
|------------------------|-----------------------------|-----------------------------|
| Fixtures and equipment | \$ 17,296,852               | \$ 17,380,985               |
| Leasehold improvements | 6,566,044                   | 5,926,622                   |
| Vehicles               | 655,645                     | 654,189                     |
| Office equipment       | <u>1,479,344</u>            | <u>1,546,005</u>            |
| <b>TOTAL</b>           | <b>\$ <u>25,997,885</u></b> | <b>\$ <u>25,507,801</u></b> |

## Note 3 INVESTMENT IN REAL ESTATE

In a prior year the Company foreclosed on the note receivable from Violet Plaza, LLC. As a result of the foreclosure, the Company received a piece of real estate valued at \$1,390,651 and had to assume a note payable of \$500,000 payable to various individuals and a profit sharing plan. Also, as a result of the transaction the Company booked an interest expense accrual of \$166,750 related to the note payable the Company assumed. During the current year, the \$500,000 note payable and the accrued interest associated with the transaction were paid off in full.

## Note 4 INTANGIBLE ASSETS

Various covenants not to compete have been acquired and capitalized in the purchase of several store locations and are being amortized using the straight-line method over terms ranging from seven to fifteen years. Costs incurred in connection with obtaining financing through the bank have been capitalized and are being amortized using the straight-line method over the life of the related financing arrangement. Amortization expense for the year ended December 27, 2014 and December 28, 2013 were \$66,554 and \$17,110, respectively.

The Company's intangible assets consisted of the following at December 27, 2014 and December 28, 2013:

|                          | <u>2014</u>              | <u>2013</u>              |
|--------------------------|--------------------------|--------------------------|
| <b>LOAN FEES</b>         |                          |                          |
| Costs                    | 147,028                  | 220,066                  |
| Accumulated amortization | ( <u>9,889</u> )         | ( <u>58,402</u> )        |
|                          | <u>137,139</u>           | <u>161,664</u>           |
| <b>TOTALS</b>            |                          |                          |
| Costs                    | 147,028                  | 220,066                  |
| Accumulated amortization | ( <u>9,889</u> )         | ( <u>58,402</u> )        |
| <b>TOTAL NET</b>         | <b>\$ <u>137,139</u></b> | <b>\$ <u>161,664</u></b> |

Future amortization expenses as of December 27, 2014 are as follows:

### Year Ending:

|                   |                          |
|-------------------|--------------------------|
| December 26, 2015 | \$ 18,703                |
| December 31, 2016 | 16,059                   |
| December 30, 2017 | 13,703                   |
| December 29, 2018 | 13,703                   |
| December 28, 2019 | 13,703                   |
| Thereafter        | <u>61,268</u>            |
| <b>TOTAL</b>      | <b>\$ <u>137,139</u></b> |

## Note 5 NOTES PAYABLE

Notes payable consist of the following at December 27, 2014 and December 28, 2013:

|   | <u>2014</u> | <u>2013</u> |
|---|-------------|-------------|
| Note payable to C & S Wholesale Grocers, Inc., Revolving Credit Line in the amount of \$2,000,000 from November 1 to May 31, and \$1,500,000 from June 1 to October 31, currently matures on July 31, 2014, interest at 7%, no longer in affect at December 27, 2014.                           | \$ 0        | \$ 0        |
| Note payable to National Cooperative Bank, Revolving Credit Line in the amount of \$2,000,000, currently matures on June 1, 2016, interest at 4.25% which is based on the lenders base rate plus 100 basis points, secured by inventory, property and equipment.                                | 0           | 0           |
| Note payable to Ford Motor Credit Company, payable in monthly installments of \$721, including interest at 7.99%, original note \$35,506, due April 2014, secured by vehicle  | 0           | 2,834       |
| Note payable to four individuals and a Profit Sharing plan, payable in monthly interest-only installments of \$3,333, interest is accruing at 11%, only being paid at 8%. The difference is being posted to accrued interest and is due at the loan maturity date of May 2014, secured by land. | 0           | 500,000     |
| Note payable to Ford Motor Credit Company, payable in monthly installments of \$657, including interest at 7.49%, original note \$27,174 due January 2015, secured by vehicle.  | 653         | 8,178       |
| Note payable to R & K Market, payable in monthly installments of \$2,769, including interest at 10%, original note \$60,000, due January 2015.  | 2,746       | 33,978      |
| Note payable to PG&E, payable in monthly installments of \$2,651, including interest at 0%, original note \$98,078, due September 2015, unsecured.  | 23,857      | 55,666      |
| Note payable to PG&E, payable in monthly installments of \$2,564, including interest at 0%, original note \$100,000, due January 2016, unsecured.   | 33,333      | 64,103      |
| Note payable to PG&E, payable in monthly installments of \$2,403, including interest at 0%, original note \$67,273, due June 2016, unsecured.   | 43,247      | 0           |
| Note payable to PG&E, payable in monthly installments of \$2,192, including interest at 0%, original note \$61,368, due October 2016, unsecured.  | 48,218      | 0           |
| Note payable to PG&E, payable in monthly installments of \$2,041, including interest at 0%, original note \$100,000, due December 2016, unsecured.  | 48,980      | 73,470      |

Note 5 NOTES PAYABLE – (Continued)

|  |        |        |
|--|--------|--------|
| Note payable to PG&E, payable in monthly installments of \$2,041, including interest at 0%, original note \$100,000, due December 2016, unsecured.                       | 48,980 | 73,470 |
| Note payable to Ford Motor Credit, payable in monthly installments of \$598, including interest at 4.24%, original note \$26,355, due December 2016, secured by vehicle. | 13,735 | 20,178 |
| Note payable to Ford Motor Credit, payable in monthly installments of \$598, including interest at 4.24%, original note \$26,355, due December 2016, secured by vehicle. | 13,735 | 20,179 |
| Note payable to PG&E, payable in monthly installments of \$1,907, including interest at 0%, original note \$99,183, due January 2017, unsecured.                         | 47,684 | 70,572 |
| Note payable to PG&E, payable in monthly installments of \$1,923, including interest at 0%, original note \$100,000, due March 2017, unsecured.                          | 75,000 | 98,077 |
| Note payable to PG&E, payable in monthly installments of \$1,818, including interest at 0%, original note \$100,000, due May 2017, unsecured.                            | 52,727 | 74,545 |
| Note payable to Plumas Bank, payable in monthly installments of \$661, including interest at 7.24%, original note \$33,100, due July 2017, secured by vehicle.           | 0      | 24,920 |
| Note payable to PG&E, payable in monthly installments of \$1,534, including interest at 0%, original note \$73,615, due September 2017, unsecured.                       | 50,610 | 69,014 |
| Note payable to PG&E, payable in monthly installments of \$2,174, including interest at 0%, original note \$100,000, due September 2017, unsecured.                      | 71,739 | 97,826 |
| Note payable to Ally Bank, payable in monthly installments of \$647, including interest at 4.99%, original note \$34,301, due October 2017, secured by vehicle.          | 20,480 | 27,045 |
| Note payable to Ford Motor Credit, payable in monthly installments of \$513, including interest at 0%, original note \$30,783, due November 2017, secured by vehicle.    | 17,957 | 24,113 |
| Note payable to Ford Motor Credit, payable in monthly installments of \$649, including interest at 4.99%, original note \$34,313, due January 2018, secured by vehicle.  | 22,175 | 28,655 |
| Note payable to Toyota Financial, payable in monthly installments of \$462, including interest at 3.49%, original note \$25,349, due August 2018, secured by vehicle.    | 19,021 | 23,795 |
| Note payable to PG&E, payable in monthly installments of \$1,169, including interest at 0%, original note \$70,131, due November 2018, unsecured.                        | 54,936 | 68,962 |

Note 5 NOTES PAYABLE – (Continued)

|  |           |           |
|--|-----------|-----------|
| Note payable to Toyota Financial Services, payable in monthly installments of \$488, including interest at 3.49%, original note \$26,240, due March 2019, secured by vehicle.  | 22,594    | 0         |
| Note payable to Toyota Financial Services, payable in monthly installments of \$488, including interest at 3.49%, original note \$26,240, due March 2019, secured by vehicle.  | 22,594    | 0         |
| Note payable to Chrysler Corporation, payable in monthly installments of \$463, including interest at 3.69%, original note \$25,288, due April 2019, secured by vehicle.   | 22,184    | 0         |
| Note payable to Toyota Financial Services, payable in monthly installments of \$508, including interest at 0%, original note \$30,461, due August 2019, secured by vehicle.  | 28,430    | 0         |
| Note payable to Toyota Financial Services, payable in monthly installments of \$584, including interest at 1.90%, original note \$33,353, due August 2019, secured by vehicle..  | 31,228    | 0         |
| Note payable to Toyota Financial Services, payable in monthly installments of \$492, including interest at 1.90%, original note \$28,100, due January 2020, secured by vehicle.  | 28,100    | 0         |
| Note payable to C & S Wholesale Grocers, Inc., payable in seven annual installments of \$277,814, interest at 0%, payments to be deducted from the earned annual rebates based on purchase volume, original note \$1,944,695, due May 2021, secured by a second position to National Cooperative Bank in inventory, property and equipment.  | 1,944,695 | 0         |
| Note payable to C & S Wholesale Grocers, Inc., Principal amount of up to \$7,200,000, interest only at 7%. On each anniversary of the loan the principal of the loan shall be forgiven by the lender in an amount equal to the principal forgiveness amount set forth in the loan agreement, provided that purchases are no less than the corresponding amount of merchandise required by supply agreement. Loan matures July 2019, secured by all assets not previously encumbered. | 0         | 4,105,892 |
| Note payable to Lavonne Morgan, related party, related to the purchase of shares for the ESOP, payable in monthly installments of \$15,094, including interest at 7%, original note \$2,633,156, due February 2022, unsecured (See Note 13).   | 1,425,200 | 1,599,567 |
| Note payable to National Cooperative Bank, FSB, payable in sixty monthly installments of \$66,667, plus interest at 5.16% through June 1, 2019, after which 60 payments of principal plus interest at the greater of 5% or the then prevailing Five Year Treasury Rate plus 350 basis points, original note \$8,000,000, secured by inventory, property and equipment.   | 7,600,000 | 0         |

## Note 5 NOTES PAYABLE – (Continued)

Note payable to Richard Morgan, Jr. and Lavonne Morgan, the 54% shareholder and related party respectively, payable in monthly installments of \$27,895, including interest at 8%, original note \$3,800,000, due November 2032, unsecured (See Note 13).

|                      |               |               |
|----------------------|---------------|---------------|
|                      | 0             | 3,257,239     |
| Total Notes Payable  | 11,834,838    | 10,422,278    |
| Less Current Portion | ( 1,625,365 ) | ( 1,167,639 ) |
| LONG-TERM PORTION    | \$ 10,209,473 | \$ 9,254,639  |

Maturities for notes payable for each of the next five years and thereafter are as follows:

### Year Ending

|                     |               |
|---------------------|---------------|
| December 26, 2015   | \$ 1,625,365  |
| December 31, 2016   | 1,566,933     |
| December 30, 2017   | 1,434,615     |
| December 29, 2018   | 1,367,696     |
| December 28, 2019   | 1,345,820     |
| Thereafter          | 4,494,409     |
| TOTAL NOTES PAYABLE | \$ 11,834,838 |

The note agreement with National Cooperative Bank, FSB contains two restrictive covenants, debt service coverage ratio and EBITDA to funded debt. The Company is in compliance with all loan covenants at December 27, 2014.

The note agreements with C & S Wholesale Grocers, Inc. contain a number of restrictive covenants, including net payables to inventory, cash plus inventory per square foot, collateral requirements and EBITDA to funded debt. The Company was in compliance with all loan covenants at December 28, 2013.

## Note 6 OPERATING LEASE COMMITMENTS

The Company occupies all of its store facilities under operating lease agreements, which expire at various dates. Rent expenses under these leases for the year ended December 27, 2014 and December 28, 2013 were \$4,334,192 and \$4,106,023 respectively. Future minimum payments under these leases are as follows:

|                                     |               |
|-------------------------------------|---------------|
| <u>Year Ending</u>                  |               |
| December 26, 2015                   | \$ 3,840,983  |
| December 31, 2016                   | 3,615,540     |
| December 30, 2017                   | 3,492,266     |
| December 29, 2018                   | 2,590,021     |
| December 28, 2019                   | 1,804,794     |
| Thereafter                          | 9,119,020     |
| TOTAL FUTURE MINIMUM LEASE PAYMENTS | \$ 24,462,624 |

Many of these leases have renewal options and require payment of property taxes and insurance. At December 27, 2014, some store leases provide for additional rentals based on a percentage of sales, (ranging from 1% to 2%) if sales exceed a specified amount.



## Note 7 CAPITALIZED LEASES

Leased property under capital leases at December 27, 2014 and December 28, 2013 consists of:

|                               | 2014              | 2013              |
|-------------------------------|-------------------|-------------------|
| Fixtures and equipment        | \$ 791,271        | \$ 658,301        |
| Less accumulated depreciation | ( 496,086 )       | ( 426,410 )       |
| <b>LEASED PROPERTY, NET</b>   | <b>\$ 295,185</b> | <b>\$ 231,891</b> |

The following is a schedule by years of future minimum lease payments for all capital leases, together with the present value of the net lease payments at December 27, 2014:

| <u>Year Ending</u>                                    |                   |
|---|-------------------|
| December 26, 2015                                     | \$ 84,033         |
| December 31, 2016                                     | 59,133            |
| December 30, 2017                                     | 42,896            |
| December 29, 2018                                     | 41,396            |
| December 28, 2019                                     | 6,549             |
| Thereafter  | 0                 |
| <b>Total Minimum Lease Payments</b>                   | <b>243,007</b>    |
| Less amount representing interest and executors costs | ( 59,825 )        |
| <b>Present Value of Net Minimum Lease Payments</b>    | <b>183,182</b>    |
| Less Current Portion                                  | ( 76,084 )        |
| <b>LONG-TERM PORTION</b>                              | <b>\$ 107,098</b> |

## Note 8 PROFIT-SHARING PLAN

The Company has a profit-sharing plan for its eligible employees. The Company maintains a deferred-salary arrangement under Internal Revenue Service code section 401(k). The Company's matching contribution is discretionary; additional contributions may be made at the discretion of the Board of Directors. The expense for the profit sharing plan was \$0 for the year ended December 27, 2014 and December 28, 2013.

## Note 9 ESOP

On January 1, 2006 the company adopted an Employee Stock Ownership Plan for its employees. Employees are eligible to participate after attaining the age of 21, completing one year of service and are credited with at least 1,000 hours of service during the year. All contributions to the plan are made by the employer and are at the employer's discretion. Company stock that was in the company's 401K plan was transferred to the ESOP in 2006. The company expensed \$674,198 as a result of additions to the ESOP during the year ended December 27, 2014. The company expensed \$345,056 as a result of additions to the ESOP during the year ended December 28, 2013.

## Note 10 INCOME TAX EXPENSE

Income tax expense consists of the following for the year ending December 27, 2014 and December 28, 2013:

|                                     | 2014             | 2013             |
|-------------------------------------|------------------|------------------|
| Federal income tax                  | \$ 0             | \$ 0             |
| Federal income tax – deferred       | 0                | 0                |
| State income tax                    | 98,428           | 69,037           |
| State income tax – deferred         | 741              | 268              |
| <b>INCOME TAX EXPENSE (BENEFIT)</b> | <b>\$ 99,169</b> | <b>\$ 69,305</b> |

## Note 10 INCOME TAX EXPENSE – (continued)

Deferred income tax expense arises from timing differences between financial and tax reporting and relates principally to depreciation, amortization and vacation accruals. On July 30, 2006, the Company converted to an S-Corp and is no longer subject to Federal taxes.

The net deferred tax asset (liabilities) in the accompanying balance sheet includes the following amounts of deferred tax assets (liabilities):

|                          | 2014          |               | 2013          |               |
|--------------------------|---------------|---------------|---------------|---------------|
|                          | State         | Total         | State         | Total         |
| Deferred tax current     | \$ ( 2,829 )  | \$ ( 2,829 )  | \$ ( 2,080 )  | \$ ( 2,080 )  |
| Deferred tax non-current | ( 12,048 )    | ( 12,048 )    | ( 12,056 )    | ( 12,056 )    |
| NET DEFERRED TAX         |               |               |               |               |
| ASSETS (LIABILITIES)     | \$ ( 14,877 ) | \$ ( 14,877 ) | \$ ( 14,136 ) | \$ ( 14,136 ) |

The deferred tax liability results from the use of accelerated methods of depreciation of property and equipment and the difference in amortization methods and the items that can be amortized between tax and GAAP. The deferred tax asset results from a difference in inventory basis due to overhead costs capitalized in accordance with tax law and vacation accruals.

## Note 11 STATEMENT OF CASH FLOWS

Cash paid for interest and income taxes for the year ended December 27, 2014 and December 28, 2013:

|                   | 2014       | 2013       |
|-------------------|------------|------------|
| Interest Paid     | \$ 806,356 | \$ 858,616 |
| Income Taxes Paid | \$ 37,100  | \$ 69,037  |

## Note 12 STOCK TRANSACTIONS

During the fiscal year ending July 29, 2006 North State Grocery, Inc., had a 200 for 1 stock split. After the stock split the company agreed to redeem 80,000 shares of stock from its 36% shareholder, effectively buying them out, for a purchase price of \$2,633,156. A note for \$2,633,156 was issued to pay for the purchase with monthly payments of \$15,094 at a 7% interest rate. An annual principal payment of \$100,000 will be paid in addition to the monthly payment above. The transaction resulted in an adjustment of \$2,629,156, which was recorded in the retained earnings account.

Immediately after the purchase of the 80,000 shares of stock they were sold to the ESOP plan for \$2,128,000. The transaction resulted in an increase of \$2,124,000 to additional paid in capital and created a new account, Unearned ESOP Shares, to account for the shares that have not yet been allocated in the ESOP

## Note 13 RELATED PARTY TRANSACTIONS

The Company leases stores and office facilities from a related party. Rent expense for these facilities for the year ended December 27, 2014 and December 28, 2013 were \$612,324 and \$612,324 respectively.

The Company has a covenant not to compete with a related party. The amortization expense under this covenant for the year ended December 27, 2014 and December 28, 2013 was \$0 and \$2,274, respectively.

The Company has an outstanding loan with a related party, related to the purchase of company stock for the ESOP. The balance as of December 27, 2014 and December 28, 2013 is \$1,425,200 and \$1,599,567, respectively.

#### Note 13 RELATED PARTY TRANSACTIONS – (continued)

The Company has an outstanding loan with the 54% shareholder and a related party. The balances as of December 27, 2014 and December 28, 2013 are \$0 and \$3,257,239, respectively. The shareholder and related party secured a note with Rabobank the loan was put in place in 2002 to replace an existing company loan that was secured by company assets. The new loan is secured by non-company assets, all of the proceeds of the loan were placed in the company. Payments are disbursed directly from the corporation to Rabobank. The loan was paid off in 2014 using the proceeds from the new loan with National Cooperative Bank.

#### Note 14 SUBSEQUENT EVENTS

The Company has evaluated subsequent events through July 14, 2015, the date which the financial statements were available to be issued.

## **SUPPLEMENTAL SCHEDULES**

NORTH STATE GROCERY, INC.  
SCHEDULES OF GROSS PROFIT  
For The Year Ended December 27, 2014 and December 28, 2013

|                     | 2014          |           |    | 2013        |           |
|---------------------|---------------|-----------|----|-------------|-----------|
|                     | AMOUNT        | %         |    | AMOUNT      | %         |
| SALES:              |               |           |    |             |           |
| Grocery             | \$ 58,917,375 | 30.8      | \$ | 57,392,336  | 31.3      |
| Grocery DSD         | 26,897,638    | 14.1      |    | 25,971,634  | 14.2      |
| Produce             | 22,883,121    | 11.9      |    | 21,179,331  | 11.6      |
| Liquor              | 17,502,589    | 9.2       |    | 16,229,132  | 8.9       |
| Meat                | 15,165,180    | 7.9       |    | 14,011,145  | 7.7       |
| Meat/Deli           | 14,749,398    | 7.7       |    | 13,718,941  | 7.5       |
| Fuel                | 12,614,270    | 6.6       |    | 12,632,722  | 6.9       |
| Bakery              | 12,623,612    | 6.6       |    | 12,315,840  | 6.7       |
| General merchandise | 6,583,428     | 3.4       |    | 6,274,567   | 3.4       |
| Bakery/Deli         | 4,226,574     | 2.2       |    | 3,813,007   | 2.1       |
| Discounts           | ( 700,731 )   | ( .4 )    |    | ( 631,002 ) | ( .3 )    |
| TOTAL SALES         | 191,462,454   | 100.0     |    | 182,907,653 | 100.0     |
| COST OF SALES:      |               |           |    |             |           |
| Grocery             | 43,249,249    | 22.6      |    | 41,958,847  | 22.9      |
| Grocery DSD         | 19,370,235    | 10.1      |    | 18,876,697  | 10.3      |
| Produce             | 15,959,570    | 8.3       |    | 14,850,902  | 8.1       |
| Liquor              | 13,517,082    | 7.1       |    | 12,637,811  | 6.9       |
| Meat                | 11,538,691    | 6.0       |    | 10,436,128  | 5.8       |
| Meat/Deli           | 10,260,040    | 5.4       |    | 9,619,056   | 5.3       |
| Fuel                | 11,711,731    | 6.1       |    | 12,046,124  | 6.6       |
| Bakery              | 7,597,452     | 4.0       |    | 7,576,274   | 4.1       |
| General merchandise | 4,518,559     | 2.4       |    | 4,262,830   | 2.3       |
| Bakery/Deli         | 2,760,754     | 1.4       |    | 2,525,262   | 1.4       |
| TOTAL COST OF SALES | 140,483,363   | 73.4      |    | 134,789,931 | 73.7      |
| GROSS PROFIT:       |               |           |    |             |           |
| Grocery             | 15,668,126    | 26.6      |    | 15,433,489  | 26.9      |
| Grocery DSD         | 7,527,403     | 28.0      |    | 7,094,937   | 27.3      |
| Produce             | 6,923,551     | 30.3      |    | 6,328,429   | 29.9      |
| Liquor              | 3,985,507     | 22.8      |    | 3,591,321   | 22.1      |
| Meat                | 3,626,489     | 23.9      |    | 3,575,017   | 25.5      |
| Meat/Deli           | 4,489,358     | 30.4      |    | 4,099,885   | 29.9      |
| Fuel                | 902,539       | 7.2       |    | 586,598     | 4.6       |
| Bakery              | 5,026,160     | 39.8      |    | 4,739,566   | 38.5      |
| General Merchandise | 2,064,869     | 31.4      |    | 2,011,737   | 32.1      |
| Bakery/Deli         | 1,465,820     | 34.7      |    | 1,287,745   | 33.8      |
| Discounts           | ( 700,731 )   | ( 100.0 ) |    | ( 631,002 ) | ( 100.0 ) |
| TOTAL GROSS PROFIT  | \$ 50,979,091 | 26.6      | \$ | 48,117,722  | 26.3      |

See accountant's report.

NORTH STATE GROCERY, INC.  
SCHEDULES OF OPERATING EXPENSES  
For The Year Ended December 27, 2014 and December 28, 2013

|                               | 2014          |      | 2013          |      |
|-------------------------------|---------------|------|---------------|------|
|                               | AMOUNT        | %    | AMOUNT        | %    |
| OPERATING EXPENSE:            |               |      |               |      |
| Wages                         | \$ 18,807,920 | 9.8  | \$ 18,484,359 | 10.1 |
| Occupancy costs               | 4,690,929     | 2.4  | 4,789,517     | 2.6  |
| Employee benefits             | 4,371,185     | 2.3  | 4,638,415     | 2.6  |
| Utilities                     | 3,372,845     | 1.8  | 3,354,010     | 1.8  |
| Payroll taxes                 | 1,905,782     | 1.0  | 1,860,505     | 1.0  |
| Bank charges                  | 1,820,011     | 1.0  | 1,704,627     | .9   |
| Operating supplies            | 1,697,647     | .9   | 1,790,826     | 1.0  |
| Worker's compensation         | 1,560,199     | .8   | 1,717,438     | .9   |
| Depreciation and amortization | 1,296,753     | .7   | 1,150,824     | .6   |
| Repairs and maintenance       | 1,019,974     | .5   | 1,179,688     | .6   |
| Promotions                    | 634,661       | .3   | 650,336       | .4   |
| Dues and subscriptions        | 454,980       | .2   | 313,902       | .2   |
| Insurance                     | 444,444       | .2   | 466,440       | .3   |
| Legal and accounting          | 437,335       | .2   | 456,102       | .2   |
| Training                      | 359,262       | .2   | 280,341       | .2   |
| Janitorial and laundry        | 281,564       | .2   | 286,120       | .2   |
| Telephone                     | 252,023       | .1   | 259,517       | .1   |
| Taxes and licenses            | 181,703       | .1   | 149,657       | .1   |
| Advertising                   | 178,789       | .1   | 280,822       | .2   |
| Auto expense                  | 154,322       | .1   | 158,392       | .1   |
| Office supplies               | 132,616       | .1   | 108,515       | .1   |
| Other contract services       | 107,816       | .1   | 48,404        | .0   |
| Security                      | 36,718        | .0   | 17,030        | .0   |
| Travel                        | 24,898        | .0   | 45,946        | .0   |
| Cash shortage                 | 19,989        | .0   | 14,349        | .0   |
| Equipment rent                | 9,586         | .0   | 5,545         | .0   |
| Settlements                   | 4,750         | .0   | 5,767         | .0   |
| Bad debts                     | 2,531         | .0   | 6,922         | .0   |
| TOTAL OPERATING EXPENSES      | \$ 44,261,232 | 23.1 | \$ 44,224,316 | 24.2 |

See accountant's report.