

MCRAE INDUSTRIES INC

Form 10-Q/A

June 27, 2005

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 10-Q/A

(Amendment No. 1)

þ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarter Ended January 29, 2005

OR

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission file number 1-8578

McRae Industries, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

56-0706710

(I.R.S. Employer Identification No.)

400 North Main Street

Mt. Gilead, North Carolina 27306

(Address of principal executive offices)

Telephone Number (910) 439-6147

(Registrant's telephone number, including area code)

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 periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes No

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

Yes No

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

Common Stock, \$1 Par Value Class A: 1,948,153 shares as of March 11, 2005.

Common Stock, \$1 Par Value Class B: 817,846 shares as of March 11, 2005.

INTRODUCTORY NOTE

McRae Industries, Inc. (the Company, which may be referred to as we, us, or our) is filing this Amendment No. 1 (Amendment No. 1) to the Form 10-Q originally filed March 15, 2005 (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. Except as set forth above and for such other changes as required by applicable law, no attempt has been made in this Amendment No. 1 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 Part I, Item 4, this Amendment No. 1 does not reflect events occurring after the date of the original filing on March 15, 2005.

PART I. FINANCIAL INFORMATION

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the attached unaudited condensed consolidated financial statements and notes thereto, and with the Company's Annual Report on Form 10-K/A for the fiscal year ended July 31, 2004 including the financial information and management's discussion and analysis contained therein.

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 ESTIMATES

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, useful lives for intangible assets, and asset valuation allowances (including those for bad debts, inventory, and deferred income tax assets). Our most critical accounting estimates include the following:

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. Actual future performance may be different from management's projections.

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 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 establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we 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 would establish an additional valuation allowance, which could materially impact our financial position and results of operations.

FINANCIAL CONDITION AND LIQUIDITY

Our cash and cash equivalents for the six months ended January 29, 2005, totaled approximately \$13.4 million as compared to approximately \$2.5 million at July 31, 2004. Working capital at the end of the first six months of fiscal 2005 amounted to \$29.2 million, up slightly from \$28.8 million at July 31, 2004.

Currently, we have two lines of credit with a bank totaling \$4.75 million, all of which was available at January 29, 2005. 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 2006. The \$3.0 million credit line expires in November 2005.

We believe that our current cash and cash equivalents, cash generated from operations, and available lines of credit will be sufficient to meet our capital requirements for the remainder of fiscal 2005. Our contractual commitments for fiscal 2005 are approximately \$178,000.

Selected cash flow data for the first six months of fiscal 2005 are presented below (in thousands):

	For the Six Months Ended January 29, 2005
Source (Use) of Cash	
Operating activities:	
Net earnings from continuing operations adjusted for depreciation	\$ 1,579
Accounts receivable	1,482
Inventories	5,520
Accounts payable	(2,202)
Net cash provided by operating activities	5,194
Net cash provided by discontinued operations	9,403

Net cash provided by operating activities for the first six months of fiscal 2005 totaled approximately \$5.2 million. Net earnings from continuing operations, adjusted for depreciation, provided \$1.6 million of cash. Trade accounts receivable provided \$1.5 million of cash primarily attributable to the timing of collection of accounts related to heavy first quarter sales with declining second quarter sales to the U.S. Government. Inventory fell by approximately \$5.5 million primarily the result of higher than anticipated demand for western and work boot products and the decline in military boot requirements by the U.S. Government. The decrease in accounts payable used approximately \$2.2 million of cash primarily attributable to the timing of payments for inventory related to the military boot and western and work boot businesses.

Capital expenditures consisting primarily of production molds for the new bar code product totaled approximately \$113,000.

For the first six months of fiscal 2005, we used approximately \$3.1 million to reduce our long-term debt obligations. Dividend payments amounted to approximately \$272,000.

The decrease in military boot requirements by the U.S. Government may adversely impact the Company's liquidity over the long run.

Off-Balance Sheet Arrangements

We do not currently utilize any off-balance sheet financing arrangements and do not anticipate doing so in the future.

SECOND QUARTER FISCAL 2005 COMPARED TO SECOND QUARTER FISCAL 2004

Consolidated net revenues from continuing operations for the second quarter of fiscal 2005 amounted to \$15.5 million as compared to \$14.9 million for fiscal 2004. This increase in net revenues resulted from higher demand for western and work boot business and bar code business products and was partially offset by lower military boot requirements by the U.S. Government.

Consolidated gross profit for the second quarter of fiscal 2005 amounted to \$3.8 million, an increase of 31.0% over the \$2.9 million reported for fiscal 2004. As a percentage of net revenues, gross profit for the second quarter of fiscal 2005 was 24.5% as compared to 19.5% for the same period of fiscal 2004. This increase in gross profit was primarily due to increased net revenues and higher margins on imported western and work boots.

Consolidated research and development (R&D) from continuing operations for the second quarter of fiscal 2005 amounted to \$289,000 as compared to \$449,000 for the same period of fiscal 2004 as the new bar code product moved from the development stage to the production stage.

Consolidated selling, general and administrative (SG&A) expenses from continuing operations totaled \$2.8 million, an increase of 21.7% over the \$2.3 million reported for the second quarter of fiscal 2004. As a percentage of net revenues, SG&A expenditures for the second quarter of fiscal 2005 were 18.1% as compared to 15.4% for the second quarter of fiscal 2004. This increase in SG&A expenses resulted primarily from higher expenditures for sales commissions, advertising costs, professional fees (including significant costs incurred to achieve compliance with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002), and employee benefit costs, which were partially offset by lower group health insurance costs, primarily attributable to the sale of our McRae Office Solutions business and bad debt expenses.

As a result of the above, consolidated operating profit from continuing operations amounted to \$663,000 for the second quarter of fiscal 2005 as compared to consolidated operating profit from continuing operations of \$170,000 for the second quarter of fiscal 2004.

Bar Code Business

Net revenues for the bar code business for the second quarter of fiscal 2005 amounted to \$2.9 million as compared to \$2.7 million for fiscal 2004. This growth in net revenues resulted primarily from an improved market for technology products. Our new product, which was introduced to the market late in the second quarter, had only a minimal impact on net revenues. However, we expect increased contributions from this product for the remainder of this fiscal year.

Gross profit totaled \$811,000 for the second quarter of fiscal 2005, up from \$792,000 for the same period of fiscal 2004 primarily attributable to the increase in net revenues. As a percentage of net revenues, gross profit fell from 29.3% for the second quarter of fiscal 2004 to 28.0% for the second quarter of fiscal 2005 primarily the result of lower margin resale products comprising a larger percentage of the overall sales mix.

Selling, general and administrative (SG&A) and research and development (R&D) costs for the second quarters of both fiscal 2005 and 2004 amounted to approximately \$1.2 million. R&D costs fell from \$450,000 for the second quarter of fiscal 2004 to \$289,000 for the second quarter of fiscal 2005 as the new bar code product moved from development to production. SG&A expenses increased approximately \$150,000 primarily attributable to higher sales and marketing costs and professional fee expenditures.

As a result of the above, the bar code business loss from operations totaled \$347,000 for the second quarter of fiscal 2005 as compared to a loss from operations of \$370,000 for the second quarter of fiscal 2004.

Military Boot Business

Net revenues for the military boot business for the second quarter of fiscal 2005 amounted to \$6.5 million, a decrease of 12.2% from the \$7.4 million reported for the same period of fiscal 2004. This decrease in net revenues resulted primarily from lower military boot requirements for the U.S. Government (the Government), which was partially offset by slightly higher sales of military boots to Israel.

Gross profit for the second quarter of fiscal 2005 was approximately \$856,000, down from \$923,000 for the second quarter of fiscal 2004 primarily the result of reduced net revenues. As a percentage of net revenues, gross profit grew from 12.5% for the second quarter of fiscal 2004 to 13.2% for the second quarter of fiscal 2005 primarily attributable to lower per unit costs resulting from manufacturing efficiencies associated with increased production levels and a greater proportion of higher margin sales to Israel in the sales mix.

Selling, general and administrative expenses for the military boot business for the second quarter of fiscal 2005 totaled approximately \$569,000, an increase from the \$338,000 reported for the second quarter of fiscal 2004. This increase is primarily attributable to higher group health insurance costs and professional fees due to an increased allocation of overhead expenses due to the sale of our McRae Office Solutions business.

As a result of the above, the military boot business earnings from operations for the second quarter of fiscal 2005 amounted to \$287,000, as compared to \$586,000 reported for the second quarter of fiscal 2004.

On September 30, 2004, the U.S. Government (the Government) exercised the first year option under our Contract with the Government awarded to us on September 30, 2003 (the Contract). Since the completion of the surge requirement in the first quarter of fiscal 2005, the Government has reduced its production requirement and the minimum boot requirement under the Contract has been reduced from 276,460 pair to 138,230 pair. In addition, we were not successful in securing a recent Government contract to supplement our current Contract. As a result, on March 3, 2005 we decided to consolidate all military boot production at our North Carolina plant by closing our Tennessee manufacturing facility effective March 18, 2005. The closing of this plant will impact 120 employees and we estimate will cause us to incur approximately \$130,000 to \$140,000 in severance costs. We are currently evaluating asset

impairment issues (the Tennessee manufacturing facility currently has a book value of approximately \$330,000) and other matters related to the plant closing.

Western and Work Boot Business

Net revenues for the western and work boot business for the second quarter of fiscal 2005 totaled \$5.9 million, an increase of 15.7% over the \$5.1 million reported for the second quarter of fiscal 2004 primarily the result of increased demand for western and work boot products. Indicators point to an emerging fashion trend for these products.

Gross profit for the second quarter of fiscal 2005 amounted to \$1.9 million as compared to \$1.2 million for the second quarter of fiscal 2004 primarily attributable to increased net revenues and higher margins associated with the shift from manufacturing to importing our western and work boots. As a percentage of net revenues, gross profit increased from 23.5% for the second quarter of fiscal 2004 to 32.2% for the second quarter of fiscal 2005.

SG&A expenses for the second quarter of fiscal 2005 totaled \$1.3 million as compared to \$1.2 million for the same period for fiscal 2004. This increase in SG&A expenses resulted primarily from higher expenditures for sales commissions, group health insurance, office supplies, and advertising expenses, which were slightly offset by lower bad debt charges, sales and marketing expenses, and professional fees.

As a result of the above, operating profit for the western and work boot business for the second quarter of fiscal 2005 amounted to \$587,000 as compared to an operating loss of \$38,000 for the second quarter of fiscal 2004.

FIRST SIX MONTHS FISCAL 2005 COMPARED TO FIRST SIX MONTHS FISCAL 2004

Consolidated net revenues from continuing operations for the first six months of fiscal 2005 amounted to \$36.0 million as compared to \$30.9 million for the first six months of fiscal 2004 as all three of our main businesses posted increased net revenues which are further discussed below.

Consolidated gross profit from continuing operations for the first six months of fiscal 2005 totaled \$8.4 million as compared to \$7.0 million for the first six months of fiscal 2004 primarily the result of the increase in net revenues. As a percentage of net revenues, gross profit remained consistent at approximately 23% for the first six months of both fiscal 2005 and fiscal 2004.

Consolidated research and development (R&D) expenses from continuing operations for the first six months of fiscal 2005 was \$629,000, down from \$789,000 reported for the first six months from continuing operations of fiscal 2004. This decrease resulted from the completion of the development stage of the new bar code product, which was introduced to the market in January 2005.

Consolidated selling, general and administrative (SG&A) expenses from continuing operations for the first six months of fiscal 2005 amounted to \$5.9 million as compared to \$4.7 million reported for the same period of fiscal 2004. This 25.5% growth in SG&A costs is primarily the result of increased expenditures for group health insurance, professional fees (including

significant costs incurred to achieve compliance with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002), sales commissions, employee benefit costs and advertising, which were partially offset by decreased expenditures for sales and marketing costs, and bad debt charges.

As a result of the above, net earnings from continuing operations for the first six months of fiscal 2005 totaled \$1.9 million as compared to \$1.4 million reported for the first six months from continuing operations of fiscal 2004.

Bar Code Business

Net revenues for the first six months of fiscal 2005 totaled \$5.7 million, as compared to the \$4.9 million reported for the first six months of fiscal 2004. This growth in net revenues resulted primarily from an improving market for bar code products and the introduction of our new bar code product.

Gross profit for the first six months of fiscal 2005 grew to \$1.6 million, up from \$1.5 million for the first six months of fiscal 2004 primarily attributable to the increase in net revenues. As a percentage of net revenues, gross profit decreased to 28.1% for the first six months of fiscal 2005 as compared to 30.6% reported for the first six months of fiscal 2004. This decline in gross profit resulted primarily from lower margin purchased products being a greater part of the overall sales mix.

SG&A and R&D expenses for the first six months of fiscal 2005 amounted to \$2.4 million as compared to \$2.2 million reported for the first six months of fiscal 2004. R&D expenditures fell \$160,000 for the first six months of fiscal 2005 as compared to the same period of fiscal 2004 as a result of the completion of the new bar code product development phase and movement to the production phase. SG&A expenses totaled \$1.7 million for the first six months of fiscal 2005 as compared to \$1.4 million for the first six months of fiscal 2004. This increase in SG&A expenses resulted primarily from higher expenditures for sales commissions, group health insurance, and professional fees, which were partially offset by lower expenditures for travel expenses.

As a result of the above, the bar code business loss from operations for the first six months of fiscal 2005 amounted to \$798,000 as compared to an operating loss of \$738,000 for the first six months of fiscal 2004.

Military Boot Business

Net revenues for the military boot business for the first six months of fiscal 2005 amounted to \$18.0 million as compared to \$15.7 million for the first six months of fiscal 2004. This 14.6% increase in net revenues is primarily the result of the Government's surge requirement being in effect for a greater portion of the fiscal 2005 period as compared to the fiscal 2004 period.

Gross profit amounted to \$2.6 million for the first six months of fiscal 2005 as compared to \$2.7 million for the first six months of fiscal 2004. As a percentage of net revenues, gross profit decreased from the 17.2% reported for the first six months of fiscal 2004 to 14.4% for the same period of fiscal 2005. These declines in gross profit resulted primarily from lower sales prices associated with the option year contract with the Government.

SG&A expenditures for the first six months of fiscal 2005 amounted to approximately \$1.4 million as compared to \$671,000 for the first six months of fiscal 2004. This increase resulted primarily from higher expenditures for group health insurance and professional fees resulting from increased allocation of overhead expenses due to the sale of our McRae Office Solutions business.

As a result of the above, net earnings from operations for the first six months of fiscal 2005 amounted to \$1.2 million as compared to the \$2.1 million reported for the first six months of fiscal 2004.

Western and Work Boot Business

Net revenues for the western and work boot business for the first six months of fiscal 2005 totaled \$12.0 million up from \$11.0 million for the first six months of fiscal 2004 primarily attributable to stronger demand for western and work boot products.

Gross profit for the first six months of fiscal 2005 amounted to \$4.0 million, a 48.1% increase over the \$2.7 million reported for the same period of fiscal 2004. Gross profit as a percentage of net revenues grew from 24.5% for the first six months of fiscal 2004 to 33.3% for the same period of fiscal 2005. This improvement in gross profit was primarily attributable to increased net revenues and higher margins associated with the shift from manufacturing to importing our western and work boots.

SG&A expenditures for the first six months of fiscal 2005 were approximately \$2.7 million as compared to \$2.5 million for the first six months of fiscal 2004. This increase in SG&A expenses was primarily the result of higher expenditures for sales commissions, advertising, and employee benefit costs. These expenditures were partially offset by lower charges for professional fees and bad debts.

As a result of the above, the western and work boot business earnings from operations for the first six months of fiscal 2005 amounted to \$1.3 million as compared to \$108,000 reported for the first six months of fiscal 2004.

Discontinued Operations

On September 9, 2004, McRae Industries, Inc. entered into a definitive agreement under which it sold substantially all the assets of its McRae Office Solutions, Inc. subsidiary to Connected Office Products, Inc. (COPI). COPI is a subsidiary of TOPAC U.S.A., Inc., which is headquartered in Irvine, California, and operates a network of wholly owned subsidiaries involved in the sales, service, and distribution of office products. Under the terms of the Asset Purchase Agreement, COPI purchased substantially all of the assets of McRae Office Solutions, Inc. for \$11,000,000 subject to adjustment based on the net book value of the acquired assets as of August 28, 2004. Based on the Company's post-closing calculation of the net book value of the acquired assets, the Company expects an approximate \$206,000 reduction in the purchase price, which is reflected in the gain calculation. COPI has reviewed this calculation and has asserted a claim for an additional \$248,000 reduction. We disagree with COPI's assertion and have disputed this claim.

Discontinued operations net revenues for the first six months of fiscal 2005, which consisted of only one month of operations, amounted to \$1.3 million as compared to \$9.9 million for the first six months of fiscal 2004. The net loss from discontinued operations for the first six months of fiscal 2005 and fiscal 2004 amounted to \$270,000 and \$402,000, respectively, net of income tax benefit.

The estimated gain on the sale of the office products business assets totaled approximately \$2.2 million net of a \$1.4 million tax provision.

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In November 2004, Statement of Financial Accounting Standards (SFAS) No. 151, *Inventory Costs*, an amendment of ARB No. 43, Chapter 4 was issued to clarify the accounting for abnormal amounts of facility expense, freight, handling costs, and wasted material (spoilage). We are currently evaluating how this standard applies to our business. SFAS No. 151 will be effective for us in fiscal 2006.

In December 2004, SFAS No. 152, *Accounting for Real Estate Time-Sharing Transactions* was issued to amend several components of FASB Statements No. 66 and No. 67. This standard is not applicable to our business.

In December 2004, SFAS No. 153, *Exchange of Non-Monetary Assets* was issued to amend APB Opinion No. 29 to eliminate the exception for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. We are currently evaluating how this standard applies to our business. SFAS No. 153 will be effective for us in fiscal 2006.

In December 2004, SFAS No. 123 (revised 2004), *Share-Based Payment*, was issued to establish standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. We currently have no plans to participate in transactions of this type. SFAS No. 123 (revised 2004) will be effective for us in fiscal 2006.

FORWARD-LOOKING STATEMENTS

In addition to historical information, this Quarterly 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 4. DISCLOSURE CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed by us in reports that we file under the Securities and Exchange Act of 1934 (the Exchange Act) is recorded, processed, summarized, and reported, within the time periods specified in Securities and Exchange Commission rules and forms. Disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, include controls and procedures designed to ensure that information required to be disclosed by the Company in the reports we file or submit under the Exchange Act is accumulated and communicated to our Company's management, including our Chief Executive Officer and Vice President of Finance, as appropriate, to allow timely decisions regarding required disclosure. It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met.

Under the supervision and with the participation of our management, including the Chief Executive Officer and Vice President of Finance, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, for the reasons discussed below, the Chief Executive Officer and Vice President of Finance concluded that these disclosure controls and procedures were not effective at the reasonable assurance level at such time.

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 condensed consolidated 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 condensed consolidated financial statements and to enable the completion of the independent auditor's audit of our condensed consolidated financial statements.

During the second quarter of fiscal 2005, we initiated certain corrective actions to address certain of the internal control deficiencies that have been identified, including several relating to our accounting for inventory at our military boot operation. Other than these actions, there were no changes in our internal control over financial reporting that occurred during the second quarter of fiscal 2005 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 6. Exhibits

(a) Exhibits

- 3.1 Certificate of Incorporation (Incorporated by reference to Exhibit 3.1 to the registrant's Form S-14, Registration No. 2-85908).
- 3.2 Amendment to the Certificate of Incorporation (Incorporated by reference to Exhibit 3 to the registrant's Form 10-K for the year ended August 1, 1987).
- 3.3 Restated Bylaws of the registrant effective May 29, 2001 (Incorporated by reference to Exhibit 3.3 to the registrant's Form 10-K for the year ended July 28, 2001).
- 31.1 Rule 13a-14(a)/15d-14(a) Certification for D. Gary McRae, President and CEO (Filed herewith).
- 31.2 Rule 13a-14(a)/15d-14(a) Certification for Marvin G. Kiser, Sr., Vice President of Finance (Filed herewith).
- 32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350), for D. Gary McRae, President and CEO (Incorporated by reference to Exhibit 32.1 to the registrant's Form 10-Q for the quarter ended January 29, 2005 filed on March 15, 2005).
- 32.2 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350), for Marvin G. Kiser, Sr., Vice President of Finance (Incorporated by reference to Exhibit 32.1 to the registrant's Form 10-Q for the quarter ended January 29, 2005 filed on March 15, 2005).

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

McRae Industries, Inc.
(Registrant)

Date: June 24, 2005

By: /s/ D. Gary McRae

D. Gary McRae
President and CEO
(Principal Executive Officer)

Date: June 24, 2005

By: /s/ Marvin G. Kiser, Sr.

Marvin G. Kiser, Sr.
(Principal Accounting Officer)