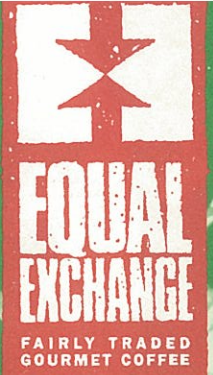


EQUAL EXCHANGE, INC.

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ANNUAL
REPORT
1996





YEAR OF RESULTS & CHALLENGES

Jonathan Rosenthal, Executive Director

Wow! 1996 was an incredible year, one of both flattering results and new challenges. We continued our healthy growth trends: our sales grew to \$3.6 million, our pretax profits were \$350,000, we purchased one million pounds of green beans, we added several new producer groups and we continued to strengthen our staff through training and additional hirings.

Flattering results? 1996 was a turning point in the marketplace. Our success over the past decade has finally begun to spawn imitators. More and more, specialty coffee companies and natural foods retailers began using the language of fair trade in 1996. And, encouragingly, some of them supported their marketing claims by purchasing a portion of their coffee using some of the international fair trade standards.

We encourage all of our coffee peers to embrace the code of practice of the International Federation of Alternative Trade (IFAT) and the Standards of the Fair Trade Labeling Organization International. These are the recognized standards of fair trade used throughout the world. But, at this time, Equal Exchange is the only coffee company in the United States abiding by these principles.

Challenges? In addition to being flattered by our peers, we were challenged by them as well. Fair trade — what was not so long ago seen as a fringe concept — is now seen as a marketing tool. One of the concrete ways we have addressed this challenge is by putting many more resources into marketing. This dramatic new direction, led by a new team, has created a lot of excitement internally and is beginning to make waves in the marketplace.



UNDERSTANDING THE EQUAL EXCHANGE MODEL

Jonathan Rosenthal, Executive Director

To understand the full impact of Equal Exchange, it is necessary to look at the total allocation of funds. Equal Exchange is building a new model of business in which profits are accountable to a variety of stakeholders upholding our mission—not just to those controlling the capital. Funds are distributed as follows:

Trade: We negotiate price directly, and pay at least the current market price directly to the farmer cooperative. When the market is lower than the cost of production for the farmer, we pay a guaranteed minimum price of \$1.26/lb., even when the price goes as low as \$.48/lb., as it did in 1992. In addition, Equal Exchange pays an organic premium of \$.15/lb. plus a quality premium when appropriate.

Credit: We provide up to 60% of the purchase price (or the guaranteed minimum) as credit as soon as contracts are signed prior to the harvest. This credit is available for up to 10 months in advance and is given directly to farmers' cooperatives.

Patronage rebates: Up to 20% of profits are allocated to the members of the Equal Exchange worker co-op (of 20 workers, 12 were members at the close of 1996; approximately 14% will accrue to these 12 members). **Taxes:** We pay corporate taxes on all profits except the patronage rebates paid to Equal Exchange worker-owners.

Dividends: After taxes, we pay outside shareholders a dividend targeted at 5%, if a profit is made. For 1996, we will pay an 8% dividend, due to unusually large profits.

Profits: The remaining profits are retained by Equal Exchange to further the mission of fair trade. For example, if we dissolve the corporation, after all obligations are paid, the remaining funds or assets would be used to support other fair trade activity, such as training for farmer cooperatives.

Here's where Equal Exchange's profits go:

1996		1995	
Gross Sales	\$3,611,293		\$2,902,719
Income*	\$332,934		\$138,882
Charitable Contributions	\$27,200		\$0
8.2%			0.0%
Outside Shareholders' Dividend	\$37,012		\$13,872
11.1%			10.0%
Worker-Owner Rebate	\$38,995		\$15,411
11.7%			11.1%
Income Taxes	\$112,449		\$40,844
33.8%			29.4%
Retained Earnings	\$122,300		\$68,755
35.2%			49.5%

*Income refers to "Income Before Taxes" plus "Charitable Contributions" (from the Income Statement) plus "Worker-Owner Rebate" to illustrate how profits are allocated.

*Eliza Brown, Editor
Erbin Crowell, Design*

EQUAL EXCHANGE, INC. INCOME STATEMENTS

Years Ended December 31, 1996 and 1995

	<u>1996</u>	<u>1995</u>
SALES	\$3,611,293	\$2,902,719
COST OF SALES	<u>2,119,383</u>	<u>1,989,763</u>
GROSS PROFIT	1,491,910	912,956
OTHER OPERATING REVENUE	989	1,508
TOTAL OPERATING REVENUE	1,492,899	914,464
OPERATING EXPENSES	<u>1,136,792</u>	<u>755,905</u>
INCOME FROM OPERATIONS	<u>356,107</u>	<u>158,559</u>
OTHER INCOME (EXPENSE):		
Interest Income	3,352	3,487
Charitable Contributions	(27,200)	—
Loss on Disposal of Assets	(10,198)	—
Interest Expense	<u>(55,322)</u>	<u>(34,406)</u>
TOTAL OTHER INCOME (EXPENSE)	<u>(89,368)</u>	<u>(30,919)</u>
INCOME BEFORE TAXES	266,739	127,640
PROVISION FOR INCOME TAXES	<u>112,449</u>	<u>40,844</u>
NET INCOME	<u>\$ 154,290</u>	<u>\$ 86,796</u>

STATEMENT OF CHANGES IN RETAINED EARNINGS

Years Ended December 31, 1996 and 1995

	<u>1996</u>	<u>1995</u>
BALANCE AT BEGINNING OF YEAR	\$ 164,317	\$ 89,495
NET INCOME	154,290	86,796
DIVIDENDS DECLARED ON PREFERRED STOCK	(13,872)	(11,974)
BALANCE AT END OF YEAR	<u>\$ 304,735</u>	<u>\$ 164,317</u>

Along with our new marketing department and initiative, we have also expanded our sales team, our warehouse team, our administrative team and have begun to build a political organizing campaign around fair trade issues.

To make it possible to do all of this, we also successfully completed our yearlong equity campaign, having raised almost \$300,000 in new equity and added more than 60 new investors to our growing family of people who are investing in social change through fair trade. We further supported our growth by expanding our inventory credit facility through Shared Interest, an alternative lender that works with Third World producers and fair trade organizations.

We also broadened our own scope of support for fair trade by investing 10% of our pretax profits (in the form of charitable contributions) in other initiatives working toward creating more fair trade and a better world.

Finally, we expanded our ability to offer advance credit (through Shared Interest) to our producers and can now advance up to 60% of the purchase price as far as 10 months in advance of shipment. This is a crucial part of the fair trade equation and one that is not offered (as far as we know) by any of our socially responsible competitors. Although this is a financial risk and a lot of work (we make a 25% guarantee of all advances), we remain committed to working with producers to build a sustainable model of trade that creates real structural change in their communities.

In closing, I am happy to report that our small but growing community remains inspired, passionate and energized; we invite you to join us as we continue to stretch what's possible to make another small piece of our dream part of our daily experience.

BOARD OF DIRECTORS

Hilary Abell
Clark Arrington
Bob Burke
Rink Dickinson
Myrna S. Greenfield
Jean Mason
Michael Rozyne
Mark Sweet
Lisa Woodside



DECADE OF FAIR TRADE

Michael Rozyne, Cofounder

After ten years in the fair trade coffee business, we elected to take time out to reflect on our mission, our assumptions and our relationships. Is the fair trade model working? Are we delivering the goods? Beginning in April of 1996, I devoted myself part time to this examination which we called Deepen and Define.

In a series of internal reports, I described the history of the company's fair trade philosophy, policies and practices. Equal Exchange organizer Virginia Berman interviewed 25 farmer/fair trade organizational leaders for their perspective on how fair trade impacts coffee producers. Her findings appear in a report, "Never Underestimate Hope," coauthored by myself and Virginia. The company retreat in 1996 focused on the pros and cons of building a national seal of approval for fair trade — a strategy to increase the volume of fair trade coffee sales by offering the program to other roasters.

To the questions, *Is the model working?* and *Are we delivering the goods?* there are no absolute, hard-edged answers. Equal Exchange and the world fair trade network have a significant positive impact on coffee farming communities. Fair trade interacts with dynamic social, political and economic forces everywhere it is active. The results are as varied as the countries and circumstances in which we operate. While it is clear that the four cornerstones of fair trade — a guaranteed floor price, credit, trade with democratic cooperatives and direct, long-term relationships — are on target, it is also clear there are many ways in which we must explore strengthening our fair trade practices in the decade to come.

Liabilities & Stockholders' Equity

	1996	1995
CURRENT LIABILITIES		
Advances Under Lines of Credit	446,053	—
Short-term Notes	63,000	58,000
Notes Payable to Shareholders	59,600	124,200
Current Portion of Long-Term Debt	110,573	42,710
Accounts Payable	130,434	83,714
Accrued Expenses	69,730	15,162
Patronage Rebates Payable	38,995	15,411
Income Taxes Payable	78,994	38,622
TOTAL CURRENT LIABILITIES	<u>\$ 997,379</u>	<u>\$ 377,819</u>
OTHER LIABILITIES		
Long-Term Debt	278,408	332,392
(net of current portion)	7,634	3,154
Deferred Patronage Rebate	8,508	—
Deferred Income Tax	294,550	335,546
TOTAL OTHER LIABILITIES	<u>\$1,291,929</u>	<u>\$ 713,365</u>
STOCKHOLDERS' EQUITY		
Preferred Stock	550,034	309,613
Common Stock	26,694	21,866
Common Stock Subscriptions Receivable	(4,791)	(8,796)
Retained Earnings	304,735	164,317
TOTAL STOCKHOLDERS' EQUITY	<u>876,672</u>	<u>487,000</u>
TOTAL LIABILITIES & EQUITY	<u>\$2,168,601</u>	<u>\$1,200,365</u>

An in-depth analysis of the 1996 Financial Statements is available on request.

EQUAL EXCHANGE, INC.

BALANCE SHEETS

December 31, 1996 and 1995

	Assets	
	<u>1996</u>	<u>1995</u>
CURRENT ASSETS		
Cash	\$ 435,435	\$ 79,620
Accounts Receivable (net of allowance for doubtful accounts of \$7,587 in 1996 and \$6,994 in 1995)	390,016	375,617
Inventory	1,138,033	570,607
Prepaid Expenses	26,921	7,424
Deferred Income Tax	<u>13,541</u>	<u>—</u>
TOTAL CURRENT ASSETS	<u>2,003,946</u>	<u>1,033,268</u>
PROPERTY & EQUIPMENT		
Furniture, Fixtures and Equipment	221,926	198,306
Leasehold Improvements	<u>48,054</u>	<u>37,488</u>
TOTAL	269,980	235,794
Less Accum. Depreciation	<u>125,042</u>	<u>89,432</u>
NET PROPERTY & EQUIPMENT	<u>144,938</u>	<u>146,362</u>
OTHER ASSETS		
Organizational Costs (net of amortization of \$3,273 in 1996 and \$2,868 in 1995)	12,923	13,328
Lease Acquisition Costs (net of amortization of \$792 in 1996 and \$179 in 1995)	2,274	2,887
Deposits	<u>4,520</u>	<u>4,520</u>
TOTAL OTHER ASSETS	<u>19,717</u>	<u>20,735</u>
TOTAL ASSETS	<u>\$2,168,601</u>	<u>\$1,200,365</u>



Rink Dickinson, Director of Sales

Rink Dickinson
Thomas Hanlon-Wilde
Beth Milardo
Jessie Myszka
Mark Sweet

Annual sales in 1996 reached \$3.6 million, up 24% from 1995. This success was due to several factors, including the position of the world coffee market, continued retention and growth of our loyal account base and the addition of important new accounts. Even more importantly, 1996 saw the smooth transition of two people into and two people out of the department.

Because coffee prices remained high, particularly in the specialty market, Equal Exchange was able to both pay farmers good prices and receive a relatively high price from our customers.

Equal Exchange maintained its record of strong account retention and growth in 1996. Over 95% of our top 100 accounts from 1995 remained strong in 1996. The majority of them grew. This retention, coupled with significant new account growth, led to our impressive growth of over 24%. Noteworthy new customers for the year included: Good Day Market (Maine), Merchant of Vino (Michigan), Horizon Distributors (Canada), Brown University (Rhode Island) and Medici Restaurant (Illinois).

Among the disappointments of 1996 was Hilary Abell leaving the sales team after great success in both New York and Wisconsin. At the same time, Erbin Crowell was recruited into a position in design, marketing and organizing.

Two new farmer representatives joined the department in June; Beth Milardo and Jessie Myszka. Their intelligence, commitment and enthusiasm have greatly strengthened and energized the sales team.

FARMER RELATIONS

Thomas Hanlon-Wilde, Farmers' Representative

This past year saw an exciting amount of progress by many of the small-scale farmer organizations who are the foundation of our fair trade efforts.

In many ways, the Union of Indigenous Communities of the Region of the Isthmus (UCIRI), with whom we have worked since 1990, is a leader among peasant organizations throughout Latin America. In 1996, UCIRI took an important step forward for its members by making fully operational their newly constructed health clinic. This clinic provides affordable primary and emergency care as well as dental care for UCIRI members and the community.

We have also been expanding the services we offer to farmers. The Agrarian Coffee Cooperatives of Northeast Peru (CECOOAC NOR), our trading partners in Peru, was the first group to utilize our expanded pre-shipment financing program. Working with Shared Interest, Equal Exchange now provides small farmer co-ops with 60% of the cost of coffee up to 10 months before shipment. This important program provides farmers with an advance on coffee destined for our customers, and thereby helps these farmers stay out of the cycle of debt and poverty that is common throughout rural communities.

Of course, no year can be free from the grave difficulties which confront small-scale farmers in Latin America. Just this past December, an armed group of men burst into the offices of the Society of Agrarian Reform Cooperatives (SOCRA) and stole computers, fax machines, photocopiers and other valuables, including three years of computer records on pricing and operations. Although no one was physically harmed, the crime deeply affected the group. In coordination with organizations such as Oxfam-America and Mothers & Others, Equal Exchange lent moral support and pledged financial support to SOCRA to assist in recovering from this crime. The event was a potent reminder of how difficult it is to keep and build upon the gains we make through fair trade.

FINANCE

Eliza Brown, Marketing Coordinator

With a record year in the sales and operations departments, the finance team had their hands full keeping up.

For all the cases of coffee that left the warehouse and all the new accounts the sales team brought on board, the finance team had an equal amount of work in providing accounting support for our growth—growth that made us realize that we had *outgrown* our current accounting software system.

Accordingly, we laid concrete plans to install a more comprehensive system. The first phase of the conversion (to be complete Summer 1997) moves us from a single user to a multi-user system that is also more sophisticated and stable. Stage 2 (beginning Autumn 1997) will integrate the sales team with the purchasing and inventory systems—with both the staff and our customers seeing the benefits.

Sparked and managed by Lisa Woodside, our employee and worker-owner benefits were expanded and improved in 1996 to include a 401K plan, subsidized dependent healthcare, dental insurance, a public transit subsidy and other features.

1997 will bring the continuation of our software conversion, an expanded finance team and a new set of challenges. We are looking forward to them all.

*Clark Arrington
Rodney North
Jonathan Rosenthal
Lisa Woodside*

OUR MISSION

Equal Exchange's mission is to build long-term trade partnerships that are economically just and environmentally sound, to foster mutually beneficial relations between farmers and consumers and to demonstrate, through our success, the viability of worker cooperatives and fair trade.

GUIDING PRINCIPLES

- Trade directly with democratically organized small farmer cooperatives
- Provide producers with advance credit for crop production
- Pay producers a guaranteed minimum price that provides a stable source of income as well as improved social services
- Provide high quality food products
- Support sustainable farming practices
- Build a democratically-run cooperative workplace
- Develop more environmentally sound business practices

FAIR TRADE CAPITAL

Clark Arrington, Capital Coordinator

Our private placement offering of Class B Preferred stock netted 65 new shareholders and increased our equity base to in excess of \$550,000. Of the 65 new shareholders, the overwhelming majority were either cutting edge, socially responsible investors or political activists. All of the investors, however, manifested a commitment to fair trade and recognition that a growing fair trade enterprise needs fair trade capital.

For the eighth consecutive year we declared dividends on the Class B Preferred. The 1996 dividend was a record high 8%. We will still continue to target dividends at 5%, but when we experience extraordinary success as we did in 1996, we are committed to sharing that success with all of our stakeholders.

Being the only for-profit, fair trade company in the United States, we are not yet ready to declare success in establishing fair trade as a viable, alternative way of doing business. Yet 1996 brought increased encouragement, optimism and confidence that this goal can be achieved. Last year's profits and new equity capital allowed us to expand our producers from 9 to 12 and also allowed us to launch our first-ever marketing campaign. So far the results have been very encouraging.

As we continue to grow, so will our needs for fair trade capital. Another private offering is planned for Summer 1997. We look forward to this challenge and are encouraged by the investor support and company performance experienced in 1996.

Eliza Brown
Erbin Crowell
Charlotte Mann
Bruce McKinnon

MARKETING

Eliza Brown, Marketing Coordinator

With the hiring of a new marketing director and the formation of a marketing team, 1996 brought the full launch of Equal Exchange's marketing strategy to generate greater awareness of fair trade and our brand name among ethical consumers.

The new design was created to further communicate our credentials and commitment to fairly traded gourmet coffee while capturing the excitement and dynamism of the fair trade movement. The new logo has evolved to visually communicate a message of fairness and equality.

Our first national advertising campaign has generated a surprisingly large response. Designed not as a direct-response ad, but an awareness-building ad, we are thrilled with the amount of direct inquiries we have had so far.

With more than 5 million people in our target market we are confident that the ads in *Utne Reader*, *Sierra Magazine*, *The Nation*, *E the Environmental Magazine*, *Atlantic Monthly* and *Mother Jones* are effectively reaching a large portion of these ethical consumers.

In tandem with the ad campaign and the new design launch, we are using the Internet and public relations tools to generate further awareness of and excitement about fair trade and Equal Exchange. In recent months, articles about fair trade with mention of Equal Exchange have appeared in numerous trade journals as well as *The New York Times* and *The Economist*. Our web page (www.equalexchange.com), while still a new medium for us, looks like a promising piece of our overall strategy.

Virginia Berman
Erbin Crowell
Rink Dickinson
Rob Everts

Ethan Cruze
Truc Dang
L. Tremayne Powell
Mark S. Souza

ORGANIZING

Rink Dickinson, Director of Sales

In late 1996 Equal Exchange began investing in building a consumer movement for fair trade. The organizing team was created as part of the sales department and was staffed by myself, Erbin Crowell, and Virginia Berman, the first person hired specifically as an organizer.

For operations, 1996 was a record year — we shipped 71,589 cases of coffee. Yes, we shipped 71,589 cases of coffee from our 9,500-square-foot warehouse with a staff of four, two of which work behind desks.

While we saw the departure of two loyal and loved warehouse employees, Thuy Truong and Ed Brome — Thuy to become a full-time student and Ed to join the ministry — we saw the arrival of two new staff people, Ethan Cruze and Tremayne Powell. Both Ethan and Tremayne have been valuable to our success and welcome additions to the warehouse team.

In early 1996 we streamlined our delivery system by computerizing everything from timetables to our customers. Other improvements included the upgrading of in-store display units and acrylic bins and private Equal Exchange labeling on most of our brewing and grinding equipment.

We look forward to breaking a new case record in 1997.