



TWENTY-TWENTY VISIONING

Equal Exchange 2005 Annual Report



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.



Felix Emilio Rey Reyes, Coffee Farmer and Member of CEPICAFE Cooperative, Peru



Office of Executive Directors Report

A Vision for the Future

by Rob Everts & Rink Dickinson, Co-directors

Was it fate or just delicious symmetry? As we entered our 20th year, we passed \$20 million in annual sales. Either way, for us, it's a humbling and exhilarating moment.

It was an exceptional year for other reasons as well. We initiated coffee roasting in 2005 within the walls of our new home in West Bridgewater, Massachusetts. While over the years we often contemplated a roasting component, time and again we determined that our energy should be steered to building understanding and demand for Fair Trade. Finally, this past August, we were ready to take the leap. We began roasting and packaging coffee, and thanks to the skill and sweat and stamina of a key team of people here, we are producing thousands of pounds of fabulous quality coffee each day.

2005 was also a year of historic growth. We outpaced even the previous year's dollar increase by growing sales from \$16.5 million to \$20.7 million. After charitable contributions and worker-owner patronage disbursements, we realized a net income before taxes of \$991,255. Roasted coffee sold grew by another 500,000 pounds, from 2.5 million pounds in 2004 to 3 million pounds last year.

Our payments to farmer co-ops reflected the higher commodity price of coffee. Despite the increase in pounds, Fair Trade above-market premiums were down from \$1.6 million the previous year to \$515,000 last year. That is a decrease we can feel good about! The higher the world commodity price, the smaller the spread between that and the Fair Trade price, which means that more farmers get a higher price for their beans. In 2005, we also arranged for an unprecedented \$1.7 million in pre-shipment financing to our producer partners.

The strong sales increase was distributed across sectors, from Natural Foods to the Interfaith base. Also contributing significantly to this dollar growth was the explosion of the chocolate line. Chocolate bars, hot cocoa, and cocoa powder together totaled \$2 million in sales. At the same time, we devoted considerable energy to planning dramatic expansions to our chocolate, sugar, and tea lines, with several new products that will be introduced in the fall of 2006.

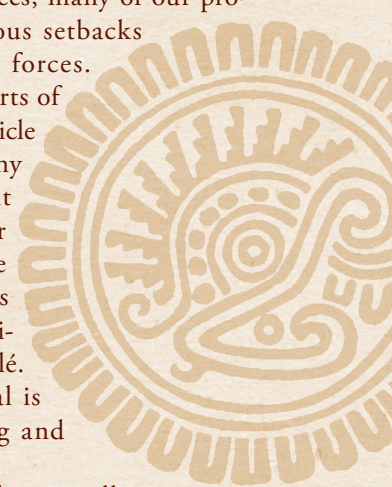
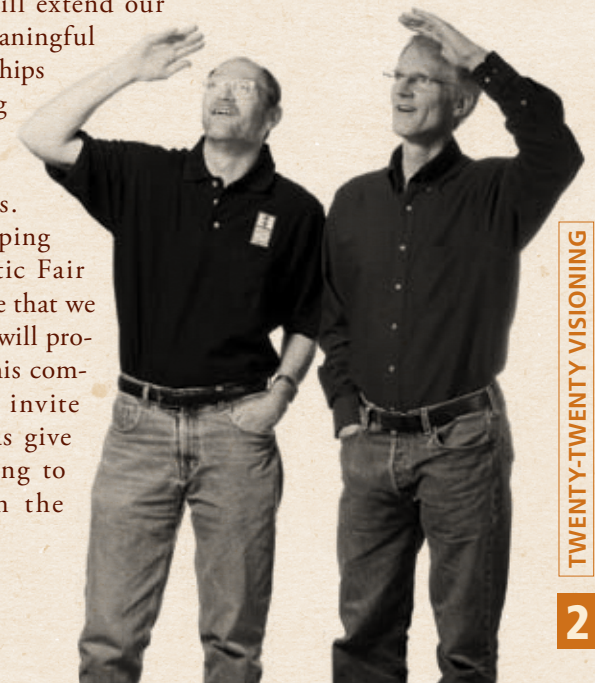
We are more in tune than ever before with how fortunate we are to count on remarkable relationships with our outside investors who now number more than 400. We have always needed capital to fund green bean inventory and

other key elements to grow the business; but the purchase of a new building along with roasting and packaging equipment over the past two years has brought this need into sharp relief. So it was reassuring that coming off an unprecedented year for new equity investments in 2004, we raised an additional \$833,000 last year. This helps us to remain on extremely solid footing.

Despite higher commodity prices, many of our producer partners have suffered serious setbacks owing to natural and man-made forces. Hurricane Stan devastated many parts of Mexico and Central America (see article on page 7). Over the past year, many small-scale farmers have also felt threatened by the policies of our Fair Trade certifier, FLO (Fair Trade Labeling Organization) as it continues to recruit large plantations and multinational corporations such as Nestlé. We believe that the Fair Trade seal is masking the reprehensible trading and labor practices of these companies.

For good reason, then, our 20th year will not only be a year of celebrating remarkable achievements together, but it will also be a time of reflection and setting our course for decades to come. Included in this visioning process, we will extend our practice of meaningful trade relationships to struggling family farmers here in the United States.

We are developing a new domestic Fair Trade initiative that we are optimistic will produce results this coming year. We invite you to help us give deeper meaning to Fair Trade in the years ahead.





Quality Control Report

Beyond a Common Vocabulary

by Beth Ann Caspersen, Quality Control Manager

Our quest to find great-tasting coffees has taken us all over the world. In the coffee industry it's common knowledge that unless you source the highest quality green beans your roasting efforts will be in vain. So we go to great lengths to buy fantastic green beans and to accentuate their characteristics through roasting.

Equal Exchange plays a unique role in the coffee industry as an importer and roaster. We continue to deepen our relationships with cooperatives by interacting in person with their quality control personnel—often referred to as “cuppers”—and through developing a common vocabulary. In both 2004 and 2005, we traveled abroad to meet with our producer partners and cuppers and, in turn, their coffee quality personnel visited us here in the U.S.

As part of this intercultural exchange, we host a week-long course called “Cooperación en Calidad” (Cooperation in Quality). So far six Nicaraguans and two Peruvians have joined us in sorting and roasting a variety of green beans, discussing the characteristics of the aroma and the flavor attributes of each coffee, and developing our common

vocabulary. The course focuses on the quality-control protocol for Equal Exchange with an emphasis on the terms used to evaluate different bean characteristics, such as acidity, mouth-feel, and special flavor attributes such as tangerine or jasmine. The hands-on experience is invaluable for all involved.

However, perhaps just as important is the broader cultural interaction for the cuppers while they're in the U.S. Built into the program are visits to partner stores so that the cuppers can view firsthand what their co-op's coffee looks like in a retail environment. The specialty coffee market in the U.S. is complex, with different roast colors and blends, and drink styles from espressos to lattes—not to mention the packaging and other marketing materials. The look and feel of their coffee in a store provides cuppers with a context and more information to bring back to their cooperatives.

Carmen Vallarejos from the CECOCAFEN cooperative in Nicaragua, who participated in the week-long course, reported that it had a huge impact on her understanding of coffee characteristics and U.S. consumer coffee preferences. “Equal Exchange is like another member of our family,” she said. “The relationship is excellent; they learn from us and we learn from them.”



Travel Journal

Co-ops Are Movements

by Kelly Fain, Marketing Director at the Hendersonville Community Co-op, North Carolina

“My life was changed by seeing the way coffee farmers in other parts of the world live, and \$8 or \$9 for a pound of coffee is so little when you consider how very difficult it is to produce coffee. My trip made me so proud to be a part of a cooperative. Over here in the U.S. we may see co-ops as an alternative to shopping at a retail grocery store. In Chiapas, the co-ops are a way for people to organize themselves and begin to have the basic human rights that they were denied when their own native land was sold by the government out from under them. It is a way for them to get a fair price for their trade, and have a relationship with a company that knows who they are and what their lives are like. Because of this, co-ops are movements, and the coffee producers I met were fiercely loyal to Equal Exchange and to their own co-ops.”



Sales Report

The Relationships that Shape Fair Trade

by Tom Hanlon-Wilde, West Division Sales Manager

The Sales Department maintained its high rate of growth in 2005, led by increases of 30% or more in each of three sectors: private label sales, chocolate products, and web store sales. The diversity of Equal Exchange's markets not only represents the fundamental soundness of our business, but also the broad-based support for our mission.

Cooperatively owned food stores are the backbone of our grocery retail customer base. Direct sales to such customers of bulk and brewed coffee grew 11% over the prior year to a record \$3.5 million in 2005. Other family-owned and independent food stores represented an additional \$1.5 million in revenue.

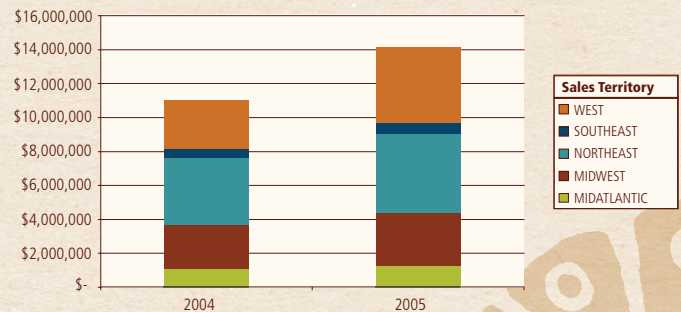
The strong relationships between Equal Exchange worker-owners and the managers of these stores are most evident during the producer trips organized by Phyllis Robinson and Kristin Howard. In 2005, owners and managers of 19 stores traveled with Equal Exchange staff to visit farmers in Mexico, Nicaragua, and Peru. The lasting power of these trips was clear last year in Peru when farmer Enrique Mellado stopped me to ask about Kevin Stormans, the owner of Bayview Thriftway, who had participated in a trip four years ago. Enrique told me that he and his family still remembered "the tall guy," and wanted me to tell Kevin that they would never forget him.

Strong relationships were also at the center of our fastest growing markets: direct sales to consumers and sales to Fair Trade shops. Both of these channels provide consumers with the most informative and interactive way to learn about and support small-scale producers. Direct sales to consumers doubled to just under a half a million dollars thanks to a strong boost from an expanded web store program led by Cara Ross, Ann Cherin, and Gary Goodman.

In explaining the 22% growth in sales to Fair Trade shops, Program Coordinator Lilla Woodham credited the managers at the independent Fair Trade stores, noting, "They work hard, they've created awareness for Fair Trade in their areas, and in doing that they're creating a market for small-scale farmers."

Growth in the private label and distributor channels of trade was driven by the introduction of new products. In 2005, these sectors grew 88% and 54% respectively, over the sales levels recorded a year ago. Sales of our hot cocoa mix and chocolate bars in 2005 far exceeded expectations.

Wholesale & Distributor Sales Top 5 Major Regions



On the other hand, corporately owned supermarket chains had another disappointing year in 2005. A careful evaluation of our sales to these mainstream stores was completed in mid-2005, and as a result of this the Sales Department began diverting resources away from mainstream supermarkets to more fully take advantage of opportunities within direct sales, Fair Trade shops, and the cooperative food sector.

Sales in the food service channel held steady in 2005 compared with the previous year. Lynsey Miller was hired as Food Service Manager late in 2005 to strengthen and refocus the program. Perhaps the most important accomplishment was the linking up of independent coffee shops in Philadelphia and Ohio. According to Food Service team member L.J. Taylor, "We always talk about better coffee through better relationships; this was an extension of that idea. It's really powerful to see coffeehouse business owners working together."

Building a strong Fair Trade network of consumers, retailers, worker-owners, and farmers by working together was at the heart of Equal Exchange's success in 2005. As we look toward our 20th year in 2006, it will be those relationships that drive and shape the Fair Trade market.



Production Report

The World's Largest Worker-Owned Coffee Roastery

by Todd Caspersen, Director of Purchasing

It's still pretty astounding to think that Equal Exchange has become the largest Alternative Trade Organization (ATO) roaster and the largest worker-owned coffee roastery in the world. When we finished installing the roasting facility in West Bridgewater last August, history was made.

If you've tasted a cup of Equal Exchange coffee recently, you've probably experienced the results of the new roastery. The cast-iron Probat roaster, which emigrated from

Europe to join us early last summer, combines proven technology with creative alchemy to yield spectacular coffees.

During the past year, we've devoted much thought to how to assess the new roastery. Roasting can be viewed as an artisan activity that progresses through different stages, the two main factors being time and temperature. One's life as a roaster is calculated in minutes, your day broken into short intervals between important process steps like "first crack," "second crack," "de-stoning," and so forth. Those minutes are marked by a fast drop in temperature at the beginning of each roast followed by a variable rise in temperature during the middle and end of the roast.

However, the key factors of time and temperature are ultimately not how we appraise the roastery's overall performance. We measure this according to three different criteria. First and foremost are quality standards. Are we

producing a superlative coffee experience for our customers? The answer is a resounding "yes." Taste our new Black Silk Espresso, or any of the coffees that we offer, and you will be seduced by the various flavors and textures found throughout our entire coffee line. Think heavy-bodied fruits; sweet, bitter chocolates; and sparkling acidity. Think "aah."

Next we assess the bottom line. Are we succeeding financially? When you examine the 2005 financial tables at the end of this report, you will see for yourself that our endeavor is going very well. The payoff over time will be even better.

Finally, and perhaps most importantly, we have to appraise our roastery's function in the context of Equal Exchange's mission and guiding principles: are our functions and roles consistent with one another? Again, flying colors. Equal Exchange offers the cooperative movement in the U.S. a worker-controlled supply chain from farm to consumer. It is a coffee roastery that is wholly owned by its workers.

These three measures paint in broad strokes what is really a complex process involving a unique pairing of people and machines. Our dedicated roasting team consists of Steve, Thomas, Beth Ann, Antonio, Domingos, and Rick. Each of these folks deserves a huge amount of credit for getting the roastery up and running—and for keeping it going—so that it produces lovely, fragrant beans every week. *Abrazos para todos.* Thanks to the team, to the banks, to you, the investors, for helping our amazing worker-owned roastery get off the ground.





Interfaith Report

Many Small Steps: 53,668,656 Cups

by Anna Utech, Interfaith Director

“In Fair Trade the main support comes from the consumer. With each cup of Fair Trade coffee that you drink, Fair Trade will advance. Fair Trade is walking forward with small steps.”
—Santiago Dolmus, CECOCAFEN Cooperative, Nicaragua.

Many small steps make a big difference. Each cup of fairly traded coffee brewed for fellowship hour, a holiday bazaar, or special event is a small step forward, and last year people of faith combined those steps into leaps and bounds. During 2005, thousands of faith communities’ creative energy and effort helped extend the benefits of Fair Trade to more farmers. Interfaith Program participants purchased more than 425 tons of fairly traded products, 373 tons of which were fairly traded coffee—enough to brew 53,668,656 cups.

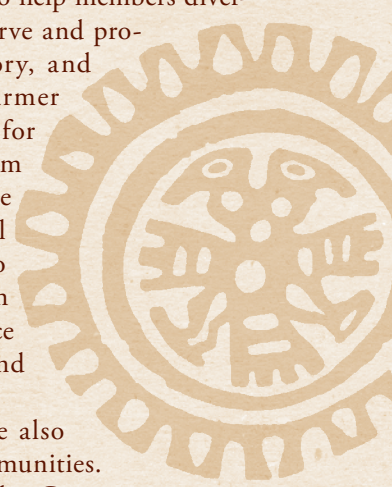
By the end of the year more than 2,500 new congregations and faith-based schools, camps, and organizations had joined the program bringing our grand total to more than 14,160 participants. Our sales to faith communities and organizations grew 34%, largely through partnership with faith-based relief, development, and human rights organizations. This work in partnership continues to empower communities of faith to be agents of change in the global economy, strengthen small-scale farmer cooperatives, and set a high standard for what Fair Trade can be as the movement grows.

As the Interfaith Program grows, so do the relationships between our faith-based partners and farmer cooperatives (see bottom). Small Farmer Funds are one part of how

partners connect with farmer cooperatives. For every pound of fairly traded products that participants purchase through one of our partnerships, Equal Exchange makes a donation to that partner’s Small Farmer Fund.

With these donations Lutheran World Relief (LWR) has made grants to a new ecotourism project in the CECOCAFEN coffee cooperative in Nicaragua. CECOCAFEN started the project to help members diversify their income sources and preserve and promote their region’s culture, history, and natural diversity. LWR Small Farmer Funds have helped fund training for women farmers to manage the tourism project. The American Friends Service Committee’s New England Regional Office channels these donations to their Latin America Action Program to promote economic and social justice for workers in the global south and immigrants to the U.S.

Our faith-based partners have also responded to crises in farming communities. In the fall of 2005 the United Methodist Committee on Relief donated \$70,000 in relief and reconstruction aid to coffee cooperatives devastated by Hurricane Stan in Mexico, Guatemala, and El Salvador, helping those cooperatives meet their members’ basic needs so they can rebuild and get back to farming as soon as possible.



Sisters Make the Movement Grow

Women make Fair Trade happen, and last July Equal Exchange and Lutheran World Relief (LWR) launched Organic Sisters’ Blend in honor of those very women. This special LWR Coffee Project blend from farmer cooperatives in Nicaragua and Peru honors women coffee farmers and cooperative leaders in the developing world and Lutheran women who are advocates for Fair Trade in the U.S.

We are grateful for our work in partnership with:

American Friends Service Committee
Brethren Witness/Washington Office
Lutheran World Relief

Mennonite Central Committee U.S.
Presbyterian Church (USA)
Unitarian Universalist Service Committee

United Church of Christ Justice and Witness Ministries
United Methodist Committee on Relief

2005: Producer Partner Highs & Lows

by Phyllis “Felicia” Robinson, Producer Relations Coordinator

2005 was a mixed year for our farmer co-op partners. Some experienced tremendous success and growth: increased sales to the Fair Trade market, greater national and international recognition for the quality of their products, social improvements and business advances for their cooperatives. For others, natural disasters—made worse by poverty and human degradation of the environment—caused loss of life, trauma, and economic hardship from which it will take years to recover.

In August, the Organization of Agrarian Coffee Cooperatives of the Sandia Valley (CECOVASA) opened its second coffee quality lab, this one located in the Inambari Valley, in southern Peru. This new lab, together with the first one opened in 2003, will greatly assist the organization in its efforts to continue learning about and improving the quality of coffee coming from the Quechua and Aymara producers in both regions in which they work. CECOVASA was also pleased to announce that it won first, fourth, and fifth prizes in a national Peruvian cupping competition last year.

The Organization of Agrarian Coffee Cooperatives (COCLA), was named “an exemplary model business in the Inca region” for its consistent offer of high-quality coffee and its contribution to economic development in the Cusco region. Over the past decade, COCLA has succeeded in developing different regional blends of coffee and has consistently been recognized in the international market for the high quality of its cup.

In Northern Peru, the Organization of Piuran Coffee Growers (CEPICAFE) exported approximately 40,000 bags of coffee and 10,000 bags of sugar to European, U.S., and Canadian markets. After three years of negotiations with governmental regulatory agencies, CEPICAFE finally succeeded in obtaining a license to build its own processing plant, which will be used to sort and process coffee, and also to homogenize and pack sugar and process fresh fruit and jams. Owning a processing plant will enable CEPICAFE to have more control over the quality of coffee beans, help lower production costs, and increase its income by allowing it to

offer third-party services, and provide many jobs to members of the surrounding communities.

CEPICAFE, along with two other Fair Trade coffee cooperatives, was also proud to inaugurate “Norandino,” an exciting new savings and credit cooperative that will provide benefits to thousands of coffee families throughout northern and northeastern Peru. All over the world, farmers confront the virtually impossible challenge of obtaining credit from financial institutions. Lack of credit keeps farmers living hand to mouth, often forcing them off their land. And so in October, Norandino was launched to serve as a sustainable financial business that will offer timely and competitive financial loans in accordance with the needs of the farmers themselves.

In Nicaragua, our Fair Trade cooperative partners continue to thrive. Cafenica, the Association of Cooperatives of Small Coffee Producers of Nicaragua, which groups together 10 organizations representing 6,500 small scale producers, now produces 15% of all of Nicaragua’s coffee. During each of the past three years, Cafenica’s cooperative members have won many of the top places in the international Cup of Excellence competition. Last year, these cooperatives won 18 of the top 35 prizes, with the first prize going to our trading partner, the Organization





for the Cooperative Development of the Segovias, (PRODECOOP).

The Indigenous and Environmental Federation in Chiapas, Mexico (FIECH), opened up its first Fair Trade café in Tuxtla Gutierrez. Like many coffee-producing countries, Mexico has not yet developed a domestic market for high-quality coffee. FIECH is hoping to change this in the city of Tuxtla Gutierrez by opening up a café across the street from a popular city park where many pedestrians come out to hear the nightly marimba music. The café has tables both inside and out on the sidewalk, and serves Fair Trade coffee, cappuccino and lattes, along with delicious cakes and pastries.

But in spite of these successes, several other partner groups have had to devote energy and resources to reconstruction following a variety of natural disasters. After the devastating Asian tsunami that occurred in December 2004, our partners in Indonesia, The Gayo Organic Coffee Farmers Association (PPKGO), had a stressful year, spending the first half of 2005 bringing emergency supplies to the survivors and internally displaced people in Aceh. During the second half of the year they were able to use reconstruction money to design and implement close to one hundred individual reconstruction projects in conjunction with other community groups and NGOs operating in Sumatra. Altogether they have succeeded in repairing or building numerous local processing facilities, which

include wet mills with depulpers, fermentation tanks, and drying patios. They have also repaired and rebuilt homes, offices, community schools, religious facilities, and community water and sanitation systems.

2005 was also a traumatic year for hundreds of thousands of farmers throughout El Salvador, Guatemala, and southern Mexico. In October, Hurricane Stan swept through the region with torrential rains that lasted anywhere from four days to an entire week. The rains caused landslides and flooding that killed approximately 1,000 people, destroyed tens of thousands of homes, flooded villages, and—in the case of Guatemala—buried entire communities under layers of mud. The floods also washed away dozens of roads and bridges, cutting off many of the most hard-hit communities from communication and emergency relief efforts which were underway. One of our partners in Guatemala, Manos Campesinas, has estimated that total damages to the grassroots cooperatives reached \$700,000. Owing to the strong relationships that Equal Exchange has developed with our cooperative partners, a number of co-ops contacted us as soon as the hurricane hit.

As a result, Equal Exchange was able to alert our allies and to raise funds for emergency relief. The United Methodist Committee on Relief, our long-time Interfaith partner, quickly wired funds to four of our cooperative partners for a total of \$70,000. Equal Exchange raised an additional \$8,000 through its staff, friends, families and consumer allies. The cooperatives we work with estimate that they lost approximately 25-30% of their coffee production capacity. And since coffee trees take three to five years to bear fruit, the hurricane will continue to cause serious economic hardship during this harvest and for many years to come.



Worker-Owner Report

Worker-Owner Education and Training

by Jessica Hiemenz, Education Committee Chair

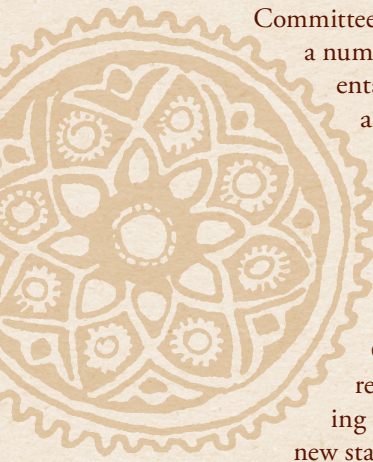
The Equal Exchange Education Committee plays a key role for the worker-owner body. It's charged with the important work of providing co-op members with resources and enough training so they feel that they can participate in elections for Board of Directors representatives and the Worker-Owner Coordinator. Members also need to feel sufficiently informed to make wide-ranging decisions about the organization's by-laws and changes in operations. The Education

Committee oversees this education and training in a number of ways, through presenting an orientation for new employees; maintaining and updating curriculum; supporting the Mentor Program; offering "Exchange Time," an educational program every Thursday; providing an onsite book and video library; and, distributing worker-owner manuals.

In 2005, the Education Committee made huge strides through redeveloping its structure and by providing leadership roles for worker-owners and new staff members. The Mentor Program is an example of an important program that stimulates staff participation and unification. When an employee starts

at Equal Exchange, a mentor is assigned to provide guidance and support throughout the first year. Each year the Education Committee holds a mentor-buddy breakfast where all mentors and their buddies can socialize with one another while they learn more about the history and governance of the company. This past fall, the Education Committee also initiated a Co-op Celebration in which representatives from various cabinets, committee members, and volunteer groups explained their roles and available opportunities to the rest of the staff.

The Equal Exchange Education Committee still has a number of issues to tackle. A handful of employees now work outside of our main office—several in different time zones—and are unable to call in for our 9 a.m. Eastern Standard Time meetings. We also have employees who speak English as their second language, and right now almost all of our materials are printed in English. In the next year the Education Committee will continue to figure out solutions to these challenges and to provide as much education and training as possible to its members. 2005 was a major restructuring year for the Education Committee. We accomplished a great deal and we're looking forward to what's coming up next.





Capital Report

With a Lot of Help from our Friends

by Alistair Williamson, Investment Coordinator

Rapid growth is exhilarating, and Equal Exchange has been experiencing rapid growth for four straight years. To change the world—and it's a big place—we need to continue to grow. But to ensure that we don't suddenly deflate, that growth is best guided by mission, blended with prudence, and leavened with cash. Equal Exchange has a history of conservative planning and is intrinsically mission-driven—so I'm going to focus here on cash.

We had a very successful year in 2005 raising \$833,000 in investments and \$250,000 in mission-based loans with the help of three important partners. In February 2005 we also closed an investment round, over \$400,000 of which was raised through Progressive Asset Management, a socially responsible investment brokerage firm. More than 70 of their clients are now our shareholders, making them the largest single community of our investors.

In April, Mennonite Mutual Aid made a \$250,000 low-interest loan. Mennonite groups have been fair traders

since the 1940s and are a core partner in our Interfaith Program. We're truly happy to work together and further strengthen our mutual missions.

To close the year, Trillium Asset Management, an independent investment firm that concentrates solely on socially responsible investing, facilitated more than \$330,000 of investments from their clients. Trillium, which was founded just a few years before us, is employee-owned, zealous in their mission, and chocolate-loving—what could be better?

For me personally, discovering and getting to know people throughout the world of finance who are committed to making money work for good has been a great joy of this job. Thanks to everyone.

Board Report

And the Visioning Continues

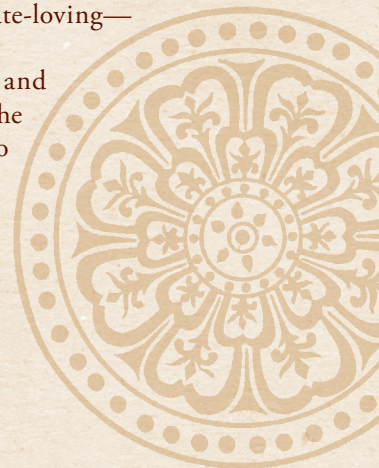
by Beth Ann Caspersen, Board of Directors Chair

Our growth as a Fair Trade cooperative has been stunning over the past four years. Each year we prepare for growth and continue to surpass our budgetary expectations. Most of our success has stemmed from our sales in coffee, but diversity in products and innovative ideas are propelling us straight to our twenty-year vision. After two years of brainstorming, challenging the status quo, and settling on a star to shoot for, we will be reaching a common vision in 2006. Our vision promises challenges and further jaw dropping feats to be achieved through the efforts of pioneers with their eyes on the prize. I promise you that the results of this visioning process will be worth the wait.

Equal Exchange is measured as a business through our growth and a set of expectations that we call the "Measures of Success" (MOS). These measures include traditional measures of business, and measures that were crafted specifically to evaluate aspects of our cooperative model and dedication

to Fair Trade. We surpassed these goals in 2005 and will begin to reevaluate the MOS in 2006, looking beyond our role in the coffee market, \$25 million in sales, and the meaning of diversification. We will work in unison with our new twenty-year vision and will delve deeper into the heart of the slightly unknown.

In addition to our visioning work and the MOS, the Equal Exchange Board of Directors approved a new and very exciting offering of an Equal Exchange certificate of deposit (CD) through Wainwright Bank. Our alliance with Wainwright enables Equal Exchange supporters to purchase CD's for \$1,000 or more and provides our cooperative with the capital that is raised through the offering. We look forward to watching this new investment strategy flourish, and to witnessing the creative minds at Equal Exchange continue to innovate into the future.





Business Model

The Equal Exchange Model

by Erbin Crowell, Domestic Fair Trade Coordinator

As a worker cooperative and Fair Trade organization, Equal Exchange represents an innovative way of doing business that seeks to balance the interests of many stakeholders—including farmers, workers, investors and lenders, our customers and community, and the earth. Because traditional financial statements don't recognize all of the ways that we advance our mission, we separate out some of the unique aspects of our model below:

Fair Trade with Farmers. Equal Exchange trades directly with small farmer cooperatives, paying a fair price and supporting sustainable agriculture. For example, we share risk with farmers by paying at least a guaranteed minimum price of \$1.26 per pound of green coffee, and \$1.41 for organic, no matter how low the world market may fall. As part of our pricing structure, we also pay farmer co-ops a "Fair Trade Premium," which is allocated by their members to development projects in their communities. In 2005, Equal Exchange also facilitated

more than \$1.7 million in advance payment to farmer co-ops through our partnerships with EcoLogic, Shared Interest, and the Green Development Fund, providing them with capital for credit and other programs for their members. And through our Interfaith Program, we allocate additional funding to our faith-based relief and development partners for support of Fair Trade, small farmers' organizations and their communities.

Worker Cooperation. Core to our mission is the building of a democratic, participatory, and equitable worker cooperative. For example, Equal Exchange has a limited pay ratio of just 3 to 1 from the highest-paid employee to the lowest. We also allocate a share of our profits (or losses) to worker-owners through patronage dividends. Once preferred shareholders have received their annual dividend, up to 20% of the remaining profits are distributed among worker-owners.

A Fair Return on Outside Capital. Equal Exchange is committed to fair relationships with outside lenders and

investors who help us accomplish our mission. Our preferred shareholders have first claim on Equal Exchange's post-tax profits. These shareholders receive a targeted annual dividend of 5% on their investment. Over the past 17 years, investor dividends have averaged just over 5%.

Community. Equal Exchange pays corporate taxes on all profits except those allocated to worker-owners. We also allocate 10% of profits each year to charitable organizations supporting the cause of Fair Trade and cooperation. Recipients of grants in 2005 included the Federation of Southern Cooperatives, Marketplace of India, Red Tomato, Provender Alliance, the National Family Farm Coalition, Grassroots International, and Farm Aid.

Reinvestment in Our Model. Remaining profits are reinvested in Equal Exchange for the furthering of our mission and enterprise. These assets are held in trust by the members of our co-op, and in the event that our organization were to cease operations all assets remaining after the payment of all obligations would be donated to another Fair Trade organization to further the movement for trade justice and cooperation.

CONTRIBUTION TO OUR MISSION

	2005	2004
Gross Sales	\$20,779,047	\$16,534,986
Fair Trade Commitment	2005	2004
Total Fair Trade Purchases	\$8,061,914	\$5,835,385
Above Market Prices (Coffee Only) ¹	\$297,139	\$1,575,000
Fair Trade Premium (Coffee Only)	\$218,600	\$125,000
Small Farmer Funds	\$118,000	\$123,000
Advance Payment Facilitated	\$1,700,000	\$1,300,000
Allocation of Income	2005	2004
Revised Income ²	\$1,176,478	\$431,437
Charitable Contributions	\$65,035	\$35,000
Class B Shareholder Dividends	\$120,324	\$96,259
Member Patronage Dividends	\$120,188	\$38,140
Taxes	\$415,000	\$155,000
Retained Earnings (Reinvested)	\$455,931	\$107,038

¹Because world coffee market prices have recovered somewhat in 2005, the amount allocated to "Above Market Prices" is less than in previous years.

²In order to show allocation of profits, "Revised Income" is "Income Before Taxes" plus "Charitable Contributions" plus "Member Patronage Dividends".



Financial Report

Income Statement

by Denise Abbott, Director of Finance and Administration

In 2005, Equal Exchange changed its financial reporting as it became subject to the Uniform Cost Capitalization (UNICAP) rules for both financial and tax reporting purposes. The new regulations resulted from the fact that first, the company's average revenue for the preceding three years exceeded \$10 million; and second, when Equal Exchange became a roaster, its status changed from distributor to manufacturer.

Under the UNICAP rules, Equal Exchange is required to capitalize direct costs and a portion of indirect costs related to inventory produced or acquired for resale. As a result, \$270,000 in expenses were moved from expenses and reclassified as a part of the inventory.

As you review the 2005 financial statements you will also notice that while there was a 25% increase in sales there is only a nominal increase in the receivables. The sales projections resulted in additional green coffee beans purchased, which means that we have a substantial increase in the inventory on hand.

Finally, with the purchase of the building and the roaster, Equal Exchange's balance sheets have become a greater focal point of our financial activity. We were able to use our new assets to increase equity investments and to leverage more funding from banks and other institutions.

	2005	2004	2003
Total Sales	\$20,779,000	\$16,535,000	\$13,007,000
Cost of Sales (coffee/tea/chocolate, roasting, packaging, shipping)	\$12,701,000	\$10,263,000	\$7,878,000
Operating Expenses (marketing, sales, administration, education)	\$6,621,000	\$5,639,000	\$4,486,000
Other Expenses (primarily interest on loans)	\$466,000	\$275,000	\$163,000
Total Costs	\$19,788,000	\$16,177,000	\$12,527,000
Income Before Taxes	\$991,000	\$358,000	\$480,000
Taxes	\$415,000	\$155,000	\$195,000
Shareholder Dividends	\$120,000	\$96,000	\$82,000
Annual Retained Earnings (reinvested in the business)	\$456,000	\$107,000	\$203,000

Featured Investor

Investment and Change

by Robin Polastri, Investor

I first heard about Equal Exchange at the Presbyterian Women's Gathering in 2003, and helped to convince our church to switch to Fair Trade coffee on Sundays. This also led to a youth project to sell fairly traded products. At the same time, my husband Gian and I were looking to align our investments with our values. We were thrilled to learn that we could support Fair Trade—and earn a fair return—by investing in Equal Exchange. Eighteen months later, I was part of Equal Exchange's first investor trip to El Salvador. We visited the coffee co-ops, and studied the history of the country and learned about Fair Trade firsthand. This

inspired me to share my experiences with more church congregants who, last year, became part of a church-wide trip to El Salvador hosted by Equal Exchange. On my return some things had changed. Two years ago, during my home stay, Meghan Hubbs and I shared a hammock during a long, cold, sleepless night. This time the same family welcomed me back—but there was a mattress! Not only did the church trip inspire everyone who took part, but it also opened up a passionate discussion about socially responsible investing. I am changed, and determined to change the world: one cup of coffee, one bar of chocolate, one investor at a time.



Audited Financial Statements

These financial statements are extracts from the Audited Financial Statements of Equal Exchange, Inc. for the years ending December 31, 2004 and 2005. This independent audit was conducted in accordance with auditing standards generally accepted in the United States of America by the firm of Morris and Morris P.C., Certified Public Accountants of Needham Heights, Massachusetts.

BALANCE SHEETS ASSETS

	Dec. 31, 2005	Dec. 31, 2004
CURRENT ASSETS:		
Cash and Equivalents	\$239,854	\$805,724
Accounts Receivable - Trade, Net Allowance for Doubtful Accounts of \$100,00 in 2005 and \$83,000 in 2004	1,443,128	1,461,109
Note Receivable - Other	20,500	35,000
Inventories	5,578,710	4,094,456
Prepaid Expenses and Other Current Assets	84,283	109,506
Prepaid Income Taxes	-	92,378
Deposits	-	168,345
Deferred Income Tax Asset	<u>96,000</u>	<u>88,000</u>
TOTAL CURRENT ASSETS	<u>7,462,475</u>	<u>6,854,518</u>
PROPERTY AND EQUIPMENT, at Cost		
	6,982,421	4,077,454
Less: Accumulated Depreciation and Amortization	<u>(901,824)</u>	<u>(591,163)</u>
	6,080,597	3,486,291
DEFERRED FINANCING COSTS		
	81,119	38,103
OTHER ASSETS		
	<u>22,774</u>	<u>12,018</u>
TOTAL ASSETS	<u>\$13,646,965</u>	<u>\$10,390,930</u>

BALANCE SHEETS Continued LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:	
Notes Payable - Lines-of-Credit	
Mortgages and Notes Payable, Current Portion	
Capital Lease Obligations	
Accounts Payable - Trade	
Accrued Expenses and	
Other Current Liabilities	
Patronage Rebates Payable	
TOTAL CURRENT LIABILITIES	
MORTGAGES AND NOTES PAYABLE, Non-Current Portion	
CAPITAL LEASE OBLIGATIONS, Non-Current Portion	
DEFERRED INCOME TAXES	
COMMITMENTS AND CONTINGENCIES	
TOTAL LIABILITIES	
STOCKHOLDERS' EQUITY:	
Preferred Stock; Authorized 299,800 Shares; Issued and Outstanding, 139,791 Shares in 2005 and 107,188 Shares in 2004	
Common Stock; Authorized 200 Shares; Issued and Outstanding, 70 Shares in 2005 and 60 Shares in 2004	
Less: Common Stock Subscriptions Receivable	
Retained Earnings	
TOTAL STOCKHOLDERS' EQUITY	
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	

STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

SALES
COST OF SALES
GROSS PROFIT
OPERATING EXPENSES
INCOME FROM OPERATIONS
OTHER (EXPENSE) INCOME:
Interest Expense
Charitable Contributions Expense
Interest Income
Loss on Disposal of Equipment
INCOME BEFORE INCOME TAXES
PROVISIONS FOR INCOME TAXES:
Current
Deferred
NET INCOME
RETAINED EARNINGS, Beginning of Year
Less: Preferred Stock Dividends
RETAINED EARNINGS, End of Year

STATEMENTS OF CASH FLOWS

			<u>Dec. 31, 2005</u>	<u>Dec. 31, 2004</u>
		CASH FLOWS FROM OPERATING ACTIVITIES:		
		Cash Received from Customers	\$20,797,028	\$16,443,278
		Cash Paid for Operating Expenses	(19,891,427)	(15,795,608)
		Interest Paid	(410,634)	(239,080)
		Income Taxes Paid	(60,359)	(300,160)
		Interest Received	9,978	4,075
		Net Cash Provided by Operating Activities	<u>444,586</u>	<u>112,505</u>
		CASH FLOWS FROM INVESTING ACTIVITIES:		
		Cash Paid for Purchase of Property and Equipment	(1,345,310)	(712,802)
		Cash Paid for Deferred Financing Costs	(80,619)	(57,512)
		Cash Repaid on Note Receivable	<u>14,500</u>	<u>5,000</u>
		Net Cash (Used for) Investing Activities	<u>(1,411,429)</u>	<u>(765,314)</u>
		CASH FLOWS FROM FINANCING ACTIVITIES:		
		Proceeds from Issuance of Preferred Stock	833,804	709,815
		Proceeds Received from New Long-Term Debt Borrowings	250,000	-
		Proceeds Received from Dividend Reinvestment	81,952	66,001
		Proceeds Received from Common Stock Subscriptions	30,036	30,009
		Net Cash (Payments) Advances Notes Payable - Lines of Credit	(518,671)	606,693
		Preferred Stock Dividends Paid	(120,324)	(96,259)
		Cash Paid to Reduce Mortgage and Notes Payable	(85,336)	(116,949)
		Cash Paid to Reduce Capital Lease Obligations	(38,188)	-
		Cash Paid to Redeem Preferred Stock	(19,166)	(11,990)
		Cash Paid to Redeem Common Stock	(13,134)	(5,500)
		Repayment of Notes Payable - Stockholder	<u>-</u>	<u>(9,600)</u>
		Net Cash Provided by Financing Activities	<u>400,973</u>	<u>1,172,220</u>
		NET (DECREASE) INCREASE IN CASH	(565,870)	519,411
		CASH AND EQUIVALENTS, Beginning of Year	<u>805,724</u>	<u>286,313</u>
		CASH AND EQUIVALENTS, End of Year	<u>\$239,854</u>	<u>\$805,724</u>
		RECONCILIATIONS OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
		Net Income	\$576,255	\$203,297
		Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
		Depreciation and Amortization	337,508	227,553
		Loss on Disposal of Equipment	-	4,948
		Changes in Assets and Liabilities:		
		Decrease (Increase) in Accounts Receivable - Trade	17,981	(91,708)
		(Increase) in Inventories	(1,484,254)	(465,524)
		Decrease (Increase) in Prepaid Expenses and Other Assets	25,223	(36,564)
		Decrease (Increase) in Prepaid Income Taxes	92,378	(92,378)
		(Increase) in Deferred Income Tax Asset	(8,000)	(20,000)
		Decrease in Other Assets	-	4,470
		Increase in Accounts Payable	447,964	177,692
		Increase in Accrued Expenses and Other Current Liabilities	73,451	221,524
		Increase (Decrease) in Accrued Income Taxes Payable	202,263	(112,782)
		Increase in Accrued Patronage Rebates Payable	95,817	11,977
		Increase in Deferred Income Taxes Payable	<u>68,000</u>	<u>80,000</u>
		Total Adjustments	<u>(131,669)</u>	<u>(90,792)</u>
		Net Cash Provided by Operating Activities	<u>\$444,586</u>	<u>\$112,505</u>
<u>Dec. 31, 2005</u>	<u>Dec. 31, 2004</u>			
\$1,524,011	\$2,042,682			
373,044	186,324			
236,738	-			
978,467	530,503			
702,614	426,900			
<u>185,288</u>	<u>89,471</u>			
4,000,162	3,275,880			
3,162,672	3,184,728			
1,116,386	-			
148,000	80,000			
-	-			
<u>8,427,220</u>	<u>6,540,608</u>			
3,844,270	2,947,680			
188,515	160,399			
(68,490)	(57,276)			
<u>1,255,450</u>	<u>799,519</u>			
<u>5,219,745</u>	<u>3,850,322</u>			
<u>\$13,646,965</u>	<u>\$10,390,930</u>			
<u>Dec. 31, 2005</u>	<u>Dec. 31, 2004</u>			
\$20,779,047	\$16,534,986			
<u>12,701,086</u>	<u>10,262,936</u>			
8,077,961	6,272,050			
<u>6,621,015</u>	<u>5,638,800</u>			
<u>1,456,946</u>	<u>633,250</u>			
(410,634)	(239,080)			
(65,035)	(35,000)			
9,978	4,075			
-	(4,948)			
<u>(465,691)</u>	<u>(274,953)</u>			
<u>991,255</u>	<u>358,297</u>			
355,000	95,000			
<u>60,000</u>	<u>60,000</u>			
<u>415,000</u>	<u>155,000</u>			
576,255	203,297			
799,519	692,481			
<u>(120,324)</u>	<u>(96,259)</u>			
<u>\$1,255,450</u>	<u>\$799,519</u>			



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