



***EQUAL EXCHANGE, INC. AND SUBSIDIARY***

***Consolidated Audited Financial Statements  
and  
Supplementary Information***

***Years Ended December 31, 2011 and 2010***

**LMHS, P.C.**

*Certified Public Accountants and Advisors*

EQUAL EXCHANGE, INC. AND SUBSIDIARY  
CONSOLIDATED AUDITED FINANCIAL STATEMENTS  
AND SUPPLEMENTARY INFORMATION  
YEARS ENDED DECEMBER 31, 2011 AND 2010

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LMHS, P.C.

*Certified Public Accountants and Advisors*

INDEPENDENT AUDITORS' REPORT

To The Stockholders  
Equal Exchange, Inc.  
West Bridgewater, Massachusetts

We have audited the accompanying consolidated balance sheets of Equal Exchange, Inc. (a Massachusetts corporation) and OKE USA Fruit Company (a subsidiary) as of December 31, 2011 and 2010, and the related consolidated statements of earnings, retained earnings, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Equal Exchange, Inc. and subsidiary as of December 31, 2011 and 2010, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*LMHS, P.C.*

LMHS, P.C.

March 7, 2012

EQUAL EXCHANGE, INC. AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS  
DECEMBER 31, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
<u>ASSETS</u>		
CURRENT ASSETS:		
Cash	\$ 757,429	\$ 823,669
Accounts Receivable	2,849,063	2,655,707
Inventory	15,117,041	8,290,646
Notes Receivable, Current Portion	34,800	17,538
Prepaid Expenses and Other	800,338	535,330
Deferred Income Taxes	<u>367,496</u>	<u>377,496</u>
	19,926,167	12,700,386
PROPERTY AND EQUIPMENT, NET	5,979,771	6,653,683
OTHER ASSETS:		
Intangible Assets, Net	182,212	211,153
Investments	43,360	68,513
Notes Receivable, Net of Current Portion	<u>39,249</u>	<u>38,501</u>
	<u>264,821</u>	<u>318,167</u>
	<u>\$ 26,170,759</u>	<u>\$ 19,672,236</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
CURRENT LIABILITIES:		
Notes Payable - Lines of Credit	\$ 3,463,192	\$ 567,952
Current Portion of Long-Term Debt	1,253,534	121,793
Accounts Payable and Accrued Expenses	2,198,802	1,539,374
Corporate Income Taxes Payable	271,632	
Patronage Rebates Payable	<u>376,382</u>	<u>147,000</u>
	7,563,542	2,376,119
LONG-TERM LIABILITIES:		
Long-Term Debt, Net of Current Portion	2,616,521	3,228,784
Deferred Income Taxes	<u>850,000</u>	<u>900,000</u>
	3,466,521	4,128,784
MINORITY INTEREST IN CONSOLIDATED SUBSIDIARY	165,324	163,276
STOCKHOLDERS' EQUITY:		
Preferred Stock, \$1 Par Value; 390,116 Shares		
Authorized; Issued and Outstanding, 390,116		
Shares in 2011 and 333,262 Shares in 2010	10,728,960	9,156,382
Common Stock, \$1 Par Value; 200 Shares		
Authorized, Issued and Outstanding, 108 Shares		
in 2011 and 107 Shares in 2010	318,753	313,343
Less: Common Stock Subscriptions Receivable	( 59,480)	( 60,682)
Retained Earnings	<u>3,987,139</u>	<u>3,595,014</u>
	<u>14,975,372</u>	<u>13,004,057</u>
	<u>\$ 26,170,759</u>	<u>\$ 19,672,236</u>

See Notes to Consolidated Financial Statements

EQUAL EXCHANGE, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF EARNINGS AND RETAINED EARNINGS  
YEARS ENDED DECEMBER 31, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
NET SALES	\$ 46,819,829	\$ 36,525,856
COST OF SALES	<u>33,617,786</u>	<u>23,659,316</u>
GROSS PROFIT	13,202,043	12,866,540
OPERATING EXPENSES	<u>11,350,116</u>	<u>11,234,758</u>
EARNINGS FROM OPERATIONS	1,851,927	1,631,782
OTHER INCOME AND (EXPENSE):		
Interest Income	7,346	14,832
Interest Expense	<u>( 387,182)</u>	<u>( 323,662)</u>
	<u>( 379,836)</u>	<u>( 308,830)</u>
EARNINGS BEFORE INCOME TAXES AND MINORITY INTEREST	1,472,091	1,322,952
INCOME TAXES (CREDIT):		
Current:		
Federal	500,000	336,000
State	<u>189,000</u>	<u>148,000</u>
	689,000	484,000
Deferred:		
Federal	( 55,000)	38,000
State	<u>15,000</u>	<u>56,000</u>
	<u>( 40,000)</u>	<u>94,000</u>
	649,000	578,000
MINORITY INTEREST IN INCOME OF CONSOLIDATED SUBSIDIARY	<u>2,049</u>	
NET EARNINGS	821,042	744,952
RETAINED EARNINGS, BEGINNING	3,595,014	3,174,783
PREFERRED STOCK DIVIDENDS PAID	<u>( 428,917)</u>	<u>( 324,721)</u>
RETAINED EARNINGS, ENDING	<u>\$ 3,987,139</u>	<u>\$ 3,595,014</u>

See Notes to Consolidated Financial Statements

EQUAL EXCHANGE, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
YEARS ENDED DECEMBER 31, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net Earnings	\$ 821,042	\$ 744,952
Noncash Items Included in Net Earnings:		
Deferred Income Taxes (Credit), Net	( 40,000)	( 132,496)
Depreciation and Amortization	979,992	915,949
(Increase) Decrease in:		
Accounts Receivable	( 193,356)	( 469,939)
Inventory	( 6,826,395)	3,083
Prepaid Expenses and Other	( 265,008)	( 120,191)
Increase (Decrease) in:		
Accounts Payable and Accrued Expenses	659,428	449,671
Corporate Income Taxes Payable	271,632	
Patronage Rebates Payable	<u>229,382</u>	<u>( 274,875)</u>
	( 4,363,283)	1,116,154
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Additions to Property and Equipment	( 275,077)	( 531,480)
Increase in Intangible Assets	( 2,062)	( 203,047)
Decrease in Investments, Net	25,153	313,348
(Increase) Decrease in Notes Receivable, Net	<u>( 18,010)</u>	<u>274,996</u>
	( 269,996)	( 146,183)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
New Borrowings:		
Notes Payable - Lines of Credit	5,888,215	500,000
Long-Term Debt	620,000	
Debt Reduction:		
Notes Payable - Lines of Credit	( 2,992,975)	( 556,976)
Capital Lease Obligations		( 1,125,216)
Long-Term Debt	( 100,522)	( 390,070)
Increase in Minority Interest	2,048	163,276
Proceeds From Common Stock Subscriptions	44,582	47,495
Proceeds From Issuance of Preferred Stock	1,432,684	1,036,500
Proceeds From Dividend Reinvestment	277,169	212,418
Redemption of Preferred Stock	( 137,275)	( 70,965)
Redemption of Common Stock	( 37,970)	( 14,710)
Preferred Stock Dividends Paid	<u>( 428,917)</u>	<u>( 324,721)</u>
	4,567,039	( 522,969)
<b>NET INCREASE (DECREASE) IN CASH</b>	( 66,240)	447,002
<b>CASH - BEGINNING</b>	<u>823,669</u>	<u>376,667</u>
<b>CASH - ENDING</b>	<u>\$ 757,429</u>	<u>\$ 823,669</u>

See Notes to Consolidated Financial Statements

EQUAL EXCHANGE, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
YEARS ENDED DECEMBER 31, 2011 AND 2010  
(Continued)

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

	<u>2011</u>	<u>2010</u>
Cash Paid During The Year For:		
Interest	<u>\$ 364,865</u>	<u>\$ 334,347</u>
Income Taxes	<u>\$ 425,600</u>	<u>\$ 445,917</u>

See Notes to Consolidated Financial Statements

EQUAL EXCHANGE, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

1. Principles of Consolidation - The consolidated financial statements include the accounts of Equal Exchange, Inc. and its majority-owned subsidiary OKE USA Fruit Company (the Company). All significant intercompany transactions and balances have been eliminated in these consolidated financial statements. At January 1, 2010, Equal Exchange, Inc. had a 45 percent interest in OKE USA Fruit Company, which was accounted for under the cost method. On December 28, 2010, Equal Exchange, Inc. acquired an additional 45 percent interest in OKE USA Fruit Company. For financial reporting purposes, this transaction was treated with an effective date of December 31, 2010, and, in accordance with FASB ASC 805-10-25-6, the operating activity of the subsidiary for 2010 is not included as a component of the consolidated statement of earnings and retained earnings.
2. Organization - Equal Exchange, Inc. was organized under the General Laws of the Commonwealth of Massachusetts as a worker cooperative and commenced operations in 1986. All voting stock is owned by employees of Equal Exchange, Inc., each of whom is limited to one share. Equal Exchange, Inc. distributes a portion of its annual profits to the worker-owners as a patronage rebate. Worker-owners may decide to extend membership to an employee after one year of service; employees may not continue with Equal Exchange, Inc. without becoming stockholders. Equal Exchange, Inc. also offers non-voting preferred stock, which pays a variable, noncumulative, annual dividend, targeted at five percent of the value of the preferred stock.

OKE USA Fruit Company was incorporated under the laws of the state of Delaware on May 18, 2006.

3. Operations - Equal Exchange, Inc. is engaged in the manufacturing and distribution of coffee, tea, chocolate and related products nationally, with its main office located at 50 United Drive, West Bridgewater, Massachusetts. Equal Exchange, Inc. was formed to establish equitable trade relationships between small farmers around the world and U.S. consumers. Equal Exchange, Inc. buys green coffee beans directly from farmers' cooperatives and imports the coffee to the United States. Equal Exchange, Inc. pays a price that covers the cost of production, provides farmers a living wage, and includes a social premium to the cooperative, in accordance with internationally established fair trade practices. Tea, cocoa and sugar are also purchased according to fair trade practices. Equal Exchange, Inc. performs coffee roasting and packaging production at its West Bridgewater, Massachusetts facility. In addition, Equal Exchange, Inc. contracts for coffee roasting, cocoa and chocolate manufacturing, and product packaging, and sells and distributes its products nationally through distributors, retail stores, restaurants and solidarity organizations. To better serve its customers, Equal Exchange, Inc. purchases and loans coffee grinders, brewers and retail display equipment to its customers.

OKE USA Fruit Company wholesales produce to customers in the United States while establishing a model for international trade that fosters farmer ownership, fair trade practices and environmental protection.



EQUAL EXCHANGE, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

A. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (Continued)

4. Method of Accounting - The Company's policy is to prepare its consolidated financial statements on the accrual method of accounting whereby revenues are recognized when earned and expenses are recognized when incurred. This method of accounting conforms to generally accepted accounting principles.
5. Concentration of Credit Risk - Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of deposits in excess of federally insured limits, accounts receivable, and credit guarantees for certain vendors. These risks are managed by maintaining all deposits in high quality financial institutions, obtaining signed sales orders, and/or establishing credit limits with all customers, and obtaining signed contracts with vendors. Management believes that the Company is not exposed to any significant credit risk as a result of these credit concentrations.
6. Cash and Cash Equivalents - For purposes of the consolidated statements of cash flows, the Company considers all highly liquid investments available for current use with an initial maturity of three months or less to be cash equivalents.
7. Inventory - The Company's inventory is valued at the lower of cost (first in, first out) or market.
8. Property and Equipment - Property and equipment are recorded at cost. Maintenance and repairs are charged to expense as incurred whereas major betterments are capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of the assets.
9. Intangible Assets - Intangible assets subject to amortization include capitalized software and development costs and deferred financing costs, all of which are amortized using the straight-line method over 7-10 years.
10. Freight - The Company includes freight in as a component of inventory and freight out as part of cost of sales.
11. General and Administrative Expenses - These expenses are charged to operations as incurred and are not allocated to cost of sales.
12. Income Taxes - The Company exists for income tax purposes as two separate entities: Equal Exchange, Inc. and OKE USA Fruit Company. Federal and state income taxes are provided based upon earnings and tax rates applicable to the Company using the method of accounting described above.

EQUAL EXCHANGE, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Continued)

A. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (Continued)

Deferred income taxes are provided for differences in timing in reporting income for consolidated financial statement and tax purposes arising principally from differences in the methods of accounting for allowances for bad debts, accrued absences and depreciation. Bad debts are reported for tax purposes on the direct write-off method and for consolidated financial statement purposes on the allowance method. Accrued absences are reported for tax purposes on the cash method and for consolidated financial statement purposes on the accrual method. Depreciation is reported for tax purposes over shorter periods of time and at a more accelerated rate than the method for consolidated financial statement purposes. Deferred tax assets and liabilities are classified as current or non-current in the accompanying consolidated balance sheets, based upon classification of the related asset or liability.

13. Use of Estimates - The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

14. Patronage Rebates - The By-Laws of Equal Exchange, Inc. require it to make a patronage rebate to each worker-owner, based on its current year profit. Accordingly, the Company accounts for patronage rebates as an increase in operating expenses in the current year.

B. ALLOWANCE FOR DOUBTFUL ACCOUNTS:

The Company utilizes the allowance method to account for uncollectible accounts receivable balances. Under the allowance method, an estimate of uncollectible customer balances is made based on the Company's prior history and other factors such as the credit quality of the customer and economic conditions of the market. Based on these factors, at December 31, 2011 and 2010, there was an allowance for doubtful accounts of \$57,041.

C. INVENTORY:

Inventory consists of the following at December 31,:

	<u>2011</u>	<u>2010</u>
Unprocessed green coffee beans and bananas	\$ 11,065,602	\$ 4,863,718
Processed coffee, tea, cocoa, chocolate, and snacks and supplies	<u>4,051,439</u>	<u>3,426,928</u>
	<u>\$ 15,117,041</u>	<u>\$ 8,290,646</u>

D. NOTES RECEIVABLE:

Notes Receivable consists of the following at December 31,:

	<u>2011</u>	<u>2010</u>
5.00% Installment Note Receivable - La Siembra: Due in monthly installments of \$1,625, including interest to September, 2013.	\$ 32,607	\$ 56,039

EQUAL EXCHANGE, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Continued)

D. NOTES RECEIVABLE: (Continued)

	<u>2011</u>	<u>2010</u>
5.00% Installment Note Receivable - La Siembra: Due in monthly installments of \$1,625, including interest to January, 2014.	41,442	
	74,049	56,039
Current Portion	( 34,800)	( 17,538)
	<u>\$ 39,249</u>	<u>\$ 38,501</u>

The following is a schedule by years of the aggregate maturities of notes receivable at December 31,:

2012	\$ 34,800
2013	37,631
2014	1,618
	<u>\$ 74,049</u>

E. PROPERTY AND EQUIPMENT:

Property and Equipment consists of the following at December 31,:

	<u>2011</u>	<u>2010</u>
Land	\$ 502,688	\$ 502,688
Building and Improvements	3,773,609	3,750,884
Coffee Roasting and Packaging Equipment	3,531,339	3,518,220
Furniture, Fixtures, Equipment and Software	2,836,382	2,695,101
	10,644,018	10,466,893
Accumulated Depreciation	( 4,664,247)	( 3,813,210)
	<u>\$ 5,979,771</u>	<u>\$ 6,653,683</u>

F. INTANGIBLE ASSETS:

Intangible Assets consists of the following at December 31,:

	<u>2011</u>	<u>2010</u>
Capitalized Software and Development Costs, Net of Accumulated Amortization of \$34,095 and \$13,892 in 2011 and 2010, respectively.	\$ 182,212	\$ 200,353
Deferred Financing Costs, Net of Accumulated Amortization of \$96,545 and \$85,745 in 2011 and 2010, respectively.		10,800
	<u>\$ 182,212</u>	<u>\$ 211,153</u>

In accordance with FASB ASC 350-40-30-1, the Company capitalized the costs associated with establishing a cooperative supply chain referred to as P6. These costs include software development, product branding, website design and launch, brochure production, legal costs and marketing initiatives.

EQUAL EXCHANGE, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Continued)

G. INVESTMENTS:

Investments consist of the following at December 31,:

	<u>2011</u>	<u>2010</u>
SHCU - Weaver Street	\$ -	\$ 25,153
Liberation Foods	23,360	23,360
Coop Capital Fund NE	20,000	20,000
	<u>\$ 43,360</u>	<u>\$ 68,513</u>

H. NOTES PAYABLE - LINES OF CREDIT:

At December 31, 2011, the Company has a \$5,750,000 secured line of credit with TD Bank, N.A, with a maturity date of June 30, 2013. This line of credit was increased from \$3,750,000 in July, 2011. This line of credit bears interest at the bank's prime lending rate plus two percent and is secured by substantially all business assets of the Company, crossed to existing collateral pledged to TD Bank, N.A. behind the PCI second mortgage. At December 31, 2011 and 2010, there were no amounts outstanding on this line of credit.

The Company has a \$3,200,000 unsecured rolling credit facility with Shared Interest, a socially responsible organization based in the United Kingdom. The purpose of this credit facility is to finance purchases from small farmer associations approved by Shared Interest. Under the terms of this credit facility, Shared Interest pays producers for coffee shipped to the Company. The Company is required to repay Shared Interest in full within five months following the settlement date. Advances bear interest at the borrowing rate of Shared Interest, plus one percent, 7.5% at December 31, 2011. This credit facility may be terminated upon 180 days notice. At December 31, 2011 and 2010, the outstanding balance on this rolling credit facility amounted to \$2,523,192 and \$567,952, respectively.

The Company also has a \$1,000,000 secured line of credit with Eastern Bank, formerly Wainwright Bank. This line of credit bears interest at the bank's prime lending rate and is secured by certificates of deposit held by Eastern Bank that are owned by individuals and institutions affiliated with the Company. The Company can borrow up to ninety percent of the face value of the certificates of deposit. At December 31, 2011 and 2010, the outstanding balance on this line of credit amounted to \$940,000 and zero, respectively.

I. LONG-TERM DEBT:

Long-Term Debt consists of the following at December 31,:

	<u>2011</u>	<u>2010</u>
4.50% Note Payable - Calvert Social Investment Foundation:		
Due in semi-annual interest-only payments with a balloon payment due December, 2012.	\$ 1,000,000	\$ 700,000
4.25% Note Payable - MMA Community Development Investment:		
Due in semi-annual interest-only payments with a balloon payment due August, 2013.	250,000	250,000

EQUAL EXCHANGE, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Continued)

I. LONG-TERM DEBT: (Continued)

	<u>2011</u>	<u>2010</u>
7.14% Mortgage Note Payable - T.D. Bank, N.A.: Due in monthly installments of approximately \$13,676 including interest to July, 2014. The interest rate is hedged through the use of a swap contract.	1,356,280	1,417,572
3.00% Notes Payable - Various Individuals and to Institutions:		
5.00% Due in annual or semiannual interest-only payments, with balloon payments due at varying maturity dates through July, 2014.	486,000	166,000
6.00% Mortgage Note Payable - PCI: Due in monthly installments of \$7,321 including interest to October, 2014.	777,775	817,005
	3,870,055	3,350,577
Current Portion	( 1,253,534)	( 121,793)
	<u>\$ 2,616,521</u>	<u>\$ 3,228,784</u>

The following is a schedule by years of the aggregate maturities of indebtedness at December 31,:

2012	\$ 1,253,534
2013	470,000
2014	<u>2,146,521</u>
	<u>\$ 3,870,055</u>

J. MINORITY INTEREST IN SUBSIDIARY:

An ownership interest of 10 percent in the subsidiary is held by unrelated parties. This interest, reflected on the balance sheet as a separate line item, is the summation of the investments made by these unrelated parties plus their proportionate share of the inception-to-date earnings and loss, and is not necessarily reflective of its market value.

K. CAPITAL STRUCTURE:

1. Preferred Stock

The Company has a single class of non-voting Class B preferred stock. These shares have a par value of \$1 and a face value of \$27.50, and are sold to individuals and organizations. The Company pays annual cash dividends, targeted at five percent of the face value of the preferred stock. The actual amount is declared annually by the Board of Directors based on Company performance. The dividend is non-cumulative. The preferred shares have a dissolution preference equal to their face value.

In 2010, the Board of Directors authorized and approved a subscription agreement in which the corporation intended to raise up to \$2,000,000 through the sale of Class B Preferred Stock. In accordance with this subscription agreement, the Company sold 37,690 shares of Class B Preferred Stock and raised \$1,036,500. In 2011, the Company sold 52,098 shares of Class B Preferred Stock and raised \$1,432,684.

EQUAL EXCHANGE, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Continued)

K. CAPITAL STRUCTURE: (Continued)

All stock subscription agreements referred to above were executed in accordance with the rules and regulations under Section 3(b) of Regulation D, Rule 505 of the Securities and Exchange Commission pursuant to the Securities Act of 1933.

Stockholders owning preferred stock may, beginning two years after the original purchase date, sell their preferred stock back to the Company in accordance with the following schedule:

After year 2 - at 70% of face value  
After year 3 - at 80% of face value  
After year 4 - at 90% of face value  
After year 5 - at 100% of face value

The Company has the option of making the redemptions described above by converting the preferred shares to five year, five percent promissory notes.

If at any time the debt-to-equity ratio of the Company (defined as the Company's total liabilities divided by the Company's total stockholders' equity) exceeds 2:1, the Board of Directors may postpone or refuse a request for redemption. In addition, if at any time the Board of Directors determines that a requested redemption would impair the ability of the Company to operate effectively, the Board of Directors may limit, postpone or refuse the requested redemption.

The face value of preferred stock, eligible for redemption under the terms described above, are as follows for the year ending December 31,:

2012	\$ 10,260,743
2013	294,273
2014	172,444
2015	1,500
	<u>\$ 10,728,960</u>

2. Common Stock

The Company has a single class of voting Class A common stock, referred to as membership shares. Class A common shares have a \$1 par value and are sold at a price equal to \$2,000 per share, plus inflation since 1990. In 2011 and 2010, the price per share was \$3,290 and \$3,240, respectively. After one year's service, and upon approval of two-thirds of the existing members, employees of the Company may purchase one membership share. No individual may own more than one membership share. No dividends are paid on these shares, but the employees who hold them are eligible for patronage rebates.

3. Common Stock Subscriptions Receivable

Members usually choose to pay for their membership share through payroll deductions over several years. The Company issues the membership share immediately and credits the common stock account for the full issue price of the share; unpaid amounts due from the member are recorded as Common Stock Subscriptions Receivable, which are separately reflected as a reduction to Stockholders' Equity.

EQUAL EXCHANGE, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Continued)

K. CAPITAL STRUCTURE: (Continued)

4. Preferred Stock Transactions

	<u># of Shares</u>	<u>Par Value</u>	<u>Premium Over Par Value</u>	<u>Total Paid In on Preferred Stock</u>
Balance, December 31, 2009	290,429	\$290,429	\$ 7,688,000	\$ 7,978,429
Shares issued for cash	37,690	37,690	998,810	1,036,500
Dividends Reinvested	7,724	7,724	204,694	212,418
Shares redeemed for cash	<u>( 2,581)</u>	<u>( 2,581)</u>	<u>( 68,384)</u>	<u>( 70,965)</u>
Balance, December 31, 2010	333,262	\$333,262	\$ 8,823,120	\$ 9,156,382
Shares issued for cash	52,098	52,098	1,380,586	1,432,684
Dividends Reinvested	9,748	9,748	267,421	277,169
Shares redeemed for cash	<u>( 4,992)</u>	<u>( 4,992)</u>	<u>( 132,283)</u>	<u>( 137,275)</u>
Balance, December 31, 2011	<u>390,116</u>	<u>\$390,116</u>	<u>\$10,338,844</u>	<u>\$10,728,960</u>

The Company has authorized at Board Meetings the issuance of additional shares of preferred stock beyond the number of shares authorized in the Articles of Incorporation. The Board is currently planning a vote to amend the Articles to allow for these additional shares.

5. Common Stock Transactions

	<u># of Shares</u>	<u>Par Value</u>	<u>Premium Over Par Value</u>	<u>Total Paid In on Common Stock</u>
Balance, December 31, 2009	99	\$ 99	\$ 282,584	\$ 282,683
Shares issued for subscriptions receivable	13	13	45,357	45,370
Shares redeemed for cash	<u>( 5)</u>	<u>( 5)</u>	<u>( 14,705)</u>	<u>( 14,710)</u>
Balance, December 31, 2010	107	\$ 107	\$ 313,236	\$ 313,343
Shares issued for subscriptions receivable	12	12	39,368	39,380
Shares redeemed for cash	<u>( 11)</u>	<u>( 11)</u>	<u>( 33,959)</u>	<u>( 33,970)</u>
Balance, December 31, 2011	<u>108</u>	<u>\$ 108</u>	<u>\$ 318,645</u>	<u>\$ 318,753</u>

EQUAL EXCHANGE, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Continued)

L. INCOME TAXES:

The Company accounts for income taxes in accordance with FASB ASC 740, whereby deferred taxes are provided for temporary differences arising from assets and liabilities whose bases are different for financial reporting and income tax purposes. Deferred taxes relate primarily to differences in calculating depreciation on fixed assets and the timing of deductibility of certain other operating expenses.

M. PATRONAGE REBATES:

The By-Laws of Equal Exchange, Inc. require it to make an annual patronage rebate to each worker-owner. The patronage rebate is calculated at forty percent of the net profit or loss, after state income taxes and preferred stock dividend payments, but before charitable donations and federal income taxes. The rebate is then adjusted to reflect the ratio of hours worked by worker-owners to hours worked by all employees. Each year, the Board of Directors determines the allocation of the patronage rebate between payments in cash versus deferral held in the worker-owners' capital accounts, subject to a requirement that at least twenty percent be paid in cash. Profits not paid as dividends on preferred stock or as patronage rebates are retained to capitalize the business, and are not allocated to any individual worker-owners. For the years ended December 31, 2011 and 2010, patronage rebate expense amounted to \$369,213 and \$294,000, respectively.

N. ADVERTISING AND BUSINESS PROMOTION:

The Company follows the policy of charging the costs of advertising and business promotion to expense as incurred. For the years ended December 31, 2011 and 2010, advertising costs amounted to \$994,875 and \$1,240,237, respectively.

O. CHARITABLE CONTRIBUTIONS:

The Company makes charitable contributions to unrelated tax exempt organizations that promote Fair Trade Industry activities. For the years ended December 31, 2011 and 2010, charitable contributions amounted to \$130,104 and \$69,628, respectively.

P. OPERATING LEASES:

The Company leases distribution and retail space in Massachusetts, Minnesota and Oregon for terms in excess of one year. Rent expense for the years ended December 31, 2011 and 2010 amounted to \$206,437 and \$176,465, respectively.

The following is a schedule by years of the future minimum lease payments as of December 31,:

2012	\$ 166,944
2013	145,988
2014	126,312
2015	41,076
2016 and Thereafter	106,113
	<u>\$ 586,433</u>



EQUAL EXCHANGE, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Continued)

Q. GUARANTEE OF PRODUCER INDEBTEDNESS:

Shared Interest has committed up to \$800,000 for advances directly to producers with contracts to sell coffee to the Company. These advances are limited to sixty percent of the contract price, with a maximum amount per producer of \$135,000, and are available to producers up to ten months before coffee is delivered to the Company. The Company guarantees 25% of the producer advances made by Shared Interest. At December 31, 2011 and 2010, producer advances guaranteed by the Company amounted to \$429,384 and \$143,750, respectively. During the years ended December 31, 2011 and 2010, the Company did not incur any losses related to guaranteed producer advances.

R. RETIREMENT PLAN:

The Company sponsors a Safe Harbor 401(k) Retirement Plan for its eligible employees. To become eligible for the Plan, an employee must have completed one full year of continuous employment. For the years ended December 31, 2011 and 2010, the Company contributed 3% of each eligible employee's annual compensation. For the years ended 2011 and 2010, the Company's contribution to this plan totaled \$131,550 and \$127,347, respectively.

S. MAJOR CUSTOMER:

For the years ended December 31, 2011 and 2010, the Company had one major customer, to which sales accounted for approximately 22% of the Company's revenue. At December 31, 2011 and 2010, accounts receivable from this customer represented approximately 14% and 31%, respectively, of the total accounts receivable balance.

T. SUBSEQUENT EVENTS:

Management has evaluated events occurring after the consolidated balance sheet date through March 7, 2012, the date in which the consolidated financial statements were available to be issued. No material events have been identified which would require disclosure under FASB ASC 855-10-50-1.



LMHS, P.C.

*Certified Public Accountants and Advisors*

INDEPENDENT AUDITORS' REPORT  
ON SUPPLEMENTARY INFORMATION

To The Stockholders  
Equal Exchange, Inc.  
West Bridgewater, Massachusetts

We have audited the consolidated financial statements of Equal Exchange, Inc. and subsidiary as of and for the years ended December 31, 2011 and 2010, and our report thereon dated March 7, 2012, which expressed an unqualified opinion on those consolidated financial statements, appears on page 1. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

*LMHS, P.C.*

LMHS, P.C.

March 7, 2012

EQUAL EXCHANGE, INC. AND SUBSIDIARY  
CONSOLIDATING BALANCE SHEET  
DECEMBER 31, 2011

	<u>EQUAL EXCHANGE, INC</u>	<u>OKE USA FRUIT COMPANY</u>	<u>CONSOLIDATING ENTRIES</u>	<u>CONSOLIDATED BALANCE SHEET</u>
<u>ASSETS</u>				
<b>CURRENT ASSETS:</b>				
Cash	\$ 438,613	\$ 318,816	\$ -	\$ 757,429
Accounts Receivable	2,683,686	165,377		2,849,063
Inventory	15,039,512	77,529		15,117,041
Notes Receivable, Current Portion	284,800		(250,000)	34,800
Prepaid Expenses and Other	698,015	102,323		800,338
Deferred Income Taxes	156,000	211,496		367,496
	<u>19,300,626</u>	<u>875,541</u>	<u>(250,000)</u>	<u>19,926,167</u>
<b>PROPERTY AND EQUIPMENT:</b>				
Land	502,688			502,688
Building and Improvements	3,773,609			3,773,609
Coffee Roasting and Packaging Equipment	3,531,339			3,531,339
Furniture, Fixtures, Equipment and Software	2,836,382			2,836,382
	<u>10,644,018</u>			<u>10,644,018</u>
Accumulated Depreciation	(4,664,247)			(4,664,247)
	<u>5,979,771</u>			<u>5,979,771</u>
<b>OTHER ASSETS:</b>				
Intangible Assets, Net	182,212			182,212
Investments	394,943		(351,583)	43,360
Notes Receivable, Net of Current Portion	39,249			39,249
	<u>616,404</u>		<u>(351,583)</u>	<u>264,821</u>
	<u>\$25,896,801</u>	<u>\$ 875,541</u>	<u>\$ (601,583)</u>	<u>\$26,170,759</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>				
<b>CURRENT LIABILITIES:</b>				
Notes Payable - Lines of Credit	\$ 3,463,192	\$ -	\$ -	\$ 3,463,192
Current Portion of Long-Term Debt	1,253,534	250,000	(250,000)	1,253,534
Accounts Payable and Accrued Expenses	2,092,289	90,454	16,059	2,198,802
Corporate Income Taxes Payable	269,511	2,121		271,632
Patronage Rebates Payable	376,382			376,382
	<u>7,454,908</u>	<u>342,575</u>	<u>(233,941)</u>	<u>7,563,542</u>
<b>LONG-TERM LIABILITIES:</b>				
Long-Term Debt, Net of Current Portion	2,616,521			2,616,521
Deferred Income Taxes	850,000			850,000
	<u>3,466,521</u>			<u>3,466,521</u>
<b>MINORITY INTEREST IN CONSOLIDATED SUBSIDIARY</b>			165,324	165,324
<b>STOCKHOLDERS' EQUITY:</b>				
Class A Shares		580,639	(580,639)	
Class B Shares		190,000	(190,000)	
Class C Shares		27,000	(27,000)	
Preferred Stock	10,728,960			10,728,960
Common Stock	318,753			318,753
Less: Subscriptions Receivable	(59,480)			(59,480)
Retained Earnings	3,987,139	(264,673)	264,673	3,987,139
	<u>14,975,372</u>	<u>532,966</u>	<u>(532,966)</u>	<u>14,975,372</u>
	<u>\$25,896,801</u>	<u>\$ 875,541</u>	<u>\$ (601,583)</u>	<u>\$26,170,759</u>

See Independent Auditor's Report on Supplementary Information

EQUAL EXCHANGE, INC. AND SUBSIDIARY  
CONSOLIDATING STATEMENT OF EARNINGS  
YEAR ENDED DECEMBER 31, 2011

	<u>EQUAL EXCHANGE, INC</u>	<u>OKE USA FRUIT COMPANY</u>	<u>CONSOLIDATING ENTRIES</u>	<u>CONSOLIDATED EARNINGS</u>
NET SALES	\$43,340,250	\$ 3,479,579	\$ -	\$46,819,829
COST OF SALES:				
Purchases	27,363,203	2,142,446		29,505,649
Freight	2,471,609	1,037,167		3,508,776
Utilities	145,215			145,215
Warehouse Occupancy Costs	97,044			97,044
Depreciation	361,102			361,102
	<u>30,438,173</u>	<u>3,179,613</u>		<u>33,617,786</u>
GROSS PROFIT	12,902,077	299,966		13,202,043
OPERATING EXPENSES:				
Salaries and Wages	5,201,843	95,588		5,297,431
Payroll Taxes	1,553,339	25,301		1,578,640
Advertising and Business Promotion	987,199	7,676		994,875
Bad Debt Expense	6,631			6,631
Certification Fees	46,842			46,842
Charitable Contributions	130,104			130,104
Computer Expense and Service	40,322			40,322
Consulting Expense	209,139			209,139
Contracted Services	82,767	31,900		114,667
Credit Card Service Fees	269,038			269,038
General and Administrative	95,968	36,000		131,968
Insurance	87,061	4,872		91,933
Office Expense	153,763	6,193		159,956
Patronage Rebates	369,213			369,213
Payroll Processing Fees	36,758			36,758
Postage	32,268			32,268
Professional Fees	118,127	27,683		145,810
Real Estate Taxes	63,608			63,608
Rent	197,437	9,000		206,437
Repairs and Maintenance	279,151			279,151
Selling Expenses	328,118			328,118
Telephone	83,281	4,003		87,284
Utilities	111,033			111,033
Amortization	31,003			31,003
Depreciation	587,887			587,887
	<u>11,101,900</u>	<u>248,216</u>		<u>11,350,116</u>
EARNINGS FROM OPERATIONS	1,800,177	51,750		1,851,927
OTHER INCOME AND (EXPENSE):				
Interest Income	7,327	19		7,346
Equity in Earnings of Subsidiary	20,719		(20,719)	
Interest Expense	(377,181)	(10,001)		(387,182)
	<u>(349,135)</u>	<u>(9,982)</u>	<u>(20,719)</u>	<u>(379,836)</u>
EARNINGS BEFORE INCOME TAXES AND MINORITY INTEREST	1,451,042	41,768	(20,719)	1,472,091
INCOME TAXES (CREDIT):				
Current	685,000	4,000		689,000
Deferred	(55,000)	15,000		(40,000)
	<u>630,000</u>	<u>19,000</u>		<u>649,000</u>
MINORITY INTEREST			(2,049)	(2,049)
NET EARNINGS	<u>\$ 821,042</u>	<u>\$ 22,768</u>	<u>\$ (22,768)</u>	<u>\$ 821,042</u>

See Independent Auditor's Report on Supplementary Information

EQUAL EXCHANGE, INC. AND SUBSIDIARY  
CONSOLIDATING BALANCE SHEET  
DECEMBER 31, 2010

	<u>EQUAL EXCHANGE, INC</u>	<u>OKE USA FRUIT COMPANY</u>	<u>CONSOLIDATING ENTRIES</u>	<u>CONSOLIDATED BALANCE SHEET</u>
<u>ASSETS</u>				
<b>CURRENT ASSETS:</b>				
Cash	\$ 657,124	\$ 166,545	\$ -	\$ 823,669
Accounts Receivable	2,304,912	350,795		2,655,707
Inventory	8,224,913	65,733		8,290,646
Notes Receivable, Current Portion	267,538		(250,000)	17,538
Prepaid Expenses and Other	447,077	88,253		535,330
Deferred Income Taxes	151,000	226,496		377,496
	<u>12,052,564</u>	<u>897,822</u>	<u>(250,000)</u>	<u>12,700,386</u>
<b>PROPERTY AND EQUIPMENT:</b>				
Land	502,688			502,688
Building and Improvements	3,750,884			3,750,884
Coffee Roasting and Packaging Equipment	3,518,220			3,518,220
Furniture, Fixtures, Equipment and Software	2,690,176	4,925		2,695,101
	<u>10,461,968</u>	<u>4,925</u>		<u>10,466,893</u>
Accumulated Depreciation	(3,808,285)	(4,925)		(3,813,210)
	<u>6,653,683</u>			<u>6,653,683</u>
<b>OTHER ASSETS:</b>				
Intangible Assets, Net	211,153			211,153
Investments	399,377		(330,864)	68,513
Notes Receivable, Net of Current Portion	38,501			38,501
	<u>649,031</u>		<u>(330,864)</u>	<u>318,167</u>
	<u>\$ 19,355,278</u>	<u>\$ 897,822</u>	<u>\$ (580,864)</u>	<u>\$ 19,672,236</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>				
<b>CURRENT LIABILITIES:</b>				
Notes Payable - Lines of Credit	\$ 567,952	\$ -	\$ -	\$ 567,952
Current Portion of Long-Term Debt	121,793	250,000	(250,000)	121,793
Accounts Payable and Accrued Expenses	1,385,692	137,624	16,058	1,539,374
Patronage Rebates Payable	147,000			147,000
	<u>2,222,437</u>	<u>387,624</u>	<u>(233,942)</u>	<u>2,376,119</u>
<b>LONG-TERM LIABILITIES:</b>				
Long-Term Debt, Net of Current Portion	3,228,784			3,228,784
Deferred Income Taxes	900,000			900,000
	<u>4,128,784</u>			<u>4,128,784</u>
<b>MINORITY INTEREST IN CONSOLIDATED SUBSIDIARY</b>			163,276	163,276
<b>STOCKHOLDERS' EQUITY:</b>				
Class A Shares		580,639	(580,639)	
Class B Shares		190,000	(190,000)	
Class C Shares		27,000	(27,000)	
Preferred Stock	9,156,382			9,156,382
Common Stock	313,343			313,343
Less: Subscriptions Receivable	(60,682)			(60,682)
Retained Earnings	3,595,014	(287,441)	287,441	3,595,014
	<u>13,004,057</u>	<u>510,198</u>	<u>(510,198)</u>	<u>13,004,057</u>
	<u>\$ 19,355,278</u>	<u>\$ 897,822</u>	<u>\$ (580,864)</u>	<u>\$ 19,672,236</u>

See Independent Auditor's Report on Supplementary Information

EQUAL EXCHANGE, INC. AND SUBSIDIARY  
SUPPLEMENTARY INFORMATION  
YEARS ENDED DECEMBER 31, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
<u>CONSOLIDATED SCHEDULES OF COST OF SALES:</u>		
Purchases	\$ 29,505,649	\$ 20,780,706
Freight	3,508,776	2,217,547
Utilities	145,215	138,254
Warehouse Occupancy Costs	97,044	85,174
Depreciation	361,102	437,635
	<u>\$ 33,617,786</u>	<u>\$ 23,659,316</u>
<u>CONSOLIDATED SCHEDULES OF OPERATING EXPENSES:</u>		
Salaries and Wages	\$ 5,297,431	\$ 5,293,406
Payroll Taxes	1,578,640	1,659,656
Advertising and Business Promotion	994,875	1,240,237
Bad Debt Expense	6,631	9,313
Certification Fees	46,842	153,211
Charitable Contributions	130,104	69,628
Computer Expense and Service	40,322	38,245
Consulting Expense	209,139	63,598
Contracted Services	114,667	118,631
Credit Card Service Fees	269,038	297,369
General and Administrative	131,968	116,963
Insurance	91,933	108,962
Office Expense	159,956	129,867
Patronage Rebates	369,213	294,000
Payroll Processing Fees	36,758	30,139
Postage	32,268	30,148
Professional Fees	145,810	83,599
Real Estate Taxes	63,608	73,557
Rent	206,437	176,465
Repairs and Maintenance	279,151	283,741
Selling Expenses	328,118	295,894
Telephone	87,284	90,143
Utilities	111,033	99,672
Amortization	31,003	25,588
Depreciation	587,887	452,726
	<u>\$ 11,350,116</u>	<u>\$ 11,234,758</u>

See Independent Auditors' Report on Supplementary Information