Mountain Equipment Co-operative

Consolidated Financial Statements
December 26, 2010
(in thousands of dollars)

PRICEWATERHOUSECOOPERS

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April 12, 2011

Independent Auditor's Report

To the Members
of Mountain Equipment Co-operative

We have audited the accompanying consolidated financial statements of Mountain Equipment Co-operative, which comprise the consolidated balance sheet as at December 26, 2010 and the statements of earnings, accumulated comprehensive income and cash flows for the fiscal year then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the consolidated financial statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Mountain Equipment Co-operative as at December 26, 2010 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

(signed) PricewaterhouseCoopers LLP

Chartered Accountants

Vancouver, BC
Canada

Mountain Equipment Co-operative

Consolidated Balance Sheet

(in thousands of dollars)

	December 26, 2010 $	December 27, 2009 $
Assets		
Current assets		
Cash and cash equivalents (note 4)	6,145	6,089
Accounts receivable	1,333	1,009
Inventory (note 5)	54,813	60,758
Prepaids and deposits	1,526	1,388
Future income taxes (note 9(c))	112	1,143
	63,929	70,387
Property and equipment (note 7)	119,375	107,232
	183,304	177,619
Liabilities and Members' Equity		
Current liabilities		
Amounts owing to suppliers, governments and employees	21,696	20,302
Gift certificates and provision for sales returns	7,839	6,976
Foreign exchange contracts (note 6)	474	4,809
Mortgage loans payable (note 8)	-	2,367
Current portion of deferred lease inducements	100	105
	30,109	34,559
Deferred lease inducements	259	359
Future income taxes (note 9(b))	979	729
	31,347	35,647
Members' shares (note 10)	149,906	143,187
Contributed surplus (note 11)	712	548
Surplus	1,637	822
Accumulated other comprehensive loss	(298)	(2,585)
	151,957	141,972
	183,304	177,619

Commitments and contingencies (note 12)

Approved by the Board of Directors

(signed) Denise Lawson Director (signed) Shauna Sylvester Director

The accompanying notes are an integral part of these financial statements.

Mountain Equipment Co-operative

Consolidated Statement of Accumulated Comprehensive Income

(in thousands of dollars)

	Surplus $	Accumulated other comprehensive (loss) income - net of tax $	Accumulated comprehensive income (loss) $
Net earnings for the year ended December 27, 2009	300	-	300
Foreign exchange contracts designated as cash flow hedges			
Unrealized loss for current year - net of future income tax	-	(2,778)	(2,778)
Reversal of prior year's unrealized gain - net of future income tax	-	(4,338)	(4,338)
Currency translation of hedged accounts payable			
Unrealized gain for current year - net of future income tax	-	193	193
Reversal of prior year's unrealized loss - net of future income tax	-	374	374
	300	(6,549)	(6,249)
Balance - December 28, 2008	522	3,964	4,486
Balance - December 27, 2009	822	(2,585)	(1,763)
Net earnings for the year ended December 26, 2010	815	-	815
Foreign exchange contracts designated as cash flow hedges			
Unrealized loss for current year - net of future income tax	-	(345)	(345)
Reversal of prior year's unrealized loss - net of future income tax	-	2,778	2,778
Currency translation of hedged accounts payable			
Unrealized gain for current year - net of future income tax	-	47	47
Reversal of prior year's unrealized gain - net of future income tax	-	(193)	(193)
	815	2,287	3,102
Balance - December 27, 2009	822	(2,585)	(1,763)
Balance - December 26, 2010	1,637	(298)	1,339

The accompanying notes are an integral part of these financial statements.

Mountain Equipment Co-operative

Consolidated Statement of Earnings

(in thousands of dollars)

	Fiscal year ended December 26, 2010 $	Fiscal year ended December 27, 2009 $
Sales	261,374	262,056
Cost of sales	174,871	175,606
Gross margin	86,503	86,450
Selling and administration expenses (schedule)	80,084	75,396
	6,419	11,054
Other income and expense (schedule)	2,585	1,785
Earnings before patronage return and income taxes	9,004	12,839
Patronage return	7,891	12,176
Earnings before income taxes	1,113	663
Provision for income taxes (note 9)		
Current	48	-
Future	250	363
	298	363
Net earnings for the year	815	300

The accompanying notes are an integral part of these financial statements.

Mountain Equipment Co-operative

Consolidated Statement of Cash Flows

(in thousands of dollars)

	Fiscal year ended December 26, 2010 $	Fiscal year ended December 27, 2009 $
Cash flows from operating activities		
Net earnings for the year	815	300
Items not affecting cash		
Depreciation and amortization	7,947	7,758
Loss on disposal of property and equipment	114	196
Amortization of deferred lease inducements	(105)	(128)
Future income taxes	250	363
Unrealized loss on foreign exchange contracts	(803)	803
Shares issued by application of patronage return	7,891	12,176
	16,109	21,468
Change in non-cash working capital items related to operations	7,553	(10,369)
	23,662	11,099
Cash flows from financing activities		
Repayment of mortgage loans payable	(2,367)	(1,150)
Shares issued to new members	1,063	1,160
Shares redeemed	(2,234)	(349)
Shares withdrawn	(1)	(1)
Contributed surplus from unclaimed share redemptions - net	164	15
	(3,375)	(325)
Cash flows from investing activities		
Purchase of property and equipment	(20,247)	(8,764)
Proceeds on disposal of property and equipment	16	4
	(20,231)	(8,760)
Increase in cash and cash equivalents	56	2,014
Cash and cash equivalents - Beginning of year	6,089	4,075
Cash and cash equivalents - End of year	6,145	6,089

Supplementary cash flow information (note 14)

The accompanying notes are an integral part of these financial statements.

(in thousands of dollars)

1 Nature of operations and reporting period

Mountain Equipment Co-operative (the Co-operative) is a member owned and directed retail consumer co-operative. It is incorporated under the Co-operative Association Act of British Columbia and serves its members through stores across Canada as well as through a catalogue and website.

The current fiscal year consists of 364 days (December 28, 2009 to December 26, 2010) and the comparative fiscal year consists of 364 days (December 29, 2008 to December 27, 2009).

2 Summary of significant accounting policies

Consolidation and preparation of financial statements

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include the accounts of the Co-operative's wholly owned subsidiary, 1314625 Ontario Limited, a substantially inactive company.

Revenue recognition

The Co-operative recognizes revenue when the title of goods passes to the member. Revenue from store sales is recognized at the point of sale and revenue from online and catalogue sales is recognized when the product is shipped. Revenue from gift certificates is recognized as certificates are redeemed. The Co-operative reports its revenue net of sales discounts and estimated returns.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances with banks and short-term investments with maturities of less than 30 days.

Inventory

Inventory is valued at the lower of weighted average cost and net realizable value. The cost of inventory includes all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

(in thousands of dollars)

Property and equipment

Property and equipment are recorded at cost less accumulated depreciation. Depreciation is recorded annually using the following rates and methods:

Buildings	4% to 6%, declining balance
Furniture, fixtures and equipment	20% to 55%, declining balance
Computer software	5 years, straight-line

Leasehold improvements are amortized on a straight-line basis over the lesser of the estimated useful life of the asset or the term of the lease plus one renewal period. The amortization terms range from 2 to 25 years.

Leased premises

The Co-operative records rent expense on a straight-line basis over the term of the lease. Accordingly, reasonably assured rent escalations are amortized over the lease term.

Free rent periods and lease inducements are deferred and amortized over the lease term plus one renewal period as a reduction of annual rent expense.

Patronage return

The patronage return is deducted from earnings for the year in which the return is declared by the Board of Directors and represents a refund of the current year's sales proceeds to the members based on their purchases during the year.

Derivative financial instruments and hedge accounting

The Co-operative uses foreign exchange contracts in its hedging strategy to manage its exposure to currency risks on highly probable US dollar inventory purchases. The foreign exchange contracts are recorded on the consolidated balance sheet at their fair value. The contracts are presented as an asset when the fair value is positive and as a liability when the fair value is negative.

Where the requirements for hedge accounting are met, the Co-operative designates and documents the foreign exchange contracts as cash flow hedges. The documentation identifies the anticipated cash flows being hedged, the risk that is being hedged, the type of hedging instrument used and how effectiveness will be assessed. The hedging instrument must be highly effective in offsetting changes in the anticipated cash flows both at inception and throughout the life of the instrument. Hedge accounting is discontinued prospectively if it is determined that the hedging instrument is no longer effective as a hedge, the hedging instrument is terminated, or upon the sale or early termination of the hedge.

In a cash flow hedging relationship, the effective portion of the change in the fair value of the hedging instrument, net of taxes, is recognized in other comprehensive income (OCI). Unrealized exchange gains and losses on foreign exchange contracts that do not qualify for hedge accounting are recognized in other income (expense).

(in thousands of dollars)

Foreign currency translation

The Co-operative translates assets and liabilities denominated in foreign currencies at exchange rates in effect at the end of the year. Exchange gains and losses from unhedged transactions denominated in foreign currencies relating to inventory purchases are included in cost of sales. Included in the 2010 cost of sales was a foreign exchange gain of $1,571 (2009 - loss of $1,025).

Employee benefits

The Co-operative contributes on a defined contribution basis to assist employees with retirement savings. The cost of this is included in salaries, wages and employee benefits expense. Contributions of $1,104 (2009 - $1,031) were made during the fiscal year ended December 26, 2010.

Income taxes

The Co-operative follows the liability method of accounting for income taxes. Under this method, income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective tax bases, using substantively enacted income tax rates. The effect of a change in income tax rates on future income tax liabilities and assets is recognized in the results of the period in which the change occurs.

Use of estimates and measurement uncertainty

In preparing the Co-operative's financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the period. Actual results could differ from these estimates. Areas of measurement uncertainty include inventory valuation, allowance for sales returns, allowance for future warranty expenses and the amount of gift certificates likely to be redeemed.

Capital disclosures

The Co-operative defines capital to consist of members' shares as set out in note 10. There are no externally imposed requirements relating to member share capital. In managing member share capital, the Co-operative assesses its long-term cash flow needs and, accordingly, the timing and magnitude of share redemptions or patronage return. There were no changes to the Co-operative's approach to capital management during the year.

(in thousands of dollars)

Financial instruments

The Co-operative has made the following classifications for its financial instruments:

- Cash and cash equivalents are classified as "available for sale" and are measured at fair value at the end of each period with any resulting gains or losses recognized in operations;

- Accounts receivable are classified as "loans and receivables" and are recorded at cost, which upon their initial measurement is equal to their fair value. Subsequent measurement of accounts receivable is at amortized cost, which usually corresponds to the amount initially recorded less any allowance for doubtful accounts;

- Amounts owing to suppliers, governments and employees are classified as "other financial liabilities" and are measured at amortized cost; and

- The mortgage loans payable are classified as "other financial liabilities" and are measured at amortized cost.

Comprehensive income

Comprehensive income consists of net earnings and OCI. OCI of the Co-operative includes the change in the fair value of the effective portion of cash flow hedging instruments, which consist of foreign exchange contracts entered into to fix the price of inventory purchases, and the unrealized foreign exchange gain or loss on the translation of hedged amounts owing to suppliers. Both of these items are presented net of taxes. The cumulative changes in OCI are included in accumulated other comprehensive income (loss), which is presented as a category of members' equity on the consolidated balance sheet.

3 Generally Accepted Accounting Principles for Private Enterprises

In September 2009, the Accounting Standards Board approved the issuance of a set of generally accepted accounting principles standards for private enterprises (ASPE). The standards for private enterprises are effective for annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Co-operative has elected to adopt ASPE for financial reporting purposes commencing with the fiscal year beginning December 27, 2010. The initial assessment for converting to ASPE is that it will have little or no impact on the Co-operative's financial position and results of operations.

(in thousands of dollars)

4 Cash and cash equivalents

Cash and cash equivalents consist of the following:

	December 26, 2010 $	December 27, 2009 $
Cash and cash equivalents less outstanding cheques	(3,349)	1,589
Bankers' acceptances and term deposits (at 1.02% to 1.04%)	9,494	4,500
	6,145	6,089

The Co-operative has available demand credit facilities of $30 million that have been arranged to fund general operations and capital projects. The facilities can be drawn through bankers' acceptances, operating loans, and letters of credit. The Co-operative has provided a general security agreement as security for these credit facilities. As at December 26, 2010, $26,204 (2009 - $25,561) of the facilities was available. See also note 12(b) with respect to outstanding letters of credit.

5 Inventory

	December 26, 2010 $	December 27, 2009 $
Raw materials	1,101	1,669
Work-in-progress	767	548
Finished goods	52,945	58,541
	54,813	60,758

The amount of inventories recognized as a component of cost of sales during the year was $159,353 (2009 - $161,092).

Also included within cost of sales for the year ended December 26, 2010 are charges to inventory within the normal course of business, made throughout the year, of $2,724 (2009 - $2,317). These charges include the disposal of obsolete and damaged product, shrinkage, and permanent markdowns to net realizable values.

(in thousands of dollars)

6 Foreign exchange contracts

Foreign exchange contracts include a number of option-dated forward contracts that are intended to settle future US dollar inventory purchases.

At the balance sheet date, the Co-operative had contracts outstanding totalling US$42,000 (2009 - US$63,450) at an average rate of CA$1.021 (2009 - CA$1.126) that mature at various dates to December 30, 2011 (2009 - to December 31, 2009). At December 26, 2010, the fair value of these contracts was $474 unfavourable (2009 - $4,809 unfavourable). For the foreign exchange contracts designated as cash flow hedges, the Co-operative has recorded a loss of $345 (2009 - loss of $2,778), net of future income tax recovery of $129 (2009 - $1,228) in OCI as a result of marking these contracts to their fair market values at December 26, 2010. At December 27, 2009, the Co-operative held foreign exchange contracts that did not qualify for hedge accounting, and therefore recorded a loss of $803 in other income (expense) as a result of marking these contracts to their fair market values. At December 26, 2010, the Co-operative does not hold any foreign exchange contracts that do not qualify for hedge accounting.

7 Property and equipment

			December 26, 2010	**December 27, 2009**
	Cost $	**Accumulated depreciation and amortization $**	**Net $**	**Net $**
Land	30,230	-	30,230	30,230
Buildings	56,381	12,288	44,093	46,621
Furniture, fixtures and equipment	35,916	24,716	11,200	11,182
Leasehold improvements	32,416	10,501	21,915	16,249
Computer software	14,992	12,685	2,307	1,941
	169,935	60,190	109,745	106,223
Capital projects in progress	9,630	-	9,630	1,009
	179,565	60,190	119,375	107,232

See also note 12(c) for commitments.

(in thousands of dollars)

8 Mortgage loans payable

	December 26, 2010 $	December 27, 2009 $
Mortgage at a fixed interest rate of 4.79%, maturing October 1, 2010	-	2,367

Interest expense for the year on the mortgage loans payable amounted to $91 (2009 - $149).

Under the terms of the mortgage loans, the Co-operative had provided the related land and building as security.

9 Income taxes

a) The reconciliation of income tax computed at the statutory tax rates to the income tax provision is set out below.

The statutory income tax rate applicable to the Co-operative is 29.30% (2009 - 30.69%).

	Fiscal year ended December 26, 2010 $	Fiscal year ended December 27, 2009 $
Provision for income taxes based on statutory rates	326	203
Adjustment for permanent differences	52	73
Change in future income tax liabilities due to change in income tax rates	29	70
Other adjustments/recoveries of over accruals	(109)	17
Income tax provision	298	363

(in thousands of dollars)

b) The tax effect of temporary differences that give rise to significant components of the future income tax assets and future income tax liabilities is presented below:

	December 26, 2010 $	December 27, 2009 $
Future income tax assets		
Non-capital loss carryforwards	-	64
Deferred lease inducements	94	118
General reserves	573	496
Other assets	219	192
	886	870
Future income tax liabilities		
Property and equipment	1,865	1,599
Net future income tax liabilities	979	729

c) The current future income taxes relating to items included in OCI are:

	December 26, 2010 $	December 27, 2009 $
Foreign exchange contracts	129	1,228
Translation of hedged amounts owing to suppliers	(17)	(85)
Future income tax asset	112	1,143

10 Members’ shares

The authorized capital of the Co-operative is an unlimited number of shares with a par value of $5.00 per share. Each member is required to purchase one share for cash. The Co-operative distinguishes separately the number of outstanding shares issued for cash and the number issued by application of patronage return.

As set out in the rules of the Co-operative, membership entitles each member to one vote in the governance of the Co-operative and the right to purchase goods. Also as set out in the rules, member-initiated withdrawals are limited to 1% of the total share capital, subject to the discretion of the Board of Directors.

(in thousands of dollars)

The cumulative shares issued by source are as follows:

	December 26, 2010		December 27, 2009	
	Number of shares (000s)	**Amount $**	**Number of shares (000s)**	**Amount $**
Membership shares issued	3,406	17,036	3,194	15,973
Shares issued by application of patronage return	26,575	132,870	25,444	127,214
	29,981	149,906	28,638	143,187

A summary of shares issued and redeemed during the year is as follows:

	December 26, 2010		December 27, 2009	
	Number of shares (000s)	**Amount $**	**Number of shares (000s)**	**Amount $**
Balance - Beginning of year	28,638	143,187	26,040	130,201
Shares issued to new members	212	1,063	232	1,160
Shares issued by application of patronage return	1,578	7,891	2,436	12,176
Shares redeemed	(447)	(2,234)	(70)	(349)
Shares withdrawn	-	(1)	-	(1)
Balance - End of year	29,981	149,906	28,638	143,187

11 Contributed surplus

The changes in contributed surplus are as follows:

	December 26, 2010 $	**December 27, 2009 $**
Balance - Beginning of year	548	533
Unclaimed share redemption amounts	165	18
Claims of redemption amounts previously allocated to contributed surplus	(1)	(3)
Balance - End of year	712	548

(in thousands of dollars)

12 Commitments and contingencies

a) Lease commitments

The Co-operative has operating lease commitments for premises and certain equipment. The minimum annual lease payments scheduled for the next five years and thereafter are as follows:

	$
2011	4,366
2012	4,237
2013	4,232
2014	3,927
2015	2,568
Thereafter	9,577

b) Letters of credit

Letters of credit outstanding at December 26, 2010 amounted to US$3,772 (2009 - US$4,228). Of this amount, US$1,054 (2009 - US$1,391) has been included in amounts owing to suppliers, governments and employees in the consolidated balance sheet of the Co-operative.

c) Capital project commitments

The Co-operative is committed to future construction costs relating to a new store of up to $nil (2009 - $6,937).

13 Financial instruments and risk management

The Co-operative is exposed to the following risks related to its financial assets and liabilities:

a) Currency risk

The Co-operative is exposed to currency risk on some of its amounts owing to suppliers and expected inventory purchases, which are denominated in currencies other than Canadian dollars. The Co-operative uses foreign exchange forward contracts to manage the majority of this exposure.

(in thousands of dollars)

The consolidated balance sheet includes US dollar cash and cash equivalents, as well as US dollar amounts owing to suppliers. The balances in Canadian dollars and in US dollars are as follows:

	December 26, 2010		**December 27, 2009**	
	CA$	**US$**	**CA$**	**US$**
Outstanding cheques in excess of cash and cash equivalents	486	483	272	259
Amounts owing to suppliers	409	408	1,903	1,813

b) Fair value

The Co-operative's financial instruments include cash and cash equivalents, accounts receivable, and amounts owing to suppliers, governments and employees. The fair values of these financial instruments approximate their carrying values due to their relative short term to maturity.

c) Interest rate risk

The Co-operative is exposed to interest rate risk dependent upon the balance of its cash and cash equivalents.

d) Credit risk

Financial instruments that potentially subject the Co-operative to credit risk consist of cash and cash equivalents, bankers' acceptances and term deposits, and accounts receivable. The Co-operative uses reputable financial institutions for cash, bankers' acceptances and term deposits and believes the risk of loss to be remote. The Co-operative has accounts receivable from corporate members and governmental agencies, none of which the Co-operative believes represent a significant credit risk.

e) Liquidity risk

Liquidity risk is the risk that the Co-operative will not be able to meet its obligations as they become due. The Co-operative's approach to managing liquidity risk is to ensure that it always has sufficient cash flows and cash on hand and credit facilities to meet its operating obligations. The magnitude and timing of share redemptions is considered in managing liquidity risk.

(in thousands of dollars)

14 Supplementary cash flow information

		Fiscal year ended December 26, 2010 $	Fiscal year ended December 27, 2009 $
a)	Interest paid	255	453
b)	Income and capital taxes paid	61	59
c)	The following non-cash transactions occurred in the year:		
	Property and equipment purchased included in amounts owing to suppliers	430	403

Mountain Equipment Co-operative

Consolidated Schedules of Selling and Administration Expenses and Other Income and Expense

(in thousands of dollars)

	Fiscal year ended December 26, 2010 $	Fiscal year ended December 27, 2009 $
Selling and administration expenses		
Salaries, wages and employee benefits	46,275	43,949
Supplies and services	13,461	11,820
Rent and occupancy	10,259	9,179
Depreciation and amortization	7,947	7,758
Catalogue and membership	1,760	1,982
Interest	255	453
Provincial capital taxes	13	59
Loss on disposal of property and equipment	114	196
	80,084	75,396
Other income (expense)		
GST, HST and QST to be recovered in respect of patronage dividend	585	753
Gear swap proceeds	139	128
Rent and parking	1,278	1,208
Interest	6	4
Gift certificates unlikely to be cashed	107	160
Miscellaneous income	470	335
Unrealized loss on foreign exchange contracts (note 6)	-	(803)
	2,585	1,785