Financial Statements of

MOUNTAIN EQUIPMENT CO-OPERATIVE

Year ended December 30, 2012

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INDEPENDENT AUDITORS' 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 30, 2012, the consolidated statements of earnings and surplus and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

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 accounting standards for private enterprises, 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.

Auditors' 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 our 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, we consider 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 consolidated financial position of Mountain Equipment Co-operative as at December 30, 2012, and its consolidated results of operations and its consolidated cash flows for the year then ended in accordance with Canadian accounting standards for private enterprises.

Comparative information

The consolidated financial statements of Mountain Equipment Co-operative as at and for the year ended December 25, 2011, were audited by another auditor who expressed an unmodified opinion on those financial statements on April 11, 2012.

KPMG LLP

Chartered Accountants

April 10, 2013
Vancouver, Canada

MOUNTAIN EQUIPMENT CO-OPERATIVE

Consolidated Balance Sheet
(Expressed in thousands of dollars)

December 30, 2012, with comparative information for 2011

	December 30, 2012	December 25, 2011
Assets		
Current assets:		
Cash and cash equivalents (note 3)	$ 5,495	$ 8,905
Accounts receivable	789	1,038
Inventory (note 4)	69,343	62,470
Prepaids and deposits	2,760	2,830
	78,387	75,243
Property and equipment (note 6)	144,036	118,237
	$ 222,423	$ 193,480
Liabilities and Members' Equity		
Current liabilities:		
Operating loan (note 8(a))	$ 3,000	$ -
Amounts owing to suppliers, governments and employees (note 7)	26,085	23,699
Gift cards and provision for sales returns	8,570	8,402
Current portion of long-term debt (note 8(b))	985	-
Current portion of deferred lease inducements	132	126
	38,772	32,227
Long-term debt (note 8(b))	13,990	-
Deferred lease inducements	328	383
Future income taxes (note 9)	828	916
	53,918	33,526
Members' shares (note 10)	166,879	157,541
Contributed surplus (note 11)	653	673
Surplus	973	1,740
	168,505	159,954
Commitments and contingencies (note 12)		
Subsequent events (note 14)		
	$ 222,423	$ 193,480

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:

(signed) Bill Gibson Director (signed) Jonathan Gallo Director

MOUNTAIN EQUIPMENT CO-OPERATIVE

Consolidated Statement of Earnings and Surplus
(Expressed in thousands of dollars)

Year ended December 30, 2012, with comparative information for 2011

	Year ended December 30, 2012	Year ended December 25, 2011
Sales	$ 302,040	$ 270,157
Cost of sales	205,368	178,130
Gross margin	96,672	92,027
Selling and administration expenses (schedule)	91,898	85,364
	4,774	6,663
Other income (schedule)	2,583	2,510
Earnings before patronage return and income taxes	7,357	9,173
Patronage return	8,116	9,000
Earnings (loss) before income taxes	(759)	173
Provision for (recovery of) income taxes (note 9):		
Current	96	133
Future	(88)	(63)
	8	70
Net earnings (loss)	(767)	103
Surplus, beginning of year	1,740	1,637
Surplus, end of year	$ 973	$ 1,740

See accompanying notes to consolidated financial statements.

MOUNTAIN EQUIPMENT CO-OPERATIVE

Consolidated Statement of Cash Flows
(Expressed in thousands of dollars)

Year ended December 30, 2012, with comparative information for 2011

	Year ended December 30, 2012	Year ended December 25, 2011
Cash provided by (used in):		
Operations:		
Net earnings (loss)	$ (767)	$ 103
Items not involving cash:		
Amortization	8,435	8,346
Loss on disposal of property and equipment	23	-
Amortization of deferred lease inducements	(127)	(101)
Future income taxes	(88)	(63)
Shares issued by application of patronage return	8,116	9,000
	15,592	17,285
Change in non-cash operating working capital items related to operations	(3,700)	(5,208)
	11,892	12,077
Financing:		
Proceeds from operating loan	3,000	-
Proceeds from long-term debt	14,975	-
Shares issued to new members	1,229	1,128
Shares redeemed	(6)	(2,492)
Shares withdrawn	(1)	(1)
Contributed surplus from unclaimed share redemptions, net	(20)	(39)
	19,177	(1,404)
Investments:		
Purchase of property and equipment	(34,479)	(7,913)
Increase (decrease) in cash and cash equivalents	(3,410)	2,760
Cash and cash equivalents, beginning of year	8,905	6,145
Cash and cash equivalents, end of year	$ 5,495	$ 8,905
The following non-cash transactions occurred in the year:		
Property and equipment purchased included in amounts owing to suppliers	$ 717	$ 939

See accompanying notes to consolidated financial statements.

(Expressed in thousands of dollars)

1. Operations:

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 call centre and website.

The current fiscal year consists of 371 days (December 26, 2011 to December 30, 2012) and the comparative fiscal year consists of 364 days (December 27, 2010 to December 25, 2011).

2. Significant accounting policies:

(a) Consolidation and preparation of financial statements:

These consolidated financial statements have been prepared in accordance with accounting standards for private enterprises (“ASPE”) and include the accounts of the Co-operative’s wholly owned subsidiary, 1314625 Ontario Limited, a substantially inactive company.

(b) 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 call centre 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 returns.

(c) 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.

(d) Inventory:

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

Net realizable value is the estimated selling price in the ordinary course of business less the estimated necessary costs to make the sale.

(e) Property and equipment:

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

Asset	Basis	Rate
Buildings	Declining balance	4 - 6%
Furniture, fixtures and equipment	Declining balance	6 - 55%
Computer software	Straight line	5 years

2. Significant accounting policies (continued):

(e) Property and equipment (continued):

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.

(f) Lease inducements:

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.

(g) 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.

(h) 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 United States ("US") dollar inventory purchases.

Where the requirements for hedge accounting are met, the Co-operative designates and documents the foreign exchange contracts as hedges of anticipated US dollar inventory purchases. The documentation identifies the anticipated transaction 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.

The foreign exchange contracts held by the Co-operative at year-end that qualify for hedge accounting are not presented on the year-end balance sheet at their fair value. The gains and losses relating to these contracts are recognized as an adjustment to any gain or loss arising on the settlement of the hedged inventory purchases.

(i) 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 2012 cost of sales was a foreign exchange gain of $805 (2011 - gain of $1,457).

2. Significant accounting policies (continued):

(j) Employee benefits:

The Co-operative contributes on a defined contribution basis to assist employees with retirement savings. The cost is included in salaries, wages and employee benefits expense. Contributions of $1,237 (2011 - $1,185) were made during the fiscal year ended December 30, 2012.

(k) 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 financial statement carrying amount of existing assets and liabilities.

Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the year that includes the date of enactment or substantive enactment. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized. Income tax expense or benefit is the sum of the Co-operative's provision for the current income taxes and the difference between the opening and ending balances of the future income tax assets and liabilities.

(l) 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.

(m) Financial instruments:

Financial instruments are recorded at fair value on initial recognition. Freestanding derivative instruments that are not in a qualifying hedging relationship and equity instruments that are quoted in an active market are subsequently measured at fair value. All other financial instruments are subsequently measured at cost or amortized cost, unless management has elected to carry the instruments at fair value. The Co-operative has not elected to carry any such financial instruments at fair value.

Transaction costs incurred on the acquisition of financial instruments measured subsequently at fair value are expensed as incurred. All other financial instruments are adjusted by transaction costs incurred on acquisition and financing costs. These costs are amortized using the straight-line method.

(Expressed in thousands of dollars)

2. Significant accounting policies (continued):

(m) Financial instruments (continued):

Financial assets are assessed for impairment on an annual basis at the end of the fiscal year if there are indicators of impairment. If there is an indicator of impairment, the Co-operative determines if there is a significant adverse change in the expected amount or timing of future cash flows from the financial asset. If there is a significant adverse change in the expected cash flows, the carrying value of the financial asset is reduced to the highest of the present value of the expected cash flows, the amount that could be realized from selling the financial asset or the amount the Co-operative expects to realize by exercising its right to any collateral. If events and circumstances reverse in a future period, an impairment loss will be reversed to the extent of the improvement, not exceeding the initial impairment charge.

(n) Comparative information:

Certain comparative information has been reclassified to conform with the financial statement presentation adopted for the current year.

3. Cash and cash equivalents:

Cash and cash equivalents consist of the following:

	December 30, 2012	December 25, 2011
Cash and cash equivalents less outstanding cheques	$ 5,495	$ (2,026)
Bankers' acceptances and term deposits (at 1.00% to 1.01%)	-	10,795
Restricted cash	-	136
	$ 5,495	$ 8,905

Restricted cash relates to amounts held in trust for construction holdbacks.

4. Inventory:

	December 30, 2012	December 25, 2011
Raw materials	$ 925	$ 1,543
Work-in-progress	585	522
Finished goods	69,171	61,861
Inventory provision	(1,338)	(1,456)
	$ 69,343	$ 62,470

(Expressed in thousands of dollars)

4. Inventory (continued):

The amount of inventories recognized as a component of cost of sales during the year was $185,408 (2011 - $159,608).

Also included within cost of sales for the year ended December 30, 2012 are charges to inventory within the normal course of business, made throughout the year, of $3,743 (2011 - $3,061). These charges include the disposal of obsolete and damaged product, shrinkage, and permanent markdowns to net realizable values.

5. Foreign exchange contracts:

The Co-operative holds 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 to purchase US currency outstanding totalling USD$50,000 (2011 - USD$43,700) at an average rate of CAD$0.99 (2011 - CAD$0.99) that mature at various dates to August 2, 2013 (2011 - to September 7, 2012). At December 30, 2012, these contracts all qualified for hedge accounting.

6. Property and equipment:

			December 30, 2012	December 25, 2011
	Cost	Accumulated amortization	Net book value	Net book value
Land	$ 51,971	$ -	$ 51,971	$ 30,230
Buildings	71,619	17,324	54,295	41,659
Furniture, fixtures and equipment	41,251	30,045	11,206	11,142
Leasehold improvements	33,258	13,720	19,538	20,095
Computer software	16,518	14,034	2,484	2,598
	214,617	75,123	139,494	105,724
Capital projects in progress	4,542	-	4,542	12,513
	$ 219,159	$ 75,123	$ 144,036	$ 118,237

Amortization for the year amounted to $8,435 (2011 - $8,346).

7. Amounts owing to suppliers, governments and employees:

Government remittances payable at December 30, 2012 in the amount of $2,129 (2011 - $1,560) relating to federal and provincial sales taxes, payroll taxes, and workers' safety insurance are included in amounts owing to suppliers, governments and employees.

8. Operating loan and long-term debt:

(a) Operating loan:

The Co-operative has available a revolving demand credit facility of $45,000 that has been arranged to fund general operations. The facility can be drawn through bankers' acceptances, Canadian and US dollar operating loans, LIBOR loans and letters of credit (note 12(b)). The loan is secured by a general security agreement and a first charge on certain property. As at December 30, 2012, $36,019 (2011 - $25,276) of the facility was available.

LIBOR based loans accrue interest at Libor plus 1.0% - 1.5%. Operating loans accrue interest at the bank's prime rate plus 0% - 0.5%. US operating loans accrue interest at the US base rate plus 0% - 0.5%. Bankers Acceptances accrue interest at the banker's acceptance rate plus 1.0% - 1.5%. The amount of the spread, in excess of the base interest rate, varies with reference to certain financial ratios of the Co-operative.

The outstanding loan as at December 30, 2012 has been advanced through Bankers' Acceptances.

(b) Long-term debt:

The Co-operative has a long-term debt facility of $15,000 that has been arranged to fund capital expenditures. The facility can be drawn through bankers' acceptances and Canadian operating loans and is secured by a general security agreement and a first charge on certain property. Repayment of the long-term debt is in quarterly installments of $250,000, plus interest, amortized over a 15-year period. The loan matures on September 30, 2014. As at December 30, 2012, the loan balance is $15,000 (2011 - nil).

Operating loans accrue interest at the bank's prime rate plus 0% - 0.5%. Bankers Acceptances accrue interest at the banker's acceptance rate plus 1.0% - 1.5%. The amount of the spread, in excess of the base interest rate, varies with reference to certain financial ratios of the Co-operative.

The outstanding loan as at December 30, 2012 has been drawn through Bankers' Acceptances.

Under the terms of the above mentioned credit facilities, the Co-operative is required to meet certain financial covenants. As at December 30, 2012, the Co-operative was in compliance with the covenants.

(Expressed in thousands of dollars)

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 25.73% (2011 - 27.29%).

	December 30, 2012	December 25, 2011
Provision for income taxes based on statutory rates	$ (195)	$ 47
Adjustment for permanent differences	157	49
Change in future income tax liabilities due to change in income tax rates	4	12
Other adjustment/recoveries of over accruals	42	(38)
	$ 8	$ 70

(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 30, 2012	December 25, 2011
Future income tax assets:		
Deferred lease inducements	$ 119	$ 130
General reserves	659	614
Other assets	118	113
	896	857
Future income tax liabilities:		
Property and equipment	1,724	1,773
	$ 828	$ 916

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.

10. Members' shares (continued):

The cumulative shares issued by source are as follows:

	December 30, 2012		December 25, 2011	
	Number of shares	Amount	Number of shares	Amount
	(000s)		(000s)	
Membership shares issued	3,879	$ 19,395	3,633	$ 18,165
Shares issued by application of patronage return	29,497	147,484	27,875	139,376
	33,376	$ 166,879	31,508	$ 157,541

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

	December 30, 2012		December 25, 2011	
	Number of shares	Amount	Number of shares	Amount
	(000s)		(000s)	
Balance, beginning of year	31,508	$ 157,541	29,981	$ 149,906
Shares issued to new members	246	1,229	225	1,128
Shares issued by application of patronage return	1,623	8,116	1,800	9,000
Shares redeemed	(1)	(6)	(498)	(2,492)
Shares withdrawn	-	(1)	-	(1)
	33,376	$ 166,879	31,508	$ 157,541

11. Contributed surplus:

The changes in contributed surplus are as follows:

	December 30, 2012	December 25, 2011
Balance, beginning of year	$ 673	$ 712
Unclaimed share redemption amounts	22	-
Claims of share redemption amounts previously allocated to contributed surplus	(42)	(39)
	$ 653	$ 673

(Expressed 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:

2013	$	4,890
2014		4,828
2015		3,684
2016		3,025
2017		2,873
Thereafter		11,217

(b) Letters of credit:

At December 30, 2012, the Co-operative had outstanding letters of credit in various currencies through its financial institutions to provide guarantees to certain suppliers. The letters of credit outstanding at December 30, 2012 amounted to CAD$855 and USD$4,541 and Euro $461; 2011 - CAD$526 and USD$4,098. Of this amount, USD$2,228 (2011 - USD$1,201) 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 store expansion of up to $262 (2011 - construction of a new store $4,216). At December 30, 2012, the Co-operative had a standby letter of credit relating to delivery of certain municipal requirements for the expansion project of $113 (2011 - nil). No accrual has been made for this standby letter of credit as all required deliverables are expected to be met through the project.

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.

(Expressed in thousands of dollars)

13. Financial instruments and risk management (continued):

(a) Currency risk (continued):

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 30, 2012		December 25, 2011	
	CAD	USD	CAD	USD
Outstanding cheques in excess of cash and cash equivalents	$ 1,124	$ 1,129	$ 1,003	$ 983
Amounts owing to suppliers	5,410	5,436	2,482	2,431

(b) Interest rate risk:

The Co-operative's exposure to interest rate risk depends upon the balance of its cash and cash equivalents, operating loan and long-term debt. The demand-operating loan and long-term debt are subject to interest rate risk as the required cash flow to service the debt will fluctuate as a result of changing market interest rates.

(c) 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 government agencies, none of which the Co-operative believes represent a significant credit risk.

(d) 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 are considered in managing liquidity risk.

14. Subsequent events:

(a) Sale agreement - Vancouver property:

Subsequent to year end, the Co-operative entered into an agreement to sell a property located in Vancouver, British Columbia and entered into a development management agreement and related leaseback arrangement with the purchaser. The total project cost, which will be financed by the purchaser, is estimated to be between $51,060 and $54,600 and is expected to complete in 2014. It is anticipated that this sale leaseback transaction will be recorded as a capital lease on the balance sheet of the Cooperative. The transaction is not expected to result in any net financial gain or loss.

(b) Sale agreement - Ottawa property:

Subsequent to year end, the Co-operative completed the remaining processes required to meet the conditions outstanding on a sale agreement of an investment property in Ottawa, Ontario. This property was incidental to a larger parcel acquired to allow for the expansion of the Ottawa store. The sale of the property will result in a net gain of $140.

MOUNTAIN EQUIPMENT CO-OPERATIVE

Consolidated Schedules of Selling and Administration Expenses and Other Income
(Expressed in thousands of dollars)

Year ended December 30, 2012, with comparative information for 2011

	Year ended December 30, 2012	Year ended December 25, 2011
Selling and administration expenses:		
Salaries, wages and employee benefits	$ 54,142	$ 49,671
Supplies and services	16,628	14,451
Rent and occupancy	11,752	11,047
Amortization	8,435	8,346
Catalogue and membership	-	1,713
Interest	918	136
Loss on disposal of property and equipment	23	-
	$ 91,898	$ 85,364

	Year ended December 30, 2012	Year ended December 25, 2011
Other income (expenses):		
Rent and parking	$ 1,580	$ 1,380
Gear swap and MEC events proceeds	299	193
Gift certificates unlikely to be cashed	760	148
Miscellaneous income (expense)	329	(25)
Interest	19	17
GST, HST and QST to be recovered in respect of patronage dividend, net of costs incurred	(404)	797
	$ 2,583	$ 2,510