



Recreational Equipment, Inc. and Subsidiaries
FINANCIAL STATEMENTS
 For the years ended December 31, 2007 and 2006



Report of Independent Certified Public Accountants

Board of Directors
 Recreational Equipment, Inc.

We have audited the accompanying consolidated balance sheets of Recreational Equipment, Inc. (a Washington corporation) and Subsidiary as of December 31, 2007 and 2006, and the related consolidated statements of income, members' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 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 Recreational Equipment, Inc. and Subsidiary as of December 31, 2007 and 2006, 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.

Grant Thornton LLP
 Seattle, Washington
 March 21, 2008

Recreational Equipment, Inc.

CONSOLIDATED BALANCE SHEETS

For the years ended December 31, 2007 and 2006

(IN THOUSANDS)

	2007	2006
Assets		
Current assets:		
Cash and cash equivalents	\$ 13,506	\$ 14,756
Short-term investments	131,447	145,198
Accounts receivable, less allowance for doubtful accounts of \$256 and \$169, respectively	22,615	12,634
Inventories	180,971	155,265
Deferred income taxes	23,248	20,437
Prepaid expenses and other	17,880	12,130
Total current assets	<u>389,667</u>	<u>360,420</u>
Property, plant, and equipment, net	368,360	306,486
Deferred income taxes	3,526	2,714
Other	6,803	5,207
Total assets	<u>\$ 768,356</u>	<u>\$ 674,827</u>
Liabilities and members' equity		
Current liabilities:		
Accounts payable	\$ 64,996	\$ 50,944
Customer related obligations	69,986	58,042
Patronage refunds payable	58,598	55,062
Accrued payroll and related benefits	37,073	34,705
REI Visa rebate payable	28,451	24,950
Business taxes and other accrued liabilities	21,537	21,117
Retirement and profit-sharing liabilities	19,451	17,095
Income taxes payable	8,349	11,243
Total current liabilities	<u>308,441</u>	<u>274,058</u>
Deferred rent and other liabilities	41,882	33,555
Members' equity:		
Memberships	102,067	92,675
Retained earnings	315,966	274,539
Total members' equity	<u>418,033</u>	<u>367,214</u>
Total liabilities and members' equity	<u>\$ 768,356</u>	<u>\$ 674,827</u>

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

Recreational Equipment, Inc.

CONSOLIDATED STATEMENTS OF INCOME

For the years ended December 31, 2007 and 2006

(IN THOUSANDS)

	2007	2006
Net sales	\$ 1,342,024	\$ 1,181,531
Cost of sales	<u>754,671</u>	<u>659,568</u>
Gross profit	587,353	521,963
Operating expenses:		
Payroll-related costs	253,852	224,844
Occupancy, general and administrative	<u>226,975</u>	<u>191,569</u>
	480,827	416,413
Operating income	106,526	105,550
Other income, net	10,798	7,721
Income before patronage refunds and income taxes	117,324	113,271
Patronage refunds	<u>53,423</u>	<u>49,409</u>
Income before income taxes	63,901	63,862
Provision for income taxes	<u>22,474</u>	<u>23,589</u>
Net income	<u>\$ 41,427</u>	<u>\$ 40,273</u>

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

Recreational Equipment, Inc.

CONSOLIDATED STATEMENT OF MEMBERS' EQUITY

For the years ended December 31, 2007 and 2006

(IN THOUSANDS)

	Memberships	Retained Earnings	Total Members' Equity
Balance at January 1, 2006	\$ 84,407	\$ 236,510	\$ 320,917
Cumulative effect of adoption of accounting principle, net of tax of \$1,314 (note A)	-	(2,244)	(2,244)
Memberships issued	8,268	-	8,268
Net income	-	40,273	40,273
Balance at December 31, 2006	92,675	274,539	367,214
Memberships issued	9,392	-	9,392
Net income	-	41,427	41,427
Balance at December 31, 2007	\$ 102,067	\$ 315,966	\$ 418,033

The accompanying notes are an integral part of this financial statement.

6

Recreational Equipment, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2007 and 2006

NOTE A - SIGNIFICANT ACCOUNTING POLICIES

1. Business Overview

Recreational Equipment, Inc. and its subsidiary ("REI" or the "Company") operate as a cooperative for the purpose of purchasing and selling outdoor equipment and sporting goods through 96 retail stores located throughout the United States and via the Internet and mail order to the United States and internationally. The Company sells and services gift cards through its wholly owned subsidiary, REI Customer Services, Inc.

2. Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary. All intercompany balances and transactions have been eliminated upon consolidation.

3. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

4. Cash and Cash Equivalents

The Company considers all highly liquid instruments with original maturities of three months or less to be cash equivalents. Cash and cash equivalents include payments due from banks for third-party credit card and debit card deposits which are typically received within 24 to 48 hours of the sales transaction, except for transactions occurring on a Friday, which are generally processed the following Monday. Amounts due from banks for these transactions, which are classified as cash, totaled \$9,365,000 and \$6,998,000 at December 31, 2007 and 2006, respectively. The Company maintains cash and cash equivalent balances with financial institutions that exceed federally insured limits. The Company has not experienced any losses related to these balances, and management believes its credit risk to be minimal.

5. Cash Management

The Company's cash management system provides for the reimbursement of all major bank disbursement accounts on a daily basis. Accounts payable at December 31, 2007 and 2006 included \$13,406,000 and \$10,713,000, respectively, of checks issued but not yet presented for payment. Furthermore, accrued payroll at December 31, 2007 and 2006 included \$1,204,000 and \$1,366,000, respectively, of checks issued but not yet presented for payment.

8

Recreational Equipment, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31, 2007 and 2006

(IN THOUSANDS)

	2007	2006
Operating activities		
Net income	\$ 41,427	\$ 40,273
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	40,772	34,131
Provision for sales returns	2,169	2,377
Benefit from deferred income taxes	(3,623)	(5,221)
Deferred rent expense	1,812	1,836
Loss on sale of equipment and asset write-downs	116	1,156
Changes in operating assets and liabilities:		
Increase in accounts receivable	(9,981)	(4,729)
Increase in inventories	(22,956)	(18,665)
Increase in prepaids and other current assets	(5,750)	(2,113)
Increase in payables and other accrued expenses	27,769	22,966
Net cash provided by operating activities	71,755	72,911
Investing activities:		
Purchases of short-term investments	(1,191,072)	(1,075,665)
Proceeds from sale of short-term investments	1,204,823	1,054,873
Purchases of property and equipment	(105,283)	(63,259)
Proceeds from landlords for leasehold improvements	9,135	7,770
Net cash used in investing activities	(82,397)	(76,281)
Financing activities:		
Proceeds from sale of memberships	9,392	8,268
Net cash provided by financing activities	9,392	8,268
Net increase (decrease) in cash and cash equivalents	(1,250)	3,998
Cash and cash equivalents at beginning of year	14,756	10,758
Cash and cash equivalents at end of year	\$ 13,506	\$ 14,756
Supplemental disclosures of cash flow information		
Cash paid for:		
Interest	\$ 27	\$ -
Income taxes	\$ 28,971	\$ 26,783

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

7

Recreational Equipment, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2007 and 2006

NOTE A - SIGNIFICANT ACCOUNTING POLICIES - Continued

6. Short-Term Investments

Short-term investments consist primarily of auction rate securities purchased from institutions. Such securities have legal maturities that typically are at least 20 years, but have interest rates that reset on a periodic basis (typically less than 90 days). Furthermore, the Company has the right to sell these securities at each reset date, and as such are deemed short-term investments. These securities are carried at cost, which approximates fair value and which is based on quoted market values. Beginning in mid-February 2008, many auction rate securities failed auction due to sell orders exceeding buy orders. Anticipating this possibility, the Company sold their investments in auction rate securities in advance of these failed auctions and did not experience any losses related to the sales of these securities.

7. Fair Value of Financial Instruments

The carrying value of financial instruments, including cash and cash equivalents, receivables, and payables, approximate fair value at December 31, 2007 and 2006.

8. Inventories

Inventories are valued at the lower of cost or market. Cost is determined by using a weighted-average cost method. The Company records a write-down of inventories which are obsolete or slow-moving based upon historical experience and the application of the specific identification method.

9. Property, Plant, and Equipment

Property, plant, and equipment are recorded at cost. Depreciation is computed primarily by using the straight-line method based on the assets' estimated useful lives, which are 15 to 30 years for buildings and improvements; 3 to 10 years for equipment, furniture, and fixtures; and 3 years for rental equipment. Leasehold improvements are amortized using the straight-line method over the lease period or useful life of the improvements, whichever is shorter. Maintenance and repairs are charged to expense as incurred, and renewals and betterments which add to the productive capacity or extend the useful life of the asset are capitalized. Pre-opening costs for new store locations are expensed as incurred.

The Company capitalizes certain costs incurred in connection with developing or obtaining internal-use software in accordance with Statement of Position (SOP) No. 98-1, *Accounting for the Costs of Computer Software Developed for or Obtained for Internal Use*. Costs of \$4,522,000 and \$3,692,000 were capitalized for the year ended December 31, 2007 and 2006, respectively, and have been recorded within property, plant, and equipment.

9

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2007 and 2006

NOTE A - SIGNIFICANT ACCOUNTING POLICIES - Continued

10. Deferred Rent

As part of entering into certain retail store leases, the lessor provides the Company with a tenant improvement allowance. Typically, such allowances are in the form of cash and represent reimbursements to the Company for tenant improvements made to the leased space. These improvements are capitalized as fixed assets, and the allowances are classified as a deferred rent liability. In accordance with Financial Accounting Standards Board (FASB) Technical Bulletin No. 88-1, *Issues Relating to Accounting for Leases*, this incentive is considered a reduction of rental expense by the lessee over the term of the lease and recognized on a straight-line basis over the same term. Tenant allowances in the amounts of \$28,049,000 and \$21,435,000 were included as a component of deferred rent during the years ended December 31, 2007 and 2006, respectively.

A majority of the Company's retail store leases have payment escalation clauses. The Company records rent expense on a straight-line basis in accordance with SFAS No. 13, *Accounting for Leases*. Rent expense in excess of cash payments is recorded as a deferred rent obligation.

11. Revenue Recognition

The Company recognizes revenue from product sales when products are purchased by customers at the Company's stores or when products are shipped for internet and mail order. Revenue is recorded net of sales discounts and allowances for returns. Shipping revenue is included in net sales and the related costs of shipping are included in cost of goods sold. Proceeds received from gift cards are recorded as deferred revenue which is a component of customer related obligations on the consolidated balance sheets. The Company recognizes revenue associated with gift cards at such time as the items are redeemed for merchandise or services, or redemption becomes unlikely. The determination of the likelihood of redemption is based on an analysis of the Company's historical redemption trends.

12. Memberships

As a cooperative, the Company is owned by its members. Each member is entitled to one vote in the election of the Company's Board of Directors. The nontransferable, nontransferable, one-time membership fee is \$15 dollars. As of December 31, 2007, there were approximately 8.8 million members.

13. Patronage Refunds

The Company declares a patronage refund to members based on the level of qualifying member purchases during the year, which is limited to the distribution of operating income as defined, as required by the Company's bylaws. Members have an unqualified right to redeem their refunds in the year they are issued plus the succeeding year. For example, if a patronage refund is issued in February 2007, those members would have a right to redeem their refund through December 31, 2008. Members may redeem their refunds for merchandise credit upon receipt of the refund notice, or they may redeem the refunds for cash between June 30th and December 31st. Members lose their right to redeem the refunds allocated to them if they do not request payment or obtain a merchandise credit within this period.

10

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2007 and 2006

NOTE A - SIGNIFICANT ACCOUNTING POLICIES - Continued

18. Sabbatical Leave

In accordance with the provisions of EITF 06-02, *Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43*, the Company records the compensation cost associated with sabbatical leaves over the requisite service periods. The Company provides paid leave to employees with service of 15 or more years. This pronouncement was effective for fiscal year beginning after December 15, 2006. The Company elected to early adopt this guidance for the year ended December 31, 2006 and recorded a cumulative effect adjustment to retained earnings as of January 1, 2006 in the amount of \$2,244,000 which is net of income taxes of \$1,314,000. The sabbatical leave liability as of December 31, 2007 and 2006 was \$2,853,000 and \$3,200,000, respectively.

19. Recent Accounting Pronouncements

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (FIN 48). This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. In January 2008, the FASB issued a staff position deferring the effective date for adoption of FIN 48 for private companies to fiscal years beginning after December 15, 2007. The Company does not expect that the adoption of this statement will have a material impact on the consolidated results of operations or financial condition.

In June 2006, the FASB ratified the consensus reached on Emerging Issues Task Force (EITF) Issue No. 06-03, *How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (that is, Gross Versus Net Presentation)*. The EITF reached a consensus that the presentation of taxes on either a gross or net basis is an accounting policy decision that requires disclosure. EITF 06-03 was effective for beginning January 1, 2007. The Company collects amounts from customers, which under common trade practices are referred to as sales taxes, and records these amounts on a net basis. The Company has not modified this accounting policy; therefore, the adoption of EITF 06-03 did not have any effect on the Company's financial statements.

20. Reclassification

Certain reclassifications of the prior year amounts presented have been made to conform to the current year financial statement presentation. The reclassifications had no impact on operating income or net income.

12

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2007 and 2006

NOTE A - SIGNIFICANT ACCOUNTING POLICIES - Continued

The Company records the patronage refunds payable liability based upon its estimated refunds that will be claimed by its members prior to the refund expiration date. The Company has historical experience that demonstrates that less than 100% of its members claim their patronage refunds within the time period these refunds are available to them. The 2007 patronage refunds of \$53,423,000 are net of estimated refunds that will expire in 2009, and the 2006 patronage refunds of \$49,409,000 are net of estimated refunds that will expire in 2008.

14. Customer Related Obligations

Customer related obligations consist primarily of deferred revenue for unredeemed gifts cards and merchandise credits. The Company recognizes income from gift cards and merchandise credits when: 1) the gift card or merchandise credit is redeemed by the customer, or 2) the likelihood of the gift card or merchandise credit being redeemed by the customer is remote (breakage). Breakage rates are determined based upon historical redemption patterns. Gift card and merchandise breakage income is included in other income in the consolidated statements of income.

15. Income Taxes

The Company operates as a cooperative subject to taxes on all income not distributed to members. The Company computes income taxes using the asset and liability method, under which deferred income taxes are provided for the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the tax basis. The deferred tax assets and liabilities are calculated using the enacted tax rates that are expected to be in effect when the differences are expected to reverse. The Company establishes a valuation allowance for deferred tax assets if it is more likely than not that these items will expire before the Company is able to realize the benefit or future deductibility is uncertain.

16. Advertising

The Company expenses the costs of advertising as incurred. Advertising expense for the years ended December 31, 2007 and 2006 was \$33,710,000 and \$27,037,000, respectively.

17. Asset Impairment and Closure of Certain Operations

When facts and circumstances indicate that the carrying values of long-lived assets may be impaired, an evaluation for impairment is performed. An asset is considered impaired when estimated undiscounted, future cash flows are less than the carrying amount of the asset. In the event that the carrying amount of such asset is not deemed recoverable, the asset is adjusted to its estimated fair value. Fair value is generally determined based upon discounted future cash flow. Property, plant, and equipment assets are grouped at the lowest level in which there are identifiable cash flows when assessing impairment. Cash flows for retail assets are identified at the individual store level. No long-lived assets are considered impaired at December 31, 2007 or 2006.

11

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2007 and 2006

NOTE B - PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment consist of the following (in thousands):

	2007	2006
Property, plant, and equipment:		
Buildings and improvements	\$ 198,037	\$ 169,032
Equipment, furniture, and fixtures	230,529	183,376
Leasehold improvements	99,343	79,775
Rental equipment	2,838	2,843
	530,747	435,026
Less: accumulated depreciation and amortization	264,837	231,872
	265,910	203,154
Land	81,101	79,841
Construction-in-progress	21,349	23,491
Net property, plant, and equipment	\$ 368,360	\$ 306,486

NOTE C - LINES OF CREDIT

The Company has a line of credit available with a bank that permits borrowings of up to \$4,000,000. Interest on outstanding borrowings accrues at the prime rate. No amounts were outstanding under this line of credit at December 31, 2007 and 2006. At December 31, 2007, approximately \$347,000 of the amounts available under the line of credit was reserved for outstanding letters of credit. The Company was in compliance with all covenants imposed by the line of credit agreement as of December 31, 2007 and 2006.

13

Recreational Equipment, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended December 31, 2007 and 2006

NOTE D - INCOME TAXES

The provision for income taxes is as follows for the years ended December 31 (in thousands):

	2007	2006
Provision for income taxes:		
Current:		
U.S. federal	\$ 22,740	\$ 25,534
State	3,357	3,276
	26,097	28,810
Deferred	(3,623)	(5,221)
	<u>\$ 22,474</u>	<u>\$ 23,589</u>

A reconciliation from the U.S. statutory rate to the effective tax rate is as follows for the years ended December 31 (in thousands):

	2007		2006	
	Amount	Percent	Amount	Percent
Tax at U.S. statutory rate	\$ 22,365	35.00%	\$ 22,352	35.00%
State income taxes, net of federal tax benefit	2,182	3.41%	2,129	3.33%
Tax-exempt income	(1,005)	(1.57%)	(1,054)	(1.65%)
Other	(1,068)	(1.67%)	162	0.26%
	<u>\$ 22,474</u>	<u>35.17%</u>	<u>\$ 23,589</u>	<u>36.94%</u>

14

Recreational Equipment, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended December 31, 2007 and 2006

NOTE F - COMMITMENTS AND CONTINGENCIES

1. Leases

The Company conducts a majority of its operations from leased facilities that include 72 domestic retail stores. These leases are classified as operating leases. All leases expire within the next 20 years but contain various renewal options. Certain of these leases contain provisions for contingent rentals based on a percentage of sales revenue. Contingent rentals totaled \$79,000 and \$266,000 during 2007 and 2006, respectively. Rental expense under operating leases was approximately \$27,009,000 and \$21,588,000 for the years ended December 31, 2007 and 2006, respectively.

Future minimum lease payments under noncancelable operating leases with remaining terms in excess of one year as of December 31, 2007, are as follows (in thousands):

2008	\$ 31,736
2009	33,683
2010	33,847
2011	33,550
2012	31,132
Thereafter	131,672
	<u>\$ 295,620</u>

2. Other Commitments

In the ordinary course of opening new stores or remodeling existing stores, the Company enters into construction related contracts. These commitments are typically for a period of less than one year and totaled approximately \$5,683,000 as of December 31, 2007.

3. Contingencies

The Company is subject to legal proceedings and claims that have arisen in the ordinary course of business that have not been finally adjudicated. In management's opinion, these actions, when finally concluded and determined, will not have a material adverse effect upon the consolidated financial position of the Company.

16

Recreational Equipment, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended December 31, 2007 and 2006

NOTE D - INCOME TAXES - Continued

Significant components of the Company's deferred income taxes are as follows for December 31, (in thousands):

	2007	2006
Deferred tax assets (liabilities):		
Current:		
Patronage refunds	\$ 5,221	\$ 4,662
Inventory basis differences	(4,524)	(3,941)
Gift cards	14,464	12,577
Accruals for financial statements in excess of tax deductions	7,608	6,633
State tax expense	479	506
	23,248	20,437
Noncurrent:		
Fixed asset depreciation and basis differences	(2,706)	(2,408)
Accruals for financial statements in excess of tax deductions	5,201	4,485
Nonqualified pension accrual	1,031	631
Other	-	6
	3,526	2,714
Net deferred tax assets	<u>\$ 26,774</u>	<u>\$ 23,151</u>

NOTE E - EMPLOYEE BENEFITS PLAN

The Company has a defined contribution retirement and profit-sharing plan covering employees meeting certain eligibility requirements (generally, one year and 1,000 hours of service). Company contributions are based on a percentage of eligible participant compensation ranging from 5% to 15%, depending on the Company's profitability. The retirement and profit-sharing plan Company contributions were approximately \$19,063,000 and \$16,792,000 for the years ended December 31, 2007 and 2006, respectively.

The Company also has a nonqualified, deferred compensation plan which provides the Company's highly compensated employees with a contribution equal to that which would have been allocated to them under the qualified retirement plan were it not for the limitations imposed by IRC Section 401(a)(17) and Section 415. The plan also provides a voluntary pay deferral option enabling participants to contribute a portion of their respective annual compensation. The Company's contributions to the nonqualified deferred compensation plan are based on a percentage of eligible participant compensation ranging from 5% to 15%, depending on the Company's profitability. Total participant and employer contributions were approximately \$1,208,000 and \$1,197,000 for the years ended December 31, 2007 and 2006, respectively.

15

Recreational Equipment, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended December 31, 2007 and 2006

NOTE G - RELATED PARTY TRANSACTIONS

During 2006, the Company purchased a 20 percent equity interest for \$1,000,000 in a company that designs and distributes footwear. During 2007, the Company purchased additional common stock in the amount of \$251,000 which increased its equity interest to 21.6%. The Company accounts for this investment under the equity method and recognized their proportionate share of losses during the years ended December 31, 2007 and 2006 in the amount of \$130,000 and \$92,000, respectively. Additionally, as of December 31, 2007, the Company advanced \$1,897,000 to this entity for merchandise to be received in 2008, which is reflected in prepaid expenses.

17