ACE HARDWARE CORPORATION
2019 Annual Report

ACE HARDWARE CORPORATION
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Auditors

The Board of Directors
Ace Hardware Corporation

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Ace Hardware Corporation, which comprise the consolidated balance sheets as of December 28, 2019 and December 29, 2018, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the three fiscal years in the period ended December 28, 2019, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

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. 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Ace Hardware Corporation at December 28, 2019 and December 29, 2018, and the consolidated results of its operations and its cash flows for each of the three fiscal years in the period ended December 28, 2019, in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

Chicago, Illinois
February 12, 2020

ACE HARDWARE CORPORATION
CONSOLIDATED BALANCE SHEETS
(In millions, except share data)

	December 28, 2019	December 29, 2018
Assets		
Cash and cash equivalents	$ 18.2	$ 25.6
Marketable securities	59.5	50.4
Receivables, net of allowance for doubtful accounts of $5.4 and $6.7, respectively	486.5	434.4
Inventories	930.8	931.8
Prepaid expenses and other current assets	45.5	50.4
Total current assets	1,540.5	1,492.6
Property and equipment, net	381.7	368.6
Notes receivable, net of allowance for doubtful accounts of $1.5 and $2.8, respectively	9.9	11.8
Goodwill and other intangible assets	90.5	94.2
Other assets	105.4	91.3
Total assets	$ 2,128.0	$ 2,058.5
Liabilities and Equity		
Current maturities of long-term debt	$ 67.0	$ 60.6
Accounts payable	791.8	748.9
Patronage distributions payable in cash	70.4	55.0
Patronage refund certificates payable	17.4	10.2
Accrued expenses	205.9	173.6
Total current liabilities	1,152.5	1,048.3
Long-term debt	209.9	267.1
Patronage refund certificates payable	107.3	95.6
Other long-term liabilities	92.5	79.7
Total liabilities	1,562.2	1,490.7
Member Retailers' Equity:		
Class A voting common stock, $1,000 par value, 10,000 shares authorized, 2,691 and 2,719 issued and outstanding, respectively	2.7	2.7
Class C nonvoting common stock, $100 par value, 6,000,000 shares authorized, 4,827,851 and 4,648,554 issued and outstanding, respectively	482.7	464.8
Class C nonvoting common stock, $100 par value, issuable to retailers for patronage distributions, 546,146 and 439,591 shares issuable, respectively	54.6	44.0
Contributed capital	18.8	18.5
(Accumulated deficit) retained earnings	(8.7)	24.8
Accumulated other comprehensive income (loss)	0.9	(1.2)
Equity attributable to Ace member retailers	551.0	553.6
Equity attributable to noncontrolling interests	14.8	14.2
Total equity	565.8	567.8
Total liabilities and equity	$ 2,128.0	$ 2,058.5

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(In millions)

	Years Ended		
	December 28, 2019 (52 Weeks)	**December 29, 2018 (52 Weeks)**	**December 30, 2017 (52 Weeks)**
Revenues:			
Wholesale revenues	$ 5,564.5	$ 5,341.6	$ 5,091.2
Retail revenues	506.7	375.4	297.2
Total revenues	6,071.2	5,717.0	5,388.4
Cost of revenues:			
Wholesale cost of revenues	4,898.6	4,707.4	4,466.9
Retail cost of revenues	280.0	214.5	167.2
Total cost of revenues	5,178.6	4,921.9	4,634.1
Gross profit:			
Wholesale gross profit	665.9	634.2	624.3
Retail gross profit	226.7	160.9	130.0
Total gross profit	892.6	795.1	754.3
Wholesale operating expenses:			
Distribution operations expenses	178.2	163.7	151.7
Selling, general and administrative expenses	195.1	187.7	182.2
Retailer success and development expenses	166.8	159.1	149.3
Retail operating expenses	201.5	154.4	113.9
Retail pre-opening expenses	8.7	1.7	1.2
Goodwill impairment charge	8.5	-	-
Total operating expenses	758.8	666.6	598.3
Operating income	133.8	128.5	156.0
Interest expense	(22.7)	(20.4)	(14.6)
Interest income	6.9	9.6	4.3
Other income, net	10.8	8.0	6.4
Income tax benefit (expense)	11.6	2.5	(4.7)
Net income	140.4	128.2	147.4
Less: net income attributable to noncontrolling interests	-	0.5	0.8
Net income attributable to Ace Hardware Corporation	$ 140.4	$ 127.7	$ 146.6
Patronage distributions accrued	$ 182.2	$ 141.8	$ 155.5
Patronage distributions accrued for third party retailers	$ 172.5	$ 135.4	$ 150.6

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In millions)

	Years Ended		
	December 28, 2019 (52 Weeks)	**December 29, 2018 (52 Weeks)**	**December 30, 2017 (52 Weeks)**
Net income	$ 140.4	$ 128.2	$ 147.4
Other comprehensive income (loss), net of tax:			
Unrealized gain (loss) on investments	1.5	(6.5)	1.7
Unrealized (loss) gain on derivative financial instrument	(0.8)	1.1	1.3
Total other comprehensive income (loss), net	0.7	(5.4)	3.0
Comprehensive income	141.1	122.8	150.4
Less: Comprehensive income attributable to noncontrolling interests	-	0.5	0.8
Comprehensive income attributable to Ace Hardware Corporation	$ 141.1	$ 122.3	$ 149.6

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION
CONSOLIDATED STATEMENTS OF EQUITY
(In millions)

	Shareholders of Ace Hardware Corporation								
	Capital Stock								
	Class A	Class C	Class C Stock Issuable to Retailers for Patronage Dividends	Additional Stock Subscribed	Contributed Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Total Equity
Balances at December 31, 2016	$ 2.7	$ 413.2	$ 52.3	$ -	$ 18.2	$ 37.2	$ 0.5	$ 9.2	$ 533.3
Net income	-	-	-	-	-	146.6	-	0.8	147.4
Other comprehensive income	-	-	-	-	-	-	3.0	-	3.0
Net payments on subscriptions	-	-	-	1.0	-	-	-	-	1.0
Stock issued	0.1	52.7	(52.3)	(1.0)	-	-	-	-	(0.5)
Change in noncontrolling interests	-	-	-	-	(0.2)	-	-	3.0	2.8
Stock repurchased	(0.1)	(24.6)	-	-	(0.1)	-	-	-	(24.8)
Patronage distributions issuable	-	-	48.9	-	-	-	-	-	48.9
Patronage distributions payable	-	-	-	-	-	(150.6)	-	-	(150.6)
Other	-	-	-	-	0.4	-	-	-	0.4
Balances at December 30, 2017	$ 2.7	$ 441.3	$ 48.9	$ -	$ 18.3	$ 33.2	$ 3.5	$ 13.0	$ 560.9
Net income	-	-	-	-	-	127.7	-	0.5	128.2
Other comprehensive loss	-	-	-	-	-	-	(5.4)	-	(5.4)
Net payments on subscriptions	-	-	-	1.2	-	-	-	-	1.2
Stock issued	0.1	49.1	(48.9)	(1.2)	-	-	-	-	(0.9)
Change in noncontrolling interests	-	-	-	-	(0.2)	-	-	0.7	0.5
Stock repurchased	(0.1)	(25.6)	-	-	-	-	-	-	(25.7)
Patronage distributions issuable	-	-	44.0	-	-	-	-	-	44.0
Patronage distributions payable	-	-	-	-	-	(135.4)	-	-	(135.4)
Adoption of accounting standard	-	-	-	-	-	(0.7)	0.7	-	-
Other	-	-	-	-	0.4	-	-	-	0.4
Balances at December 29, 2018	$ 2.7	$ 464.8	$ 44.0	$ -	$ 18.5	$ 24.8	$ (1.2)	$ 14.2	$ 567.8
Net income	-	-	-	-	-	140.4	-	-	140.4
Other comprehensive income	-	-	-	-	-	-	0.7	-	0.7
Net payments on subscriptions	-	-	-	1.1	-	-	-	-	1.1
Stock issued	0.1	43.8	(44.0)	(1.1)	-	-	-	-	(1.2)
Change in noncontrolling interests	-	-	-	-	(0.2)	-	-	0.6	0.4
Stock repurchased	(0.1)	(25.9)	-	-	-	-	-	-	(26.0)
Patronage distributions issuable	-	-	54.6	-	-	-	-	-	54.6
Patronage distributions payable	-	-	-	-	-	(172.5)	-	-	(172.5)
Adoption of accounting standard	-	-	-	-	-	(1.4)	1.4	-	-
Other	-	-	-	-	0.5	-	-	-	0.5
Balances at December 28, 2019	$ 2.7	$ 482.7	$ 54.6	$ -	$ 18.8	$ (8.7)	$ 0.9	$ 14.8	$ 565.8

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)

	Years Ended		
	December 28, 2019 (52 Weeks)	**December 29, 2018 (52 Weeks)**	**December 30, 2017 (52 Weeks)**
Operating Activities			
Net income	$ 140.4	$ 128.2	$ 147.4
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	60.1	55.7	48.4
Goodwill impairment charge	8.5	-	-
Amortization of deferred financing costs	0.4	0.5	0.5
Gain on disposal of assets, net	(5.5)	(4.9)	(0.6)
Credit for doubtful accounts	(0.9)	(0.3)	(0.8)
Warehouse facility closure costs	-	-	0.2
Other, net	0.8	1.1	0.4
Changes in operating assets and liabilities, exclusive of effect of acquisitions:			
Receivables	(69.7)	(45.2)	(31.3)
Inventories	30.0	(144.6)	(26.3)
Other current assets	4.2	(8.9)	1.3
Other long-term assets	(9.8)	6.7	(0.3)
Accounts payable and accrued expenses	56.2	66.6	55.1
Other long-term liabilities	12.9	10.9	8.3
Deferred taxes	(13.6)	(2.1)	1.9
Net cash provided by operating activities	214.0	63.7	204.2
Investing Activities			
Purchases of marketable securities	(46.5)	(27.8)	(4.3)
Proceeds from sale of marketable securities	41.4	25.4	5.4
Purchases of property and equipment	(76.5)	(61.1)	(64.6)
Cash paid for acquired businesses, net of cash acquired	(22.5)	(18.5)	(57.5)
Increase in notes receivable, net	(9.0)	(5.8)	(7.3)
Proceeds from sale of assets	22.0	0.1	0.3
Other, net	(0.8)	(1.2)	(3.8)
Net cash used in investing activities	(91.9)	(88.9)	(131.8)
Financing Activities			
Net (payments) borrowings under revolving lines of credit	(58.0)	104.8	2.6
Principal payments on long-term debt	(10.9)	(11.0)	(9.2)
Payments of debt issuance costs	(1.3)	-	-
Payments of cash portion of patronage distribution	(51.3)	(58.0)	(58.7)
Payments of patronage refund certificates	(5.3)	(6.4)	-
Repurchase of stock	(3.8)	(2.5)	(1.7)
Purchase of noncontrolling interests	(0.2)	(0.2)	(0.1)
Other, net	1.3	1.1	0.9
Net cash (used in) provided by financing activities	(129.5)	27.8	(66.2)
(Decrease) increase in cash and cash equivalents	(7.4)	2.6	6.2
Cash and cash equivalents at beginning of period	25.6	23.0	16.8
Cash and cash equivalents at end of period	$ 18.2	$ 25.6	$ 23.0
Supplemental disclosure of cash flow information:			
Interest paid	$ 20.2	$ 17.7	$ 11.0
Income taxes paid	$ 1.4	$ 2.1	$ 1.7

See accompanying notes to the consolidated financial statements.

(1) Summary of Significant Accounting Policies

The Company and Its Business

Ace Hardware Corporation ("the Company") is a wholesaler of hardware, paint and other related products. The Company also provides to its retail members value-added services such as advertising, marketing, merchandising and store location and design services. The Company's goods and services are sold predominately within the United States, primarily to retailers that operate hardware stores and with whom the Company has a retail membership agreement. As a retailer-owned cooperative, the Company distributes substantially all of its patronage sourced income in the form of patronage distributions to member retailers based on their volume of merchandise purchases.

Ace Ecommerce Holdings LLC ("AEH"), a majority-owned and controlled subsidiary of the Company, owns The Grommet, an e-commerce company that operates a website that markets and sells new and innovative products created by independent entrepreneurs.

Ace Wholesale Holdings LLC ("AWH") owns and operates Emery Jensen Distribution and its related wholesale companies. AWH was formed in 2014 so that the Company could begin making wholesale hardware sales to non-member retailers.

Ace Retail Holdings LLC ("ARH") is the owner of the 135 store Westlake Ace Hardware ("Westlake") retail chain. As a result, the Company is also a retailer of hardware, paint and other related products.

In March 2019, ARH acquired the remaining 58 percent of the outstanding stock of Great Lakes Ace Hardware, Inc. ("GLA") that it did not already own. GLA is based in Farmington Hills, Michigan and is the owner of 51 neighborhood hardware stores located in Michigan and Ohio. See Note 2 for additional details of this acquisition.

Ace Hardware International Holdings, Ltd. ("AIH"), is a majority-owned and controlled subsidiary of the Company with a 20.8 percent noncontrolling interest owned by its international retailers. International retailers do not own shares of stock in the Company nor receive patronage dividends.

In September 2019, the Company formed the Ace Services Holdings LLC ("ASH") legal entity. On September 5, 2019, ASH acquired Handyman Matters Inc., a franchisor of home improvement, maintenance and repair services. See Note 2 for additional details of this acquisition.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). The Company's fiscal year ends on the Saturday nearest December 31. Accordingly, fiscal years 2019, 2018 and 2017 ended on December 28, 2019, December 29, 2018 and December 30, 2017, respectively. Unless otherwise noted, all references herein for the years 2019, 2018 and 2017 represent fiscal years ended December 28, 2019, December 29, 2018 and December 30, 2017, respectively. Fiscal years 2019, 2018 and 2017 consisted of 52 weeks each.

Subsequent events have been evaluated through February 12, 2020, the date these statements were issued.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All intercompany transactions have been eliminated.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current financial statement presentation, with no net effect on the consolidated financial statements.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash, Cash Equivalents and Marketable Securities

In the normal course of business, the Company has outstanding checks that exceed the cash balances in the Company's bank accounts, which create a book overdraft and are recorded as a liability. As of December 28, 2019 and December 29, 2018, the Company had outstanding checks in excess of bank balances totaling $70.2 million and $63.1 million, respectively, which have been included in accounts payable in the accompanying consolidated balance sheets. These outstanding amounts were subsequently funded through cash receipts and borrowings under the Company's debt facilities during the following fiscal year.

The Company classifies all highly liquid investments with original maturities of three months or less as cash equivalents.

The Company determines the appropriate classification of its investments in marketable securities, which are predominately held by the Company's New Age Insurance, Ltd. ("NAIL") subsidiary, at the time of purchase and evaluates such designation at each balance sheet date. All marketable securities have been classified and accounted for as available for sale. The Company may hold debt securities until maturity. In response to changes in the availability of and the yield on alternative investments as well as liquidity requirements, securities are occasionally sold prior to their stated maturities. Debt securities with maturities beyond twelve months are viewed by the Company as available to support current operations and are therefore classified as current assets in the accompanying Consolidated Balance Sheets. Marketable securities are carried at fair value based on quoted market prices, with unrealized gains and losses, net of taxes, reported as a component of Accumulated other comprehensive income ("AOCI"). Realized gains and losses on securities are determined using the specific identification method.

In the normal course of NAIL's operations, standby letters of credit totaling $11.0 million and $11.7 million at December 28, 2019 and December 29, 2018, respectively, were issued in favor of the insurance companies that reinsure a portion of NAIL's loss exposure. At December 28, 2019, NAIL has pledged substantially all of its cash and cash equivalents and marketable securities as collateral for these letters of credit. The Company has created a multiemployer welfare association (MEWA) to offer medical insurance and other welfare benefits to employees of the Company and Retailers and their employees at participating Ace retail locations. The Company was required to provide a $10.0 million standby letter of credit to the State of Vermont in connection with the MEWA. See Note 15 for more information.

Revenue Recognition

In May 2014, the Financial Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606) along with amendments issued in 2015 and 2016. During the first quarter 2019, the Company adopted this new revenue standard using the modified retrospective method applied to those contracts which were not completed as of December 29, 2018. Results for reporting periods beginning after December 30, 2018 are presented under the new revenue standard, while prior period amounts are not adjusted and continue to be reported in accordance with historic accounting under Accounting Standards Codification ("ASC") Topic 605. The impact of adopting the new standard had no impact on the consolidated financial statements.

Revenue is recognized when performance obligations under the terms of contracts with our customers are satisfied; generally, this occurs with the transfer of control of merchandise or services. Revenue is measured as the amount of consideration we expect to receive in exchange for transferring goods or providing services. The Company excludes sales and usage-based taxes collected and recognizes revenues net of expected returns. Provisions for sales returns are provided at the time the related sales are recorded based on historic returns activity.

The Company's warehouse merchandise revenue originates with a single performance obligation to ship the products, and therefore the Company's performance obligations are satisfied when control of the products is transferred to the customer per the arranged shipping terms. The customer takes ownership and assumes risk of loss for warehouse merchandise upon delivery. Although products are generally shipped FOB shipping point, the Company effectively retains the responsibilities of ownership until the goods reach the customer. Generally, customer billings for warehouse merchandise occur in bi-weekly intervals subsequent to revenue recognition. The Company considers shipping and handling as activities to fulfill its performance obligation for warehouse merchandise revenues. Billings for freight are accounted for as Revenues and shipping and handling costs are accounted for in Cost of revenues.

The Company has direct shipment arrangements with various vendors to deliver products to its customers without having to physically hold the inventory at the Company's warehouses, thereby increasing efficiency and reducing costs. The Company recognizes revenue for direct shipment arrangements upon delivery to the customer with contract terms that typically specify FOB destination. The Company recognizes the revenue and cost of goods sold from these arrangements on a gross basis as the principal in the transaction. The Company is primarily responsible for fulfilling the promise to customers to provide merchandise at negotiated prices with the vendors, assumes inventory risk if the product is returned by the customers, and assumes all the credit risk for the vendors with the customers. Therefore, the Company concluded it is the principal for these transactions.

Retail revenues from retail locations owned and operated by the Company and e-commerce revenues are recognized when the customer takes ownership of the products sold and assumes the risk of loss. The customer takes ownership and assumes risk of loss generally at the point of sale in our owned retail locations. The Company's e-commerce revenues come from Ace Hardware's website and sales from AEH. For e-commerce transactions, customers choose whether to have merchandise delivered to them (using third-party parcel delivery companies) or to collect their merchandise from one of our stores ("in-store pick up"). For items delivered directly to the customer, control passes and revenue is recognized when delivery has been completed to the customer, as title has passed and we have transferred possession to the customer. For in-store pick up, control passes and revenue is recognized once the customer has taken possession of the merchandise. Any fees charged to customers for delivery are a component of the transaction price and are recognized when delivery has been completed. Payment terms for retail and e-commerce sales are at the point of sale.

(In millions)

Service revenues (advertising activities, brand building initiatives and fees for other services provided primarily to domestic retailers) are recognized when the service is complete as this is when the retailer has the ability to direct the use of and obtain the benefits from the service.

The Company offers its retailers various incentive programs which provide the retailers with certain sales allowances. The Company offers these incentive programs in anticipation of future sales to the retailers that participate in these programs. Since the sales allowances provide future economic benefit to the Company, they are capitalized in Other assets and amortized as a reduction of revenue on a straight-line basis over the period of expected future sales to these retailers, which is generally five years.

The following table provides a summary of revenues by sales category:

	Years Ended	
	December 28, 2019	December 29, 2018
Warehouse merchandise	$ 4,125.2	$ 3,996.1
Direct shipment merchandise	1,136.1	1,078.8
Retail revenues	466.9	329.7
E-commerce	111.2	90.3
Service revenues	258.9	248.7
Amortization of sales allowances under retailer incentive programs	(27.1)	(26.6)
Total revenues	$ 6,071.2	$ 5,717.0

Receivables

Receivables from customers include amounts invoiced for the sale of merchandise, services and equipment used in the operation of customers' businesses.

Notes Receivable

The Company makes available to its retailers various lending programs whose terms exceed one year. The notes bear interest at various rates based on market rates, the loan program or the retailer's credit quality and are recorded at face value. Interest is recognized over the life of the note on the effective interest method. Loan origination fees were not material for any period presented.

Allowance for Doubtful Accounts

Management records an allowance for doubtful accounts based on judgments considering a number of factors, primarily historical collection statistics, current customer credit information, the current economic environment, the aging of receivables, the evaluation of compliance with lending covenants and the offsetting amounts due to members for stock, notes, interest and anticipated but unpaid patronage distributions. The Company considers accounts and notes receivable past due if invoices remain unpaid past their due date and provides for the write-off of uncollectible receivables after exhausting all commercially reasonable collection efforts.

Inventories

Wholesale inventories are valued at the lower of cost or net realizable value. Cost is determined primarily using the last-in, first-out ("LIFO") method for all inventories.

Inventories at retail locations operated by ARH and at AEH are valued at the lower of cost or net realizable value. Inventory cost is determined using the moving average method, which approximates the first-in, first-out ("FIFO") method.

Vendor Funds

The Company receives funds from vendors in the normal course of business principally as a result of purchase volumes, sales, early payments or promotions of vendors' products. Based on the provisions of the vendor agreements in place, management develops accrual rates by estimating the point at which the Company will have completed its performance under the agreement and the amount agreed upon will be earned. Due to the complexity and diversity of the individual vendor agreements, the Company performs analyses and reviews of historical trends throughout the year to ensure the amounts earned are appropriately recorded. As part of these analyses, the Company validates its accrual rates based on actual purchase trends and applies those rates to actual purchase volumes to determine the amount of funds that should be accrued by the Company and receivable from the vendor. Amounts accrued throughout the year could be impacted if actual purchase volumes differ from projected annual purchase volumes, especially in the case of programs that provide for increased funding when graduated purchase volumes are met. At year-end, the accrual reflects actual purchases made throughout the year.

(In millions)

Vendor funds are treated as a reduction of inventory cost, unless they represent a reimbursement of specific, incremental and identifiable costs incurred by the Company to sell the vendor's product, in which case the costs are netted. The majority of the vendor funds that the Company receives do not meet the specific, incremental and identifiable criteria. Therefore, the Company treats a majority of these funds as a reduction in the cost of inventory as the amounts are accrued and recognizes these funds as a reduction of cost of revenues when the inventory is sold.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Expenditures for maintenance, repairs and renewals of relatively minor items are generally charged to expense. Significant improvements or renewals are capitalized.

Depreciation expense is computed on the straight-line method based on estimated useful lives as follows:

Buildings and improvements	6 – 40 years
Equipment	3 - 20 years

Leasehold improvements are generally amortized on a straight-line basis over the lesser of the lease term or the estimated useful life of the asset.

The Company evaluates long-lived assets, such as property and equipment, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds its fair value.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the cost of an acquired business over the fair value of the net tangible assets acquired and identified intangible assets. Goodwill is not amortized but is tested for impairment at a reporting unit level on an annual basis or more frequently, if circumstances change or an event occurs that would more likely than not reduce the fair value of a reporting unit below its carrying amount. See Note 7 for additional information regarding the Company's annual goodwill impairment testing.

The Company's other intangible assets primarily relate to trademarks, tradenames, customer and vendor relationships and developed technology. The intangibles are amortized over their estimated useful lives. For additional information, see Note 7.

Internal-Use Software

Included in fixed assets is the capitalized cost of internal-use software. The Company capitalizes costs incurred during the application development stage of internal-use software and amortizes these costs over its estimated useful life. Costs incurred related to design or maintenance of internal-use software are expensed as incurred. For fiscal year 2019, 2018 and 2017, the Company capitalized $10.8 million, $8.1 million and $5.4 million, respectively, of software development costs related to internal programming time. Amortization of these capitalized costs was $4.1 million, $3.0 million and $2.6 million for fiscal 2019, 2018 and 2017, respectively. As of December 28, 2019 and December 29, 2018, the Company had $2.3 million and $1.5 million, respectively, of capitalized costs for internal-use software that had not been placed into service.

Leases

The Company leases certain warehouse and distribution space, office space, retail locations, equipment and vehicles. All of the Company's leases are operating leases. As leases expire, management expects that in the normal course of business, certain leases will be renewed or replaced.

Certain lease agreements include escalating rent over the lease terms and rent holidays and concessions. The Company expenses rent on a straight-line basis over the life of the lease, which commences on the date the Company has the right to control the property. The cumulative expense recognized on a straight-line basis in excess of the cumulative payments is included in Other long-term liabilities in the Consolidated Balance Sheets.

Advertising Expense

The Company expenses advertising costs when incurred. Gross advertising expenses amounted to $209.2 million, $207.6 million, and $187.1 million in fiscal 2019, 2018 and 2017, respectively.

Gift Cards

The Company sells gift cards to customers through its retailers, the Company website and select third parties. The gift cards do not expire. A liability is initially established for the value of the gift card when sold. Gift card breakage income is recognized ratably over the average redemption period of 18 months based on historical gift card redemption patterns and represents the balance of gift cards for which the Company believes the likelihood of redemption by the customer is remote. The breakage income calculation takes into account any legal obligation to remit the unredeemed portion to relevant jurisdictions. During fiscal years 2019, 2018 and 2017, the Company recognized gift card breakage income of $1.1 million, $2.1 million and $0.4 million, respectively, which is included in the accompanying Consolidated Statements of Income in Wholesale revenues in fiscal 2019 and in Other income, net in fiscal 2018 and 2017. The Company does not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions that we use to record breakage.

Retirement Plans

The Company sponsors health benefit plans for its retired officers and a limited number of retired non-officer employees. The Company and its subsidiaries also sponsor defined contribution plans for substantially all employees. The Company's contributions under these plans is determined annually by the Board of Directors and charged to expense in the period in which it is earned by employees.

Income Taxes

The Company accounts for income taxes using the asset and liability method. Under this approach, deferred taxes are recognized for the future tax consequences of differences between the financial statement and income tax bases of existing assets and liabilities, and measured based upon enacted tax laws and rates.

Self-Insurance

The Company has a wholly-owned subsidiary, NAIL, which operates as a captive insurance company. This entity provides the reinsurance of property and casualty insurance policies for some retailer members and is the direct insurer for certain property and casualty insurance policies of the Company. These insurance programs are subject to varying retention levels of self-insurance. Such self-insurance relates to losses and liabilities primarily associated with property, general liability, workers' compensation and auto liability insurance programs. Losses are accrued based upon the Company's estimates of the aggregate liability for claims incurred using certain actuarial assumptions based on Company experience and insurance industry metrics.

Concentration of Credit Risk

Credit risk pertains primarily to the Company's trade and notes receivables. The Company extends credit to its customers as part of its day-to-day operations. Management believes that as no specific receivable or group of receivables comprises a significant percentage of total trade accounts, its concentration of credit risk with respect to trade receivables is limited. Additionally, management believes that its allowance for doubtful accounts is adequate with respect to overall customer credit risks. Also, the Company's certificate of incorporation and by-laws specifically provide that the Company may set-off its obligation to make any payment to a member for such member's stock, notes, interest and declared and unpaid distributions against any obligation owed by the member to the Company. The Company, but not the member, may at its sole discretion exercise these set-off rights when any such funds become due to former members with outstanding accounts and notes receivable owed to the Company and current members with past due receivables owed to the Company.

Impact of New Accounting Standards

New Accounting Pronouncements – Adopted

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments – Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Financial Liabilities." ASU 2016-01 requires the change in fair value measurement for certain equity investments to be recognized in net income, simplifies the impairment assessment for equity investments without readily determinable fair values, eliminates disclosure requirements related to fair value of financial instruments measured at amortized cost for non-public entities, eliminates the requirement to disclose methods and assumptions used to estimate fair value of financial instruments measured at amortized cost for public entities and requires public entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. Additionally, ASU 2016-01 provides disclosure presentation guidance and clarification related to valuation allowances on deferred tax assets related to available-for-sale securities. ASU 2016-01 is effective for the Company for fiscal 2019 year-end financial statements and quarterly financial statements in fiscal 2020, with early adoption permitted in fiscal 2018. The Company adopted ASU 2016-01 in the first quarter of 2019. This resulted in a reclassification adjustment of a $1.4 million net loss from AOCI to retained earnings related to the unrealized loss on the Company's equity investments.

New Accounting Pronouncements – Issued

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)" along with amendments issued through 2019. The guidance requires that lessees recognize assets and liabilities for leases with lease terms greater than twelve months in the statement of financial position. The guidance also requires improved disclosures to help users of financial statements better understand the amount, timing and uncertainty of cash flows arising from leases. The Company's leases primarily consist of retail space, offices, warehouses, distribution centers and vehicles. The Company has completed the initial assessment of the standard. The Company implemented new leasing software and is finalizing its lease liability calculations and validation procedures. The Company continues to establish new processes and internal controls required to comply with the new lease accounting and disclosure requirements set by the standard.

ASU 2016-02 is effective for the Company for fiscal 2021 year-end financial statements and quarterly financial statements in fiscal 2022, with early adoption permitted. The Company has elected the package of practical expedients that allows companies to not reassess: (1) whether any expired or existing contracts are or contain leases, (2) lease classification for any expired or existing leases and (3) initial direct costs for any expired or existing leases. In addition, the Company has elected to treat the lease and non-lease components of leases as a single lease component and to exempt leases with an initial term of twelve months or less from balance sheet recognition. Consequently, short-term leases will be expensed over the lease term. The Company has not elected to adopt the hindsight practical expedient and therefore will maintain the lease terms previously determined under ASC 840.

The Company will adopt this standard using the modified retrospective method as of December 29, 2019, the first day of its 2020 fiscal year. The most significant and material impact of adoption will be the recognition of right-of-use assets and lease liabilities on the consolidated balance sheets for operating leases, while the accounting for capital leases remains substantially unchanged. The Company estimates total assets and liabilities will increase between $430 and $530 million upon adoption. The Company does not believe the standard will materially affect the consolidated statements of income or cash flows.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" along with amendments issued in 2018. The guidance requires financial assets measured at amortized cost basis to be presented at the net amount expected to be collected. The amortized cost basis of financial assets should be reduced by expected credit losses to present the net carrying value in the financial statements at the amount expected to be collected. The measurement of expected credit losses is based on past events, historical experience, current conditions and forecasts that affect the collectability of the financial assets. Additionally, credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. ASU 2016-13 is effective for the Company for year-end financial statements and quarterly financial statements in fiscal 2023. The Company is evaluating the impact that ASU 2016-13 will have on the Company's consolidated financial statements.

(In millions)

(2) Acquisitions

In March 2019, ARH acquired the remaining 58 percent of the outstanding stock of GLA, the owner of a 51 store chain that operates retail hardware stores in Michigan and Ohio, in a series of transactions for $11.3 million. The Company previously held a 42 percent interest in GLA which it acquired in 2017 for $3.7 million.

The Company has estimated the fair value of GLA to be $18.6 million as of the acquisition date based upon a valuation prepared by an independent third-party based on inputs provided by the Company. The transaction has been accounted for as a business combination. As of December 28, 2019, the Company recorded a preliminary allocation of the fair value to the acquired tangible assets and liabilities assumed based on their estimated fair value at the acquisition date. The Company expects to complete the purchase price allocation by the end of the first quarter of 2020. Based on the preliminary purchase price allocation, the Company recorded no goodwill or other intangibles.

The following table summarizes the fair value of GLA based on the valuation report:

Fair value of assets acquired and liabilities assumed:	
Cash	$ 1.1
Receivables	2.4
Inventories	26.1
Other current assets	0.9
Property and Equipment	5.6
Other assets	4.6
Short-term debt (GLA Facility – See Note 9)	(9.6)
Current liabilities	(12.5)
Acquisition purchase price	$ 18.6

In addition, during 2019, ARH acquired additional retail stores for consideration of $8.9 million, prior to working capital adjustments. These acquisitions resulted in ARH recording $5.3 million of goodwill. In September 2019, the Company acquired Handyman Matters Inc., a franchisor of home improvement, maintenance and repair services and recorded a preliminary allocation of the purchase price of $3.4 million to goodwill and other intangibles. Goodwill has an indefinite life and, therefore, is not amortized. The goodwill is expected to be deductible for tax purposes.

(3) Receivables, net

Receivables, net include the following amounts:

	December 28, 2019	December 29, 2018
Trade	$ 411.1	$ 365.7
Other	64.5	63.0
Notes receivable – current portion	16.3	12.4
Less: allowance for doubtful accounts	(5.4)	(6.7)
Receivables, net	$ 486.5	$ 434.4

Other receivables are principally amounts due from suppliers for promotional and advertising allowances.

(4) Inventories

Inventories consist of wholesale merchandise inventories held for sale to customers and retail merchandise inventory held for resale at ARH retail locations and at AEH’s warehouse locations. Substantially all of the Company’s wholesale inventories are valued on the LIFO method. The excess of replacement cost over the LIFO value of inventory was $104.5 million and $85.7 million at December 28, 2019 and December 29, 2018, respectively. Inventories at retail locations operated by ARH and at AEH’s warehouses are valued at the lower of cost or net realizable value. Inventory cost is determined using the moving average method, which approximates the FIFO method. The Company regularly reviews its inventory and establishes a reserve for excess and obsolete inventory based on a number of factors, including historical sales, sales forecasts, obsolescence due to technology changes and defective goods.

(In millions)

Inventories consisted of:

	December 28, 2019	December 29, 2018
Wholesale merchandise inventory (LIFO)	$ 773.9	$ 824.5
Retail merchandise inventory at ARH stores and AEH warehouses (FIFO)	156.9	107.3
Inventories	$ 930.8	$ 931.8

(5) Property and Equipment, net

Property and equipment, net is summarized as follows:

	December 28, 2019	December 29, 2018
Land	$ 14.7	$ 14.7
Buildings and improvements	294.6	289.1
Warehouse equipment	186.9	188.2
Computer hardware and software and other office equipment	343.9	307.5
Transportation equipment	39.1	38.9
Leasehold improvements	56.3	48.6
Construction in progress	5.1	6.0
Property and equipment, gross	940.6	893.0
Accumulated depreciation and amortization	(558.9)	(540.2)
Assets held for sale, net	-	15.8
Property and equipment, net	$ 381.7	$ 368.6

Depreciation and amortization expense related to property and equipment for fiscal years 2019, 2018 and 2017 was $55.1 million, $50.0 million and $47.3 million, respectively.

As of December 29, 2018, the Company ceased operations at its Prince George Retail Support Center ("RSC") and in accordance with ASC, "Property, Plant and Equipment," (Topic 360) met the criteria to classify the long-lived assets (land and building) as assets held for sale. In the third quarter of 2019, the Company sold the Prince George RSC for net proceeds of approximately $20.7 million and recorded a gain of $4.9 million on the transaction.

(6) Notes Receivable, net

The Company makes available to its retailers various lending programs whose terms exceed one year. At December 28, 2019 and December 29, 2018, the outstanding balance of the notes was $27.7 million and $27.0 million, respectively, of which the current portion of $16.3 million and $12.4 million, respectively, was recorded in Receivables, net.

	December 28, 2019	December 29, 2018
Notes receivable, gross	$ 43.4	$ 38.4
Less: estimated patronage applications from 2019 and 2018, respectively	(15.7)	(11.4)
Net	27.7	27.0
Less: current portion	(16.3)	(12.4)
Less: allowance for doubtful accounts	(1.5)	(2.8)
Notes receivable, net	$ 9.9	$ 11.8

(In millions)

For substantially all of the Company's Notes receivable, the amounts due are generally expected to be collected through the non-cash portion of the patronage distribution. In the event a retailer cancels its membership with the Company, any outstanding loans are transferred from Notes receivable to Accounts receivable and are due immediately. As the non-cash portion of the patronage distribution is used to settle the Notes receivable, there are no loans that are currently past due. The patronage distribution for each retailer can vary from year to year based on the Company's financial performance as well as the volume of patronage-based merchandise that each retailer purchases from the Company. The contractual maturities, assuming no patronage deductions, of the Notes receivable are as follows:

	December 28, 2019
0 – 4 years	$ 15.4
5 – 8 years	13.1
9 – 10 years	14.9
Total	$ 43.4

Pursuant to the Company's Amended and Restated Certificate of Incorporation and the Company's by-laws, notes receivable (like all obligations owed to the Company by the Company's retailers) are secured by the Company stock owned by the retailers. However, for some retailers, the redemption value of their stock does not fully cover their obligations.

The Company evaluates risk on its loan portfolio by categorizing each loan into an internal risk category. The Company's risk categories include:

Low – The retailer possesses a strong financial position, above average payment record to both Ace and other vendors, and the business is well established.

Medium – The retailer possesses an average financial position, an average payment record to both Ace and other vendors, and the business is somewhat established.

High – The retailer possesses a weak financial position, a substandard payment record to Ace or other vendors, or the business is somewhat new.

Based upon these criteria, the Company has classified its loan portfolio as follows:

	December 28, 2019	December 29, 2018
Corporate Credit Exposure:		
Low risk	$ 20.9	$ 19.2
Moderate risk	11.0	7.7
High risk	11.5	11.5
Total	$ 43.4	$ 38.4

The Company applies a consistent practice of establishing an allowance for notes that it feels may become uncollectible by monitoring the financial strength of its retailers. The collectability of all notes is evaluated on an individual basis. The Company has evaluated the collectability of the notes and has established an allowance for doubtful accounts of $1.5 million and $2.8 million at December 28, 2019 and December 29, 2018, respectively. Management records the allowance for doubtful accounts based on the above information as well as judgments made considering a number of factors, primarily historical collection statistics, current member retailer credit information, the current economic environment and the offsetting amounts due to members for stock, notes, interest and declared and unpaid patronage distributions. The components of changes to the Notes receivable allowance for doubtful accounts for 2019 and 2018 were as follows:

(In millions)

	December 28, 2019	December 29, 2018
Allowance for doubtful accounts:		
Beginning balance	$ 2.8	$ 5.4
Provision (Reversal)	(0.7)	(1.5)
Reclassifications to accounts receivable allowance for doubtful accounts	(0.8)	(1.6)
Reclassifications from accounts receivable allowance for doubtful accounts	0.2	0.5
Ending balance	$ 1.5	$ 2.8

Notes bear interest at various rates and are recorded at face value. Interest is recognized over the life of the note based on the outstanding balance and stated interest rate, which approximates the effective interest method. During fiscal years 2019, 2018 and 2017, $2.5 million, $2.0 million and $1.7 million respectively, were recorded as interest income related to the notes.

Generally, in the event a retailer cancels their membership with the Company, any outstanding Notes receivable, and related allowance for doubtful accounts, are transferred to trade receivables and the retailer is billed for any unpaid principal and interest balances. In fiscal 2019 and 2018, $9.3 million and $10.3 million, respectively, of Notes receivable were transferred to trade receivables as an event occurred which made the notes due immediately. Upon transfer of the Notes receivable to trade receivables, $0.8 million and $1.6 million in fiscal 2019 and 2018, respectively, of the Notes receivable allowance for doubtful accounts was transferred to the Receivables allowance for doubtful accounts to properly match the reserve against the asset on the Consolidated Balance Sheet.

(7) Goodwill and Other Intangible Assets

Changes in the carrying value of goodwill were as follows:

Balance at December 30, 2017 (1)	$ 83.0
Acquired goodwill	8.7
Allocation to identifiable intangible assets (1)	(17.7)
Balance at December 29, 2018	74.0
Acquired goodwill	9.1
Impairment charge	(8.5)
Balance at December 28, 2019	$ 74.6

(1) Upon finalization of the purchase accounting for The Grommet in 2018, a portion of the preliminary goodwill reported as of December 30, 2017 was reclassified to identifiable intangible assets.

Impairment exists when a reporting unit's carrying value exceeds its fair value. The Company tests reporting units for impairment annually as of the first day of the fourth quarter, or more frequently if events or circumstances indicate it is more likely than not that the fair value of a reporting unit is less than its carrying value.

The Company performed its impairment tests in the fourth quarter, and while there was no single determinative event or factor, the consideration in totality of several factors that developed during the fourth quarter of 2019 led the Company to conclude that it was more likely than not that the fair value of AEH was below its carrying amount. These factors included: (i) continued operating results below management expectations; (ii) a reduction in revenues from the wholesale business; and (iii) an increase in the costs to acquire customers which has led to decreased revenues from the consumer business.

An impairment test includes comparing the carrying value of the reporting unit, including existing goodwill and intangible assets, to the fair value of the reporting unit. If the carrying amount of the reporting unit exceeds its fair value, a goodwill impairment charge is recorded for the amount in which the carrying value of the reporting unit exceeds the fair value of the reporting unit, up to the amount of goodwill attributed to the reporting unit. The Company utilized the discounted cash flow method under the income approach to estimate the fair value of the AEH reporting unit. As a result of the impairment test, it was determined that the carrying amount exceeds the AEH reporting unit's fair value, resulting in an impairment charge of $8.5 million for the year ended December 28, 2019. The impairment charge of $8.5 million represented the entire balance of AEH goodwill.

(In millions)

Identifiable intangible assets were as follows:

	December 28, 2019	December 29, 2018
Trademarks and trade name	$ 9.9	$ 9.9
Customer relationships	8.1	8.1
Maker relationships	7.7	7.7
Developed technology	2.2	2.2
Wholesale relationships	0.6	0.6
Total identifiable intangible assets	28.5	28.5
Less: accumulated amortization	(12.6)	(8.3)
Identifiable intangible assets, net	$ 15.9	$ 20.2

The trademarks and trade name are being amortized over 10-20 years. The customer and maker relationships are being amortized over 3-10 years. Developed technology is being amortized over three years. Net amortization expense related to all intangible assets was $4.3 million, $5.2 million and $0.7 million for fiscal years 2019, 2018 and 2017, respectively. The estimated net amortization expense over the next five fiscal years is $10.0 million.

(8) Patronage Distributions and Refund Certificates Payable

The Company operates as a cooperative organization and has paid or may pay patronage distributions to member retailers on a portion of patronage-based income derived from business done with such retailers. Patronage distributions are allocated in proportion to the volume of purchases by member retailers during the period. The cash portion of the patronage distribution was approximately 40 percent for all years presented.

The accrued patronage distributions composition is summarized as follows:

	Years Ended		
	December 28, 2019	December 29, 2018	December 30, 2017
Cash portion	$ 70.4	$ 55.0	$ 61.5
Class C stock	54.6	44.0	48.9
Patronage refund certificates	30.0	23.7	27.9
Patronage financing deductions	17.5	12.7	12.3
Total patronage distributions accrued for third party retailers	$ 172.5	$ 135.4	$ 150.6

Patronage distributions are allocated on a fiscal year basis with issuance in the following year.

In those instances where the maximum Class C stock requirements have been met, the non-cash portion of the patronage distribution is distributed in the form of patronage refund certificates with a five-year term and bearing interest at 4 percent.

The patronage refund certificates outstanding at December 28, 2019 are payable as follows:

	Amount	Interest Rate
2020	$ 17.4	4.00%
2021	26.6	4.00%
2022	27.4	4.00%
2023	23.3	4.00%
2024	30.0	4.00%
Total patronage refund certificates payable	$ 124.7	
Less current portion	(17.4)	
Net patronage refund certificates payable	$ 107.3	

(9) Debt

Prior to February 2019, the Company had a $600.0 million line of credit that was expandable to $750.0 million through a $150.0 million accordion feature. At the Company's discretion, borrowings under the prior credit facility incurred interest at a rate of either 25 to 100 basis points over the prime rate or 125 to 200 basis points over the London Interbank Offered Rate ("LIBOR") depending on the Company's leverage ratio. The credit facility was due to expire on May 29, 2020.

On February 1, 2019, the Company amended its line of credit facility, increasing its borrowing capacity to $700.0 million. The new facility is expandable to $1.0 billion through a $300.0 million accordion that is exercisable without the consent of existing lenders provided that the Company is not in default of the credit agreement and further provided that none of the existing lenders are required to provide any portion of the increased facility. At the Company's discretion, borrowings under the credit facility bear interest at a rate of either 0 to 75 basis points over the prime rate or 100 to 175 basis points over the LIBOR rate depending on the Company's leverage ratio as defined under the agreement. The credit facility was priced at LIBOR plus 125 basis points at December 28, 2019. The credit facility expires on February 1, 2024 and requires maintenance of certain financial covenants including a maximum allowable average leverage ratio and a minimum fixed charge coverage ratio. As of December 28, 2019, the Company was in compliance with its covenants and $196.5 million was outstanding under the credit facility.

The credit facility includes a $175.0 million sublimit for the issuance of standby and commercial letters of credit. As of December 28, 2019, a total of $12.5 million in letters of credit were outstanding. The credit facility requires the Company to pay fees based on the unused portion of the line of credit at a rate of 12.5 to 25 basis points per annum depending on the Company's leverage ratio.

The credit facility allows the Company to make revolving loans and other extensions of credit to AIH in an aggregate principal amount not to exceed $75.0 million at any time. As of December 28, 2019, there were no loans or other extensions of credit provided to AIH.

The Company entered into an interest rate swap derivative agreement to reduce the risk of interest rate volatility for the credit facility. The interest rate swap started on March 13, 2017 and expires on May 13, 2020. The swap agreement fixes the LIBOR rate on $150.0 million of the revolving credit facility at 2.18 percent, resulting in an effective rate of 3.43 percent after adding the 1.25 percent margin based on the current pricing tier per the credit agreement. The swap arrangement has been designated as a cash flow hedge and has been evaluated to be highly effective. As a result, the after-tax change in the fair value of the swap is recorded in AOCI as a gain or loss on derivative financial instruments.

Prior to March 5, 2019, the Company's Westlake subsidiary had a $75.0 million asset-based revolving credit facility ("Westlake Facility"). The Westlake Facility was due to mature on October 24, 2022 and was expandable to $100.0 million under certain conditions. Under this facility, Westlake had the right to issue letters of credit up to a maximum of $7.5 million. At Westlake's discretion, borrowings under this facility incurred interest at a rate of either the prime rate plus an applicable spread of 25 to 50 basis points or LIBOR plus an applicable spread of 125 to 150 basis points, depending on Westlake's average availability under the Westlake Facility as measured on a trailing 12-month basis.

On March 5, 2019, Westlake amended its credit facility, increasing the Westlake Facility size by $25.0 million to $100.0 million and reduced the unused fees to 15 basis points. All other terms remained the same. The Westlake Facility was priced at LIBOR plus 125 basis points at December 28, 2019.

The Westlake Facility is collateralized by substantially all of Westlake's personal property and intangible assets. Borrowings under the facility are subject to a borrowing base calculation consisting of certain advance rates applied to eligible collateral balances (primarily consisting of certain receivables and inventories). This agreement requires maintenance of certain financial covenants including a minimum fixed charge coverage ratio. As of December 28, 2019, ARH was in compliance with its covenants and had $52.0 million outstanding under the Westlake Facility.

The Company's GLA subsidiary has a $20.0 million asset-based revolving credit facility ("GLA Facility"). The GLA Facility matures on November 6, 2022. Borrowings under the GLA Facility are subject to a borrowing base calculation consisting of certain advance rates applied to eligible receivables and inventory. The interest rate is based on either the lender's prime rate plus 100 basis points or LIBOR plus 200 basis points. As of December 28, 2019, GLA was in compliance with its covenants and had $4.5 million outstanding under the GLA Facility. As of December 28, 2019, $1.0 million of the outstanding debt was priced at LIBOR plus 200 basis points and $3.5 million was priced at prime plus 100 basis points.

Both the GLA Facility and the Westlake Facility include a lender-controlled cash concentration system that results in all of GLA and Westlake's daily available cash being applied to the outstanding borrowings under their facilities. As a result, pursuant to FASB Accounting Standards Codification Section 470-10-45, "Classification of Revolving Credit Agreements Subject to Lock-Box Arrangements and Subjective Acceleration Clauses," the borrowings under the GLA Facility and Westlake Facility have been classified as a Current maturity of long-term debt as of December 28, 2019.

(In millions)

Total debt outstanding is comprised of the following:

	December 28, 2019	December 29, 2018
Revolving Credit Facility	$ 196.5	$ 251.7
Westlake Facility	52.0	49.5
GLA Facility	4.5	-
Installment notes with maturities through 2023 at a fixed rate of 6.00%	23.9	26.5
Total debt	276.9	327.7
Less: maturities within one year	(67.0)	(60.6)
Long-term debt	$ 209.9	$ 267.1

The aggregate scheduled maturities of total debt at December 28, 2019 are as follows:

Fiscal Year	Amount
2020	$ 67.0
2021	6.7
2022	4.8
2023	1.9
2024	196.5
Total debt	$ 276.9

(10) Retirement Plans

The Company has healthcare plans under which a limited number of qualified retired employees receive certain health care, dental care, life insurance or related benefits. Amounts expensed under these plans were $0.1 million or less in each of the fiscal years 2019, 2018 and 2017.

The Company and its subsidiaries maintain profit sharing and 401k retirement plans for substantially all employees. Amounts expensed under these plans totaled $28.8 million, $22.8 million and $23.7 million during fiscal 2019, 2018 and 2017, respectively.

(11) Accrued Expenses

Accrued expenses include the following components:

	December 28, 2019	December 29, 2018
Salaries and wages	$ 62.8	$ 50.3
Insurance reserves	20.9	19.9
Deferred income	3.9	3.5
Vendor funds	7.3	4.0
Taxes	16.3	15.1
Profit sharing	14.4	9.7
Gift card	10.1	10.3
Interest	5.0	4.5
Advertising and marketing	25.1	17.2
Other	40.1	39.1
Accrued expenses	$ 205.9	$ 173.6

(In millions)

(12) Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There is a three-level hierarchy for disclosure to show the extent and level of judgment used to estimate fair value measurements.

Level 1 – Uses unadjusted quoted prices that are available in active markets for the identical assets or liabilities as of the reporting date.

Level 2 – Uses inputs other than Level 1 that are either directly or indirectly observable as of the reporting date through correlation with market data, including quoted prices for similar assets and liabilities in active markets and quoted prices in markets that are not active. Level 2 also includes assets and liabilities that are valued using models or other pricing methodologies that do not require significant judgment since the input assumptions used in the models, such as interest rates and volatility factors, are corroborated by readily observable data.

Level 3 – Uses inputs that are unobservable and are supported by little or no market activity and reflect the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management's estimates of market participant assumptions.

The tables below set forth, by level, the Company's financial assets, liabilities and derivative instruments that were accounted for at fair value as of December 28, 2019 and of December 29, 2018. The tables do not include cash on hand and also do not include assets and liabilities that are measured at historical cost or any basis other than fair value. The carrying values for other current financial assets and liabilities, such as accounts receivable and accounts payable, approximate fair value due to the short maturity of such instruments. Long-term notes receivable approximate fair value because the Company charges its retailers an interest rate and a significant portion of the notes have the Company's stock as collateral.

Items measured at fair value on a recurring basis	Carrying Value Measured at Fair Value December 28, 2019	Level 1	Level 2	Level 3
Assets:				
Cash equivalents:				
Money market funds	$ 3.7	$ 3.7	$ -	$ -
Marketable securities:				
Corporate fixed income securities	31.0	-	31.0	-
Mortgage-backed securities	10.8	-	10.8	-
U.S. government notes	17.0	11.7	5.3	-
Other	0.7	-	0.7	-
Total marketable securities	$ 59.5	$ 11.7	$ 47.8	$ -
Accrued expenses:				
Interest rate swap derivative	$ 0.3	$ -	$ 0.3	$ -

(In millions)

Items measured at fair value on a recurring basis	Carrying Value Measured at Fair Value December 29, 2018	Level 1	Level 2	Level 3
Assets:				
Cash equivalents:				
Money market funds	$ 7.7	$ 7.7	$ -	$ -
Marketable securities:				
Corporate fixed income securities	14.1	-	14.1	-
Equity mutual fund securities	14.5	14.5	-	-
Mortgage-backed securities	6.5	-	6.5	-
U.S. government notes	12.4	11.8	0.6	-
Other	2.9	-	2.9	-
Total marketable securities	$ 50.4	$ 26.3	$ 24.1	$ -
Other assets:				
Interest rate swap derivative	$ 0.8	$ -	$ 0.8	$ -

Money market funds, Equity mutual fund securities and U.S. government notes – The Company's valuation techniques used to measure the fair values of money market funds, equity mutual fund securities and U.S. government notes, that were classified as Level 1 in the tables above, are derived from quoted market prices for identical instruments, as active markets for these instruments exist.

Corporate fixed income securities, Mortgage-backed securities and Other – Other securities primarily consist of taxable municipal bonds, corporate asset-backed securities, and U.S. Agency fixed rate notes and bonds. The Company's valuation techniques used to measure the fair values of corporate fixed income securities, mortgage-backed securities and other securities, that were classified as Level 2 in the tables above, are derived from the following: non-binding market consensus prices that are corroborated by observable market data, quoted market prices for similar instruments, or pricing models, such as discounted cash flow techniques, with all significant inputs derived from or corroborated by observable market data.

The fair value of the Company's marketable securities was greater than their cost by $1.3 million at December 28, 2019 and was less than their cost by $2.3 million at December 29, 2018.

Gross proceeds from the sale of marketable securities and the related realized gains and losses for the fiscal years ended December 28, 2019, December 29, 2018 and December 30, 2017 were as follows:

	Years Ended		
	December 28, 2019	December 29, 2018	December 30, 2017
Gross proceeds	$ 41.4	$ 25.4	$ 5.4
Gross realized gains	0.8	5.6	0.7
Gross realized losses	(0.2)	(0.3)	(0.1)

Gross realized gains and losses were determined using the specific identification method. For the fiscal year ended December 28, 2019, the Company reclassified $0.7 million of unrealized gains and $0.1 million of unrealized losses on marketable securities that were recorded in AOCI as of December 29, 2018 into realized income. These amounts were recorded to Other income, net in the Consolidated Statement of Income.

(In millions)

The following table summarizes the contractual maturity distributions of the Company's debt securities at December 28, 2019. Actual maturities may differ from the contractual or expected maturities since borrowers may have the right to prepay obligations with or without prepayment penalties.

Fair value of available-for-sale debt securities	Due in One Year or Less	Due After One Year through Five Years	Due After Five Years through Ten Years	Due After Ten Years	Total
Corporate fixed income securities	$ 1.4	$ 14.5	$ 10.6	$ 4.5	$ 31.0
Mortgage-backed securities	-	0.2	1.3	9.3	10.8
U.S. government notes	2.4	6.3	3.2	5.1	17.0
Other	-	-	0.2	0.5	0.7
Total	$ 3.8	$ 21.0	$ 15.3	$ 19.4	$ 59.5

The Company uses variable-rate LIBOR debt to finance its operations. These debt obligations expose the Company to interest rate volatility risk. The Company has historically attempted to minimize this risk and fix a portion of its overall borrowing costs through the utilization of interest rate swap derivatives. Variable cash flows from outstanding debt are converted to fixed-rate cash flows by entering into receive-variable, pay-fixed interest rate swaps. The Company does not use derivative instruments for trading or speculative purposes, and all derivative instruments are recognized in the Consolidated Balance Sheet at fair value. Hedge ineffectiveness is eliminated by matching all terms of the hedged item and the hedging derivative at inception and on an ongoing basis. The Company does not exclude any terms from consideration when applying the matched terms method.

The Company entered into an interest rate swap derivative agreement, which started on March 13, 2017 and expires on May 13, 2020. The swap agreement fixes the LIBOR rate on $150.0 million of the revolving credit facility at 2.18 percent, resulting in an effective rate of 3.43 percent after adding the 1.25 percent margin based on the current pricing tier per the credit agreement – see Note 9 for more information.

The fair value of the Company's interest rate swap is estimated using Level 2 inputs, which are based on model-derived valuations in which all significant inputs and significant value drivers are observable in active markets. The Company also considers counterparty credit risk and bilateral or "own" credit risk adjustments in estimating fair value, in accordance with the requirements of GAAP. As of December 28, 2019, the fair value of the interest rate swap was a current liability balance of $0.3 million. As of December 29, 2018, the fair value of the interest rate swap was an asset balance of $0.8 million. The Company classifies long-term derivative assets as Other assets and current derivative liabilities as Accrued expenses.

Because the interest rate swap has been designated as a cash flow hedge and has been evaluated to be highly effective, the change in the fair value is recorded in AOCI as a gain or loss on derivative financial instruments. The amount in AOCI is reclassified to earnings if the derivative instrument is sold, extinguished or terminated, or at the time it becomes expected to be sold, extinguished or terminated. The net of tax amount recorded in AOCI for the fair value adjustment of the interest rate swaps was an unrealized loss of $0.2 million as of December 28, 2019 and an unrealized gain of $0.6 million as of December 29, 2018. This unrealized loss is not expected to be reclassified into interest expense before the expiration of the hedge on May 13, 2020. The impact of any ineffectiveness is recognized in earnings. However, there was no hedge ineffectiveness related to the interest rate swap as of December 28, 2019 and December 29, 2018.

The Company's debt instruments are recorded at cost on the Consolidated Balance Sheets. The fair value of the Company's debt was approximately $277.7 million at December 28, 2019, compared to the carrying value, including accrued interest, of $277.9 million. The estimated fair value of long-term debt is based on estimated rates for similar instruments and discounted cash flow analysis using the Company's weighted-average interest rate and is, therefore, classified as Level 3 within the fair value hierarchy.

(In millions)

(13) Income Taxes

Income tax benefit (expense) includes the following components:

	Years Ended December 28, 2019	Years Ended December 29, 2018	Years Ended December 30, 2017
Current:			
Federal	$ (0.4)	$ 1.6	$ (1.0)
State	(0.4)	(0.2)	(0.4)
Foreign	(1.1)	(1.1)	(1.1)
Current income tax (expense) benefit	(1.9)	0.3	(2.5)
Deferred:			
Federal	12.0	2.2	(2.8)
State	1.5	-	0.6
Deferred income tax benefit (expense)	13.5	2.2	(2.2)
Total income tax benefit (expense)	$ 11.6	$ 2.5	$ (4.7)

Income tax differs from the amount computed by applying the statutory U.S. Federal income tax rate of 21 percent, 21 percent and 35 percent for December 28, 2019, December 29, 2018 and December 30, 2017 respectively, to pre-tax income because of the effect of the following items:

	Years Ended December 28, 2019	Years Ended December 29, 2018	Years Ended December 30, 2017
Expected tax at U.S. Federal income tax rate	$ (27.1)	$ (26.4)	$ (53.2)
Patronage distribution deductions	36.2	28.4	52.7
Net deferred tax asset re-measurement	-	-	(4.1)
Other, net	2.5	0.5	(0.1)
Income tax benefit (expense)	$ 11.6	$ 2.5	$ (4.7)

(In millions)

Deferred income taxes reflect the tax effects of temporary differences between the carrying amounts of existing assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities are as follows:

	December 28, 2019	December 29, 2018
Deferred tax assets:		
AMT and other tax credit carryforwards	$ 11.4	$ 8.8
Net operating loss carryforwards	14.0	9.9
Unearned insurance premium and loss reserves	1.1	0.9
Allowance for doubtful accounts	1.4	1.8
Inventory reserves	4.6	4.9
Deferred vendor rebates	9.7	9.2
Accrued compensation and benefits expense	13.2	11.5
Net unrealized losses	-	0.5
Other reserves	11.8	6.9
Total deferred tax assets	67.2	54.4
Less: valuation allowance	(8.9)	(8.0)
Deferred tax assets	58.3	46.4
Deferred tax liabilities:		
Depreciation and deferred gains on property and equipment	8.4	10.9
Amortization of intangibles	2.0	1.8
Net unrealized gains	0.3	-
Fair market value of leases	0.5	0.5
Prepaid expenses and deferred income	4.6	5.7
Inventory valuation	16.6	16.7
Deferred tax liabilities	32.4	35.6
Net deferred tax assets	$ 25.9	$ 10.8

Net deferred tax assets are included in Other assets on the Consolidated Balance Sheets.

At December 28, 2019, the Company has federal and state net operating loss carryforwards of $75.9 million available for offset against future taxable income. The pre-2018 federal and state net operating losses can be carried forward to the tax years 2035 through 2037. The post-2018 federal net operating loss can be carried forward indefinitely. For those states not conforming to the indefinite federal carryforward provisions, the post-2018 state net operating losses can, generally, be carried forward through the 2038 and 2039 tax years.

At December 28, 2019, the Company has foreign tax credits of $1.4 million and general business credits of $0.4 million available to offset future tax expense. The foreign tax credits may be carried forward to tax years 2028 through 2029. The general business credits may be carried forward to tax years 2038 through 2039.

At December 28, 2019, the Company has state tax credit carryforwards of $9.6 million available to offset future state income tax expense. The state tax credits may be carried forward to tax years 2020 through 2024. A valuation allowance of $8.9 million has been established against the state tax credits as it is more likely than not that the benefit of the tax credits will not be realized.

The federal income tax returns of the consolidated group are subject to examination by the Internal Revenue Service ("IRS"), generally for three years after the returns are filed. The 2015 through 2019 tax years remain subject to examination by the IRS. For state purposes, the 2014 through 2019 tax years remain subject to examination.

The Company recognizes interest and penalties related to uncertain tax positions in Income tax expense. Accrued interest and penalties included in the reserve for uncertain tax positions were $0.3 million at December 28, 2019 and December 29, 2018, respectively. The Company recognized immaterial amounts related to interest and penalties within Income tax expense for the years ended December 28, 2019, December 29, 2018 and December 30, 2017. It is reasonably possible that the total amount of unrecognized tax benefits will increase or decrease within the next twelve months. The Company currently estimates that such increases and decreases will not be significant.

(14) Capital Stock

The Company's classes of stock are described below (not in millions):

	Number of Shares at	
	December 28, 2019	December 29, 2018
Class A stock, voting, redeemable at par value:		
Authorized	10,000	10,000
Issued and outstanding	2,691	2,719
Class C stock, nonvoting, redeemable at not less than par value:		
Authorized	6,000,000	6,000,000
Issued and outstanding	4,827,851	4,648,554
Issuable as patronage distributions	546,146	439,591

No dividends can be declared on any shares of any class of the Company's stock.

Upon termination of the Company's membership agreement with any retail outlet, all shares of stock of the Company held by the retailer owning or controlling such outlet must be sold back to the Company, unless a transfer of such shares is made to another party accepted by the Company as a member retailer with respect to the same outlet. A single Class A share is issued to a member retailer only when the share subscribed has been fully paid and Class C shares are issued only when all shares subscribed with respect to a retail outlet have been fully paid. Additional stock subscribed in the accompanying consolidated financial statements represents the paid portion of stock subscribed for stores that have not opened. All shares of stock are currently issued and repurchased at par value.

(15) Commitments and Contingencies

Lease commitments

The Company rents certain warehouse and distribution space, office space, retail locations, equipment and vehicles under operating leases. At December 28, 2019, annual minimum rental commitments under leases that have initial or remaining noncancelable terms in excess of one year, net of sublease income, are as follows:

Fiscal Year	Amount
2020	$ 84.2
2021	71.6
2022	60.9
2023	55.3
2024	49.0
Thereafter	200.6
Minimum lease payments	$ 521.6

Minimum lease payments include $4.2 million of minimum lease payments for store leases that the Company has assigned to member retailers. In addition, as a condition of the sale of the former Company-owned stores, the Company remains contingently liable for payment under two lease arrangements. The leases have varying terms, the latest of which expires in 2024. The Company believes that the possibility of payment under any of these leases is remote.

All other leases expire prior to the end of 2035. Under certain leases, the Company pays real estate taxes, insurance and maintenance expenses in addition to rental expense. ARH rents a majority of its retail store location properties under long-term operating leases that generally provide for payment of minimum annual rent payments, real estate taxes, insurance and maintenance and, in some cases, contingent rent (calculated as a percentage of sales) in excess of minimum rent. The amount of contingent rent paid by ARH during 2019 was not material. With the exception of store leases assigned to member retailers, management expects that in the normal course of business, leases that expire will be renewed or replaced by other leases. Rent expense was $90.1 million, $79.6 million and $69.4 million in fiscal 2019, 2018 and 2017, respectively.

AIH has entered into service agreements for the receipt, handling, warehousing and re-dispatch of all shipments of merchandise for its Colon, Panama, Ningbo, China and Dubai, United Arab Emirates operations. Annual minimum service payments under these agreements are not significant.

(In millions)

Contingencies

The Company has certain contingent liabilities resulting from litigation and claims incident to the ordinary course of business. Management believes that the probable resolution of such contingencies will not materially affect the financial position, results of operations, or liquidity of the Company. The Company expenses legal fees as they are incurred.

Other guarantees

In the normal course of business, the Company enters into commercial commitments including standby letters of credit and guarantees that could become contractual obligations. Letters of credit are issued generally to insurance agencies and financial institutions in direct support of the Company's corporate and retailer insurance programs as well as to international vendors for imported inventory purchases. As of December 28, 2019, the Company had outstanding standby letters of credit of $11.0 million issued in the normal course of NAIL's operations and commercial letters of credit of $12.5 million.

During 2019 the Company facilitated the adoption of the Ace Hardware Corporation Cooperative Group Health Plan ("AHP"). The AHP is a multiple employer welfare arrangement ("MEWA") that provides medical insurance and other welfare benefits to employees of the Company and their families and employees and families of participating Ace retailers, beginning January 1, 2020.

The AHP is insured by Ace Group Insurance, Inc. ("AGI"), a newly-formed Vermont-based captive insurance company. AGI is owned by a newly-formed funded welfare trust ("Trust") that serves as the mechanism for the AHP to collect, hold, invest and pay funds deposited with the AHP for the conduct of AHP operations. The Trust is not owned by the Company or any of its subsidiaries.

In order to establish and provide initial capitalization of the AHP, AGI and Trust, NAIL provided a $10 million standby letter of credit in favor of AGI. The letter of credit is held by the Vermont Department of Financial Regulations ("VDFR") and can be drawn upon at VDFR's direction if AGI becomes illiquid. The Company believes that the likelihood of the letter of credit being drawn is remote.

(16) Warehouse Facility Closure Costs

During 2018 and 2019, the Company closed three leased distribution facilities and returned possession to the landlords. The Company also closed its owned RSC in Prince George, Virginia. As of December 29, 2018, the Company had a remaining liability of $1.5 million for post-employment benefits and $1.0 million for inventory markdown reserves related to these former facilities. During the twelve months ended December 28, 2019, the Company recorded a $1.0 million benefit in Wholesale cost of revenues to offset the inventory markdowns upon final disposition of the inventory related to these facilities and made $1.5 million in payments for post-employment benefits. The Company also has $1.8 million and $2.1 million of remaining net lease liability as of December 28, 2019 and December 29, 2018, respectively, relating to an ARH distribution facility that is no longer used.

Accrued warehouse facility closure costs activity for the twelve months ended December 28, 2019 is as follows:

	Remaining Net Lease Liability	Post-employment Benefits	Inventory Markdown Reserves	Total
Balance at December 29, 2018	$ 2.1	$ 1.5	$ 1.0	$ 4.6
Reclass to wholesale cost of revenues	-	-	(1.0)	(1.0)
Payments	(0.3)	(1.5)	-	(1.8)
Balance at December 28, 2019	$ 1.8	$ -	$ -	$ 1.8

(In millions)

(17) Summary of Quarterly Results

The following table provides a summary of quarterly results (unaudited) for the eight quarters prior to and including the quarter ended December 28, 2019:

	2019			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Revenues	$ 1,475.1	$ 1,530.1	$ 1,687.5	$ 1,378.5
Gross profit	214.3	240.3	247.4	190.6
Operating expenses	213.1	185.2	193.3	167.2
Net income attributable to Ace Hardware Corporation	3.9	60.3	53.7	22.5

	2018			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Revenues	$ 1,390.0	$ 1,427.2	$ 1,587.7	$ 1,312.1
Gross profit	192.4	204.9	229.1	168.7
Operating expenses	171.9	169.2	171.9	153.6
Net income attributable to Ace Hardware Corporation	25.1	36.3	54.5	11.8

(18) Supplemental Disclosures of Cash Flow Information

During fiscal 2019, 2018 and 2017, accrued patronage distributions of $19.1 million, $13.6 million and $13.3 million, respectively, were offset against trade receivables and notes receivable owed to the Company by its member retailers with no net impact in the Consolidated Statements of Cash Flows. In addition, the Company had $9.5 million in patronage refund certificates which were included in Accounts payable pending payment in Fiscal 2020 as of December 28, 2019 and had no net impact in the Consolidated Statements of Cash Flows.

During fiscal 2019, 2018 and 2017, non-cash repurchases of stock from retailers of $20.7 million, $23.1 million and $23.1 million, respectively, were offset against trade receivables of $5.5 million, $5.2 million and $3.7 million, respectively, and notes receivable of $7.0 million, $6.0 million and $5.6 million, respectively. The remaining $8.2 million, $11.9 million and $13.8 million, respectively, were primarily issued as notes payable with no net impact in the Consolidated Statements of Cash Flows.

During fiscal 2019, the Company received $5.1 million of property and equipment prior to year-end and accrued for these items as no cash payments were made. These capital expenditures were not included in the Purchases of property and equipment in the Consolidated Statement of Cash Flows for fiscal year 2019. During fiscal 2019, the Company paid $2.5 million for property and equipment that was purchased and accrued during the year ended December 29, 2018. These capital expenditures were included in the Purchases of property and equipment in the Consolidated Statement of Cash Flows for fiscal year 2019.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis summarizes the significant factors affecting the Company's consolidated operating results and financial condition during the three-year period ended December 28, 2019 (the Company's fiscal years 2019, 2018 and 2017). Fiscal years 2019, 2018 and 2017 each contain 52 weeks of operating results. Unless otherwise noted, all references herein for the years 2019, 2018 and 2017 represent fiscal years ended December 28, 2019, December 29, 2018 and December 30, 2017, respectively. This discussion and analysis should be read in conjunction with the consolidated financial statements and the related notes included in this annual report that have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP").

Company Overview

The Company is a wholesaler of hardware and other related products and provides services and best practices for retail operations. The overall home improvement industry is estimated to be almost $400 billion and consists of a broad range of products and services, including lawn and garden products, paint and sundries, certain building supplies and general merchandise typically used in connection with home and property improvement, remodeling, repair and maintenance. The industry is fragmented and competition exists between the large home improvement centers, retail hardware stores and other chains offering hardware merchandise. In addition, we face growing competition from online and multichannel retailers.

The Company's retailers generally compete in the $51 billion "convenience hardware" segment which is characterized by purchases primarily of products related to home improvement and repair, including paint and related products, lawn and garden equipment, and those products less focused on large-scale building, renovation and remodeling projects. The Company believes that the following competitive strengths distinguish it from its peers and contribute to its success in the convenience hardware market: (1) strong consumer recognition of the Ace Brand; (2) well-regarded for exceptional customer service and convenience; (3) strength of distribution operations; (4) consolidated purchasing power; (5) differentiated and localized product and service offerings; and (6) a diversified network of independent retailers.

The Company strives to be the best provider of products, services and operating methods for convenience hardware retailers. The four main drivers that support that goal and the Company's efforts to grow the business are improving the store model, accelerating new store openings, increasing store projects that drive store sales and profitability and reducing the number of store closings.

Ace Ecommerce Holdings LLC ("AEH"), a majority-owned and controlled subsidiary of the Company, operates The Grommet, an e-commerce company that operates a website that markets and sells new and innovative products created by independent entrepreneurs.

The Company's Ace Wholesale Holdings LLC ("AWH") legal entity was created to pursue sales to non-member retailers. Through acquisition and organic growth, AWH has become a distributor of hardlines products for independent lumber, paint, industrial and hardware outlets throughout the country. The Company believes that AWH will serve as a catalyst to further leverage wholesale purchasing power and advance the Company's strategic plans to be a leader in the wholesale distribution industry.

Ace Retail Holdings LLC ("ARH") is the owner of the 135 store Westlake Ace Hardware retail chain. In March 2019, ARH acquired the remaining 58 percent of the outstanding stock of Great Lakes Ace Hardware, Inc. ("GLA") that it did not already own. GLA is the owner of the 51 store Great Lakes Ace retail chain. As a result, the Company is also a retailer of hardware, paint and other related products.

Ace Hardware International Holdings, Ltd. ("AIH") is a majority-owned and controlled subsidiary of the Company with a 20.8% noncontrolling interest owned by its international retailers. AIH has wholesale distribution capabilities in Ningbo, China; Colon, Panama; and Dubai, United Arab Emirates. AIH customers operate approximately 810 stores located in approximately 65 countries.

In September 2019, the Company formed the Ace Services Holdings LLC ("ASH") legal entity. On September 5, 2019, ASH acquired Handyman Matters Inc., a franchisor of home improvement and repair services.

Worldwide Store Count

The number of worldwide Ace retail outlets during the past three fiscal years is summarized as follows:

	Fiscal Years		
	2019	**2018**	**2017**
Retail outlets at beginning of period	5,253	5,121	4,994
New retail outlets	208	257	236
Retail outlet cancellations	(95)	(125)	(109)
Retail outlets at end of period	5,366	5,253	5,121

Results of Operations

Comparison of the Year Ended December 28, 2019 to the Year Ended December 29, 2018

The following data summarizes the Company's performance in 2019 as compared to 2018 (in millions):

	2019		**2018**		**Favorable/ (Unfavorable)**	
	$	% of Revenues*	$	% of Revenues*	$	%
Revenues:						
Wholesale revenues	5,564.5	91.7%	5,341.6	93.4%	222.9	4.2%
Retail revenues	506.7	8.3%	375.4	6.6%	131.3	35.0%
Total revenues	6,071.2	100.0%	5,717.0	100.0%	354.2	6.2%
Gross profit:						
Wholesale gross profit	665.9	12.0%	634.2	11.9%	31.7	5.0%
Retail gross profit	226.7	44.7%	160.9	42.9%	65.8	40.9%
Total gross profit	892.6	14.7%	795.1	13.9%	97.5	12.3%
Operating expenses:						
Wholesale operating expenses	540.1	9.7%	510.5	9.6%	(29.6)	(5.8%)
Retail operating expenses	201.5	39.8%	154.4	41.1%	(47.1)	(30.5%)
Retail pre-opening expenses	8.7	1.7%	1.7	0.5%	(7.0)	(411.8%)
Goodwill impairment	8.5	1.7%	-	-%	(8.5)	(100.0%)
Total operating expenses	758.8	12.5%	666.6	11.7%	(92.2)	(13.8%)
Operating income	133.8	2.2%	128.5	2.2%	5.3	4.1%
Interest expense	(22.7)	(0.4%)	(20.4)	(0.4%)	(2.3)	(11.3%)
Other income, net	29.3	0.5%	19.6	0.4%	9.7	49.5%
Net income attributable to Ace Hardware Corporation	140.4	2.3%	127.7	2.2%	12.7	9.9%

*Wholesale gross profit and expenses are shown as a percentage of wholesale revenues. Retail gross profit and expenses are shown as a percentage of retail revenues. Non-operating items are shown as a percentage of total revenues.

A reconciliation of consolidated revenues follows (in millions):

	Amount	% Change vs. 2018
2018 Revenues	$ 5,717.0	
Wholesale Merchandise Revenues change based on new and cancelled domestic Ace stores:		
Revenues increase from new stores added since January 2018	186.0	3.3%
Revenues decrease from stores cancelled since January 2018	(42.7)	(0.8%)
Increase in wholesale merchandise revenues to comparable domestic Ace stores	155.1	2.7%
Decrease in AWH revenues	(11.5)	(0.2%)
Decrease in AIH revenues	(6.4)	(0.1%)
Increase in ARH revenues	136.8	2.4%
Decrease in AEH retail revenues	(5.0)	(0.1%)
Other revenue changes, net (including elimination of $56.2 million in sales to GLA)	(58.1)	(1.0%)
2019 Revenues	$ 6,071.2	6.2%

Consolidated revenues for the year ended December 28, 2019 totaled $6.1 billion, an increase of $354.2 million, or 6.2 percent, as compared to the prior year. Total wholesale revenues were $5.6 billion for fiscal 2019, an increase of $222.9 million, or 4.2 percent, as compared to the prior year. The categories with the largest revenue gains were grilling, hand and power tools and outdoor power equipment. New domestic Ace stores are defined as stores that were activated from January 2018 through December 2019. In 2019, the Company had an increase in wholesale merchandise revenues from new domestic Ace stores of $186.0 million. This increase was partially offset by a decrease in wholesale merchandise revenues due to domestic Ace store cancellations of $42.7 million. As a result, the Company realized a net increase in wholesale merchandise revenues of $143.3 million related to the impact of both new Ace stores affiliated with the Company and from stores that cancelled their membership in 2018 and 2019. Wholesale merchandise revenues to comparable domestic Ace stores increased $155.1 million compared to the prior year. This net increase was partially offset by the elimination of $56.2 million of sales to GLA which became a wholly-owned subsidiary and was fully consolidated beginning in the first quarter of 2019. This elimination was not required in 2018. Warehouse sales represented 78.9 percent of wholesale merchandise revenue in 2019 compared to 79.2 percent in 2018, while direct ship sales were 21.1 percent, up from 20.8 percent in 2018.

AWH revenues were $391.2 million during fiscal 2019. This is a decrease of $11.5 million from fiscal 2018 and was the result of the decision to reduce the number of products available for sale to certain customers due to low profitability.

AIH revenues were $253.1 million during fiscal 2019. This is a decrease of $6.4 million from fiscal 2018 and was driven by lower sales to customers in St. Maarten, UAE, Indonesia, Puerto Rico, Ecuador and Israel, partially offset by increased sales to customers in Saudi Arabia and the Philippines.

Total retail revenues were $506.7 million, an increase of $131.3 million, or 35.0 percent, as compared to the prior year. Retail revenues from ARH were $466.5 million during fiscal 2019, an increase of $136.8 million or 41.5 percent. A significant portion of this increase was due to the inclusion of GLA, which contributed $94.8 million of this increase. The remaining increase was the result of twelve new retail stores added by the Westlake retail chain since January 2018, including eleven in California. Retail revenues from AEH were $40.7 million during fiscal 2019, compared to $45.7 million during fiscal 2018. This was a decrease of $5.0 million from fiscal 2018 which was the result of a reduction in new customer acquisitions.

Wholesale gross profit for fiscal 2019 was $665.9 million, an increase of $31.7 million from fiscal 2018. The wholesale gross margin percentage was 12.0 percent of wholesale revenues in fiscal 2019, up slightly from 11.9 percent in fiscal 2018.

Retail gross profit for fiscal 2019 was $226.7 million, an increase of $65.8 million from fiscal 2018. The retail gross margin percentage was 44.7 percent of retail revenues in fiscal 2019, up from 42.9 percent in fiscal 2018. The increase in retail gross margin percentage was primarily a result of an increase in vendor income earned and the inclusion of GLA results in fiscal 2019 which carried a higher margin. For ARH, retail gross profit as reported in the Ace financial statements is based on the Ace wholesale acquisition cost of product, not ARH's acquisition cost which includes a markup from the Company.

Wholesale operating expenses increased $29.6 million, or 5.8 percent in fiscal 2019, as compared to fiscal 2018. The increase is primarily due to higher distribution costs associated with the increased volume. As a percentage of wholesale revenues, wholesale operating expenses increased slightly to 9.7 percent in fiscal 2019 from 9.6 percent in fiscal 2018.

Retail operating expenses increased $47.1 million, or 30.5 percent in fiscal 2019, as compared to fiscal 2018. ARH's retail operating expenses increased $49.8 million, or 41.9 percent, in fiscal 2019 as compared to fiscal 2018. Approximately $33.4 million of the increase was due to the inclusion of GLA operating expenses as a result of consolidating GLA results beginning in the first quarter of 2019. The remainder of the ARH increase was driven by expenses from twelve new retail stores added by Westlake in 2019. Retail operating expenses as a percentage of retail revenue decreased to 39.8 percent in fiscal 2019 from 41.1 percent in fiscal 2018.

Retail pre-opening expenses of $8.7 million were incurred in fiscal 2019 primarily related to one-time, start-up costs from eleven new stores in California opened by Westlake during fiscal 2019.

During fiscal 2019, the Company recorded a non-cash impairment charge of $8.5 million to fully eliminate the carrying amount of goodwill in the AEH subsidiary.

Interest expense increased $2.3 million or 11.3 percent compared to fiscal 2018 due to an increase in the Company's average revolver balance during fiscal 2019 and higher rates. In addition, an increase in patronage refund certificates outstanding throughout the year contributed to the increase.

Other income, net increased $9.7 million primarily due to a $4.9 million gain on the sale of the Company's former distribution center in Prince George, Virginia in fiscal 2019 and an increased tax benefit from losses incurred by certain of the Company's tax paying subsidiaries.

Comparison of the Year Ended December 29, 2018 to the Year Ended December 30, 2017

The following data summarizes the Company's performance in 2018 as compared to 2017 (in millions):

	2018		2017		Favorable/ (Unfavorable)	
	$	% of Revenues*	$	% of Revenues*	$	%
Revenues:						
Wholesale revenues	5,341.6	93.4%	5,091.2	94.5%	250.4	4.9%
Retail revenues	375.4	6.6%	297.2	5.5%	78.2	26.3%
Total revenues	5,717.0	100.0%	5,388.4	100.0%	328.6	6.1%
Gross profit:						
Wholesale gross profit	634.2	11.9%	624.3	12.3%	9.9	1.6%
Retail gross profit	160.9	42.9%	130.0	43.7%	30.9	23.8%
Total gross profit	795.1	13.9%	754.3	14.0%	40.8	5.4%
Operating expenses:						
Wholesale operating expenses	510.4	9.6%	479.2	9.4%	(31.2)	(6.5%)
Retail operating expenses	156.1	41.6%	115.1	38.7%	(41.0)	(35.6%)
Warehouse facility closure costs	0.1	-	4.0	0.1%	3.9	97.5%
Total operating expenses	666.6	11.7%	598.3	11.1%	(68.3)	(11.4%)
Operating income	128.5	2.2%	156.0	2.9%	(27.5)	(17.6%)
Interest expense	(20.4)	(0.4%)	(14.6)	(0.2%)	(5.8)	(39.7%)
Other income, net	19.6	0.4%	5.2	-	14.4	276.9%
Net income attributable to Ace Hardware Corporation	127.7	2.2%	146.6	2.7%	(18.9)	(12.9%)

*Wholesale gross profit and expenses are shown as a percentage of wholesale revenues. Retail gross profit and expenses are shown as a percentage of retail revenues. Non-operating items are shown as a percentage of total revenues.

A reconciliation of consolidated revenues follows (in millions):

	Amount	% Change vs. 2017
2017 Revenues	$ 5,388.4	
Wholesale Merchandise Revenues change based on new and cancelled domestic Ace stores:		
Revenues increase from new stores added since January 2017	154.4	2.9%
Revenues decrease from stores cancelled since January 2017	(40.9)	(0.8%)
Increase in wholesale merchandise revenues to comparable domestic Ace stores	115.3	2.1%
Increase in AWH revenues	13.8	0.3%
Increase in AIH revenues	4.5	0.1%
Increase in ARH revenues	54.1	1.0%
Increase in AEH retail revenues	24.1	0.4%
Other revenue changes, net	3.3	0.1%
2018 Revenues	$ 5,717.0	6.1%

Consolidated revenues for the year ended December 29, 2018 totaled $5.7 billion, an increase of $328.6 million, or 6.1 percent, as compared to the prior year. Total wholesale revenues were $5.3 billion for fiscal 2018, an increase of $250.4 million, or 4.9 percent, as compared to the prior year. The categories with the largest revenue gains were paint, grilling, power tools, lawn and garden and electrical. New domestic Ace stores are defined as stores that were activated from January 2017 through December 2018. In 2018, the Company had an increase in wholesale merchandise revenues from new domestic Ace stores of $154.4 million. This increase was partially offset by a decrease in wholesale merchandise revenues due to domestic Ace store cancellations of $40.9 million. As a result, the Company realized a net increase in wholesale merchandise revenues of $113.5 million related to the impact of both new Ace stores affiliated with the Company and from Ace stores that cancelled their membership in 2017 and 2018. Wholesale merchandise revenues to comparable domestic Ace stores increased $115.3 million. Warehouse sales represented 79.2 percent of wholesale merchandise revenue in 2018 compared to 79.7 percent in 2017, while direct ship sales were 20.8 percent, up from 20.3 percent in 2017.

AWH revenues were $402.7 million during fiscal 2018. This is an increase of $13.8 million from fiscal 2017 and was primarily driven by higher direct ship revenues and increased warehouse revenues in the plumbing, heating and lawn and garden departments.

AIH revenues were $259.5 million during fiscal 2018. This is an increase of $4.5 million from fiscal 2017 and was primarily driven by higher direct ship and service revenues.

Total retail revenues were $375.4 million, an increase of $78.2 million, or 26.3 percent, as compared to the prior year. Retail revenues from ARH were $329.7 million during fiscal 2018, an increase of $54.1 million or 19.6 percent. The increase was primarily the result of new retail stores added during 2018. Retail revenues from AEH, which was formed in the third quarter of 2017 to acquire The Grommet, were $45.7 million during fiscal 2018.

Wholesale gross profit for fiscal 2018 was $634.2 million, an increase of $9.9 million from fiscal 2017. The wholesale gross margin percentage was 11.9 percent of wholesale revenues in fiscal 2018, a decrease from the fiscal 2017 gross margin percentage of 12.3 percent. This decrease in the wholesale gross margin percentage was primarily the result of higher receiving costs due to lower Retail Support Center ("RSC") productivity as well as unfavorable inventory reserve adjustments and LIFO expense. These decreases were partially offset by an increase in vendor funds earned.

Retail gross profit for fiscal 2018 was $160.9 million, an increase of $30.9 million from fiscal 2017. The retail gross margin percentage was 42.9 percent of retail revenues in fiscal 2018, down from 43.7 percent in fiscal 2017. The decline in margin was primarily the result of the inclusion of lower margin revenues realized by AEH for all of 2018 versus only in the fourth quarter of 2017. Excluding the impact of The Grommet, the retail gross margin as a percentage of retail revenues was 44.3 percent in fiscal 2018 compared to 44.6 percent in fiscal 2017. Retail gross profit as reported in the Ace financial statements is based on the Ace wholesale acquisition cost of product rather than the ARH acquisition cost which includes Ace's normal markup from cost.

Wholesale operating expenses increased $31.2 million, or 6.5 percent in fiscal 2018, as compared to fiscal 2017. As a percentage of wholesale revenues, wholesale operating expenses increased to 9.6 percent in fiscal 2018 from 9.4 percent in fiscal 2017. The increase includes higher payroll expenses than the prior year to support higher revenues, lower RSC productivity due to high employee turnover and increased labor costs incurred to setup the new Fredericksburg RSC while shutting-down the Prince George RSC. In addition, marketing and advertising expenses increased from prior year to support the Ace U.S. business.

Retail operating expenses increased $41.0 million, or 35.6 percent in fiscal 2018, as compared to fiscal 2017. ARH's retail operating expenses of $120.3 million increased $19.6 million, or 19.4 percent, in fiscal 2018 as compared to fiscal 2017. This increase was primarily driven by expenses from new retail stores added in 2018. The remainder of the increase was due to the inclusion of retail operating expenses from AEH for a full twelve months which was an increase of $21.4 million. Included in AEH's operating expenses was $4.5 million of amortization of intangible assets identified as part of the final purchase accounting valuation. Retail operating expenses as a percentage of retail revenue increased to 41.6 percent in fiscal 2018 from 38.7 percent in fiscal 2017. Excluding the impact of The Grommet, retail operating expenses as a percentage of retail revenues was 38.6 percent in fiscal 2018 compared to 39.0 percent in fiscal 2017.

During fiscal 2018, the Company recorded a $0.1 million charge for warehouse facility closure costs to update its estimates from fiscal 2017. During fiscal 2017, the Company recorded warehouse facility closure costs of $4.0 million related to the future closing of certain warehouse and distribution facilities.

Interest expense increased $5.8 million or 39.7 percent compared to fiscal 2017 primarily due to an increase in the Company's revolver balance to support growth in inventories and receivables as well as higher rates. In addition, an increase in patronage refund certificates outstanding throughout the year contributed to the increase.

Other income, net increased $14.4 million primarily due to a tax benefit in the current year compared to tax expense in fiscal 2017 caused by the new tax legislation enacted in 2017. In addition, interest income increased due to a realized gain on the sale of investments in fiscal 2018.

Liquidity and Capital Resources

The Company believes that existing cash balances, along with the existing lines of credit and long-term financing, will be sufficient to finance the Company's working capital requirements, debt service, patronage distributions, capital expenditures, share redemptions from retailer cancellations and growth initiatives for at least the next 12 months.

The Company's borrowing requirements have historically arisen from, and are expected to continue to arise from, seasonal working capital needs, debt service, capital improvements and acquisitions, patronage distributions and other general corporate purposes. In the past, the Company has met its operational cash needs using cash flows from operating activities and funds from its revolving credit facilities. The Company currently estimates that its cash flows from operating activities and working capital, together with its lines of credit, will be sufficient to fund its short-term liquidity needs. Actual liquidity and capital funding requirements depend on numerous factors, including operating results, general economic conditions and the cost of capital.

The Company has a $700.0 million line of credit that is expandable to $1.0 billion through a $300.0 million accordion that is exercisable without the consent of existing lenders provided that the Company is not in default of the credit agreement and further provided that none of the existing lenders are required to provide any portion of the increased facility. At the Company's discretion, borrowings under the credit facility bear interest at a rate of either 0 to 75 basis points over the prime rate or 100 to 175 basis points over the London Interbank Offered Rate ("LIBOR") depending on the Company's leverage ratio as defined under the agreement. The credit facility was priced at LIBOR plus 125 basis points at December 28, 2019. The credit facility expires on February 1, 2024 and requires maintenance of certain financial covenants including a maximum allowable average leverage ratio and a minimum fixed charge coverage ratio. As of December 28, 2019, the Company was in compliance with its covenants and $196.5 million was outstanding under the credit facility.

The credit facility includes a $175.0 million sublimit for the issuance of standby and commercial letters of credit. As of December 28, 2019, a total of $12.5 million in letters of credit were outstanding. The credit facility requires the Company to pay fees based on the unused portion of the line of credit at a rate of 12.5 to 25 basis points per annum depending on the Company's leverage ratio.

The credit facility allows the Company to make revolving loans and other extensions of credit to AIH in an aggregate principal amount not to exceed $75.0 million at any time. As of December 28, 2019, there were no loans or other extensions of credit provided to AIH.

The Company entered into an interest rate swap derivative agreement to reduce the risk of interest rate volatility for the credit facility. The interest rate swap started on March 13, 2017 and expires on May 13, 2020. The swap agreement fixes the LIBOR rate on $150.0 million of the revolving credit facility at 2.18 percent, resulting in an effective rate of 3.43 percent after adding the 1.25 percent margin based on the current pricing tier per the credit agreement. The swap arrangement has been designated as a cash flow hedge and has been evaluated to be highly effective. As a result, the after-tax change in the fair value of the swap is recorded in accumulated other comprehensive income as a gain or loss on derivative financial instruments.

The Company's Westlake subsidiary has a $100.0 million asset-based revolving credit facility ("Westlake Facility"). The Westlake Facility matures on October 24, 2022. Under this facility, Westlake has the right to issue letters of credit up to a maximum of $7.5 million. At the Company's discretion, borrowings under this facility bear interest at a rate of either the prime rate plus an applicable spread of 25 to 50 basis points or LIBOR plus an applicable spread of 125 to 150 basis points, depending on the Company's average availability under the Westlake Facility as measured on a trailing 12-month basis. The Westlake Facility was priced at LIBOR plus 125 basis points at December 28, 2019.

The Westlake Facility is collateralized by substantially all of Westlake's personal property and intangible assets. Borrowings under the facility are subject to a borrowing base calculation consisting of certain advance rates applied to eligible collateral balances (primarily consisting of certain receivables and inventories). This agreement requires maintenance of certain financial covenants including a minimum fixed charge coverage ratio. As of December 28, 2019, ARH was in compliance with its covenants and had $52.0 million in loans outstanding under the Westlake Facility.

The Company's GLA subsidiary (see Note 2 for additional details of this acquisition) has a $20.0 million asset-based revolving credit facility ("GLA Facility"). The GLA Facility matures on November 6, 2022. Borrowings under the GLA Facility are subject to a borrowing base calculation consisting of certain advance rates applied to eligible receivables and inventory. The interest rate is based on either the lender's prime rate plus 100 basis points or LIBOR plus 200 basis points. As of December 28, 2019, GLA was in compliance with its covenants and had $4.5 million outstanding under the GLA Facility. As of December 28, 2019, $1.0 million of the outstanding debt was priced at LIBOR plus 200 basis points and $3.5 million was priced at prime plus 100 basis points.

Both the GLA Facility and the Westlake Facility include a lender-controlled cash concentration system that results in all of GLA and Westlake's daily available cash being applied to the outstanding borrowings under their facilities. As a result, pursuant to Financial Accounting Standards Board Accounting Standards Codification Section 470-10-45, "Classification of Revolving Credit Agreements Subject to Lock-Box Arrangements and Subjective Acceleration Clauses," the borrowings under the GLA Facility and Westlake Facility have been classified as a Current maturity of long-term debt as of December 28, 2019.

Total debt, the majority of which is comprised of the $253.0 million borrowed on lines of credit, was $276.9 million as of December 28, 2019, compared to $327.7 million as of December 29, 2018.

Cash Flows

The Company had $18.2 million and $25.6 million of cash and cash equivalents at December 28, 2019 and December 29, 2018, respectively. Following is a summary of the Company's cash flows from operating, investing and financing activities for fiscal years 2019 and 2018, respectively (in millions):

	2019	2018
Cash provided by operating activities before changes in assets and liabilities	$ 203.8	$ 180.3
Net changes in assets and liabilities	10.2	(116.6)
Net cash provided by operating activities	214.0	63.7
Net cash used in investing activities	(91.9)	(88.9)
Net cash provided by (used) in financing activities	(129.5)	27.8
Net change in cash and cash equivalents	$ (7.4)	$ 2.6

The Company's operating activities generated $214.0 million of cash in fiscal 2019 compared to $63.7 million in fiscal 2018. Excluding the impact of net changes in assets and liabilities, cash provided by operating activities increased from $180.3 million in fiscal 2018 to $203.8 million in fiscal 2019. This $23.5 million increase was the result of a $12.2 million increase in net income in 2019 and a $12.9 million increase in non-cash expenses for depreciation and amortization and goodwill impairment.

The net change in assets and liabilities provided $10.2 million of cash in fiscal 2019 compared to using $116.6 million in fiscal 2018. This $126.8 million decrease in net working capital was primarily driven by a $144.6 million increase in inventories in 2018 versus a $30.0 million decrease in inventories in 2019. In 2018, the Company invested in additional inventory to maintain service levels due to poor fill rates and to stock the new Fredericksburg RSC. Partially offsetting this inventory change was a $24.5 million incremental increase in receivables in 2019 compared to 2018 due to higher sales.

Net cash used for investing activities was $91.9 million in 2019 compared to $88.9 million in fiscal 2018. Investing activities in 2019 consisted of $76.5 million in capital expenditures which were partially offset by $22.0 million in proceeds from sale of assets, primarily from the sale of the Prince George RSC. There was also $22.5 million paid for the acquisition of GLA, Handyman Matters Inc., and additional retail stores by ARH. Investing activities in 2018 consisted of $61.1 million in capital expenditures, including $13.7 million for the new Fredericksburg RSC, and $18.5 million paid for the acquisition of retail stores by ARH.

Net cash used in financing activities was $129.5 million in fiscal 2019 compared to providing $27.8 million in fiscal 2018. During 2019, the Company had $58.0 million of net payments under the revolving lines of credit, paid $51.3 million for the cash portion of the 2018 patronage distributions, paid $5.3 million on patronage refund certificates and had $10.9 million in payments on long-term debt. During 2018, the Company had $104.8 million of net borrowings under the revolving lines of credit, paid $58.0 million for the cash portion of the 2017 patronage distributions, and had $11.0 million in payments on long-term debt.

Off-balance sheet arrangements

In accordance with GAAP, operating leases for the Company's real estate and other assets are not reflected in the Consolidated Balance Sheets. In addition, the Company has certain other guarantees, as further described in the Notes to the Consolidated Financial Statements – Note 15 – Commitments and Contingencies. The Company believes the likelihood of any such payment under these guarantees is remote.

Contractual Obligations and Commitments

Contractual obligations and commitments at December 28, 2019 are as follows (in millions):

	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Long-term debt (1)	$ 276.9	$ 67.0	$ 11.5	$ 198.4	$ -
Interest payments on long-term debt (2)	38.0	10.5	19.2	8.3	-
Patronage refund certificates payable	124.7	17.4	54.0	53.3	-
Operating leases (3)	521.6	84.2	132.5	104.3	200.6
Purchase commitments (4)	49.8	26.7	17.2	3.9	2.0
Total	$ 1,011.0	$ 205.8	$ 234.4	$ 368.2	$ 202.6

(1) Reflects principal payments.

(2) Reflects interest that would be paid if LIBOR rates and interest rate spreads remain unchanged from the December 28, 2019 rates and assumes consistent outstanding revolving line of credit balances until the expiration of the facilities in 2022 and 2024.

(3) Total operating lease payments include $4.2 million of minimum lease payments for store leases that the Company has assigned to member retailers.

(4) Represents minimum purchase commitments pursuant to contracts.

Application of Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses in the consolidated financial statements. On an ongoing basis, the Company evaluates its estimates and judgments based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates, and these estimates would vary under different assumptions or conditions. Management believes these estimates and assumptions are reasonable.

The Company annually reviews its financial reporting and disclosure practices and accounting policies to ensure that they provide accurate and comprehensive information relative to the current economic and business environment. The Company's significant accounting policies are described in the Notes to the Consolidated Financial Statements. The following represents those critical accounting policies which involve a relatively higher degree of judgment, estimation and complexity and where materially different amounts could be reported under different conditions or using different assumptions.

Valuation of Inventories When necessary, the Company provides allowances to adjust the carrying value of inventories to the lower of cost or market, including costs to sell or dispose of surplus or damaged/obsolete inventory, and for estimated shrinkage. Estimates of the future demand for the Company's products are key factors used by management in assessing the net realizable value of the inventories. While management believes that the estimates used are appropriate, an unanticipated decline in revenues at retail outlets or a significant decline in demand for products in selected product categories could result in valuation adjustments.

Vendor Funds The Company receives funds from vendors in the normal course of business principally as a result of purchase volumes, revenues or promotions of vendors' products. Based on the provisions of the vendor agreements in place, management develops accrual rates by estimating the point at which the Company will have completed its performance under the agreement and the amount agreed upon will be earned. Due to the complexity and diversity of the individual vendor agreements, the Company performs analyses and reviews of historical trends throughout the year to ensure the amounts earned are appropriately recorded. As part of these analyses, the Company validates its accrual rates based on actual purchase trends and applies those rates to actual purchase volumes to determine the amount of funds that should be accrued by the Company and receivable from the vendor. Amounts accrued throughout the year could be impacted if actual purchase volumes differ from projected annual purchase volumes, especially in the case of programs that provide for increased funding when graduated purchase volumes are met. At year-end, the accrual reflects actual purchases made throughout the year.

Vendor funds are treated as a reduction of inventory cost, unless they represent a reimbursement of specific, incremental and identifiable costs incurred by the customer to sell the vendor's product, in which case the costs would be netted. The majority of the vendor funds that the Company receives do not meet the specific, incremental and identifiable criteria. Therefore, the Company treats a majority of these funds as a reduction in the cost of inventory as the amounts are accrued and recognized as a reduction of cost of revenues when the inventory is sold.

Allowance for Doubtful Accounts The allowance for doubtful accounts reflects management's estimate of the future amount of accounts and notes receivable that will not be collected. Management records allowances for doubtful accounts based on judgments made considering a number of factors, primarily historical collection statistics, current member retailer credit information, the current economic environment, the aging of receivables, the evaluation of compliance with lending covenants and the offsetting amounts due to members for stock, notes, interest and anticipated but unpaid patronage distributions. While the Company believes it has appropriately considered known or expected outcomes, its customers' ability to pay their obligations, including those to the Company, could be adversely affected by declining revenues at retail resulting from such factors as contraction in the economy or competitive conditions in the wholesale and retail industry including increased competition from omni-channel retailers, discount stores, chain stores and other mass merchandisers.

The Company's allowance for doubtful accounts at December 28, 2019 and December 29, 2018 was $6.9 million and $9.5 million, respectively. Actual credit losses could vary materially from the Company's estimates.

Insurance Reserves Insurance reserves for claims related to the Company's self-insured property, general liability, workers' compensation and auto liability insurance programs are dependent on assumptions used in calculating such amounts. These assumptions include projected ultimate losses and confidence levels of the reserve requirement and consider historical loss levels and other factors. While management believes that the assumptions used are appropriate, differences in actual claims experience or changes in assumptions may affect the Company's insurance reserves.

Goodwill Goodwill represents the excess of the cost of an acquired business over the fair value of net tangible assets acquired and identified intangible assets. Goodwill is not amortized but is tested for impairment at a reporting unit level on an annual basis or more frequently, if circumstances change or an event occurs that would more likely than not reduce the fair value of a reporting unit below its carrying amount.

Qualitative factors may be assessed to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount. If an election is made to not perform the qualitative assessment, or the qualitative assessment indicates that the carrying amount is more likely than not higher than the fair value, goodwill is tested for impairment. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired. If the carrying amount of a reporting unit exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess.

Significant judgment is applied when goodwill is assessed for impairment. This judgment includes developing cash flow projections, selecting appropriate discount rates, identifying relevant market comparables, incorporating general economic and market conditions and selecting an appropriate control premium. The income approach is based on discounted cash flows, which are derived from internal forecasts and economic expectations for each respective reporting unit.

Based on the annual impairment testing performed, the Company concluded that it was more likely than not that the fair value of AEH was below its carrying amount due to several factors that developed during the fourth quarter of 2019. These factors include: (i) continued operating results below management expectations; (ii) a reduction in revenues from the wholesale business and (iii) an increase in the costs to acquire customers which has led to decreased revenues from the consumer business. As a result of the impairment test, it was determined that the carrying amount exceeds the AEH reporting unit's fair value, resulting in an impairment charge of $8.5 million for the year ended December 28, 2019. The remaining balance of goodwill after the impairment was $74.6 million at December 28, 2019. Significant adverse changes to the Company's business environment and future cash flows could cause the Company to record additional impairment charges in future periods.

Impact of New Accounting Standards

New Accounting Pronouncements – Adopted

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments – Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Financial Liabilities." ASU 2016-01 requires the change in fair value measurement for certain equity investments to be recognized in net income, simplifies the impairment assessment for equity investments without readily determinable fair values, eliminates disclosure requirements related to fair value of financial instruments measured at amortized cost for non-public entities, eliminates the requirement to disclose methods and assumptions used to estimate fair value of financial instruments measured at amortized cost for public entities and requires public entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. Additionally, ASU 2016-01 provides disclosure presentation guidance and clarification related to valuation allowances on deferred tax assets related to available-for-sale securities. ASU 2016-01 is effective for the Company for fiscal 2019 year-end financial statements and quarterly financial statements in fiscal 2020, with early adoption permitted in fiscal 2018. The Company adopted ASU 2016-01 in the first quarter of 2019. This resulted in a reclassification adjustment of a $1.4 million net loss from AOCI to retained earnings related to the unrealized loss on the Company's equity investments.

New Accounting Pronouncements – Issued

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)" along with amendments issued through 2019. The guidance requires that lessees recognize assets and liabilities for leases with lease terms greater than twelve months in the statement of financial position. The guidance also requires improved disclosures to help users of financial statements better understand the amount, timing and uncertainty of cash flows arising from leases. The Company's leases primarily consist of retail space, offices, warehouses, distribution centers and vehicles. The Company has completed the initial assessment of the standard. The Company implemented new leasing software and is finalizing its lease liability calculations and validation procedures. The Company continues to establish new processes and internal controls required to comply with the new lease accounting and disclosure requirements set by the standard.

ASU 2016-02 is effective for the Company for fiscal 2021 year-end financial statements and quarterly financial statements in fiscal 2022, with early adoption permitted. The Company has elected the package of practical expedients that allows companies to not reassess: (1) whether any expired or existing contracts are or contain leases, (2) lease classification for any expired or existing leases and (3) initial direct costs for any expired or existing leases. In addition, the Company has elected to treat the lease and non-lease components of leases as a single lease component and to exempt leases with an initial term of twelve months or less from balance sheet recognition. Consequently, short-term leases will be expensed over the lease term. The Company has not elected to adopt the hindsight practical expedient and therefore will maintain the lease terms previously determined under Accounting Standards Codification ("ASC") 840.

The Company will adopt this standard using the modified retrospective method as of December 29, 2019, the first day of its 2020 fiscal year. The most significant and material impact of adoption will be the recognition of right-of-use assets and lease liabilities on the consolidated balance sheets for operating leases, while the accounting for capital leases remains substantially unchanged. The Company estimates total assets and liabilities will increase between $430 and $530 million upon adoption. The Company does not believe the standard will materially affect the consolidated statements of income or cash flows.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" along with amendments issued in 2018. The guidance requires financial assets measured at amortized cost basis to be presented at the net amount expected to be collected. The amortized cost basis of financial assets should be reduced by expected credit losses to present the net carrying value in the financial statements at the amount expected to be collected. The measurement of expected credit losses is based on past events, historical experience, current conditions and forecasts that affect the collectability of the financial assets. Additionally, credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. ASU 2016-13 is effective for the Company for year-end financial statements and quarterly financial statements in fiscal 2023. The Company is evaluating the impact that ASU 2016-13 will have on the Company's consolidated financial statements.

Qualitative and Quantitative Disclosure About Market Risk

Inflation and Changes in Prices The Company's business is not generally governed by contracts that establish prices substantially in advance of the receipt of goods or services. As vendors increase or decrease their prices for merchandise supplied to the Company, the Company generally increases or decreases the price to its customers in an equal amount plus the normal handling charge on such amounts. In the past, these increases and decreases have provided adequate gross profit to offset the impact of inflation.

Foreign Currency Although the Company has international operating entities, its exposure to foreign currency rate fluctuations is not significant to its financial condition and results of operations.

Customer Credit Risk The Company is exposed to the risk of financial non-performance by customers. The Company's ability to collect on sales to its customers is dependent on the liquidity of its customer base. Volatility in credit markets may reduce the liquidity of the Company's customer base. To manage customer credit risk, the Company monitors historical collection statistics, current member retailer credit information, the current economic environment, the aging of receivables, the evaluation of compliance with lending covenants and the offsetting amounts due to members for stock, notes, interest and anticipated but unpaid patronage distributions. From certain customers, the Company also obtains collateral as considered necessary to reduce risk of loss. The Company does not believe the loss of any single customer would have a material adverse effect on its results of operations.

Interest Rate Volatility The Company has exposure to fluctuations in interest rates on its floating rate debt. In order to reduce the risk of interest rate volatility, the Company has historically entered into interest rate swap agreements to fix the LIBOR rate on a portion of its revolving credit facility. The Company currently maintains an interest rate swap that expires on May 13, 2020, with no plans to replace or supplement it. The Company believes that its exposure to interest rate fluctuations is not significant to its financial condition and results of operations.

Disclosure Regarding Forward-Looking Statements

This document includes certain forward-looking statements about the expectations of the Company. Although the Company believes these statements are based on reasonable assumptions, actual results may vary materially from stated expectations. Such forward-looking statements may be identified by the use of forward-looking words or phrases such as "anticipate," "believe," "expect," "intend," "may," "planned," "potential," "should," "will," "would," "project," "estimate," "ultimate," or similar phrases. Actual results may differ materially from those indicated in the Company's forward-looking statements and undue reliance should not be placed on such statements.

Factors that could cause materially different results include, but are not limited to, weather conditions; natural disasters; fair value accounting adjustments; inventory valuation; health care costs; insurance costs or recoveries; legal costs; borrowing needs; interest rates; credit conditions; economic and market conditions; accidents, leaks, equipment failures, service interruptions, and other operating risks; legislative actions; tax rulings or audit results; asset sales; significant unplanned capital needs; changes in accounting principles, interpretations, methods, judgments or estimates; performance of major customers, transporters, suppliers and contractors; labor relations; civil unrest; and acts of terrorism.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. The Company undertakes no obligation to publicly release any revision to these forward-looking statements to reflect events or circumstances after the date of this report.

FIVE YEAR SUMMARY OF EARNINGS AND DISTRIBUTIONS

	Years Ended				
	December 28, 2019 (52 Weeks)	December 29, 2018 (52 Weeks)	December 30, 2017 (52 Weeks)	December 31, 2016 (52 Weeks)	January 2, 2016 (52 Weeks)
Revenues	$ 6,071.2	$ 5,717.0	$ 5,388.4	$ 5,125.5	$ 5,045.0
Cost of revenues	5,178.6	4,921.9	4,634.1	4,412.7	4,343.3
Gross profit	892.6	795.1	754.3	712.8	701.7
Total operating and other expenses, net	752.2	667.4	607.7	551.9	547.5
Net income attributable to Ace Hardware Corporation	$ 140.4	$ 127.7	$ 146.6	$ 160.9	$ 154.2
Distribution of net income:					
Patronage distributions to third party retailers	$ 172.5	$ 135.4	$ 150.6	$ 152.8	$ 141.3
Net income (loss) of non-patronage activities	(30.7)	(7.0)	(4.0)	8.1	12.9
Adoption of accounting standard	(1.4)	(0.7)	-	-	-
Net income attributable to Ace Hardware Corporation	$ 140.4	$ 127.7	$ 146.6	$ 160.9	$ 154.2

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The consolidated financial statements presented in this Annual Report have been prepared with integrity and objectivity and are the responsibility of the management of Ace Hardware Corporation. These consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles and properly reflect certain estimates and judgments based upon the best available information.

The Company maintains a system of internal accounting controls, which is supported by an internal audit program and is designed to provide reasonable assurance, at an appropriate cost, that the Company's assets are safeguarded and transactions are properly recorded. This system is continually reviewed and modified in response to changing business conditions and operations and as a result of recommendations by the internal and external auditors. In addition, the Company has distributed to employees its policies for conducting business affairs in a lawful and ethical manner.

The consolidated financial statements of the Company have been audited by Ernst & Young LLP, independent accountants. Their accompanying report is based upon audits conducted in accordance with auditing standards generally accepted in the United States of America.

The Audit Committee of the Board of Directors meets periodically with the independent auditors and with the Company's internal auditors, both privately and with management present, to review accounting, auditing, internal control and financial reporting matters. The Audit Committee recommends to the full Board of Directors the selection of the independent auditors and regularly reviews the internal accounting controls, the activities of the outside auditors and internal auditors and the financial condition of the Company. Both the Company's independent auditors and the internal auditors have free access to the Audit Committee.

February 12, 2020

/s/ John Venhuizen
John Venhuizen
President and Chief Executive Officer

/s/ William M. Guzik
William M. Guzik
Executive Vice President and
Chief Financial Officer and Chief Risk Officer

/s/ Steven G. Locanto
Steven G. Locanto
Vice President, Corporate Controller

Ace Hardware Corporation • 2200 Kensington Court • Oak Brook, IL 60523

www.acehardware.com