

ACE HARDWARE CORPORATION  
2021 Annual Report



**ACE HARDWARE CORPORATION**  
**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND**  
**SUPPLEMENTARY DATA**

	<b><u>Page</u></b>
Report of Independent Auditors	2
Consolidated Balance Sheets as of January 1, 2022 and January 2, 2021	3
Consolidated Statements of Income for the years ended January 1, 2022, January 2, 2021 and December 28, 2019	4
Consolidated Statements of Comprehensive Income for the years ended January 1, 2022, January 2, 2021 and December 28, 2019	5
Consolidated Statements of Equity for the years ended January 1, 2022, January 2, 2021 and December 28, 2019	6
Consolidated Statements of Cash Flows for the years ended January 1, 2022, January 2, 2021 and December 28, 2019	7
Notes to Consolidated Financial Statements	8
Management’s Discussion and Analysis of Financial Condition and Results of Operations	25
Five Year Summary of Earnings and Distributions	35
Management’s Responsibility for Financial Statements	36

## Report of Independent Auditors

The Board of Directors  
Ace Hardware Corporation

### Opinion

We have audited the consolidated financial statements of Ace Hardware Corporation (the Company), which comprise the consolidated balance sheets as of January 1, 2022 and January 2, 2021, and the related consolidated statements of income, comprehensive income, equity and cash flows for each of the three fiscal years in the period ended January 1, 2022, and the related notes (collectively referred to as the “financial statements”).

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company at January 1, 2022 and January 2, 2021, and the results of its operations and its cash flows for each of the three fiscal years in the period ended January 1, 2022 in accordance with accounting principles generally accepted in the United States of America.

### Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company’s ability to continue as a going concern for one year after the date that the financial statements are available to be issued.

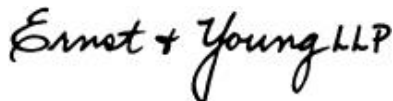
### Auditor’s Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Company’s internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company’s ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

The logo for Ernst & Young LLP, featuring the company name in a stylized, handwritten-style font.

Chicago, Illinois  
February 15, 2022

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

	<u>January 1, 2022</u>	<u>January 2, 2021</u>
<b>Assets</b>		
Cash and cash equivalents	\$ 37.6	\$ 28.9
Marketable securities	58.0	63.2
Receivables, net of allowance for doubtful accounts of \$4.3 and \$4.8, respectively	533.6	527.7
Inventories	1,224.3	1,133.0
Prepaid expenses and other current assets	63.9	55.1
Total current assets	1,917.4	1,807.9
Property and equipment, net	453.4	423.3
Operating lease right-of-use assets, net	497.3	455.5
Finance lease right-of-use assets, net	68.1	25.0
Goodwill and other intangible assets	99.5	100.3
Other assets	105.7	90.9
Total assets	\$ 3,141.4	\$ 2,902.9
<b>Liabilities and Equity</b>		
Current maturities of long-term debt	\$ 17.1	\$ 31.7
Accounts payable	1,095.2	1,109.4
Patronage distributions payable in cash	120.6	112.9
Patronage refund certificates payable	27.2	26.6
Current operating lease liabilities	64.3	64.5
Current finance lease liabilities	10.9	3.7
Accrued expenses	282.9	237.5
Total current liabilities	1,618.2	1,586.3
Long-term debt	18.6	24.8
Patronage refund certificates payable	92.8	95.3
Long-term operating lease liabilities	456.3	412.2
Long-term finance lease liabilities	56.4	20.8
Other long-term liabilities	91.0	73.6
Total liabilities	2,333.3	2,213.0
Member Retailers' Equity:		
Class A voting common stock, \$1,000 par value, 10,000 shares authorized, 2,681 and 2,689 issued and outstanding, respectively	2.7	2.7
Class C nonvoting common stock, \$100 par value, 10,000,000 shares authorized 5,838,265 and 5,015,306 issued and outstanding, respectively	583.8	501.5
Class C nonvoting common stock, \$100 par value, issuable to Retailers for patronage distributions, 1,209,075 and 1,191,050 shares issuable, respectively	120.9	119.1
Contributed capital	19.1	19.0
Retained earnings	68.9	32.3
Accumulated other comprehensive income	1.0	3.0
Equity attributable to Ace member Retailers	796.4	677.6
Equity attributable to noncontrolling interests	11.7	12.3
Total equity	808.1	689.9
Total liabilities and equity	\$ 3,141.4	\$ 2,902.9

See accompanying notes to the consolidated financial statements.

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

	Years Ended		
	January 1, 2022 (52 Weeks)	January 2, 2021 (53 Weeks)	December 28, 2019 (52 Weeks)
Revenues:			
Wholesale revenues	\$ 7,782.2	\$ 7,011.2	\$ 5,564.5
Retail revenues	812.0	751.5	506.7
Total revenues	<u>8,594.2</u>	<u>7,762.7</u>	<u>6,071.2</u>
Cost of revenues:			
Wholesale cost of revenues	6,849.6	6,132.1	4,898.6
Retail cost of revenues	450.2	417.1	280.0
Total cost of revenues	<u>7,299.8</u>	<u>6,549.2</u>	<u>5,178.6</u>
Gross profit:			
Wholesale gross profit	932.6	879.1	665.9
Retail gross profit	361.8	334.4	226.7
Total gross profit	<u>1,294.4</u>	<u>1,213.5</u>	<u>892.6</u>
Wholesale operating expenses:			
Distribution operations expenses	247.3	220.9	178.2
Selling, general and administrative expenses	222.5	210.8	195.1
Retailer success and development expenses	213.0	194.3	166.8
Retail operating expenses	269.9	253.1	201.5
Retail pre-opening expenses	2.9	1.3	8.7
Goodwill impairment charge	-	-	8.5
Total operating expenses	<u>955.6</u>	<u>880.4</u>	<u>758.8</u>
Operating income	<u>338.8</u>	<u>333.1</u>	<u>133.8</u>
Interest expense	(14.4)	(19.1)	(22.7)
Interest income	6.8	3.6	6.9
Other income, net	13.8	4.3	10.8
Income tax (expense) benefit	(15.0)	(5.0)	11.6
Net income	<u>330.0</u>	<u>316.9</u>	<u>140.4</u>
Less Net loss attributable to noncontrolling interests	<u>(0.7)</u>	<u>(0.7)</u>	<u>-</u>
Net income attributable to Ace Hardware Corporation	<u>\$ 330.7</u>	<u>\$ 317.6</u>	<u>\$ 140.4</u>
Patronage distributions accrued	<u>\$ 314.4</u>	<u>\$ 292.9</u>	<u>\$ 182.2</u>
Patronage distributions accrued for third party Retailers	<u>\$ 294.1</u>	<u>\$ 275.4</u>	<u>\$ 172.5</u>

See accompanying notes to the consolidated financial statements.

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

	<b>Years Ended</b>		
	<b>January 1, 2022 (52 Weeks)</b>	<b>January 2, 2021 (53 Weeks)</b>	<b>December 28, 2019 (52 Weeks)</b>
Net income	\$ 330.0	\$ 316.9	\$ 140.4
Other comprehensive (loss) income, net of tax:			
Foreign currency translation	(0.1)	-	-
Unrealized (loss) gain on investments	(1.9)	1.9	1.5
Unrealized gain (loss) on derivative financial instrument	-	0.2	(0.8)
Total other comprehensive (loss) income, net	(2.0)	2.1	0.7
Comprehensive income	328.0	319.0	141.1
Less Comprehensive loss attributable to noncontrolling interests	(0.7)	(0.7)	-
Comprehensive income attributable to Ace Hardware Corporation	\$ 328.7	\$ 319.7	\$ 141.1

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 C Stock Issuable to Retailers for Patronage Dividends	Additional Stock Subscribed	Contributed Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive (Loss) Income	Noncontrolling Interests	Total Equity
	Class A	Class C							
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
Net income (loss)	-	-	-	-	-	317.6	-	(0.7)	316.9
Other comprehensive income	-	-	-	-	-	-	2.1	-	2.1
Net payments on subscriptions	-	-	-	1.1	-	-	-	-	1.1
Stock issued	0.1	54.3	(54.6)	(1.1)	-	(0.1)	-	-	(1.4)
Change in noncontrolling interests	-	-	-	-	-	-	-	(0.3)	(0.3)
Stock repurchased	(0.1)	(35.5)	-	-	-	-	-	-	(35.6)
Patronage distributions issuable	-	-	119.1	-	-	-	-	-	119.1
Patronage distributions payable	-	-	-	-	-	(275.4)	-	-	(275.4)
Other	-	-	-	-	0.2	(1.1)	-	(1.5)	(2.4)
Balances at January 2, 2021	\$ 2.7	\$ 501.5	\$ 119.1	\$ -	\$ 19.0	\$ 32.3	\$ 3.0	\$ 12.3	\$ 689.9
Net income (loss)	-	-	-	-	-	330.7	-	(0.7)	330.0
Other comprehensive loss	-	-	-	-	-	-	(2.0)	-	(2.0)
Net payments on subscriptions	-	-	-	1.4	-	-	-	-	1.4
Stock issued	0.1	117.5	(119.1)	(1.4)	-	(0.1)	-	-	(3.0)
Change in noncontrolling interests	-	-	-	-	(0.1)	-	-	0.2	0.1
Stock repurchased	(0.1)	(35.2)	-	-	-	-	-	-	(35.3)
Patronage distributions issuable	-	-	120.9	-	-	-	-	-	120.9
Patronage distributions payable	-	-	-	-	-	(294.1)	-	-	(294.1)
Other	-	-	-	-	0.2	0.1	-	(0.1)	0.2
Balances at January 1, 2022	\$ 2.7	\$ 583.8	\$ 120.9	\$ -	\$ 19.1	\$ 68.9	\$ 1.0	\$ 11.7	\$ 808.1

See accompanying notes to the consolidated financial statements.

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

	Years Ended		
	January 1, 2022 (52 Weeks)	January 2, 2021 (53 Weeks)	December 28, 2019 (52 Weeks)
<b>Operating Activities</b>			
Net income	\$ 330.0	\$ 316.9	\$ 140.4
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	71.3	64.9	60.1
Goodwill impairment charge	-	-	8.5
Amortization of deferred financing costs	0.5	0.4	0.4
(Gain) loss on disposal of assets, net	(10.3)	0.9	(5.5)
Credit for doubtful accounts	(0.4)	(0.2)	(0.9)
Other, net	8.8	2.5	0.8
Changes in operating assets and liabilities, exclusive of effect of acquisitions:			
Receivables	(31.6)	(73.2)	(69.7)
Inventories	(89.7)	(194.6)	30.0
Other current assets	(8.7)	(9.6)	4.2
Other long-term assets	7.3	9.5	(9.8)
Accounts payable and accrued expenses	28.1	337.3	56.2
Other long-term liabilities	17.4	3.9	12.9
Deferred taxes	(4.8)	2.5	(13.6)
Net cash provided by operating activities	<u>317.9</u>	<u>461.2</u>	<u>214.0</u>
<b>Investing Activities</b>			
Purchases of marketable securities	(40.4)	(22.2)	(46.5)
Proceeds from sale of marketable securities	27.1	20.8	41.4
Purchases of property and equipment	(107.7)	(99.0)	(76.5)
Cash paid for acquired businesses, net of cash acquired	(2.8)	(21.5)	(22.5)
Proceeds from sale of assets	12.8	0.2	22.0
Other, net	(16.2)	(7.1)	(9.8)
Net cash used in investing activities	<u>(127.2)</u>	<u>(128.8)</u>	<u>(91.9)</u>
<b>Financing Activities</b>			
Net payments under revolving lines of credit	(23.1)	(224.9)	(58.0)
Principal payments on long-term debt	(13.4)	(10.7)	(10.9)
Payments of debt issuance costs	(0.3)	-	(1.3)
Payments of cash portion of patronage distribution	(113.8)	(66.2)	(51.3)
Payments of patronage refund certificates	(17.1)	(9.7)	(5.3)
Repurchase of stock	(5.8)	(4.8)	(3.8)
Purchase of noncontrolling interests	(0.4)	(3.0)	(0.2)
Other, net	(8.1)	(2.4)	1.3
Net cash used in financing activities	<u>(182.0)</u>	<u>(321.7)</u>	<u>(129.5)</u>
Increase (decrease) in cash and cash equivalents	8.7	10.7	(7.4)
Cash and cash equivalents at beginning of period	28.9	18.2	25.6
Cash and cash equivalents at end of period	<u>\$ 37.6</u>	<u>\$ 28.9</u>	<u>\$ 18.2</u>
Supplemental disclosure of cash flow information:			
Interest paid	<u>\$ 11.5</u>	<u>\$ 16.6</u>	<u>\$ 20.2</u>
Income taxes paid	<u>\$ 30.4</u>	<u>\$ 12.4</u>	<u>\$ 1.4</u>

See accompanying notes to the consolidated financial statements.



**ACE HARDWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(In millions)**

**(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 (“Retailers”) 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 Retailers based on their volume of merchandise purchases.

Ace Hardware International Holdings, Ltd. (“AIH”), is a majority-owned and controlled subsidiary of the Company with a 21.0 percent noncontrolling interest held by AIH customers. AIH shareholders do not own shares of stock in the Company nor receive patronage dividends.

Ace Retail Holdings LLC (“ARH”) is the owner of the 151 store Westlake Ace Hardware (“Westlake”) and the 59 store Great Lakes Ace Hardware, Inc. (“GLA”) retail chains. As a result, the Company is also a retailer of hardware, paint and other related products.

Ace Wholesale Holdings LLC (“AWH”) owns and operates Emery Jensen Distribution. AWH was formed so that the Company could begin making wholesale hardware sales to non-member retailers.

Ace Ecommerce Holdings LLC (“AEH”) owns The Grommet, an e-commerce company that operates a website that markets and sells new and innovative products created by independent entrepreneurs.

Ace Services Holdings LLC (“ASH”) owns Ace Handyman Services, a franchisor of home improvement, maintenance and repair services. In the fourth quarter of 2021, ASH began operations of Ace Senior Services, which provides basic home maintenance and essential tasks for seniors. On December 22, 2021, ASH acquired the assets of Mountain Skyline Painting LLC, a provider of home painting services.

***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 2021, 2020 and 2019 ended on January 1, 2022, January 2, 2021 and December 28, 2019, respectively. Unless otherwise noted, all references herein for the years 2021, 2020 and 2019 represent fiscal years ended January 1, 2022, January 2, 2021 and December 28, 2019, respectively. Fiscal year 2021 consists of 52 weeks, fiscal year 2020 consisted of 53 weeks, and fiscal year 2019 consisted of 52 weeks.

Subsequent events have been evaluated through February 15, 2022, 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.

***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 that are recorded as a liability. As of January 1, 2022 and January 2, 2021, the Company had outstanding checks in excess of bank balances totaling \$47.3 million and \$92.4 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

**ACE HARDWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
**(In millions)**

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 \$15.8 million and \$14.3 million at January 1, 2022 and January 2, 2021, respectively, were issued in favor of the insurance companies that reinsure a portion of NAIL’s loss exposure. At January 1, 2022, NAIL has pledged substantially all of its cash and cash equivalents and marketable securities as collateral for these letters of credit. In fiscal 2019, the Company 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, beginning January 1, 2020. NAIL has provided a \$15.0 million standby letter of credit to the State of Vermont in connection with the MEWA. See Note 12 for more information.

***Revenue Recognition***

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. 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.

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.

**ACE HARDWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
(In millions)

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

	<b>Years Ended</b>	
	January 1, 2022	January 2, 2021
Warehouse merchandise	\$ 5,833.6	\$ 5,175.2
Direct shipment merchandise	1,413.4	1,337.7
ARH revenues	776.7	704.4
E-commerce	307.8	303.8
Service revenues	290.9	267.6
Amortization of sales allowances under retailer incentive programs	(28.2)	(26.0)
<b>Total revenues</b>	<b>\$ 8,594.2</b>	<b>\$ 7,762.7</b>

***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 Retailers 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's warehouse locations 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. Amounts accrued throughout the year can be impacted if actual purchase volumes differ from projected annual purchase volumes. 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 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.

**ACE HARDWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
**(In millions)**

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 group 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.

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.

See Note 8 for additional information.

***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 2021, 2020 and 2019, the Company capitalized \$14.8 million, \$10.4 million and \$10.8 million, respectively, of software development costs related to internal programming time. Amortization of these capitalized costs was \$7.7 million, \$5.2 million and \$4.1 million for fiscal 2021, 2020 and 2019, respectively. As of January 1, 2022 and January 2, 2021, the Company had \$5.4 million and \$4.4 million, respectively, of capitalized costs for internal-use software that had not been placed into service.

***Leases***

At the commencement date of a lease, the Company recognizes a liability to make lease payments and an asset representing the right to use the underlying asset during the lease term. The lease liability is measured at the present value of lease payments over the lease term, including variable fees that are known or subject to a minimum floor. The Company generally does not include options to extend or terminate leases unless it is reasonably certain that the option will be exercised. The Company has lease agreements that contain both lease and non-lease components. The Company elected to not separate non-lease components from lease components for all categories. The Company utilizes the practical expedient to use a risk-free discount rate at commencement date based upon the lease term in determining the recognition of the operating and finance lease assets and liabilities. The initial valuation of the right-of-use ("ROU") asset includes the initial measurement of the lease liability, lease payments made in advance of the lease commencement date and initial direct costs incurred by the Company and excludes lease incentives.

Real estate operating leases also typically require payment of real estate taxes, common area maintenance and insurance. These components comprise the majority of variable lease costs and are excluded from the present value of lease obligations. Operating lease assets also include prepaid or accrued lease payments and are reduced by lease incentives.

Certain retail lease agreements also provide for contingent rentals based on sales performance in excess of specified minimums or on changes in the consumer price indexes. Contingent rentals, which are based upon future performance or changes in indices, are excluded from the determination of lease payments and were not material.

Leases with an initial term of 12 months or less are classified as short-term leases and are not recorded on the consolidated balance sheets. The lease expense for short-term leases is recognized on a straight-line basis over the lease term.

**ACE HARDWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
**(In millions)**

***Advertising Expense***

The Company expenses advertising costs when incurred. Gross advertising expenses amounted to \$264.9 million, \$240.7 million, and \$209.2 million in fiscal 2021, 2020 and 2019, 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 proportionately as redemption occurs at the approximate monthly redemption rate 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 2021, 2020 and 2019, the Company recognized gift card breakage income of \$1.5 million, \$3.4 million and \$1.1 million, respectively. 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 are 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***

NAIL, the Company's wholly-owned subsidiary, operates as a captive insurance company. NAIL provides the reinsurance of property and casualty insurance policies for some Retailers 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 Retailer for such Retailer's stock, notes, interest and declared and unpaid distributions against any obligation owed by the Retailer to the Company. The Company, but not the Retailer, may at its sole discretion exercise these set-off rights when any such funds become due to former Retailers with outstanding accounts and notes receivable owed to the Company and current Retailers with past due receivables owed to the Company.

***Impact of New Accounting Standards***

Recently issued accounting pronouncements that are not yet effective and that were not discussed below are either inapplicable to the Company or, if applicable, the Company does not expect that they will have a material impact on consolidated results of operations, consolidated financial condition, or consolidated cash flows.

***New Accounting Pronouncements - Issued***

In November 2021, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2021-09, "Leases (Topic 842): Discount Rate for Lessees That Are Not Public Business Entities". Topic 842 currently provides lessees that are not public business entities with a practical expedient that allows them to elect to use a risk-free rate as the discount rate for all leases. The amendments in this update allow those lessees to make the risk-free rate election by class of underlying asset, rather than at the entity-wide level. The guidance also requires a lessee to use the rate implicit in the lease if the rate is readily determinable, regardless

**ACE HARDWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
(In millions)

of whether the lessee has elected the risk-free rate expedient. ASU 2021-09 is effective for the Company for year-end financial statements in fiscal 2022. The Company is evaluating the impact that ASU 2021-09 will have on the Company’s consolidated financial statements.

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.

**(2) Acquisitions**

During the year ended January 1, 2022, ARH acquired additional retail stores and ASH acquired a provider of home painting services for consideration of \$2.8 million, prior to working capital adjustments. These acquisitions resulted in recording \$1.0 million of goodwill. 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:

	January 1, 2022	January 2, 2021
Trade	\$ 394.8	\$ 395.6
Other	126.4	120.4
Notes receivable – current portion	16.7	16.5
Less allowance for doubtful accounts	(4.3)	(4.8)
<b>Receivables, net</b>	<b>\$ 533.6</b>	<b>\$ 527.7</b>

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 \$172.5 million and \$109.1 million at January 1, 2022 and January 2, 2021, 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.

Inventories consisted of:

	January 1, 2022	January 2, 2021
Wholesale merchandise inventory (LIFO)	\$ 1,031.4	\$ 973.6
Retail merchandise inventory at ARH stores and AEH warehouses (FIFO)	192.9	159.4
<b>Inventories</b>	<b>\$ 1,224.3</b>	<b>\$ 1,133.0</b>

**ACE HARDWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
(In millions)

**(5) Property and Equipment, net**

Property and equipment, net is summarized as follows:

	January 1, 2022	January 2, 2021
Land	\$ 13.9	\$ 14.7
Buildings and improvements	292.6	297.9
Warehouse equipment	253.1	226.7
Computer hardware and software and other office equipment	412.5	371.2
Transportation equipment	42.4	41.5
Leasehold improvements	70.4	63.1
Assets under construction	21.6	19.6
Property and equipment, gross	1,106.5	1,034.7
Accumulated depreciation and amortization	(653.1)	(611.4)
Property and equipment, net	<u>\$ 453.4</u>	<u>\$ 423.3</u>

Depreciation and amortization expense related to property and equipment for fiscal years 2021, 2020 and 2019 was \$69.3 million, \$60.9 million and \$55.1 million, respectively.

In December 2021, the Company sold the Tampa Retail Support Center (“RSC”) for \$12.7 million and recorded a gain of \$10.2 million. The Company classified the gain as Other income, net in the Consolidated Statements of Income.

**(6) Leases**

The Company leases certain warehouse and distribution space, office space, retail locations, equipment and vehicles under finance and operating leases.

The components of total lease expense for the twelve months ended January 1, 2022 and January 2, 2021, were as follows:

	<u>Income Statement Classification</u>	<u>Years Ended</u>	
		January 1, 2022	January 2, 2021
Finance lease amortization	Cost of revenues	\$ 8.7	\$ 2.9
Finance lease interest	Interest expense	0.4	0.1
Operating lease cost, net of sublease income	Cost of revenues, operating expenses	96.7	93.4
Short-term lease cost	Cost of revenues, operating expenses	9.0	6.6
Variable lease cost	Cost of revenues, operating expenses	22.1	20.4
Net lease cost		<u>\$ 136.9</u>	<u>\$ 123.4</u>

The future minimum undiscounted lease payments under operating and finance leases at January 1, 2022 are as follows:

<u>Fiscal Year</u>	Operating Leases	Finance Leases
2022	\$ 85.0	\$ 13.7
2023	79.9	13.5
2024	73.1	13.5
2025	63.0	13.3
2026	51.1	10.2
Thereafter	205.3	4.8
Total future undiscounted lease payments	557.4	69.0
Less imputed interest	(36.8)	(1.7)
Total reported lease liability	520.6	67.3
Less current portion	(64.3)	(10.9)
Long-term lease liabilities	<u>\$ 456.3</u>	<u>\$ 56.4</u>

**ACE HARDWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
(In millions)

Additionally, the Company has excluded approximately \$175.9 million of payments (undiscounted basis) for leases that have not yet commenced. These leases will commence in 2022 with lease terms of up to fifteen years and will include a lease in Jefferson, Georgia for the replacement of the Gainesville RSC which the Company owns, a leaseback of the Gainesville RSC, and a lease for a new RSC location in Visalia, California to expand our distribution network.

Other information related to operating and finance leases was as follows:

	January 1, 2022	January 2, 2021
<b>Cash paid for amounts included in the measurement of lease liabilities:</b>		
Operating cash flows from operating leases	\$ (88.5)	\$ (93.8)
Operating cash flows from finance leases	\$ (9.7)	\$ (3.5)
<b>Lease assets obtained in exchange for new lease liabilities:</b>		
Operating leases	\$ 126.4	\$ 85.8
Finance leases	\$ 51.9	\$ 27.9
Weighted average remaining lease term for operating leases	8.4 years	8.0 years
Weighted average discount rate for operating leases	1.53%	1.53%
Weighted average remaining lease term for finance leases	5.3 years	5.5 years
Weighted average discount rate for finance leases	0.94%	0.65%

**(7) Notes Receivable, net**

The Company makes available to its Retailers various lending programs whose terms exceed one year. At January 1, 2022 and January 2, 2021, the outstanding balance of the notes was \$17.8 million and \$18.9 million, respectively, of which the current portion of \$16.7 million and \$16.5 million, respectively, was recorded in Receivables, net and the long-term portion of \$0.1 million and \$1.1 million, respectively, was recorded in Other assets.

	January 1, 2022	January 2, 2021
Notes receivable, gross	\$ 44.0	\$ 45.4
Less estimated patronage applications from 2021 and 2020, respectively	(26.2)	(26.5)
Net	17.8	18.9
Less current portion	(16.7)	(16.5)
Less allowance for doubtful accounts	(1.0)	(1.3)
Notes receivable, net	\$ 0.1	\$ 1.1

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 annual 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:

	January 1, 2022
0 – 4 years	\$ 10.1
5 – 8 years	20.5
9 – 10 years	13.4
Total	\$ 44.0

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.



**ACE HARDWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
(In millions)

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:

	January 1, 2022	January 2, 2021
Corporate Credit Exposure:		
Low risk	\$ 17.4	\$ 22.3
Moderate risk	14.7	14.8
High risk	11.9	8.3
Total	<u>\$ 44.0</u>	<u>\$ 45.4</u>

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 certain notes is evaluated on an individual basis while the remaining notes are evaluated on a collective basis. Due to the nature of the notes and the collateral held by the Company, virtually all outstanding notes were collectively evaluated for impairment.

The Company has evaluated the collectability of the notes and has established an allowance for doubtful accounts of \$1.0 million and \$1.3 million at January 1, 2022 and January 2, 2021, 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 Retailer credit information, the current economic environment and the offsetting amounts due to Retailers for stock, notes, interest and declared and unpaid patronage distributions. The components of changes to the Notes receivable allowance for doubtful accounts for 2021 and 2020 were as follows:

	January 1, 2022	January 2, 2021
Allowance for doubtful accounts:		
Beginning balance	\$ 1.3	\$ 1.5
(Reversal) Provision	(0.3)	0.2
Reclassifications to accounts receivable allowance for doubtful accounts	-	(0.4)
Ending balance	<u>\$ 1.0</u>	<u>\$ 1.3</u>

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 2021, 2020 and 2019, \$1.6 million, \$1.9 million and \$2.5 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 2021 and 2020, \$7.9 million and \$6.7 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, none of the balance in fiscal 2021 and \$0.4 million in 2020 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.

**ACE HARDWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
(In millions)

**(8) Goodwill and Other Intangible Assets**

Changes in the carrying value of goodwill were as follows:

Balance at December 28, 2019	\$ 74.6
Acquired goodwill	13.3
Balance at January 2, 2021	87.9
Acquired goodwill	1.0
Balance at January 1, 2022	\$ 88.9

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.

Identifiable intangible assets were as follows:

	January 1, 2022	January 2, 2021
Trademarks and trade name	\$ 10.0	\$ 10.0
Customer relationships	8.1	8.1
Maker relationships	7.7	7.7
Total identifiable intangible assets	25.8	25.8
Less accumulated amortization	(15.2)	(13.4)
Identifiable intangible assets, net	\$ 10.6	\$ 12.4

The trademarks and trade name are being amortized over 10-20 years. The customer and maker relationships are being amortized over 10 years. Net amortization expense related to all intangible assets was \$1.8 million, \$3.5 million and \$4.3 million for fiscal years 2021, 2020 and 2019, respectively. The estimated net amortization expense over the next five fiscal years is \$7.6 million.

**(9) Patronage Distributions and Refund Certificates Payable**

The Company operates as a cooperative organization and has paid or may pay patronage distributions to 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 Retailers during the period. The cash portion of the patronage distribution was 40 percent for all years presented.

The accrued patronage distributions composition is summarized as follows:

	Years Ended		
	January 1, 2022	January 2, 2021	December 28, 2019
Cash portion	\$ 120.6	\$ 112.9	\$ 70.4
Class C stock	120.9	119.1	54.6
Patronage refund certificates	25.2	15.6	30.0
Patronage financing deductions	27.4	27.8	17.5
Total patronage distributions accrued for third party Retailers	\$ 294.1	\$ 275.4	\$ 172.5

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.

**ACE HARDWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
(In millions)

The patronage refund certificates outstanding at January 1, 2022 are payable as follows:

	Amount
2022	\$ 27.2
2023	23.1
2024	29.3
2025	15.2
2026	25.2
Total patronage refund certificates payable	120.0
Less current portion	(27.2)
Long-term patronage refund certificates payable	<u>\$ 92.8</u>

**(10) Accrued Expenses**

Accrued expenses include the following components:

	January 1, 2022	January 2, 2021
Salaries and wages	\$ 83.4	\$ 75.9
Insurance reserves	20.6	18.2
Deferred income	2.7	6.1
Vendor funds	23.0	5.0
Taxes	25.6	23.2
Profit sharing	26.0	23.7
Gift card	18.0	11.5
Interest	5.6	5.7
Advertising and marketing	37.9	27.6
Other	40.1	40.6
Accrued expenses	<u>\$ 282.9</u>	<u>\$ 237.5</u>

**(11) Debt**

The Company has a \$700.0 million line of credit facility. The 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 London Interbank Offered Rate ("LIBOR") rate depending on the Company's leverage ratio as defined under the agreement. The credit facility was priced at LIBOR plus 100 basis points at January 1, 2022. 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 January 1, 2022, the Company was in compliance with its covenants and had no outstanding borrowings 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 January 1, 2022, a total of \$17.3 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 January 1, 2022, there were no loans or other extensions of credit provided to AIH.

The Company's Westlake subsidiary had a \$100.0 million asset-based revolving credit facility ("Westlake Facility") that was scheduled to expire on October 24, 2022. On August 3, 2021, Westlake amended the facility by increasing the maximum borrowing to \$125.0 million and extending the due date to August 3, 2026. The amended facility is expandable to \$150.0 million through a \$25.0 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. Under the

**ACE HARDWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
(In millions)

new facility, Westlake has the right to issue letters of credit up to a maximum of \$7.5 million. At Westlake’s discretion, borrowings under this facility bear interest at a rate of either the prime rate plus an applicable spread of 25 basis points to 50 basis points or LIBOR plus an applicable spread of 125 basis points to 150 basis points, depending on Westlake’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 January 1, 2022.

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 January 1, 2022, ARH was in compliance with its covenants and had \$4.9 million in borrowings outstanding under the Westlake Facility.

The Westlake Facility includes a lender-controlled cash concentration system that results in all of Westlake’s daily available cash being applied to the outstanding borrowings under their facility. 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 Westlake Facility have been classified as a Current maturity of long-term debt.

Total debt outstanding is comprised of the following:

	January 1, 2022	January 2, 2021
Revolving Credit Facility	\$ -	\$ 7.9
Westlake Facility	4.9	20.1
Installment notes with maturities through 2025 at a fixed rate of 6.00%	30.8	28.5
Total debt	35.7	56.5
Less maturities within one year	(17.1)	(31.7)
Long-term debt	\$ 18.6	\$ 24.8

The aggregate scheduled maturities of total debt at January 1, 2022 are as follows:

Fiscal Year	Amount
2022	\$ 17.1
2023	8.9
2024	6.9
2025	2.8
Total debt	\$ 35.7

**(12) Commitments and Contingencies**

*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 January 1, 2022, the Company had outstanding standby letters of credit of \$15.8 million issued in the normal course of NAIL’s operations and commercial letters of credit of \$17.3 million issued by the Company’s credit facility.

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

The AHP is insured by Ace Group Insurance, Inc. (“AGI”), a Vermont-based captive insurance company. AGI is owned by a 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.

**ACE HARDWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
(In millions)

In order to establish and provide initial capitalization of the AHP, AGI and Trust, NAIL provided a \$10.0 million standby letter of credit in favor of AGI. The letter of credit was increased to \$15.0 million in 2021 and 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.

**(13) 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.

Items measured at fair value on a recurring basis	Carrying Value Measured at Fair Value			
	January 1, 2022	Level 1	Level 2	Level 3
<b>Assets:</b>				
Cash equivalents:				
Money market funds	\$ 5.1	\$ 5.1	\$ -	\$ -
Marketable securities:				
Corporate fixed income securities	32.2	-	32.2	-
Mortgage-backed securities	8.8	-	8.8	-
U.S. government notes	10.4	9.6	0.8	-
Other	6.6	-	6.6	-
Total marketable securities	<u>\$ 58.0</u>	<u>\$ 9.6</u>	<u>\$ 48.4</u>	<u>\$ -</u>

Items measured at fair value on a recurring basis	Carrying Value Measured at Fair Value			
	January 2, 2021	Level 1	Level 2	Level 3
<b>Assets:</b>				
Cash equivalents:				
Money market funds/	\$ 2.8	\$ 2.8	\$ -	\$ -
Marketable securities:				
Corporate fixed income securities	35.1	-	35.1	-
Mortgage-backed securities	9.9	-	9.9	-
U.S. government notes	17.8	9.8	8.0	-
Other	0.4	-	0.4	-
Total marketable securities	<u>\$ 63.2</u>	<u>\$ 9.8</u>	<u>\$ 53.4</u>	<u>\$ -</u>

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 January 1, 2022 and of January 2, 2021. 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.

**ACE HARDWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
(In millions)

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.

*Money market funds and U.S. government notes* – The Company's valuation techniques used to measure the fair values of money market funds 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 January 1, 2022 and \$3.7 million at January 2, 2021, respectively.

Gross proceeds from the sale of marketable securities and the related realized gains and losses for the fiscal years ended January 1, 2022, January 2, 2021 and December 28, 2019 were as follows:

	<b>Years Ended</b>		
	January 1, 2022	January 2, 2021	December 28, 2019
Gross proceeds	\$ 20.2	\$ 20.8	\$ 41.4
Gross realized gains	0.4	0.4	0.8
Gross realized losses	(0.2)	(0.2)	(0.2)

Gross realized gains and losses were determined using the specific identification method. For the fiscal year ended January 1, 2022, the Company reclassified \$0.4 million of unrealized gains and \$0.1 million of unrealized losses on marketable securities that were recorded in AOCI as of January 2, 2021 into realized income. These amounts were recorded to Other income, net in the Consolidated Statement of Income.

The following table summarizes the contractual maturity distributions of the Company's debt securities at January 1, 2022. Actual maturities may differ from the contractual or expected maturities since borrowers may have the right to prepay obligations with or without prepayment penalties.

<b>Fair value of available-for-sale debt securities</b>	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	\$ 4.0	\$ 11.5	\$ 10.6	\$ 6.1	\$ 32.2
Mortgage-backed securities	-	0.2	0.7	7.9	8.8
U.S. government notes	0.2	7.2	0.8	2.2	10.4
Other	0.5	1.6	1.6	2.9	6.6
<b>Total</b>	<u>\$ 4.7</u>	<u>\$ 20.5</u>	<u>\$ 13.7</u>	<u>\$ 19.1</u>	<u>\$ 58.0</u>

The Company's debt instruments are recorded at cost on the Consolidated Balance Sheets. The fair value of the Company's debt approximated its carrying value at January 1, 2022. 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.

**ACE HARDWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
(In millions)

**(14) Income Taxes**

Income tax (expense) benefit includes the following components:

	<b>Years Ended</b>		
	January 1, 2022	January 2, 2021	December 28, 2019
<b>Current:</b>			
Federal	\$ (13.7)	\$ 1.4	\$ (0.4)
State	(4.2)	(3.1)	(0.4)
Foreign	(0.9)	(0.9)	(1.1)
Current income tax expense	(18.8)	(2.6)	(1.9)
<b>Deferred:</b>			
Federal	3.6	(2.8)	12.0
State	0.2	0.4	1.5
Deferred income tax benefit (expense)	3.8	(2.4)	13.5
<b>Total income tax (expense) benefit</b>	<b>\$ (15.0)</b>	<b>\$ (5.0)</b>	<b>\$ 11.6</b>

Income tax differs from the amount computed by applying the statutory U.S. Federal income tax rate of 21 percent for fiscal years ended January 1, 2022, January 2, 2021 and December 28, 2019 to pre-tax income because of the effect of the following items:

	<b>Years Ended</b>		
	January 1, 2022	January 2, 2021	December 28, 2019
Expected tax at U.S. Federal income tax rate	\$ (72.4)	\$ (67.6)	\$ (27.1)
Patronage distribution deductions	61.8	57.8	36.2
NOL carryback – tax rate differential	-	6.3	-
Other, net (expense) benefit	(4.4)	(1.5)	2.5
<b>Income tax (expense) benefit</b>	<b>\$ (15.0)</b>	<b>\$ (5.0)</b>	<b>\$ 11.6</b>

Under the CARES Act, net operating losses (“NOLs”) arising in tax years beginning after December 31, 2017 and ending before January 1, 2021 may be carried back for five years. The Company had NOLs arising in the 2018 and 2019 tax years which, prior to this legislation could only be carried forward into tax years with a federal statutory rate of 21 percent. These NOLs can now be carried back to years prior to 2018 with a federal statutory rate of 35 percent. During the year ended January 2, 2021, the Company realized a \$6.3 million federal tax benefit resulting from this tax rate differential.

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:

	January 1, 2022	January 2, 2021
<b>Deferred tax assets:</b>		
Foreign tax credits and other tax credit carryforwards	\$ 11.8	\$ 12.8
Net operating loss carryforwards	1.4	0.3
Unearned insurance premium and loss reserves	1.4	1.0
Allowance for doubtful accounts	1.1	1.1
Inventory reserves	9.1	8.0
Deferred vendor rebates	16.1	16.4
Accrued compensation and benefits expense	17.3	14.7
Other reserves	18.7	10.9
Total deferred tax assets	76.9	65.2
Less valuation allowance	(12.0)	(9.8)
<b>Deferred tax assets</b>	<b>64.9</b>	<b>55.4</b>

**ACE HARDWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
(In millions)

**Deferred tax liabilities:**

Depreciation and deferred gains on property and equipment	12.3	8.7
Amortization of intangibles	3.4	2.4
Net unrealized gains	0.3	0.3
Prepaid expenses and deferred income	4.8	4.5
Inventory valuation	17.0	16.7
Deferred tax liabilities	37.8	32.6
Net deferred tax assets	\$ 27.1	\$ 22.8

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

At January 1, 2022, the Company has state and foreign net operating loss carryforwards of \$6.1 million available for offset against future taxable income. For those states not conforming to the indefinite federal carryforward provisions, the state net operating losses can, generally, be carried forward through the 2038 tax year. A valuation allowance of \$1.0 million has been established against the foreign net operating losses as it is more likely than not that the benefit of the net operating losses will not be realized.

At January 1, 2022, the Company has foreign tax credits of \$0.5 million available to offset future tax expense. The foreign tax credits may be carried forward through the 2029 tax year.

At January 1, 2022, the Company has state tax credit carryforwards of \$11.3 million available to offset future state income tax expense. The state tax credits may be carried forward to tax years 2022 through 2026. A valuation allowance of \$11.0 million has been established against certain 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 2017 through 2021 tax years remain subject to examination by the IRS. For state purposes, the 2016 through 2021 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 January 1, 2022 and January 2, 2021, respectively. The Company recognized immaterial amounts related to interest and penalties within Income tax expense for the years ended January 1, 2022, January 2, 2021 and December 28, 2019. 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.

**(15) Capital Stock**

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

	Number of Shares at	
	January 1, 2022	January 2, 2021
Class A stock, voting, redeemable at par value:		
Authorized	10,000	10,000
Issued and outstanding	2,681	2,689
Class C stock, nonvoting, redeemable at not less than par value:		
Authorized	10,000,000	10,000,000
Issued and outstanding	5,838,265	5,015,306
Issuable as patronage distributions	1,209,075	1,191,050

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 Retailer with respect to the same outlet. A single Class A share is issued to a 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.



**ACE HARDWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
(In millions)

**(16) 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 2021, 2020 and 2019.

The Company and its subsidiaries maintain profit sharing and 401k retirement plans for substantially all employees. Amounts expensed under these plans totaled \$43.5 million, \$39.3 million and \$28.8 million during fiscal 2021, 2020 and 2019, respectively.

**(17) Supplemental Disclosures of Cash Flow Information**

During fiscal 2021, 2020 and 2019, accrued patronage distributions of \$28.3 million, \$29.2 million and \$19.1 million, respectively, were offset against trade receivables and notes receivable owed to the Company by its Retailers with no net impact in the Consolidated Statements of Cash Flows. In addition, the Company had \$25.9 million in patronage refund certificates which were included in Accounts payable pending payment as of January 1, 2022 and had no net impact in the Consolidated Statements of Cash Flows.

During fiscal 2021, 2020 and 2019, non-cash repurchases of stock from Retailers of \$29.4 million, \$30.8 million and \$20.7 million, respectively, were offset against trade receivables of \$5.5 million, \$9.9 million and \$5.5 million, respectively, and notes receivable of \$8.4 million, \$5.6 million and \$7.0 million, respectively. The remaining \$15.5 million, \$15.3 million and \$8.2 million, respectively, were primarily issued as notes payable with no net impact in the Consolidated Statements of Cash Flows.

During fiscal 2021, the Company received \$3.6 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 2021. During fiscal 2021, the Company paid \$9.4 million for property and equipment that was purchased and accrued during the year ended January 2, 2021. These capital expenditures were included in the Purchases of property and equipment in the Consolidated Statement of Cash Flows for fiscal year 2021.

**(18) 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 January 1, 2022:

	<b>2021</b>			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Revenues	\$ 2,066.9	\$ 2,028.6	\$ 2,466.9	\$ 2,031.8
Gross profit	271.0	326.8	376.9	319.7
Operating expenses	268.9	223.8	255.0	207.9
Net income attributable to Ace Hardware Corporation	9.9	99.3	116.0	105.5
	<b>2020</b>			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Revenues	\$ 2,052.7	\$ 2,000.5	\$ 2,279.1	\$ 1,430.4
Gross profit	291.4	328.9	370.6	222.6
Operating expenses	243.5	220.4	232.2	184.3
Net income attributable to Ace Hardware Corporation	43.3	98.9	139.1	36.3

## MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis summarizes the significant factors affecting Ace Hardware Corporation’s (“the Company’s”) consolidated operating results and financial condition during the three-year period ended January 1, 2022 (the Company’s fiscal years 2021, 2020 and 2019). Fiscal year 2021 contains 52 weeks of operating results, fiscal year 2020 contained 53 weeks of operating results, and fiscal year 2019 contained 52 weeks of operating results. Unless otherwise noted, all references herein for the years 2021, 2020 and 2019 represent fiscal years ended January 1, 2022, January 2, 2021 and December 28, 2019, 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 its member Retailers (“Retailers”). The overall home improvement industry is estimated to be almost \$540 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 \$63 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 Hardware International Holdings, Ltd. (“AIH”) is a majority-owned and controlled subsidiary of the Company with a 21.0 percent noncontrolling interest held by AIH customers. AIH has wholesale distribution capabilities in Ningbo, China; Santa Catarina, Mexico; Colon, Panama; and Dubai, United Arab Emirates. AIH customers operate 832 stores located in approximately 65 countries.

Ace Retail Holdings LLC (“ARH”) is the owner of the 151 store Westlake Ace Hardware (“Westlake”) and the 59 store Great Lakes Ace Hardware, Inc. (“GLA”) retail chains. As a result, the Company is also a retailer of hardware, paint and other related products.

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

Ace Ecommerce Holdings LLC (“AEH”) owns The Grommet, an e-commerce company that operates a website that markets and sells new and innovative products created by independent entrepreneurs.

Ace Services Holdings LLC (“ASH”) owns Ace Handyman Services, a franchisor of home improvement, maintenance and repair services. In the fourth quarter of 2021, ASH began operations of Ace Senior Services, which provides basic home maintenance and essential tasks for seniors. On December 22, 2021, ASH acquired the assets of Mountain Skyline Painting LLC, a provider of home painting services.

### Worldwide Store Count

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

	<b>Fiscal Years</b>		
	<b>2021</b>	<b>2020</b>	<b>2019</b>
Retail outlets at beginning of period	5,463	5,366	5,253
New retail outlets	206	201	208
Retail outlet cancellations	(86)	(104)	(95)
Retail outlets at end of period	5,583	5,463	5,366

## Results of Operations

### Comparison of the Year Ended January 1, 2022 to the Year Ended January 2, 2021

The following data summarizes the Company's performance in 2021 as compared to 2020 (in millions):

	2021		2020		Favorable/ (Unfavorable)	
	\$	% of Revenues*	\$	% of Revenues*	\$	%
<b>Revenues:</b>						
Wholesale revenues	7,782.2	90.6%	7,011.2	90.3%	771.0	11.0%
Retail revenues	812.0	9.4%	751.5	9.7%	60.5	8.1%
<b>Total revenues</b>	<b>8,594.2</b>	<b>100.0%</b>	<b>7,762.7</b>	<b>100.0%</b>	<b>831.5</b>	<b>10.7%</b>
<b>Gross profit:</b>						
Wholesale gross profit	932.6	12.0%	879.1	12.5%	53.5	6.1%
Retail gross profit	361.8	44.6%	334.4	44.5%	27.4	8.2%
<b>Total gross profit</b>	<b>1,294.4</b>	<b>15.1%</b>	<b>1,213.5</b>	<b>15.6%</b>	<b>80.9</b>	<b>6.7%</b>
<b>Operating expenses:</b>						
Wholesale operating expenses	682.8	8.8%	626.0	8.9%	(56.8)	(9.1%)
Retail operating expenses	269.9	33.2%	253.1	33.7%	(16.8)	(6.6%)
Retail pre-opening expenses	2.9	0.4%	1.3	0.2%	(1.6)	(123.1%)
<b>Total operating expenses</b>	<b>955.6</b>	<b>11.1%</b>	<b>880.4</b>	<b>11.3%</b>	<b>(75.2)</b>	<b>(8.5%)</b>
Operating income	338.8	4.0%	333.1	4.3%	5.7	1.7%
Interest expense	(14.4)	(0.2%)	(19.1)	(0.2%)	4.7	24.6%
Other income, net	6.3	0.0%	3.6	0.0%	2.7	75.0%
<b>Net income attributable to Ace Hardware Corporation</b>						
	<b>330.7</b>	<b>3.8%</b>	<b>317.6</b>	<b>4.1%</b>	<b>13.1</b>	<b>4.1%</b>

\*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. 2020
<b>2020 Revenues</b>	<b>\$ 7,762.7</b>	
<i>Wholesale Merchandise Revenues change based on new and cancelled domestic Ace stores:</i>		
Revenues increase from new stores added since January 2020	213.9	2.8%
Revenues decrease from stores cancelled since January 2020	(37.7)	(0.5%)
Increase in wholesale merchandise revenues to comparable domestic Ace stores	529.8	6.8%
Increase in AWH revenues	19.3	0.3%
Increase in AIH revenues	55.1	0.7%
Increase in ARH revenues	72.3	0.9%
Decrease in AEH retail revenues	(11.8)	(0.2%)
Increase in Acehardware.com revenues	16.3	0.2%
Other revenue changes, net	(25.7)	(0.3%)
<b>2021 Revenues</b>	<b>\$ 8,594.2</b>	<b>10.7%</b>

Consolidated revenues for the year ended January 1, 2022 totaled \$8.6 billion, an increase of \$831.5 million, or 10.7 percent, as compared to the prior year. Fiscal 2021 consisted of 52 weeks compared to 53 weeks in fiscal 2020. Excluding the 53<sup>rd</sup> week in fiscal 2020, sales increased \$931.4 million or 12.2 percent compared to fiscal 2020.

Total wholesale revenues were \$7.8 billion for fiscal 2021, an increase of \$771.0 million or 11.0 percent, as compared to the prior year. Increases were seen across almost all departments with outdoor power equipment, electrical, grilling and plumbing showing the largest gains. New domestic Ace stores are defined as stores that were activated from January 2020 through December 2021. In 2021, the Company had an increase in wholesale merchandise revenues from new domestic Ace stores of \$213.9 million. This increase was partially offset by a decrease in wholesale merchandise revenues due to domestic Ace store cancellations of \$37.7 million. As a result, the Company realized a net increase in wholesale merchandise revenues of \$176.2 million related to the impact of both new Ace stores affiliated with the Company and from stores that cancelled their membership in 2020 and 2021. Wholesale merchandise revenues to comparable domestic Ace stores increased \$529.8 million compared to the prior year. Warehouse sales represented 81.0 percent of

wholesale merchandise revenue in 2021 compared to 80.2 percent in 2020, while direct ship sales were 19.0 percent, down from 19.8 percent in 2020.

AWH wholesale revenues were \$426.2 million during fiscal 2021. This is an increase of \$19.3 million from fiscal 2020, which was primarily due to higher sales to e-commerce customers and traditional hardware stores.

AIH wholesale revenues were \$272.2 million during fiscal 2021. This is an increase of \$55.1 million from fiscal 2020. This was primarily the result of a resurgence in sales to AIH's two largest customers after pandemic induced declines in 2020.

Total retail revenues were \$812.0 million, an increase of \$60.5 million, or 8.1 percent, as compared to the prior year. Retail revenues from ARH were \$776.7 million during fiscal 2021, an increase of \$72.3 million or 10.3 percent. This increase was the result of new stores added by the Westlake and GLA retail chains in 2020 and 2021, coupled with a 3.3 percent increase in Westlake same-store-sales and a 4.8 percent increase in GLA same-store-sales. Retail revenues from AEH were \$35.3 million during fiscal 2021. This was a decrease of \$11.8 million from fiscal 2020, driven by a decrease in new customer acquisitions and a reversal of the 15.7 percent pandemic related increase in the prior year.

Wholesale gross profit for fiscal 2021 was \$932.6 million, an increase of \$53.5 million from fiscal 2020. The wholesale gross margin percentage was 12.0 percent of wholesale revenues in fiscal 2021, a decrease from the fiscal 2020 gross margin percentage of 12.5 percent. The decrease in wholesale gross margin percentage was primarily due to higher last-in, first-out ("LIFO") expense driven by increased vendor prices and higher receiving costs in our retail support centers.

Retail gross profit for fiscal 2021 was \$361.8 million, an increase of \$27.4 million from fiscal 2020. The retail gross margin percentage was 44.6 percent of retail revenues in fiscal 2021, a slight increase from 44.5 percent in fiscal 2020. 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 \$56.8 million, or 9.1 percent in fiscal 2021, as compared to fiscal 2020. The increase is due to higher distribution costs resulting from higher wholesale revenues, an increase in advertising expenses, increased healthcare costs, and an increase in lease expense driven by additional warehouse space to support increased demand. As a percentage of wholesale revenues, wholesale operating expenses decreased slightly to 8.8 percent in fiscal 2021 from 8.9 percent in fiscal 2020.

Retail operating expenses increased \$16.8 million, or 6.6 percent in fiscal 2021, as compared to fiscal 2020. This increase was primarily driven by expenses related to the new stores opened in 2020 and 2021. Retail operating expenses as a percentage of retail revenue decreased to 33.2 percent in fiscal 2021 from 33.7 percent in fiscal 2020.

Retail pre-opening expenses decreased \$1.6 million in fiscal 2021 due to fewer new stores opened by Westlake and GLA in 2021 compared to 2020.

Interest expense decreased \$4.7 million or 24.6 percent compared to fiscal 2020 due to significantly lower average borrowings outstanding and decreased London Interbank Offered Rate ("LIBOR") rates during fiscal 2021.

Other income, net increased \$2.7 million compared to fiscal 2020 as a result of the \$10.2 million gain on sale of the Company's retail support center located in Tampa, Florida, partially offset by an increase in income tax expense primarily due to changes to the tax law in 2020 that allowed the Company to carryback net operating losses which resulted in a \$6.3 million tax benefit recorded in 2020.

**Comparison of the Year Ended January 2, 2021 to the Year Ended December 28, 2019**

The following data summarizes the Company's performance in 2020 as compared to 2019 (in millions):

	2020		2019		Favorable/ (Unfavorable)	
	\$	% of Revenues*	\$	% of Revenues*	\$	%
<b>Revenues:</b>						
Wholesale revenues	7,011.2	90.3%	5,564.5	91.7%	1,446.7	26.0%
Retail revenues	751.5	9.7%	506.7	8.3%	244.8	48.3%
<b>Total revenues</b>	<b>7,762.7</b>	<b>100.0%</b>	<b>6,071.2</b>	<b>100.0%</b>	<b>1,691.5</b>	<b>27.9%</b>
<b>Gross profit:</b>						
Wholesale gross profit	879.1	12.5%	665.9	12.0%	213.2	32.0%
Retail gross profit	334.4	44.5%	226.7	44.7%	107.7	47.5%
<b>Total gross profit</b>	<b>1,213.5</b>	<b>15.6%</b>	<b>892.6</b>	<b>14.7%</b>	<b>320.9</b>	<b>36.0%</b>
<b>Operating expenses:</b>						
Wholesale operating expenses	626.0	8.9%	540.1	9.7%	(85.9)	(15.9%)
Retail operating expenses	253.1	33.7%	201.5	39.8%	(51.6)	(25.6%)
Retail pre-opening expenses	1.3	0.2%	8.7	1.7%	7.4	85.1%
Goodwill impairment	-	0.0%	8.5	1.7%	8.5	100.0%
Total operating expenses	880.4	11.3%	758.8	12.5%	(121.6)	(16.0%)
Operating income	333.1	4.3%	133.8	2.2%	199.3	149.0%
Interest expense	(19.1)	(0.2%)	(22.7)	(0.4%)	3.6	15.9%
Other income, net	3.6	0.0%	29.3	0.5%	(25.7)	(87.7%)
<b>Net income attributable to Ace Hardware Corporation</b>	<b>317.6</b>	<b>4.1%</b>	<b>140.4</b>	<b>2.3%</b>	<b>177.2</b>	<b>126.2%</b>

\*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. 2019
<b>2019 Revenues</b>	<b>\$ 6,071.2</b>	
<i>Wholesale Merchandise Revenues change based on new and cancelled domestic Ace stores:</i>		
Revenues increase from new stores added since January 2019	204.1	3.4%
Revenues decrease from stores cancelled since January 2019	(38.9)	(0.6%)
Increase in wholesale merchandise revenues to comparable domestic Ace stores	1,176.5	19.4%
Increase in AWH revenues	25.8	0.4%
Decrease in AIH revenues	(36.0)	(0.6%)
Increase in ARH revenues	237.9	3.9%
Increase in AEH retail revenues	6.4	0.1%
Increase in Acehardware.com revenues	186.5	3.1%
Other revenue changes, net (primarily elimination of increased wholesale revenue to ARH)	(70.8)	(1.2%)
<b>2020 Revenues</b>	<b>\$ 7,762.7</b>	<b>27.9%</b>

Consolidated revenues for the year ended January 2, 2021 totaled \$7.8 billion, an increase of \$1.7 billion, or 27.9 percent, as compared to the prior year. Fiscal 2020 consisted of 53 weeks compared to 52 weeks in fiscal 2019. The 53<sup>rd</sup> week added \$99.9 million in sales. Excluding the 53<sup>rd</sup> week, sales increased \$1.6 billion or 26.2 percent compared to fiscal 2019.

Total wholesale revenues were \$7.0 billion for fiscal 2020, an increase of \$1.5 billion, or 26.0 percent, as compared to the prior year. Increases were noted across all departments with grilling, paint, power tools and outdoor power equipment showing the largest gains. New domestic Ace stores are defined as stores that were activated from January 2019 through December 2020. In 2020, the Company had an increase in wholesale merchandise revenues from new domestic Ace stores of \$204.1 million. This increase was partially offset by a decrease in wholesale merchandise revenues due to domestic Ace store cancellations of \$38.9 million. As a result, the Company realized a net increase in wholesale merchandise revenues of \$165.2 million related to the impact of both new Ace stores affiliated with the Company and from stores that cancelled their membership in 2019 and 2020. Wholesale merchandise revenues to comparable domestic Ace stores increased \$1.2 billion compared to the prior year. Warehouse sales represented 80.2 percent of wholesale merchandise revenue in 2020 compared to 78.9 percent in 2019, while direct ship sales were 19.8 percent, down from 21.1 percent in 2019.

AWH wholesale revenues were \$406.9 million during fiscal 2020. This is an increase of \$25.8 million from fiscal 2019, which was primarily due to higher sales to e-commerce customers and traditional hardware stores.

AIH wholesale revenues were \$217.1 million during fiscal 2020. This is a decrease of \$36.0 million from fiscal 2019, as the global pandemic caused temporary store closures at AIH's largest customers.

Total retail revenues were \$751.5 million, an increase of \$244.8 million, or 48.3 percent, as compared to the prior year. Retail revenues from ARH were \$704.4 million during fiscal 2020, an increase of \$237.9 million or 51.0 percent. Westlake experienced a 24.7 percent increase in same-store-sales while GLA grew same-store-sales by 32.7 percent during fiscal 2020. The eleven new California stores opened by Westlake in 2019 contributed \$87.2 million of the increase. Retail revenues from AEH were \$47.1 million during fiscal 2020. This was an increase of \$6.4 million from fiscal 2019, primarily driven by new customer acquisitions.

Wholesale gross profit for fiscal 2020 was \$879.1 million, an increase of \$213.2 million from fiscal 2019. The wholesale gross margin percentage was 12.5 percent of wholesale revenues in fiscal 2020, an increase from the fiscal 2019 gross margin percentage of 12.0 percent. The increase in wholesale gross margin percentage was due to the increased volume, which led to higher vendor funds earned.

Retail gross profit for fiscal 2020 was \$334.4 million, an increase of \$107.7 million from fiscal 2019. The retail gross margin percentage was 44.5 percent of retail revenues in fiscal 2020, down slightly from 44.7 percent in fiscal 2019. 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 \$85.9 million, or 15.9 percent in fiscal 2020, as compared to fiscal 2019. The increase is due to higher distribution costs resulting from higher wholesale revenues and an increase in advertising expenses. As a percentage of wholesale revenues, wholesale operating expenses decreased to 8.9 percent in fiscal 2020 from 9.7 percent in fiscal 2019.

Retail operating expenses increased \$51.6 million, or 25.6 percent in fiscal 2020, as compared to fiscal 2019. This increase was primarily driven by compensation and operating costs to support the increase in retail revenues along with expenses related to the eleven new California stores. Retail operating expenses as a percentage of retail revenue decreased to 33.7 percent in fiscal 2020 from 39.8 percent in fiscal 2019.

Retail pre-opening expenses decreased \$7.4 million in fiscal 2020 due to expenses related to the eleven new California stores which opened in 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 decreased \$3.6 million or 15.9 percent compared to fiscal 2019 due a significant decrease in LIBOR rates during fiscal 2020.

Other income, net decreased \$25.7 million compared to fiscal 2019 primarily due to a \$16.6 million increase in income tax expense in fiscal 2020 compared to fiscal 2019 due to increased taxable income from non-patronage sources. Additionally, Other income, net decreased as a result of the \$4.9 million gain recorded in fiscal 2019 on the sale of the Company's Prince George Retail Support Center ("RSC") and decreased gains on equity investments.

## 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 facility. The 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 100 basis points at January 1, 2022. 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 January 1, 2022, the Company was in compliance with its covenants and had no outstanding borrowings 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 January 1, 2022, a total of \$17.3 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 January 1, 2022, there were no loans or other extensions of credit provided to AIH.

The Company's Westlake subsidiary had a \$100.0 million asset-based revolving credit facility ("Westlake Facility") that was scheduled to expire on October 24, 2022. On August 3, 2021, Westlake amended the facility by increasing the maximum borrowing to \$125.0 million and extending the due date to August 3, 2026. The amended facility is expandable to \$150.0 million through a \$25.0 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. Under the new facility, Westlake has the right to issue letters of credit up to a maximum of \$7.5 million. At Westlake's discretion, borrowings under this facility bear interest at a rate of either the prime rate plus an applicable spread of 25 basis points to 50 basis points or LIBOR plus an applicable spread of 125 basis points to 150 basis points, depending on Westlake'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 January 1, 2022.

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 January 1, 2022, ARH was in compliance with its covenants and had \$4.9 million in borrowings outstanding under the Westlake Facility.

The Westlake Facility includes a lender-controlled cash concentration system that results in all of Westlake's daily available cash being applied to the outstanding borrowings under their facility. Pursuant to Financial Accounting Standards Board ("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 Westlake Facility have been classified as a Current maturity of long-term debt.

Total debt, the majority of which is comprised of the \$30.8 million owed to former Retailers, was \$35.7 million as of January 1, 2022, compared to \$56.5 million as of January 2, 2021.

## Cash Flows

The Company had \$37.6 million and \$28.9 million of cash and cash equivalents at January 1, 2022 and January 2, 2021, respectively. Following is a summary of the Company's cash flows from operating, investing and financing activities for fiscal years 2021 and 2020, respectively (in millions):

	2021	2020
Cash provided by operating activities before changes in assets and liabilities	\$ 399.9	\$ 385.4
Net changes in assets and liabilities	(82.0)	75.8
Net cash provided by operating activities	317.9	461.2
Net cash used in investing activities	(127.2)	(128.8)
Net cash used in financing activities	(182.0)	(321.7)
Net change in cash and cash equivalents	\$ 8.7	\$ 10.7

The Company's operating activities generated \$317.9 million of cash in fiscal 2021 compared to \$461.2 million in fiscal 2020. Excluding the impact of net changes in assets and liabilities, cash provided by operating activities increased from \$385.4 million in fiscal 2020 to \$399.9 million in fiscal 2021. This increase of \$14.5 million was due to the \$13.1 million increase in net income.

The net change in assets and liabilities used \$82.0 million of cash in fiscal 2021 compared to \$75.8 million provided in fiscal 2020. Accounts payable and accrued expenses increased \$28.1 million during fiscal 2021 compared to an increase of \$337.3 million during fiscal 2020. Accounts payable grew at a lower rate in 2021 compared to 2020 as a result of the December 2019 balances not being impacted by the significant growth the Company has seen since the start of the pandemic. Fiscal 2020 saw a 26.0 percent increase in wholesale revenues compared to fiscal 2019 and fiscal 2021 saw an additional 11.0 percent increase in wholesale revenues compared to fiscal 2020. The smaller increase in wholesale revenues year over year led to slower growth in accounts payable for fiscal 2021 compared to fiscal 2020.

Net cash used for investing activities was \$127.2 million in fiscal 2021 compared to \$128.8 million in fiscal 2020. Investing activities in fiscal 2021 consisted of \$107.7 million in capital expenditures and \$40.4 million for the purchases of investment securities, a portion of which was used to support the Company's deferred compensation plan. These cash uses were partially offset by \$27.1 million in proceeds from the sale of marketable securities and \$12.8 million of cash proceeds from the sale of assets, which included the sale of the Tampa RSC. Investing activities in fiscal 2020 consisted of \$99.0 million in capital expenditures and \$21.5 million paid for the acquisition of additional Retail stores by ARH.

Net cash used in financing activities was \$182.0 million in fiscal 2021 compared to \$321.7 million in fiscal 2020. During fiscal 2021, the Company had \$23.1 million of net payments under the revolving lines of credit, paid \$113.8 million for the cash portion of the 2020 patronage distributions, paid \$17.1 million on patronage refund certificates and had \$13.4 million in payments on long-term debt. During 2020, the Company had \$224.9 million of net payments under the revolving lines of credit, paid \$66.2 million for the cash portion of the 2019 patronage distributions, paid \$9.7 million on patronage refund certificates and had \$10.7 million in payments on long-term debt.

## Off-balance sheet arrangements

The Company has certain other guarantees, as further described in the Notes to the Consolidated Financial Statements – Note 12 – Commitments and Contingencies. The Company believes the likelihood of any such payment under these guarantees is remote.

## 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. Amounts accrued throughout the year can 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 retailer credit information, the current economic environment, the aging of receivables, the evaluation of compliance with lending covenants and the offsetting amounts due to Retailers 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 January 1, 2022 and January 2, 2021 was \$5.3 million and \$6.1 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.

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. No goodwill impairment charge was recorded during fiscal years 2021 and 2020. The Company recorded an impairment charge of \$8.5 million in fiscal 2019.

### ***Impact of New Accounting Standards***

Recently issued accounting pronouncements that are not yet effective and that were not discussed below are either inapplicable to the Company or, if applicable, the Company does not expect that they will have a material impact on consolidated results of operations, consolidated financial condition, or consolidated cash flows.

#### ***New Accounting Pronouncements – Issued***

In November 2021, the FASB issued Accounting Standards Update ("ASU") No. 2021-09, "Leases (Topic 842): Discount Rate for Lessees That Are Not Public Business Entities". Topic 842 currently provides lessees that are not public business entities with a practical expedient that allows them to elect to use a risk-free rate as the discount rate for all leases. The amendments in this update allow those lessees to make the risk-free rate election by class of underlying asset, rather than at the entity-wide level. The guidance also requires a lessee to use the rate implicit in the lease if the rate is readily determinable, regardless of whether the lessee has elected

the risk-free rate expedient. ASU 2021-09 is effective for the Company for year-end financial statements in fiscal 2022. The Company is evaluating the impact that ASU 2021-09 will have on the Company's consolidated financial statements.

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. The U.S. economy is experiencing a significant increase in inflation as the prices of raw materials and freight have negatively impacted the costs the Company pays to acquire products. The Company attempts to offset the effect of increased costs by passing along cost increases to the Company's customers. If these increases cannot be passed to our customers, our financial condition, results of operations, liquidity, and cash flows may be negatively affected.

*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 retailer credit information, the current economic environment, the aging of receivables, the evaluation of compliance with lending covenants and the offsetting amounts due to Retailers 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. 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, ransomware attacks, 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; pandemics; 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.

In March 2020, the World Health Organization declared the outbreak of a novel coronavirus a global pandemic. The pandemic is having a significant effect on overall economic conditions and the preventative and protective measures taken by governments are resulting in global business disruptions, including the Company's customers and vendors. Some of the Company's customers have seen a temporary reduction of operating hours for their stores, as well as temporary store closures where government mandated. While the impact of the pandemic is currently expected to be temporary, there is uncertainty around the severity and duration of the disruption. Although the Company continues to see significant increases in revenues, the possibility still exists that the pandemic may negatively affect its future operating results, financial position and cash flow. However, the financial impacts cannot be reasonably estimated at

this time. The Company is monitoring its working capital, including its accounts receivable and inventory, closely for signs of deterioration due to late payments, bad debts and reduced demand.

The Company continues to monitor its operations and government recommendations and has made modifications to its normal operations because of the pandemic. These modifications vary by location depending on local conditions and government mandates. While the measures the Company has taken serve to reduce the possibility of transmission of the virus within its workplaces, they do not assure that the Company's employees will not contract the virus or bring it into the workplace. If the Company were forced to close any of its warehouses for an extended period of time, the Company's operations would be significantly disrupted resulting in a material adverse effect on the Company's business, financial condition, results of operations and liquidity.

The U.S. economy is experiencing a significant increase in inflation as the prices of raw materials and freight have negatively impacted the costs the Company pays to acquire products. The Company attempts to offset the effect of increased costs by passing along cost increases to the Company's customers. If these increases cannot be passed to our customers, our financial condition, results of operations, liquidity, and cash flows may be negatively affected.

The Company continues to monitor these market forces but cannot reasonably predict the long-term impacts of these evolving developments.

## FIVE YEAR SUMMARY OF EARNINGS AND DISTRIBUTIONS

	Years Ended				
	January 1, 2022 (52 Weeks)	January 2, 2021 (53 Weeks)	December 28, 2019 (52 Weeks)	December 29, 2018 (52 Weeks)	December 30, 2017 (52 Weeks)
Revenues	\$ 8,594.2	\$ 7,762.7	\$ 6,071.2	\$ 5,717.0	\$ 5,388.4
Cost of revenues	7,299.8	6,549.2	5,178.6	4,921.9	4,634.1
Gross profit	1,294.4	1,213.5	892.6	795.1	754.3
Total operating and other expenses, net	963.7	895.9	752.2	667.4	607.7
Net income attributable to Ace Hardware Corporation	\$ 330.7	\$ 317.6	\$ 140.4	\$ 127.7	\$ 146.6

### Distribution of net income:

Patronage distributions to third party Retailers	\$ 294.1	\$ 275.4	\$ 172.5	\$ 135.4	\$ 150.6
Net income (loss) of non-patronage activities	36.6	42.2	(32.1)	(7.7)	(4.0)
Net income attributable to Ace Hardware Corporation	\$ 330.7	\$ 317.6	\$ 140.4	\$ 127.7	\$ 146.6

## 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 15, 2022

/s/ John Venhuizen

John Venhuizen

President and Chief Executive Officer

/s/ William M. Guzik

William M. Guzik

Executive Vice President,

Chief Financial Officer and Chief Risk Officer

/s/ Steven G. Locanto

Steven G. Locanto

Vice President, Controller



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

---

[www.acehardware.com](http://www.acehardware.com)