

ACE HARDWARE CORPORATION
2023 Annual Report



ACE HARDWARE CORPORATION
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND
SUPPLEMENTARY DATA

	<u>Page</u>
Report of Independent Auditors	2
Consolidated Balance Sheets as of December 30, 2023 and December 31, 2022	3
Consolidated Statements of Income for the years ended December 30, 2023, December 31, 2022 and January 1, 2022	4
Consolidated Statements of Comprehensive Income for the years ended December 30, 2023, December 31, 2022 and January 1, 2022	5
Consolidated Statements of Equity for the years ended December 30, 2023, December 31, 2022 and January 1, 2022	6
Consolidated Statements of Cash Flows for the years ended December 30, 2023, December 31, 2022 and January 1, 2022	7
Notes to Consolidated Financial Statements	8
Management’s Discussion and Analysis of Financial Condition and Results of Operations	27
Five Year Summary of Earnings and Distributions	37
Management’s Responsibility for Financial Statements	38

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 December 30, 2023 and December 31, 2022, and the related consolidated statements of income, comprehensive income, equity and cash flows for each of the three fiscal years in the period ended December 30, 2023, 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 December 30, 2023 and December 31, 2022, and the results of its operations and its cash flows for each of the three fiscal years in the period ended December 30, 2023 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.

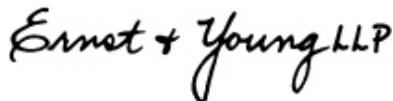
Auditor’s Responsibilities for the Audit of the Financial Statements

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 13, 2024

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

	December 30, 2023	December 31, 2022
Assets		
Cash and cash equivalents	\$ 31.9	\$ 28.5
Marketable securities	49.4	53.3
Receivables, net of allowance for doubtful accounts of \$12.1 and \$7.0, respectively	674.4	650.8
Inventories	1,235.1	1,303.7
Prepaid expenses and other current assets	69.9	59.7
Total current assets	2,060.7	2,096.0
Property and equipment, net	541.0	463.6
Operating lease right-of-use assets, net	668.0	613.8
Finance lease right-of-use assets, net	123.9	84.2
Goodwill and other intangible assets	410.9	105.7
Other assets	153.1	127.7
Total assets	\$ 3,957.6	\$ 3,491.0
Liabilities and Equity		
Current maturities of long-term debt	\$ 49.1	\$ 15.1
Accounts payable	1,081.5	1,165.5
Patronage distributions payable in cash	137.1	133.1
Patronage refund certificates payable	29.1	23.1
Current operating lease liabilities	88.5	77.0
Current finance lease liabilities	25.6	17.2
Accrued expenses	292.0	299.5
Total current liabilities	1,702.9	1,730.5
Long-term debt	359.2	23.0
Patronage refund certificates payable	149.6	111.3
Long-term operating lease liabilities	603.2	562.4
Long-term finance lease liabilities	100.4	67.6
Other long-term liabilities	120.9	104.4
Total liabilities	3,036.2	2,599.2
Member Retailers' Equity:		
Class A voting common stock, \$1,000 par value, 10,000 shares authorized, 2,615 and 2,662 issued and outstanding, respectively	2.6	2.7
Class C nonvoting common stock, \$100 par value, 10,000,000 shares authorized 7,226,176 and 6,561,209 issued and outstanding, respectively	722.6	656.1
Class C nonvoting common stock, \$100 par value, issuable to Retailers for patronage distributions, 897,317 and 1,181,824 shares issuable, respectively	89.7	118.1
Contributed capital	19.2	19.2
Retained earnings	78.2	87.2
Accumulated other comprehensive income (loss)	0.3	(2.3)
Equity attributable to Ace member Retailers	912.6	881.0
Equity attributable to noncontrolling interests	8.8	10.8
Total equity	921.4	891.8
Total liabilities and equity	\$ 3,957.6	\$ 3,491.0

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(In millions)

	Years Ended		
	December 30, 2023 (52 Weeks)	December 31, 2022 (52 Weeks)	January 1, 2022 (52 Weeks)
Revenues:			
Wholesale revenues	\$ 8,344.7	\$ 8,372.3	\$ 7,782.2
Retail revenues	786.4	797.5	812.0
Total revenues	<u>9,131.1</u>	<u>9,169.8</u>	<u>8,594.2</u>
Cost of revenues:			
Wholesale cost of revenues	7,223.1	7,368.8	6,849.6
Retail cost of revenues	430.1	439.6	450.2
Total cost of revenues	<u>7,653.2</u>	<u>7,808.4</u>	<u>7,299.8</u>
Gross profit:			
Wholesale gross profit	1,121.6	1,003.5	932.6
Retail gross profit	356.3	357.9	361.8
Total gross profit	<u>1,477.9</u>	<u>1,361.4</u>	<u>1,294.4</u>
Wholesale operating expenses:			
Distribution operations expenses	281.5	262.3	247.3
Selling, general and administrative expenses	314.7	244.6	222.5
Retailer success and development expenses	234.5	223.2	213.0
Retail operating expenses	280.1	287.5	269.9
Retail pre-opening expenses	6.0	1.9	2.9
Total operating expenses	<u>1,116.8</u>	<u>1,019.5</u>	<u>955.6</u>
Operating income	361.1	341.9	338.8
Interest expense	(38.4)	(19.2)	(14.4)
Interest income	5.4	3.2	2.0
Other (expense) income, net	(3.7)	23.7	18.6
Income tax expense	(1.0)	(9.0)	(15.0)
Net income	<u>323.4</u>	<u>340.6</u>	<u>330.0</u>
Less Net loss attributable to noncontrolling interests	<u>(2.7)</u>	<u>(1.1)</u>	<u>(0.7)</u>
Net income attributable to Ace Hardware Corporation	<u>\$ 326.1</u>	<u>\$ 341.7</u>	<u>\$ 330.7</u>
Patronage distributions accrued	<u>\$ 356.5</u>	<u>\$ 344.5</u>	<u>\$ 314.4</u>
Patronage distributions accrued for third party Retailers	<u>\$ 335.7</u>	<u>\$ 323.6</u>	<u>\$ 294.1</u>

See accompanying notes to the consolidated financial statements.

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

	Years Ended		
	December 30, 2023 (52 Weeks)	December 31, 2022 (52 Weeks)	January 1, 2022 (52 Weeks)
Net income	\$ 323.4	\$ 340.6	\$ 330.0
Other comprehensive income (loss), net of tax:			
Foreign currency translation gain (loss)	2.0	0.5	(0.1)
Unrealized gain (loss) on investments	1.1	(3.8)	(1.9)
Total other comprehensive income (loss), net	3.1	(3.3)	(2.0)
Comprehensive income	326.5	337.3	328.0
Less Comprehensive loss attributable to noncontrolling interests	(2.2)	(1.0)	(0.7)
Comprehensive income attributable to Ace Hardware Corporation	\$ 328.7	\$ 338.3	\$ 328.7

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 Other Comprehensive Income (Loss)	Noncontrolling Interests	Total Equity
	Class A	Class C							
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
Net income (loss)	-	-	-	-	-	341.7	-	(1.1)	340.6
Other comprehensive loss	-	-	-	-	-	-	(3.3)	-	(3.3)
Net payments on subscriptions	-	-	-	1.6	-	-	-	-	1.6
Stock issued	0.1	121.0	(120.9)	(1.6)	-	0.2	-	-	(1.2)
Change in noncontrolling interests	-	-	-	-	(0.1)	-	-	0.2	0.1
Stock repurchased	(0.1)	(48.7)	-	-	-	-	-	-	(48.8)
Patronage distributions issuable	-	-	118.1	-	-	-	-	-	118.1
Patronage distributions payable	-	-	-	-	-	(323.6)	-	-	(323.6)
Other	-	-	-	-	0.2	-	-	-	0.2
Balances at December 31, 2022	\$ 2.7	\$ 656.1	\$ 118.1	\$ -	\$ 19.2	\$ 87.2	\$ (2.3)	\$ 10.8	\$ 891.8
Net income (loss)	-	-	-	-	-	326.1	-	(2.7)	323.4
Other comprehensive income	-	-	-	-	-	-	3.1	-	3.1
Net payments on subscriptions	-	-	-	1.0	-	-	-	-	1.0
Stock issued	-	116.9	(118.1)	(1.0)	-	0.6	-	-	(1.6)
Change in noncontrolling interests	-	-	-	-	(0.1)	-	(0.5)	0.6	-
Stock repurchased	(0.1)	(50.4)	-	-	-	-	-	-	(50.5)
Patronage distributions issuable	-	-	89.7	-	-	-	-	-	89.7
Patronage distributions payable	-	-	-	-	-	(335.7)	-	-	(335.7)
Other	-	-	-	-	0.1	-	-	0.1	0.2
Balances at December 30, 2023	\$ 2.6	\$ 722.6	\$ 89.7	\$ -	\$ 19.2	\$ 78.2	\$ 0.3	\$ 8.8	\$ 921.4

See accompanying notes to the consolidated financial statements.

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

	Years Ended		
	December 30, 2023 (52 Weeks)	December 31, 2022 (52 Weeks)	January 1, 2022 (52 Weeks)
Operating Activities			
Net income	\$ 323.4	\$ 340.6	\$ 330.0
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	92.2	86.6	71.3
Non cash lease expense	26.9	17.1	8.8
Amortization of deferred financing costs	1.3	0.4	0.5
Loss (gain) on disposal of assets, net	5.5	(19.8)	(10.3)
Provision (credit) for doubtful accounts	6.9	3.0	(0.4)
Other, net	1.2	5.8	-
Changes in operating assets and liabilities, exclusive of effect of acquisitions:			
Receivables	(55.4)	(159.6)	(31.6)
Inventories	74.7	(77.3)	(89.7)
Other current assets	(9.1)	4.1	(8.7)
Other long-term assets	(13.5)	(9.1)	7.3
Accounts payable and accrued expenses	(104.7)	80.4	23.8
Other long-term liabilities	14.5	13.4	17.4
Deferred taxes	(0.1)	(3.1)	(4.8)
Net cash provided by operating activities	<u>363.8</u>	<u>282.5</u>	<u>313.6</u>
Investing Activities			
Purchases of investment securities	(39.9)	(60.3)	(40.4)
Proceeds from sale of investment securities	43.2	47.7	27.1
Purchases of property and equipment	(164.6)	(92.8)	(103.4)
Cash paid for acquired businesses, net of cash acquired	(309.7)	(12.8)	(2.8)
Increase in notes receivable, net	(31.8)	(19.7)	(14.3)
Proceeds from sale of assets	1.3	29.4	12.8
Other, net	(0.8)	(0.6)	(1.9)
Net cash used in investing activities	<u>(502.3)</u>	<u>(109.1)</u>	<u>(122.9)</u>
Financing Activities			
Net borrowings (payments) under revolving lines of credit	362.0	(4.9)	(23.1)
Principal payments on long-term debt	(17.8)	(7.1)	(13.4)
Principal portion of finance lease payments	(28.3)	(16.7)	(9.6)
Payments of debt issuance costs	(4.4)	-	(0.3)
Payments of cash portion of patronage distribution	(133.1)	(121.0)	(113.8)
Payments of patronage refund certificates	(26.7)	(26.1)	(17.1)
Repurchase of stock	(10.8)	(8.0)	(5.8)
Purchase of noncontrolling interests	(0.4)	(0.4)	(0.4)
Other, net	1.4	1.7	1.5
Net cash provided by (used in) financing activities	<u>141.9</u>	<u>(182.5)</u>	<u>(182.0)</u>
Increase (decrease) in cash and cash equivalents	3.4	(9.1)	8.7
Cash and cash equivalents at beginning of period	28.5	37.6	28.9
Cash and cash equivalents at end of period	<u>\$ 31.9</u>	<u>\$ 28.5</u>	<u>\$ 37.6</u>
Supplemental disclosure of cash flow information:			
Interest paid	<u>\$ 29.7</u>	<u>\$ 14.5</u>	<u>\$ 11.5</u>
Income taxes paid	<u>\$ 5.6</u>	<u>\$ 11.5</u>	<u>\$ 30.4</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 21.3 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 169-store Westlake Ace Hardware (“Westlake”) and the 66-store Great Lakes Ace Hardware (“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 is a wholesaler of hardware, paint and other related products to non-member retailers.

Ace Services Holdings LLC (“ASH”), through its subsidiaries, operates Ace Handyman Services, a franchisor of home improvement, maintenance and repair services, Ace Hardware Painting Services, a provider of home painting services, and Legacy Plumbing, Inc. and Ace Hardware Plumbing Services, providers of residential plumbing services. On April 12, 2023, Ace Heating and Cooling Services, LLC (“AHCS”), a newly-formed subsidiary of ASH merged with Unique Indoor Comfort Holdings, LLC (“UICH”), with AHCS being the surviving entity. On May 3, 2023, a subsidiary of AHCS, Unique Indoor Comfort, LLC (“UIC”), acquired Parrish Services, Inc. (“Parrish”) and on December 29, 2023, UIC acquired Climate Technologies, Inc. (“Climate”). See Note 2 for additional details regarding the acquisitions.

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 30. Accordingly, fiscal years 2023, 2022 and 2021 ended on December 30, 2023, December 31, 2022 and January 1, 2022, respectively. Unless otherwise noted, all references herein for the years 2023, 2022 and 2021 represent fiscal years ended December 30, 2023, December 31, 2022 and January 1, 2022, respectively. Fiscal years 2023, 2022, and 2021 consisted of 52 weeks.

Subsequent events have been evaluated through February 13, 2024, 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 December 30, 2023 and December 31, 2022, the Company had outstanding checks in excess of bank balances totaling \$78.4 million and \$93.8 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.

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

The Company determines the appropriate classification of its investments in marketable securities, which are predominately held by the Company's New Age Insurance, Ltd. ("NAIL") subsidiary, at the time of purchase and evaluates such designation at each balance sheet date. All marketable securities have been classified and accounted for as available for sale. The Company may hold debt securities until maturity. In response to changes in the availability of and the yield on alternative investments as well as liquidity requirements, securities are occasionally sold prior to their stated maturities. Debt securities with maturities beyond twelve months are viewed by the Company as available to support current operations and are therefore classified as current assets in the accompanying Consolidated Balance Sheets. Marketable securities are carried at fair value based on quoted market prices, with unrealized gains and losses, net of taxes, reported as a component of Accumulated other comprehensive income ("AOCI") for debt securities, while equity securities' unrealized gain and losses are recorded as a component of Other income, net. 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 \$33.3 million and \$30.8 million at December 30, 2023 and December 31, 2022, respectively, were issued in favor of the insurance companies that reinsure a portion of NAIL's loss exposure. At December 30, 2023, NAIL has pledged substantially all of its cash and cash equivalents and marketable securities as collateral for these letters of credit. The Company maintains a multiple employer welfare arrangement ("MEWA") that offers medical insurance and other welfare benefits to employees of the Company and Retailers and their employees at participating Ace retail locations. Ace 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 as 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.

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. Service revenues from the Company's residential home service businesses are recognized when the repair or installation is complete and the consumer has tendered payment. Service revenues are included in Wholesale revenues on the Consolidated Statements of Income.

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. 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.

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

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

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

	Years Ended	
	December 30, 2023	December 31, 2022
Warehouse merchandise	\$ 6,083.4	\$ 6,252.1
Direct shipment merchandise	1,491.0	1,522.8
ARH revenues	786.4	787.0
E-commerce	334.0	312.9
Service revenues	459.0	322.1
Amortization of sales allowances under retailer incentive programs	(22.7)	(27.1)
Total revenues	\$ 9,131.1	\$ 9,169.8

Trade Receivables

Trade 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 Expected Credit Losses

The Company estimates an allowance for credit losses related to future expected losses by using relevant information such as 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. Significant past due accounts are reserved on a specific identification basis. For the remainder of the accounts, the allowance is evaluated on a pool basis for accounts with similar risk characteristics and a loss-rate for each pool is determined using current conditions and historical credit loss statistics. 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 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.

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

Property and Equipment

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

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

Buildings	15 – 40 years
Leasehold improvements	Lease life
Warehouse equipment	3 – 20 years
Transportation equipment	5 – 10 years
Office equipment	3 - 10 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 group. If the carrying amount of an asset group exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset group 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 and customer relationships. 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.

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 \$297.7 million, \$263.6 million, and \$264.9 million in fiscal 2023, 2022 and 2021, 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 breakage 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 2023, 2022 and 2021, the Company recognized gift card breakage income of \$3.3 million, \$3.3 million and \$1.5 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 are 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.

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

New Accounting Pronouncements - Adopted

In June 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“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. On December 31, 2022, the Company adopted ASU 2016-13. The adoption of this ASU did not have a material impact on the Company’s consolidated financial statements other than additional disclosures.

(2) Acquisitions and Closure Activities

On April 12, 2023, AHCS, a newly-formed subsidiary of ASH merged with UICH, with AHCS being the surviving entity. On May 3, 2023, UIC, a subsidiary of AHCS, acquired Parrish. On December 29, 2023, UIC acquired Climate. Total consideration paid by the Company was \$313.7 million (including final working capital adjustments). The Company believes that the merger and acquisition will help advance the Company’s strategic plan to be a leading provider of home preservation services.

The Company accounts for all business combinations using the acquisition method to record a new cost basis for the assets acquired and liabilities assumed. The difference between the purchase price and the fair value of the assets acquired and liabilities assumed has been recorded as goodwill in the financial statements. The results of operations are reflected in the consolidated financial statements of the Company from the dates of acquisition.

As of December 30, 2023, the Company recorded a preliminary allocation of the purchase price to acquired tangible and intangible assets and liabilities assumed based on their fair value at the acquisition date. As a result, the Company recorded \$269.8 million of goodwill and \$37.3 million for the fair value of other intangible assets with varying amortization periods from 2 to 10 years. The Company expects to obtain synergies and growth from rebranding the business under the Ace brand, which will expand the Company’s residential home preservation services and enable it to compete in the sizable HVAC market. The Company believes the information gathered to date provides a reasonable basis for estimating the fair values of assets acquired and liabilities assumed, but the Company is waiting for additional information necessary to finalize those fair values. Specifically, the Company is finalizing the fair value of acquired intangible assets. Thus, the provisional measurements of fair values set forth below are subject to change. The Company expects to complete the purchase price allocation for UIC and Parrish by the end of the second quarter of 2024 and for Climate, by the end of the fourth quarter of 2024. Goodwill has an indefinite life and, therefore, is not amortized. The goodwill allocated to UIC’s disregarded entities is expected to be deductible for tax purposes.

The following table summarizes the consideration paid and the purchase price allocation at the acquisition date:

Fair value of assets acquired and liabilities assumed:	
Cash	\$ 6.8
Receivables	6.4
Inventories	5.0
Other current assets	6.4
Property and equipment	8.4
Goodwill	269.8
Other intangibles	37.3
Other long-term assets	0.6
Accounts payable	(4.5)
Other current liabilities	(16.2)
Other long-term liabilities	(6.3)
Acquisition purchase price	<u>\$ 313.7</u>

In addition, during the year ended December 30, 2023, ARH acquired additional retail stores for consideration of \$2.8 million, prior to working capital adjustments. These acquisitions resulted in ARH recording \$1.5 million of goodwill. During the year ended December 31, 2022, ARH acquired retail stores and ASH acquired the assets of Legacy Plumbing, Inc., a provider of residential

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

plumbing services. Total consideration for these acquisitions was \$14.5 million. These acquisitions resulted in the Company recording \$12.2 million of goodwill. The goodwill is expected to be deductible for tax purposes.

During the year ended December 31, 2022, the Company determined that The Grommet business model was no longer viable and announced the closure of The Grommet. The business operations of The Grommet ceased during the third quarter of 2022 and the Company sold certain intangible assets for \$1.0 million. As a result of the closure and subsequent sale of intangible assets, non-recurring charges of \$9.8 million were recorded for the year-ended December 31, 2022, including a \$0.9 million charge for the write-down of inventory and a \$8.9 million charge for the impairment of assets and severance related costs.

During the year ended December 31, 2022, the Company sold its Gainesville, Georgia retail support center (“RSC”) for proceeds of \$27.1 million and recorded a pre-tax gain of \$21.7 million which is presented in Other income, net in the Consolidated Statements of Income. The Company has leased-back this RSC on a short-term basis until construction of the replacement RSC in Jefferson, Georgia is complete.

(3) Receivables, net

Receivables, net include the following amounts:

	December 30, 2023	December 31, 2022
Trade	\$ 513.0	\$ 499.2
Vendor	120.3	121.1
Other	25.0	17.9
Notes receivable – current portion	28.2	19.6
Less allowance for doubtful accounts	(12.1)	(7.0)
Receivables, net	<u>\$ 674.4</u>	<u>\$ 650.8</u>

The components of changes to the Receivable allowance for doubtful accounts for the years ended December 30, 2023 and December 31, 2022 were as follows:

	December 30, 2023	December 31, 2022
Beginning balance	\$ 7.0	\$ 4.3
Charges to provision	5.3	2.7
Accounts written off, net of recoveries	(0.3)	(1.0)
Other	0.1	1.0
Ending balance	<u>\$ 12.1</u>	<u>\$ 7.0</u>

(4) Inventories

Inventories consist of wholesale merchandise inventories held for sale to customers and retail merchandise inventory held for resale at ARH retail locations. Substantially all of the Company’s wholesale inventories are valued on the last-in, first-out (“LIFO”) method. The excess of replacement cost over the LIFO value of inventory was \$271.0 million and \$273.9 million at December 30, 2023 and December 31, 2022, respectively. Inventories at ARH retail 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. 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:

	December 30, 2023	December 31, 2022
Wholesale merchandise inventory (LIFO)	\$ 1,000.4	\$ 1,076.8
Retail merchandise inventory at ARH stores (FIFO)	234.7	226.9
Inventories	<u>\$ 1,235.1</u>	<u>\$ 1,303.7</u>

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

(5) Property and Equipment, net

Property and equipment, net is summarized as follows:

	December 30, 2023	December 31, 2022
Land	\$ 13.3	\$ 13.3
Buildings and improvements	294.7	282.3
Warehouse equipment	301.1	265.5
Computer hardware and software and other office equipment	509.5	456.9
Transportation equipment	45.9	42.5
Leasehold improvements	81.2	74.2
Assets under construction	31.3	13.7
Property and equipment, gross	1,277.0	1,148.4
Accumulated depreciation and amortization	(736.0)	(684.8)
Property and equipment, net	<u>\$ 541.0</u>	<u>\$ 463.6</u>

Depreciation and amortization expense related to property and equipment for fiscal years 2023, 2022 and 2021 was \$88.1 million, \$79.9 million and \$69.3 million, respectively.

In January 2022, the Company sold its Gainesville, Georgia RSC for proceeds of \$27.1 million and recorded a pre-tax gain of \$21.7 million.

(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 years ended December 30, 2023 and December 31, 2022, were as follows:

	<u>Income Statement Classification</u>	December 30, 2023	December 31, 2022
Finance lease amortization	Cost of revenues	\$ 27.6	\$ 16.0
Finance lease interest	Interest expense	2.9	1.0
Operating lease cost, net of sublease income	Cost of revenues, operating expenses	117.5	102.6
Short-term lease cost	Cost of revenues, operating expenses	12.2	12.3
Variable lease cost	Cost of revenues, operating expenses	27.5	24.0
Net lease cost		<u>\$ 187.7</u>	<u>\$ 155.9</u>

The future minimum undiscounted lease payments under operating and finance leases at December 30, 2023 are as follows:

<u>Fiscal Year</u>	Operating Leases	Finance Leases
2024	\$ 115.1	\$ 33.7
2025	100.4	30.4
2026	86.0	26.3
2027	75.4	19.4
2028	63.0	11.7
Thereafter	346.3	14.1
Total future undiscounted lease payments	786.2	135.6
Less imputed interest	(94.5)	(9.6)
Total reported lease liability	691.7	126.0
Less current portion	(88.5)	(25.6)
Long-term lease liabilities	<u>\$ 603.2</u>	<u>\$ 100.4</u>

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

Additionally, the Company has excluded approximately \$191.6 million of payments (undiscounted basis) for leases that have not yet commenced. These leases will commence between the first quarter of 2024 and second quarter of 2024 with terms of up to fifteen years and will include a new RSC in Kansas City, MO and new stores for Westlake.

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

	December 30, 2023	December 31, 2022
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	\$ (112.2)	\$ (90.8)
Operating cash flows from finance leases	\$ (25.9)	\$ (15.6)
Lease assets obtained in exchange for new lease liabilities:		
Operating leases	\$ 134.8	\$ 189.5
Finance leases	\$ 66.6	\$ 33.1
Weighted average remaining lease term for operating leases	9.2 years	9.2 years
Weighted average discount rate for operating leases	2.44%	2.03%
Weighted average remaining lease term for finance leases	4.9 years	4.7 years
Weighted average discount rate for finance leases	2.79%	1.58%

(7) Notes Receivable, net

The Company makes available to its Retailers various lending programs whose terms exceed one year. At December 30, 2023 and December 31, 2022, the outstanding balance of the notes was \$30.2 million and \$19.7 million, respectively, of which the current portion of \$28.2 million and \$19.6 million, respectively, was recorded in Receivables, net and the long-term portion of \$0.4 million and \$0.1 million, respectively, was recorded in Other assets.

	December 30, 2023	December 31, 2022
Notes receivable, gross	\$ 66.4	\$ 48.1
Less accrued patronage to be applied	(36.2)	(28.4)
Net of accrued patronage	30.2	19.7
Less current portion of notes receivable included in Receivables, net	(28.2)	(19.6)
Less allowance for doubtful accounts	(1.6)	-
Notes receivable, net	<u>\$ 0.4</u>	<u>\$ 0.1</u>

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 and are therefore classified as current. In the event a Retailer cancels its membership with the Company, any outstanding loans are transferred from Notes receivable to Trade receivables and are due immediately. As the non-cash portion of the patronage distribution is used to settle the Notes receivable, there are no loans that are currently past due. The patronage distribution for each Retailer can vary from year to year based on the Company's financial performance, as well as the volume of patronage-based merchandise that each Retailer purchases from the Company. The contractual maturities, assuming no patronage deductions, of the Notes receivable are as follows:

	December 30, 2023	December 31, 2022
0 – 4 years	\$ 14.2	\$ 9.0
5 – 8 years	31.8	20.8
9 – 10 years	20.4	18.3
Total	<u>\$ 66.4</u>	<u>\$ 48.1</u>

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:

Corporate Credit Exposure:	December 30, 2023	December 31, 2022
Low risk	\$ 26.8	\$ 16.7
Moderate risk	22.1	15.4
High risk	17.5	16.0
Total	<u>\$ 66.4</u>	<u>\$ 48.1</u>

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. For this reason, as well as the fact that substantially all of the notes receivable are repaid from the following year's annual patronage distribution, the actual risk of collection is low for the notes receivable portfolio despite many Retailers being classified as Moderate and High risk.

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 \$1.6 million for December 30, 2023 and \$1.0 million for December 31, 2022. The allowance for 2022 was reclassified to Trade receivables as substantially all notes are classified as short-term. 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 2023 and 2022 were as follows:

	December 30, 2023	December 31, 2022
Beginning balance	\$ -	\$ 1.0
Charges to provision	0.6	-
Reclassifications from (to) accounts receivable allowance for doubtful accounts	1.0	(1.0)
Ending balance	<u>\$ 1.6</u>	<u>\$ -</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 2023, 2022 and 2021, \$4.6 million, \$2.2 million and \$1.6 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 2023 and 2022, \$8.5 million and \$11.6 million, respectively, of Notes receivable were transferred to trade receivables as an event occurred which made the notes due immediately.

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 January 1, 2022	\$ 88.9
Purchase accounting adjustment	0.4
Acquired goodwill	12.2
Balance at December 31, 2022	\$ 101.5
Acquired goodwill (See Note 2 for additional details)	271.8
Balance at December 30, 2023	\$ 373.3

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:

	December 30, 2023	December 31, 2022
Trademarks and trade name	\$ 9.2	\$ 7.8
Customer relationships	39.1	3.2
Total identifiable intangible assets, gross	48.3	11.0
Less accumulated amortization	(10.7)	(6.8)
Identifiable intangible assets, net	\$ 37.6	\$ 4.2

The trademarks and trade name are being amortized over 2-20 years. The customer relationships are being amortized over 10 years. During the second quarter of 2022, the Company determined that The Grommet business model was no longer viable and announced the closure of The Grommet. The business operations of The Grommet were ceased during the third quarter of 2022 and the intangible assets were written-off. Net amortization expense related to all intangible assets, including The Grommet asset write-off in 2022, was \$3.8 million, \$6.5 million and \$1.8 million for fiscal years 2023, 2022 and 2021, respectively. The estimated total amortization expense over the next five fiscal years is \$20.2 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		
	December 30, 2023	December 31, 2022	January 1, 2022
Cash portion	\$ 137.1	\$ 133.1	\$ 120.6
Class C stock	89.7	118.1	120.9
Patronage refund certificates	68.9	42.4	25.2
Patronage financing deductions	40.0	30.0	27.4
Total patronage distributions accrued for third party Retailers	\$ 335.7	\$ 323.6	\$ 294.1

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 December 30, 2023 are payable as follows:

	Amount
2024	\$ 29.1
2025	15.0
2026	24.4
2027	41.3
2028	68.9
Total patronage refund certificates payable	178.7
Less current portion	(29.1)
Long-term patronage refund certificates payable	\$ 149.6

(10) Accrued Expenses

Accrued expenses include the following components:

	December 30, 2023	December 31, 2022
Salaries and wages	\$ 64.1	\$ 84.7
Insurance reserves	28.9	22.3
Deferred income	8.7	6.9
Vendor funds	36.9	31.2
Taxes	24.3	25.3
Profit sharing	25.5	28.3
Gift card	23.7	20.6
Interest	7.8	6.1
Advertising and marketing	29.9	31.4
Other	42.2	42.7
Accrued expenses	<u>\$ 292.0</u>	<u>\$ 299.5</u>

(11) Debt

On January 24, 2023, the Company amended its existing credit facility. The January 2023 amendment extended the maturity from February 1, 2024 to January 24, 2028 and increased the capacity of the facility by \$400.0 million to \$1.1 billion. The facility is expandable to \$1.4 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. The amendment changed the benchmark for setting interest rates from the London Interbank Bank Offered Rate (“LIBOR”) to the Secured Overnight Financing Rate (“SOFR”) and borrowings under the amended credit facility now bear interest at a rate of either 25 to 100 basis points over the prime rate or 125 to 200 basis points over SOFR, depending on the Company’s leverage ratio. The credit facility was priced at SOFR plus 125 basis points and prime plus 25 basis points at December 30, 2023. Fees on the unused portion of the line of credit range from 17.5 to 27.5 basis points depending on the Company’s leverage ratio. All other terms of the credit facility remain unchanged. As of December 30, 2023, the Company was in compliance with its covenants and had \$331.5 million in borrowings outstanding under the credit facility.

The credit facility includes a \$175.0 million sublimit for the issuance of standby and commercial letters of credit. As of December 30, 2023, a total of \$38.4 million in letters of credit were outstanding.

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 \$100.0 million at any time. As of December 30, 2023, there were no loans or other extensions of credit provided to AIH.

The Company’s Westlake subsidiary has a \$125.0 million asset-based revolving credit facility that expires on August 3, 2026 (“Westlake Facility”). The 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 a portion of the increased facility. Under this facility, Westlake has the right to issue letters of credit up to a maximum of \$7.5 million. Pursuant to an April 12, 2023 amendment, borrowings under this facility now bear interest at a rate of either the prime rate plus an applicable spread of 25 to 50 basis points or SOFR plus an applicable spread of 135 to 160 basis

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

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 SOFR plus 135 basis points at December 30, 2023.

The Westlake Facility is collateralized by substantially all of Westlake’s tangible and intangible assets. Borrowings under the facility are subject to a borrowing base calculation consisting of certain advance rates applied to eligible collateral balances (primarily consisting of certain receivables and inventories). This agreement requires maintenance of certain financial covenants including a minimum fixed charge coverage ratio. As of December 30, 2023, Westlake was in compliance with its covenants and had \$30.5 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,” all borrowings under the Westlake Facility are classified as a Current maturity of long-term debt.

Total debt outstanding is comprised of the following:

	December 30, 2023	December 31, 2022
Revolving Credit Facility	\$ 331.5	\$ -
Westlake Facility	30.5	-
Installment notes with maturities through 2027 at a fixed rate of 6.00%	46.3	38.1
Total debt	408.3	38.1
Less maturities within one year	(49.1)	(15.1)
Long-term debt	<u>\$ 359.2</u>	<u>\$ 23.0</u>

The aggregate scheduled maturities of total debt at December 30, 2023 are as follows:

Fiscal Year	Amount
2024	\$ 49.1
2025	12.3
2026	10.0
2027	5.4
2028	331.5
Total debt	<u>\$ 408.3</u>

(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 December 30, 2023, the Company had outstanding standby letters of credit of \$33.3 million issued in the normal course of NAIL’s operations and commercial letters of credit of \$38.4 million issued by the Company’s credit facility.

The Company maintains the Ace Hardware Corporation Cooperative Group Health Plan (“AHP”), which 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.

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 maintained a \$15.0 million standby letter of credit in favor of AGI. The letter of credit is held by the Vermont Department of Financial Regulations (“VDFR”) and can be drawn upon at VDFR’s direction if AGI becomes illiquid. The Company believes that the likelihood of the letter of credit being drawn is remote. On March 31, 2023, the \$15.0 million standby letter of credit provided by NAIL was terminated and reissued under the Company’s credit facility.

(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 – Investments included in this category are the Company’s Fixed income mutual funds, Equity mutual funds, Money market funds and U.S. government notes. The Company’s valuation techniques used to measure the fair values of Level 1 investments are derived from quoted market prices for identical instruments, as active markets for these instruments exist. The Company has classified its investments used to support the Company’s deferred compensation plan as Other assets as these investments are restricted solely for this purpose.

Level 2 – Investments included in this category are the Company’s Corporate fixed income securities, Mortgage-backed securities, U.S. government notes and Other debt securities. Other debt 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 Level 2 securities 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.

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 that were accounted for at fair value as of December 30, 2023 and December 31, 2022. The tables do not include cash on hand and also do not include assets and liabilities that are measured at historical cost or any basis other than fair value. The carrying values for other current financial assets and liabilities, such as accounts receivable and accounts payable, approximate fair value due to the short maturity of such instruments. Long-term notes receivable approximate fair value because the Company charges its Retailers an interest rate and a significant portion of the notes have the Company’s stock as collateral.

Items measured at fair value on a recurring basis	Carrying Value Measured at Fair Value			
	December 30, 2023	Level 1	Level 2	Level 3
Assets:				
Cash equivalents:				
Money market funds	\$ 2.5	\$ 2.5	\$ -	\$ -
Marketable securities:				
Corporate fixed income securities	\$ 22.4	\$ -	\$ 22.4	\$ -
Mortgage-backed securities	14.8	-	14.8	-
U.S. government notes	4.4	4.4	-	-
Other	7.8	-	7.8	-
Total marketable securities	\$ 49.4	\$ 4.4	\$ 45.0	\$ -
Other assets:				
Money market funds	\$ 2.6	\$ 2.6	\$ -	\$ -
Fixed income mutual funds	13.0	13.0	-	-
Equity mutual funds	14.7	14.7	-	-
Total other assets	\$ 30.3	\$ 30.3	\$ -	\$ -

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

Items measured at fair value on a recurring basis	Carrying Value Measured at Fair Value			
	December 31, 2022	Level 1	Level 2	Level 3
Assets:				
Cash equivalents:				
Money market funds	\$ 1.4	\$ 1.4	\$ -	\$ -
Marketable securities:				
Corporate fixed income securities	\$ 27.8	\$ -	\$ 27.8	\$ -
Mortgage-backed securities	12.5	-	12.5	-
U.S. government notes	6.7	6.4	0.3	-
Other	6.3	-	6.3	-
Total marketable securities	<u>\$ 53.3</u>	<u>\$ 6.4</u>	<u>\$ 46.9</u>	<u>\$ -</u>
Other assets:				
Money market funds	\$ 10.1	\$ 10.1	\$ -	\$ -
Fixed income mutual funds	6.8	6.8	-	-
Equity mutual funds	8.4	8.4	-	-
Total other assets	<u>\$ 25.3</u>	<u>\$ 25.3</u>	<u>\$ -</u>	<u>\$ -</u>

The fair value of the Company's debt and equity securities were below cost by \$0.8 million and \$4.7 million at December 30, 2023 and December 31, 2022, respectively. The realized and unrealized gains and losses on equity securities are recorded to Other income, net and the realized gain or loss on debt securities are recorded in the period in which the gain or loss occurs to Other income, net in the Consolidated Statement of Income. Unrealized gains and losses on debt securities are recorded as a component of Other comprehensive income (loss), net of tax. The Company has not recorded an allowance due to the unrealized losses being driven by the market factors related to increasing interest rates as opposed to credit factors. All debt securities are expected to reach par value at their maturity dates.

Gross proceeds from the sale of money market, debt and equity securities and the related realized gains and losses for the fiscal years ended December 30, 2023, December 31, 2022 and January 1, 2022 were as follows:

	Years Ended		
	December 30, 2023	December 31, 2022	January 1 2022
Gross proceeds	\$ 43.2	\$ 47.7	\$ 20.2
Gross realized gains	0.5	1.2	0.4
Gross realized losses	(1.2)	(3.2)	(0.2)

Gross realized gains and losses were determined using the specific identification method. For the fiscal year ended December 30, 2023, the Company reclassified \$0.2 million of unrealized gains and \$1.1 million of unrealized losses on marketable securities that were recorded in AOCI as of December 31, 2022 into realized income. These amounts were recorded to Other income, net in the Consolidated Statements of Income.

The following table summarizes the contractual maturity distributions of the Company's debt securities at December 30, 2023. Actual maturities may differ from the contractual or expected maturities since borrowers may have the right to prepay obligations with or without prepayment penalties.

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

Fair value of available-for-sale debt securities	Due in One Year or Less	Due After One Year through Five Years	Due After Five Years through Ten Years	Due After Ten Years	Total
Corporate fixed income securities	\$ 2.5	\$ 7.0	\$ 7.6	\$ 5.3	\$ 22.4
Mortgage-backed securities	-	0.2	0.2	14.4	14.8
U.S. government notes	0.6	2.7	1.0	0.1	4.4
Other	0.5	1.7	2.1	3.5	7.8
Total	\$ 3.6	\$ 11.6	\$ 10.9	\$ 23.3	\$ 49.4

The Company's debt instruments are recorded at cost on the Consolidated Balance Sheets. The fair value of the Company's debt approximated carrying value at December 30, 2023. 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.

(14) Income Taxes

Income tax expense includes the following components:

	Years Ended		
	December 30, 2023	December 31, 2022	January 1, 2022
Current:			
Federal	\$ 0.1	\$ (9.1)	\$ (13.7)
State	(0.9)	(2.6)	(4.2)
Foreign	(1.2)	(1.0)	(0.9)
Current income tax expense	(2.0)	(12.7)	(18.8)
Deferred:			
Federal	0.9	3.6	3.6
State	0.1	0.1	0.2
Deferred income tax benefit	1.0	3.7	3.8
Total income tax expense	\$ (1.0)	\$ (9.0)	\$ (15.0)

Income tax differs from the amount computed by applying the statutory U.S. Federal income tax rate of 21 percent for fiscal years ended December 30, 2023, December 31, 2022 and January 1, 2022 to pre-tax income because of the effect of the following items:

	Years Ended		
	December 30, 2023	December 31, 2022	January 1, 2022
Expected tax at U.S. Federal income tax rate	\$ (68.1)	\$ (73.4)	\$ (72.4)
Patronage distribution deductions	70.5	67.9	61.8
Other, net expense	(3.4)	(3.5)	(4.4)
Income tax expense	\$ (1.0)	\$ (9.0)	\$ (15.0)

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

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

	December 30, 2023	December 31, 2022
Deferred tax assets:		
Foreign tax credits and other tax credit carryforwards	\$ 12.9	\$ 13.3
Net operating loss carryforwards	16.8	3.1
Unearned insurance premium and loss reserves	1.7	1.7
Allowance for doubtful accounts	2.1	0.9
Inventory reserves	5.5	9.4
Deferred vendor rebates	19.0	18.6
Accrued compensation and benefits expense	21.1	19.1
Amortization of intangibles	-	0.9
Net unrealized losses	0.4	0.7
Leased assets	6.9	5.6
Other reserves	13.3	12.4
Total deferred tax assets	99.7	85.7
Less valuation allowance	(18.5)	(15.1)
Deferred tax assets	81.2	70.6
Deferred tax liabilities:		
Depreciation and deferred gains on property and equipment	26.4	17.1
Amortization of intangibles	1.3	-
Prepaid expenses and deferred income	3.6	3.9
Inventory valuation	17.9	17.5
Deferred tax liabilities	49.2	38.5
Net deferred tax assets	\$ 32.0	\$ 32.1

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

At December 30, 2023, the Company has federal and state net operating loss carryforwards of \$54.5 million available for offset against future taxable income. The federal net operating loss can be carried forward indefinitely. For those states not conforming to the indefinite federal carryforward provisions, the state net operating losses can, generally, be carried forward through the 2043 tax year.

At December 30, 2023, the Company has foreign net operating loss carryforwards of \$35.8 million available for offset against future taxable income. A valuation allowance of \$8.6 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 December 30, 2023, the Company has foreign tax credits of \$2.8 million available to offset future tax expense. The foreign tax credits may be carried forward through the 2033 tax year.

At December 30, 2023, the Company has state tax credit carryforwards of \$10.1 million available to offset future state income tax expense. The state tax credits may be carried forward to tax years 2024 through 2027. A valuation allowance of \$9.9 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 2019 through 2023 tax years remain subject to examination by the IRS. For state purposes, the 2018 through 2023 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 and recognized in income tax expense are immaterial. 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.

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

(15) Capital Stock

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

	Number of Shares at	
	December 30, 2023	December 31, 2022
Class A stock, voting, redeemable at par value:		
Authorized	10,000	10,000
Issued and outstanding	2,615	2,662
Class C stock, nonvoting, redeemable at not less than par value:		
Authorized	10,000,000	10,000,000
Issued and outstanding	7,226,176	6,561,209
Issuable as patronage distributions	897,317	1,181,824

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.

(16) Retirement Plans

The Company and its subsidiaries maintain profit sharing and 401k retirement plans for substantially all employees. Amounts expensed under these plans totaled \$46.6 million, \$47.4 million and \$43.5 million during fiscal 2023, 2022 and 2021, respectively.

(17) Supplemental Disclosures of Cash Flow Information

During fiscal 2023, 2022 and 2021, accrued patronage distributions of \$42.2 million, \$31.6 million and \$28.3 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 \$22.4 million in patronage refund certificates which were included in Accounts payable pending payment as of December 30, 2023 and had no net impact in the Consolidated Statements of Cash Flows.

During fiscal 2023, 2022 and 2021, non-cash repurchases of stock from Retailers of \$39.7 million, \$40.8 million and \$29.4 million, respectively, were offset against trade receivables of \$5.2 million, \$16.9 million and \$5.5 million, respectively, and notes receivable of \$8.5 million, \$9.6 million and \$8.4 million, respectively. The remaining \$26.0 million, \$14.3 million and \$15.5 million, respectively, were primarily issued as notes payable with no net impact in the Consolidated Statements of Cash Flows.

The Company received \$9.8 million, \$11.3 million and \$7.8 million of property and equipment for fiscal years 2023, 2022 and 2021, respectively, 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 years 2023, 2022 and 2021. The Company paid \$11.3 million, \$7.8 million and \$9.4 million for property and equipment for fiscal years 2023, 2022 and 2021 that was purchased and accrued during the years ended December 31, 2022, January 1, 2022 and January 2, 2021. These capital expenditures were included in the Purchases of property and equipment in the Consolidated Statement of Cash Flows for fiscal years 2023, 2022 and 2021.

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

(18) Cybersecurity Event

On October 29, 2023, Ace was the subject of a targeted cybersecurity incident. Upon discovering this incident, the Company shut down most of its operating systems globally to manage the safety of its overall global systems environment. As this situation evolved, the Company worked with a group of technical forensic experts to manage the situation. While its systems were shut down, the Company had limited ability to conduct operations, including but not limited to, arranging for shipments of freight and distributing product to its member Retailers.

The security of the Company's systems, minimizing the impacts to its member Retailers, and providing its member Retailers with timely and accurate information are the highest priorities. The Company formally concluded a thorough investigation to ensure its systems were restored promptly and securely, and on a parallel track, Ace evaluated and mitigated the impact of this event on its member Retailers.

For the year-ended December 30, 2023, the Company incurred \$8.6 million of expenses related to this cybersecurity incident to investigate and remediate the matter. The Company may incur additional expenses in the future as it continues to fully assess the impact of the incident and there is a risk that new information could have an impact on Ace's business, revenues, results of operations and reputation.

(19) Summary of Quarterly Results

The following table provides a summary of quarterly results (unaudited) for the eight quarters prior to and including the quarter ended December 30, 2023:

	2023			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Revenues	\$ 2,124.7	\$ 2,287.6	\$ 2,632.6	\$ 2,086.2
Gross profit	310.4	408.7	436.2	322.6
Operating expenses	303.4	268.7	295.2	249.5
Net income attributable to Ace Hardware Corporation	2.1	130.5	126.9	66.6

	2022			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Revenues	\$ 2,191.4	\$ 2,231.8	\$ 2,533.0	\$ 2,213.6
Gross profit	264.0	360.6	401.8	335.0
Operating expenses	267.4	253.2	269.5	229.4
Net (loss) income attributable to Ace Hardware Corporation	(4.0)	100.7	124.9	120.1

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 December 30, 2023 (the Company's fiscal years 2023, 2022 and 2021). Fiscal years 2023, 2022 and 2021 contain 52 weeks of operating results. Unless otherwise noted, all references herein for the years 2023, 2022 and 2021 represent fiscal years ended December 30, 2023, December 31, 2022 and January 1, 2022, 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 approximately \$578 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 \$68 billion "convenience hardware" segment which is characterized by purchases primarily of products related to home maintenance 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 21.3 percent noncontrolling interest held by AIH customers. AIH shareholders do not own shares of stock in the Company nor receive patronage dividends. AIH has wholesale distribution capabilities in Ningbo, China and Cuautitlán Izcalli, Mexico. AIH customers operate 876 stores in approximately 60 countries.

Ace Retail Holdings LLC ("ARH") is the owner of the 169-store Westlake Ace Hardware ("Westlake") and the 66-store Great Lakes Ace Hardware ("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 ("EJD"). AWH is a wholesaler of hardware, paint and other related products to non-member retailers.

Ace Services Holdings LLC ("ASH"), through its subsidiaries, operates Ace Handyman Services, a franchisor of home improvement, maintenance and repair services, Ace Hardware Painting Services, a provider of home painting services, and Legacy Plumbing, Inc. and Ace Hardware Plumbing Services, providers of residential plumbing services. On April 12, 2023, Ace Heating and Cooling Services, LLC ("AHCS"), a newly-formed subsidiary of ASH merged with Unique Indoor Comfort Holdings, LLC ("UICH"), with AHCS being the surviving entity. On May 3, 2023, a subsidiary of AHCS, Unique Indoor Comfort, LLC ("UIC"), acquired Parrish Services, Inc. ("Parrish") and on December 29, 2023, UIC acquired Climate Technologies, Inc. ("Climate").

Worldwide Store Count

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

	Fiscal Years		
	2023	2022	2021
Retail outlets at beginning of period	5,746	5,583	5,463
New retail outlets	222	232	206
Retail outlet cancellations	(98)	(69)	(86)
Retail outlets at end of period	<u>5,870</u>	<u>5,746</u>	<u>5,583</u>

Results of Operations

Comparison of the Year Ended December 30, 2023 to the Year Ended December 31, 2022

The following data summarizes the Company's performance in fiscal 2023 as compared to fiscal 2022 (in millions):

	2023		2022		Favorable/ (Unfavorable)	
	\$	% of Revenues*	\$	% of Revenues*	\$	%
Revenues:						
Wholesale revenues	8,344.7	91.4%	8,372.3	91.3%	(27.6)	(0.3%)
Retail revenues	786.4	8.6%	797.5	8.7%	(11.1)	(1.4%)
Total revenues	9,131.1	100.0%	9,169.8	100.0%	(38.7)	(0.4%)
Gross profit:						
Wholesale gross profit	1,121.6	13.4%	1,003.5	12.0%	118.1	11.8%
Retail gross profit	356.3	45.3%	357.9	44.9%	(1.6)	(0.4%)
Total gross profit	1,477.9	16.2%	1,361.4	14.8%	116.5	8.6%
Operating expenses:						
Wholesale operating expenses	830.7	10.0%	730.1	8.7%	(100.6)	(13.8%)
Retail operating expenses	280.1	35.6%	287.5	36.1%	7.4	2.6%
Retail pre-opening expenses	6.0	0.8%	1.9	0.2%	(4.1)	(215.8%)
Total operating expenses	1,116.8	12.2%	1,019.5	11.1%	(97.3)	(9.5%)
Operating income	361.1	4.0%	341.9	3.7%	19.2	5.6%
Interest expense	(38.4)	(0.4%)	(19.2)	(0.2%)	(19.2)	(100.0%)
Other income, net	3.4	0.0%	19.0	0.2%	(15.6)	(82.1%)
Net income attributable to Ace Hardware Corporation						
	326.1	3.6%	341.7	3.7%	(15.6)	(4.6%)

*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. 2022
2022 Revenues	\$ 9,169.8	
<i>Wholesale Merchandise Revenues change based on new and cancelled domestic Ace stores:</i>		
Revenues increase from new stores added since January 2022	207.2	2.3%
Revenues decrease from stores cancelled since January 2022	(43.5)	(0.5%)
Decrease in wholesale merchandise revenues to comparable domestic Ace stores	(333.8)	(3.7%)
Increase in wholesale service revenues from domestic Ace stores	14.2	0.2%
Decrease in AWH wholesale revenues	(20.1)	(0.2%)
Decrease in AIH wholesale revenues	(7.6)	(0.1%)
Increase in ASH service revenues	109.0	1.2%
Increase in Acehardware.com revenues	31.5	0.3%
Decrease in ARH retail revenues	(0.6)	(0.0%)
Other revenue changes, net	5.0	0.1%
2023 Revenues	\$ 9,131.1	(0.4%)

Consolidated revenues for the year ended December 30, 2023 totaled \$9.1 billion, a decrease of \$38.7 million, or 0.4 percent, as compared to the prior year.

Total wholesale revenues were \$8.3 billion for fiscal 2023, a decrease of \$27.6 million or 0.3 percent, as compared to the prior year. Decreases were seen across many departments with plumbing, grilling and outdoor power equipment showing the largest declines. New domestic Ace stores are defined as stores that were activated from January 2022 through December 2023. In 2023, the Company had an increase in wholesale merchandise revenues from new domestic Ace stores of \$207.2 million. This increase was partially offset by a decrease in wholesale merchandise revenues due to domestic Ace store cancellations of \$43.5 million. As a result, the Company realized a net increase in wholesale merchandise revenues of \$163.7 million related to the impact of both new Ace stores affiliated with the Company and from stores that cancelled their membership in 2022 and 2023. Wholesale merchandise revenues to comparable

domestic Ace stores decreased \$333.8 million compared to the prior year. Warehouse sales represented 78.2 percent of wholesale merchandise revenue in 2023 compared to 78.3 percent in 2022, while direct ship sales were 21.8 percent, up from 21.7 percent in 2022.

AWH wholesale revenues were \$458.5 million during fiscal 2023. This is a decrease of \$20.1 million from fiscal 2022, which was primarily due to lower sales to AWH's paint, hardware and e-commerce customers.

AIH wholesale revenues were \$216.0 million during fiscal 2023. This is a decrease of \$7.6 million from fiscal 2022 due entirely to a decline in sales to AIH's largest customer.

ASH wholesale revenues were \$125.7 million during fiscal 2023. This is an increase of \$109.0 million from fiscal 2022 due to the acquisition of UICH during the second quarter of 2023, which contributed \$99.5 million of incremental revenues during fiscal 2023.

Total retail revenues were \$786.4 million, a decrease of \$11.1 million, or 1.4 percent, as compared to the prior year. Retail revenues were negatively impacted by the closure of The Grommet during the third quarter of 2022, resulting in the absence of revenues from Ace Ecommerce Holdings ("AEH") in 2023, compared with \$10.5 million in the prior year. ARH revenues decreased \$0.6 million or 0.1 percent from the prior year. The Westlake chain experienced a 1.8 percent decrease in same-store-sales while the GLA chain experienced a 4.2 percent decrease in same-store-sales in fiscal 2023. The new stores opened by Westlake and GLA in 2022 and 2023 contributed \$17.8 million of incremental revenues during fiscal 2023.

Wholesale gross profit for fiscal 2023 was \$1.1 billion, an increase of \$118.1 million from fiscal 2022. The wholesale gross margin percentage was 13.4 percent of wholesale revenues in fiscal 2023, up from 12.0 percent in fiscal 2022. The increase in wholesale gross margin percentage was primarily due to the reversal of last-in, first-out ("LIFO") from an expense in fiscal 2022 when vendor prices were rising, to LIFO income in fiscal 2023 when inflation moderated and inventory levels declined.

Retail gross profit for fiscal 2023 was \$356.3 million, a decrease of \$1.6 million from fiscal 2022. The retail gross margin percentage was 45.3 percent of retail revenues in fiscal 2023, up from 44.9 percent in fiscal 2022. This increase in gross margin percentage primarily resulted from vendor funds earned related to new store openings. 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 \$100.6 million, or 13.8 percent in fiscal 2023, as compared to fiscal 2022. This increase is primarily due to the acquisition of UICH during the second quarter of 2023, which contributed \$49.5 million of incremental operating expenses in fiscal 2023, increased lease expense driven by additional warehouse space, increased marketing and advertising expenses, increased depreciation expense and higher health insurance expenses. As a percentage of wholesale revenues, wholesale operating expenses increased to 10.0 percent of wholesale revenues in fiscal 2023 from 8.7 percent of wholesale revenues in fiscal 2022.

Retail operating expenses decreased \$7.4 million, or 2.6 percent in fiscal 2023, as compared to fiscal 2022. This decrease was driven by the closure of The Grommet during the third quarter of 2022, resulting in the absence of operating expenses from AEH in fiscal 2023. Retail operating expenses as a percentage of retail revenue decreased to 35.6 percent of retail revenues in fiscal 2023 from 36.1 percent in fiscal 2022.

Retail pre-opening expenses increased \$4.1 million in fiscal 2023 due to an increase in new stores opened by Westlake and GLA in 2023 compared to 2022.

Interest expense increased \$19.2 million compared to fiscal 2022 due to increased borrowings for the acquisition of UICH and higher interest rates.

Other income, net decreased \$15.6 million compared to fiscal 2022 due to the \$21.7 million non-recurring gain on sale of the Company's retail support center ("RSC") located in Gainesville, Georgia during 2022 and \$8.6 million of expenses incurred in 2023 related to a cybersecurity incident that took place during the fourth quarter; partially offset by a \$8.0 million decrease in income tax expense.

Comparison of the Year Ended December 31, 2022 to the Year Ended January 1, 2022

The following data summarizes the Company's performance in fiscal 2022 as compared to fiscal 2021 (in millions):

	2022		2021		Favorable/ (Unfavorable)	
	\$	% of Revenues*	\$	% of Revenues*	\$	%
Revenues:						
Wholesale revenues	8,372.3	91.3%	7,782.2	90.6%	590.1	7.6%
Retail revenues	797.5	8.7%	812.0	9.4%	(14.5)	(1.8%)
Total revenues	9,169.8	100.0%	8,594.2	100.0%	575.6	6.7%
Gross profit:						
Wholesale gross profit	1,003.5	12.0%	932.6	12.0%	70.9	7.6%
Retail gross profit	357.9	44.9%	361.8	44.6%	(3.9)	(1.1%)
Total gross profit	1,361.4	14.8%	1,294.4	15.1%	67.0	5.2%
Operating expenses:						
Wholesale operating expenses	730.1	8.7%	682.8	8.8%	(47.3)	(6.9%)
Retail operating expenses	287.5	36.1%	269.9	33.2%	(17.6)	(6.5%)
Retail pre-opening expenses	1.9	0.2%	2.9	0.4%	1.0	34.5%
Total operating expenses	1,019.5	11.1%	955.6	11.1%	(63.9)	(6.7%)
Operating income	341.9	3.7%	338.8	4.0%	3.1	0.9%
Interest expense	(19.2)	(0.2%)	(14.4)	(0.2%)	(4.8)	(33.3%)
Other income, net	19.0	0.2%	6.3	0.0%	12.7	201.6%
Net income attributable to Ace Hardware Corporation	341.7	3.7%	330.7	3.8%	11.0	3.3%

*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. 2021
2021 Revenues	\$ 8,594.2	
<i>Wholesale Merchandise Revenues change based on new and cancelled domestic Ace stores:</i>		
Revenues increase from new stores added since January 2021	230.3	2.7%
Revenues decrease from stores cancelled since January 2021	(52.8)	(0.6%)
Increase in wholesale merchandise revenues to comparable domestic Ace stores	311.5	3.7%
Increase in wholesale service revenues from domestic Ace stores	62.4	0.7%
Increase in AWH wholesale revenues	52.4	0.6%
Decrease in AIH wholesale revenues	(48.6)	(0.6%)
Increase in Acehardware.com revenues	29.9	0.3%
Increase in ARH retail revenues	10.3	0.1%
Decrease in AEH retail revenues	(24.8)	(0.3%)
Other revenue changes, net	5.0	0.1%
2022 Revenues	\$ 9,169.8	6.7%

Consolidated revenues for the year ended December 31, 2022 totaled \$9.2 billion, an increase of \$575.6 million, or 6.7 percent, as compared to the prior year.

Total wholesale revenues were \$8.4 billion for fiscal 2022, an increase of \$590.1 million or 7.6 percent, as compared to the prior year. Increases were seen across a majority of departments with outdoor power equipment, plumbing and paint showing the largest gains. New domestic Ace stores are defined as stores that were activated from January 2021 through December 2022. In 2022, the Company had an increase in wholesale merchandise revenues from new domestic Ace stores of \$230.3 million. This increase was partially offset by a decrease in wholesale merchandise revenues due to domestic Ace store cancellations of \$52.8 million. As a result, the Company realized a net increase in wholesale merchandise revenues of \$177.5 million related to the impact of both new Ace stores affiliated with the Company and from stores that cancelled their membership in 2021 and 2022. Wholesale merchandise revenues to comparable domestic Ace stores increased \$311.5 million compared to the prior year as a result of estimated wholesale price inflation of 11.5 percent. Warehouse sales represented 78.3 percent of wholesale merchandise revenue in 2022 compared to 79.2 percent in 2021, while direct ship sales were 21.7 percent, up from 20.8 percent in 2021.

AWH wholesale revenues were \$478.6 million during fiscal 2022. This is an increase of \$52.4 million from fiscal 2021, which was primarily due to inflation, new customers and higher sales to AWH's hardware and e-commerce customers.

AIH wholesale revenues were \$223.6 million during fiscal 2022. This is a decrease of \$48.6 million from fiscal 2021 due entirely to a \$48.7 million decline in sales to AIH's largest customer.

Total retail revenues were \$797.5 million, a decrease of \$14.5 million, or 1.8 percent, as compared to the prior year. The closure of The Grommet in the third quarter of 2022 drove a \$24.8 million decrease in retail sales. Retail revenues from ARH were \$787.0 million during fiscal 2022, an increase of \$10.3 million or 1.3 percent. This increase was the result of inflation and the new stores added by the Westlake and GLA retail chains in 2021 and 2022, which was mostly offset by lower transaction counts.

Wholesale gross profit for fiscal 2022 was \$1.0 billion, an increase of \$70.9 million from fiscal 2021. The wholesale gross margin percentage was unchanged at 12.0 percent of wholesale revenues in both fiscal 2022 and 2021. An increase in LIFO expense driven by vendor price inflation was offset by increased vendor funds earned for the year.

Retail gross profit for fiscal 2022 was \$357.9 million, a decrease of \$3.9 million from fiscal 2021. The closure of The Grommet in the third quarter of 2022 drove a \$10.0 million decrease in retail gross profit. The retail gross margin percentage was 44.9 percent of retail revenues in fiscal 2022, a slight increase from 44.6 percent in fiscal 2021. This increase in gross margin percentage primarily resulted from product mix and the absence of the liquidation of personal protective equipment that took place during 2021. 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 \$47.3 million, or 6.9 percent in fiscal 2022, as compared to fiscal 2021. The increase is due to higher distribution costs resulting from higher wholesale revenues 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 8.7 percent in fiscal 2022 from 8.8 percent in fiscal 2021.

Retail operating expenses increased \$17.6 million, or 6.5 percent in fiscal 2022, as compared to fiscal 2021. Included in this increase is a non-recurring charge of \$9.9 million related to the closure of The Grommet during the third quarter, for the impairment of assets and severance related costs. The remaining increase was driven by an increase in store payroll along with expenses incurred related to the new stores opened in 2021 and 2022. Retail operating expenses as a percentage of retail revenue increased to 36.1 percent in fiscal 2022 from 33.2 percent in fiscal 2021. Excluding the non-recurring charge, retail operating expenses as a percent of retail revenue was 34.8 percent in fiscal 2022.

Retail pre-opening expenses decreased \$1.0 million in fiscal 2022 due to fewer new stores opened by Westlake and GLA in 2022 compared to 2021.

Interest expense increased \$4.8 million or 33.3 percent compared to fiscal 2021 due to higher interest rates during fiscal 2022.

Other income, net increased \$12.7 million compared to fiscal 2021 as a result of the \$21.7 million gain on sale of the Company's RSC located in Gainesville, Georgia during 2022, compared to the \$10.2 million gain on sale of the Company's RSC located in Tampa, Florida during 2021.

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.

On January 24, 2023, the Company amended its existing credit facility. The January 2023 amendment extended the maturity from February 1, 2024 to January 24, 2028 and increased the capacity of the facility by \$400.0 million to \$1.1 billion. The facility is expandable to \$1.4 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. The amendment changed the benchmark for setting interest rates from the London Interbank Bank Offered Rate ("LIBOR") to the Secured Overnight Financing Rate ("SOFR") and borrowings under the amended credit facility now bear interest at a rate of either 25 to 100 basis points over the prime rate or 125 to 200 basis points over SOFR, depending on the Company's leverage ratio. The credit facility was priced at SOFR plus 125 basis points and prime plus 25 basis points at December 30, 2023. Fees on the unused portion of the line of credit range from 17.5 to 27.5 basis points depending on the Company's leverage ratio. All other terms of the credit facility remain unchanged. As of December 30, 2023, the Company was in compliance with its covenants and had \$331.5 million in borrowings outstanding under the credit facility.

The credit facility includes a \$175.0 million sublimit for the issuance of standby and commercial letters of credit. As of December 30, 2023, a total of \$38.4 million in letters of credit were outstanding.

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 \$100.0 million at any time. As of December 30, 2023, there were no loans or other extensions of credit provided to AIH.

The Company's Westlake subsidiary has a \$125.0 million asset-based revolving credit facility that expires on August 3, 2026 ("Westlake Facility"). The 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 a portion of the increased facility. Under this facility, Westlake has the right to issue letters of credit up to a maximum of \$7.5 million. Pursuant to an April 12, 2023 amendment, borrowings under this facility now bear interest at a rate of either the prime rate plus an applicable spread of 25 to 50 basis points or SOFR plus an applicable spread of 135 to 160 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 SOFR plus 135 basis points at December 30, 2023.

The Westlake Facility is collateralized by substantially all of Westlake's tangible and intangible assets. Borrowings under the facility are subject to a borrowing base calculation consisting of certain advance rates applied to eligible collateral balances (primarily consisting of certain receivables and inventories). This agreement requires maintenance of certain financial covenants including a minimum fixed charge coverage ratio. As of December 30, 2023, Westlake was in compliance with its covenants and had \$30.5 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," all borrowings under the Westlake Facility are classified as a Current maturity of long-term debt.

As of December 30, 2023, total debt was \$408.3 million and was comprised of \$362.0 million borrowed on lines of credit and \$46.3 million owed to former Retailers. As of December 31, 2022, total debt of \$38.1 million was entirely comprised of amounts owed to former Retailers.

Cash Flows

The Company had \$31.9 million and \$28.5 million of cash and cash equivalents at December 30, 2023 and December 31, 2022, respectively. Following is a summary of the Company's cash flows from operating, investing and financing activities for fiscal years 2023 and 2022, respectively (in millions):

	2023	2022
Cash provided by operating activities before changes in assets and liabilities	\$ 457.4	\$ 433.7
Net changes in assets and liabilities	(93.6)	(151.2)
Net cash provided by operating activities	363.8	282.5
Net cash used in investing activities	(502.3)	(109.1)
Net cash provided by (used in) financing activities	141.9	(182.5)
Net change in cash and cash equivalents	\$ 3.4	\$ (9.1)

The Company's operating activities generated \$363.8 million of cash in fiscal 2023 compared to \$282.5 million in fiscal 2022. Excluding the impact of net changes in assets and liabilities, cash provided by operating activities increased \$23.7 million from \$433.7 million in fiscal 2022 to \$457.4 million in fiscal 2023. Despite a \$17.2 million decrease in net income, higher non-cash operating expenses in 2023 and a non-operating gain in 2022 resulted in higher cash provided by operations in 2023.

The net change in assets and liabilities used \$93.6 million of cash in fiscal year 2023 compared to \$151.2 million used in fiscal year 2022. Accounts payable and accrued expenses decreased \$104.7 million during fiscal 2023 compared to an increase of \$80.4 million during fiscal 2022. Inventories decreased \$74.7 million during fiscal 2023 compared to an increase of \$77.3 million during fiscal 2022. These decreases were primarily due to lower vendor purchases driven by lower sales volume and an effort to reduce overstock inventory in fiscal 2023. Accounts receivable increased \$55.4 million during fiscal 2023 despite the slight sales decline in 2023 as notes receivable and past due balances from Retailers increased. This compares to an increase of \$159.6 million during fiscal 2022 when sales grew 6.7 percent.

Net cash used for investing activities was \$502.3 million in fiscal 2023 compared to \$109.1 million in fiscal 2022. Investing activities in fiscal 2023 consisted of \$309.7 million in cash paid for acquisitions to support the growth of the Ace Home Services business and \$164.6 million in capital expenditures. Investing activities in 2022 primarily consisted of \$92.8 million in capital expenditures, \$60.3 million for the purchases of investment securities, a portion of which was used to support the Company's deferred compensation plan, and \$12.8 million in cash paid for acquisitions; partially offset by \$29.4 million of cash proceeds from the sale of assets, which included the sale of the Gainesville RSC, and \$47.7 million of proceeds from the sale of investment securities.

Net cash provided by financing activities was \$141.9 million in fiscal 2023 compared to the use of \$182.5 million in fiscal 2022. During 2023, the Company had \$362.0 million of net borrowings under its revolving credit facilities, paid \$133.1 million for the cash portion of the 2022 patronage distribution, made principal payments on finance leases of \$28.3 million, paid \$26.7 million on patronage refund certificates and made payments on long-term debt of \$17.8 million. During 2022, the Company paid \$121.0 million for the cash portion of the 2021 patronage distribution, paid \$26.1 million on patronage refund certificates, made principal payments on finance leases of \$16.7 million and made payments on long-term debt of \$7.1 million.

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 Expected Credit Losses The Company estimates an allowance for credit losses related to future expected losses by using relevant information such as 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. Significant past due accounts are reserved on a specific identification basis. For the remainder of the accounts, the allowance is evaluated on a pool basis for accounts with similar risk characteristics and a loss-rate for each pool is determined using current conditions and historical credit loss statistics. 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. 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.

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 2023 and 2022.

Impact of New Accounting Standards

Recently issued accounting pronouncements that are not yet effective and that are 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 - Adopted

In June 2016, the FASB issued Accounting Standards Update (“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. On December 31, 2022, the Company adopted ASU 2016-13. The adoption of this ASU did not have a material impact on the Company’s consolidated financial statements other than additional disclosures.

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 has experienced a significant increase in inflation as the prices of raw materials and freight negatively impacted the costs the Company pays to acquire products. For the most part, the Company was able to offset the effect of increased costs by passing along cost increases to the Company’s customers. Although inflation has slowed, the Company is unable to ensure that a future increase in inflation will be able to be passed on to its customers through increased prices. 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.

Certain Other Risks

The Company relies extensively on information technology systems, some of which are managed or provided by third-party service providers, to analyze, process, store, manage and protect transactions and data. In managing the business, the Company also relies heavily on the integrity of, security of and consistent access to this data for information such as customer data, merchandise planning and inventory replenishment, supplier purchases, sales to Retailers, warehousing, distribution, inventory control, and various corporate-level financial and other functions including communication with the Retailers. The Company’s systems and the systems managed by third parties are subject to damage or interruption from a number of causes, including power outages; computer and telecommunications failures; computer viruses; security breaches or cyber-attacks. Although the Company and the third-party service providers seek to maintain the Company’s respective systems effectively and to successfully address the risk of compromise of the integrity, security and consistent operations of these systems, such efforts may not be successful. If the Company’s or our service providers’ systems are damaged, breached or cease to function properly, this could significantly disrupt the Company’s operations and be costly, time consuming and resource-intensive to remedy.

The Company and its third-party system providers receive, collect and store personally identifiable, confidential, proprietary and other information from our vendors, customers and employees so that they may, among other things, purchase products or services and enroll in promotional programs. Any breach of the Company’s or its third-party system providers’ security could result in significant costs to protect any customers, vendors, employees, and other parties whose personal data is compromised. Loss of customer, supplier, employee or other business information could disrupt operations, damage the Company’s reputation and expose the Company to claims from customers, vendors, financial institutions, regulators, payment card associations, employees and others, any of which could have a material adverse effect on the Company, its financial condition and results of operations.

The Company imports inventory from manufacturers outside the United States, particularly in Asia. Importing involves risks including duties, tariffs, quotas on imported merchandise and potential disruptions resulting from geopolitical problems in countries from which merchandise is imported. Our ability to manage the importing of goods from overseas, their production, timing of deliveries and U.S. Customs-related compliance is an important component of our merchandising strategy. Geopolitical issues and military conflicts outside of the United States may increase the likelihood of supply chain interruptions and have a negative impact on our import activities.

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

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, civil unrest; pandemics; acts of terrorism; 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; increases in fuel costs; accidents, leaks, equipment failures, ransomware attacks, cybersecurity incidents, technology disruptions and other operating risks; legislative actions; change in tax laws and tax rulings or audit results; asset sales; effective integration of acquired businesses; significant unplanned capital needs; changes in accounting principles, interpretations, methods, judgments or estimates; performance of major customers; reliance on third-party transporters, suppliers and contractors and interruption of product supply or increases in product costs; labor relations, increased labor costs and continued access to qualified labor.

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

FIVE YEAR SUMMARY OF EARNINGS AND DISTRIBUTIONS

	Years Ended				
	December 30, 2023 (52 Weeks)	December 31, 2022 (52 Weeks)	January 1, 2022 (52 Weeks)	January 2, 2021 (53 Weeks)	December 28, 2019 (52 Weeks)
Revenues	\$ 9,131.1	\$ 9,169.8	\$ 8,594.2	\$ 7,762.7	\$ 6,071.2
Cost of revenues	7,653.2	7,808.4	7,299.8	6,549.2	5,178.6
Gross profit	1,477.9	1,361.4	1,294.4	1,213.5	892.6
Total operating and other expenses, net	1,151.8	1,019.7	963.7	895.9	752.2
Net income attributable to Ace Hardware Corporation	\$ 326.1	\$ 341.7	\$ 330.7	\$ 317.6	\$ 140.4

Distribution of net income:

Patronage distributions to third party Retailers	\$ 335.7	\$ 323.6	\$ 294.1	\$ 275.4	\$ 172.5
Net (loss) income of non-patronage activities	(9.6)	18.1	36.6	42.2	(32.1)
Net income attributable to Ace Hardware Corporation	\$ 326.1	\$ 341.7	\$ 330.7	\$ 317.6	\$ 140.4

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 and Finance 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 and Finance 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 and Finance Committee.

February 13, 2024

/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 • 2915 Jorie Blvd • Oak Brook, IL 60523

www.acehardware.com