INDEX TO ANNUAL REPORT

INDEX TO ANNUAL REPORT – (Continued)

This Annual Report contains information about our company. Unless otherwise indicated or required by the context, the terms "Ace," "we," "our," "us" and the "Company" refer to Ace Hardware Corporation and all of its subsidiaries that are consolidated under U.S. generally accepted accounting principles ("GAAP"). The terms "Retailer," "you," and "your" refer to a retailer who becomes a domestic member of Ace and purchases our stock. In this Annual Report, we reference some of our own trademarked products (e.g., Clark + Kensington® paints) and services, as well as those of unrelated third parties with whom we do business (e.g., Benjamin Moore® paints); all trademarks appearing in this Annual Report are the property of their respective owners. Our fiscal years for the years 2020, 2019 and 2018 ended on January 2, 2021, December 28, 2019, and December 29, 2018, respectively. When we refer to a year, we are referring to the fiscal year ended on those respective dates. Data in this summary is as of January 2, 2021 unless indicated otherwise.

In March 2020, the World Health Organization declared the outbreak of a novel coronavirus a global pandemic. The pandemic is having a significant effect on overall economic conditions and the preventative and protective measures taken by governments are resulting in global business disruptions, including business with the Company's customers and vendors. Within the U.S., Ace Retailer stores were allowed to continue operations throughout the pandemic, albeit at reduced hours, reduced occupancy and reduced staffing levels in many cases. Despite these challenges, Ace Retailers, along with Ace Hardware Corporation, experienced significant sales growth in 2020, and this growth continues into 2021. Ace is unable to predict with any certainty whether these trends will continue or reverse.

The discussion that follows describes the historical operations of the Company without regards to the pandemic. No attempt has been made to predict the medium and long-term impacts that the pandemic may have on the Company or its Retailers.

SUMMARY

Our Company

Ace Hardware is the largest retailer-owned hardware cooperative in the world with more than 5,400 locally owned and operated hardware stores. Domestically, Ace retail hardware stores operate in all 50 states and the District of Columbia. Ace Hardware Corporation markets and distributes hardware products, paint and other merchandise to our network of independent retailers around the world. Ace also provides value-added services such as advertising, market research, merchandising assistance, promotional support, assistance with site location, store format design, retail training services, insurance and store technology services.

During fiscal 2020, approximately 82 percent of Ace's consolidated revenues were derived from transactions with domestic Ace Retailers. The remaining 18 percent was generated by the following Ace subsidiaries:

Ace Hardware International Holdings, Ltd. ("AIH"), a majority owned subsidiary of Ace, serves international retailers in approximately 65 countries. Ace and its subsidiaries operate an expansive network of distribution centers in the United States and have distribution capabilities in Ningbo, China; Colon, Panama; and Dubai, United Arab Emirates. Since 1924, Ace has been an important part of local communities around the world and known as the place with the helpful hardware folks.

Ace Retail Holdings LLC ("ARH") is the owner of the 145 store Westlake Ace Hardware ("Westlake") and the 57 store Great Lakes Ace Hardware, Inc ("GLA") retail chains. As a result, the Company is also a retailer of hardware, paint and other related products.

Ace Wholesale Holdings LLC ("AWH") markets products to non-member retailers. AWH does business as Emery Jensen Distribution ("EJD"). The Company believes that EJD will further leverage the Company's wholesale purchasing power and advance the Company's strategic plans as a leader in the wholesale distribution industry.

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

Ace Services Holdings LLC ("ASH") owns and operates Ace Handyman Services, a franchisor of home improvement and repair services.

Ace positions itself as "The Helpful Place" – conveniently located hardware stores that provide not only quality goods but also knowledgeable store staff. We believe that "The Helpful Place" is one of the most recognized slogans in the hardware and home improvement industry.

In 2020, Ace ranked "Highest in Customer Satisfaction among Home Improvement Retail Stores" according to J.D. Power. We believe that we received this award because helpfulness is a promise that all associates at local Ace stores seek to fulfill every day as they serve their retail customers across the United States and around the world. Ace received this award in thirteen of the last fourteen years.

As the principal supplier to our U.S. Retailer network, Ace purchases hardware, paint and other merchandise in quantity lots and resells this merchandise in smaller lots to our Retailers. Ace's aggregate purchasing volume and supplier relationships enable us to realize substantial purchasing savings and to pass such savings on to our Retailers. This enables Ace's Retailers to have consistent access to a broad range of hardware and related products and to better compete in their local markets.

We operate fifteen retail support centers ("RSCs"), eight freight consolidation/redistribution facilities and six bulk distribution centers across the United States that total over 13.7 million square feet of distribution space. Ten of the RSCs, with a total of approximately 7.8 million square feet of distribution space, are Company-owned. In addition, Ace and its subsidiaries also have distribution capabilities in Laredo, Texas; Dubai, United Arab Emirates; Colon, Panama; and Ningbo, China.

To help foster our Retailers' continued success, fuel their entrepreneurial spirit and enhance their viability in an increasingly competitive home improvement marketplace, Ace provides two basic programs for its Retailers – Ace Branded stores and Individually Branded stores.

Approximately 370 stores, or 8 percent, of our network of domestic stores are individually branded. Sales to these Retailers represented approximately 5 percent of our 2020 fiscal year domestic merchandise sales to Retailers. Our Individually Branded Retailer program is ideal for Retailers who have strong individual name recognition in their local communities and do not rely as much on the Ace brand for their success. While they do not participate in Ace's marketing programs, as Retailers of Ace they still rely on Ace's broad product assortment (including Ace private label products), low product pricing, extensive distribution network, and eligibility for patronage distributions. They go to market under their own business name and identity.

The remaining approximately 4,230 domestic stores, or 92 percent, of our network of domestic stores operate under the Ace brand. Sales to these Retailers represented approximately 95 percent of our 2020 fiscal year domestic merchandise sales to Retailers.

Our long-term growth strategy, Higher Ground, continues to build on Ace's commitments to enhance Retailer performance and ensure Retailer growth. Higher Ground provides Ace and our Retailers with a clear path to the future. The strategy is consumer-focused, aligned with our corporate strategy and contains two paths for growth that can be implemented separately or concurrently. The two paths for growth are Pinnacle Performance Retailing and Accelerated Store Growth. Pinnacle Performance Retailing is designed to help Ace Retailers improve their store performance by increasing sales and net profits. Accelerated Store Growth is designed to encourage Ace Retailers with the desire and ability to open new stores. It is also intended to increase store count through new investors, conversions of competitors' stores and by reducing the number of stores that leave Ace or close.

Ace's Capital Stock Structure

Our capital stock is divided into two classes, Class A and Class C. Only Class A Stock has voting rights. Class C Stock is issued in connection with all store memberships and annually as part of our patronage distribution. Our Board of Directors has the right to redeem portions or all of the outstanding shares of Class C Stock that have been issued as patronage distributions. If Ace is ever liquidated, the outstanding shares of Class C Stock have priority over the outstanding shares of Class A Stock in the distribution of our net assets. If our net assets were to exceed that priority amount, they would be distributed proportionately among the stockholders of both classes of our stock. (See "Description of Capital Stock – Voting Rights," "– Liquidation Rights" and "– Redemption Provisions.")

Ace operates as a cooperative. Accordingly, the declaration of dividends on any shares of any class of our stock is prohibited. (See "Description of Capital Stock – Dividend Rights.")

Membership Applications – Subscriptions for Class A and Class C Stock

The purchase of our stock enables prospective retailers to obtain membership in Ace. Membership entitles our Retailers to purchase merchandise and services from us that are either not available to non-member retailers (such as Ace branded merchandise) or are at prices that are not otherwise available. Retailers are also eligible to receive patronage distributions based on the volume of merchandise they purchase from us, but these distributions are dependent on Ace's patronage-based business being profitable. (See "Membership Information – Patronage Distributions – Patronage Distribution Determinations.") We cannot guarantee that patronage distributions will be made for any year.

Our stock is sold only to approved prospective retailers of hardware and related products who apply for membership in Ace Hardware Corporation. The purchase price (par value) for each share of Class A Stock is $1,000 and the purchase price (par value) for each share of Class C Stock is $100.

For an initial membership, you must subscribe and pay for one share of Class A Stock plus 40 shares of Class C Stock, with an aggregate subscription price of $5,000. You must also pay a $5,000 fee for processing your membership application. If you apply for membership for an additional store location that you own or control, you must subscribe and pay for 50 shares of Class C Stock ($5,000) for that location and pay another $5,000 processing fee.

Your membership may generally be terminated upon various notice periods and for various reasons, including voluntary termination, as provided in the Membership Agreement.

Ace also sells merchandise to customers that are not members of Ace through its AWH, AEH and AIH subsidiaries, but such non-member retailers do not own any Ace stock and are not eligible to receive any patronage distributions.

Repurchase of Shares by Ace

If your membership for a store location terminates, your Class A share and all of your Class C shares for that location must be sold back to us, generally at par value, unless the shares are transferred to another party whom we agree to accept as a Retailer for that location. We generally pay the repurchase price in a combination of cash and an interest-bearing four-year installment note. (See "Description of Capital Stock – Other Restrictions and Rights.")

Under Delaware corporate law, we are not allowed to repurchase any of our shares if our net assets are less than the par value of our aggregate outstanding shares of capital stock or if our net assets would be reduced below that amount by virtue of the repurchase.

Patronage Distributions and Income Tax Treatment

As a cooperative, we distribute patronage annually to Retailers based on their qualified merchandise purchases from us. Under our current plan, which can be modified by our Board of Directors, 40 percent of the total annual patronage distribution to each Retailer is paid in cash. The remainder is paid in shares of Class C Stock and in Patronage Refund Certificates. The cash portion of any patronage distribution payable to a past due or terminated Retailer is generally applied against that Retailer's indebtedness or other obligations to us, if any, unless the Retailer makes a written request to receive 20 percent of the patronage distribution in cash. (See "Membership Information – Patronage Distributions.")

The cash payments and stated dollar amounts of Class C Stock and Patronage Refund Certificates, along with the fair market value of any other property that we distribute as patronage, are considered income for federal income tax purposes of the recipient. (See "Federal Income Taxes – Tax Treatment of Patronage Distributions.")

Risks of Membership

Owning and operating a retail hardware store as an Ace Retailer, especially a group of such stores, can be rewarding, both financially and otherwise. There are, however, a number of risks that one should consider carefully before making a decision to become an Ace Retailer. See "Risks of Membership" for some of the more important risks. There may be other issues, risks and benefits particularly relevant to you that are not summarized in the "Risks of Membership" section.

ACE'S BUSINESS

Company History

Our company traces its history to the early 1920s, when the traditional way of buying hardware merchandise was to purchase products from a middleman or "jobber." This distribution method drove up the price on every hardware item, thereby cutting into the retailer's profit. In response, a group of Chicago-area hardware retailers - Richard Hesse, William Stauber, Frank Burke, Gern Lindquist and Oscar Fisher - decided they would pool their hardware buying needs, which allowed them to buy directly from manufacturers and to eliminate the jobber. This strategy enabled those retailers to realize considerable savings, decrease inventory costs and compete more effectively with the larger stores in their markets - a concept still valid today.

In 1928, this group of retailers incorporated their business in Illinois as Ace Stores (later re-named Ace Hardware Corporation). The Company was named in honor of the superior World War I fliers dubbed "aces." We opened our first warehouse in 1929, and by 1934, our membership had grown to 41 Retailers and our annual sales exceeded $650,000. During the 1960s, we expanded into the south and west regions of the country, and by 1969, we had opened distribution centers in Georgia and California - our first distribution facilities outside of Chicago. We opened our first international store, in Guam, in 1968.

By the early 1970s, large home center chains began to take market share from small independent retailers. In response, Ace and our Retailers began operating as a cooperative. In 1976, our Retailers took full control when shareholders elected the first Board of Directors comprised solely of Retailers. By this time, our wholesale sales had reached $382 million. Ace had Retailers in all 50 states and the District of Columbia by 1979. By 1985, Ace had reached $1 billion in sales. Ace reached $2 billion in sales in 1993, $3 billion in sales in 1998, $4 billion in sales in 2013, $5 billion in sales in 2015, $6 billion in sales in 2019 and $7 billion in sales in 2020. The 2013 fiscal year also marked Ace's first year with more than $100 million in net income. In 2020 net income exceeded $300 million.

Although Ace has had a retail presence outside the United States since the late 1960s, Ace implemented a more focused international growth strategy during the 1990s. In 2011, the Company restructured its international operations so that they were no longer a division within Ace's cooperative, but rather a stand-alone entity, with its own board of directors and management team. AIH is a majority-owned and controlled subsidiary of the Company with a noncontrolling interest owned by its international retailers. AIH currently has a retail presence in approximately 65 countries, with third-party distribution facilities in Dubai, United Arab Emirates; Colon, Panama; and Ningbo, China.

In December 2012, ARH acquired all of the outstanding shares of capital stock of WHI Holding Corp. ("WHI"). WHI owns all outstanding shares of Westlake. Westlake is based in Kansas City, Missouri and is the owner of 145 stores located throughout the country operating under the Westlake Ace Hardware and other brand names. In addition, in March 2019, ARH acquired the remaining 58 percent of the outstanding stock of GLA that it did not already own. GLA has been engaged in the business of owning and operating Ace stores in the United States since 2014 and operates 57 stores in Michigan, Ohio, Indiana and Kentucky.

In 2014, the Company formed the AWH legal entity for sales to non-member retailers. AWH owns and operates EJD.

In September 2017, AEH acquired 94.3 percent of the issued and outstanding capital stock of The Grommet. In 2020, AEH acquired the remaining outstanding stock of The Grommet it did not already own. The Grommet is an e-commerce company that operates a website that markets and sells new and innovative products created by independent entrepreneurs.

In September 2019, the Company formed the ASH legal entity. On September 5, 2019, ASH acquired Handyman Matters Inc., a franchisor of home improvement, and repair services.

Ace's customer loyalty program, Ace Rewards®, boasts approximately 54 million members as of the end of 2020. Acehardware.com is the online face of our brand and trusted destination for online products and project solutions and averaged more than 623,000 daily visitors during 2020. Ace has invested in other digital media such as Facebook, Twitter, Instagram and YouTube. Currently, Ace has more than 700,000 Facebook fans, more than 137,000 Twitter followers, more than 89,000 Instagram followers, more than 29,000 Pinterest followers, more than 57,000 LinkedIn followers, and more than 56 million video views on YouTube. Ace also has a mobile website that allows consumers to shop from their smart phone, as well as mobile apps for both iOS and Android devices. The Ace mobile apps launched in 2020 and received 1.8 million downloads.

Ace continues to rank highly on national scales of service and customer satisfaction, and has earned numerous awards and accolades during 2020, including:

- Ranked "Highest in Customer Satisfaction among Home Improvement Retail Stores" by J.D. Power, thirteen out of the last fourteen years.
- Ranked No. 1 in its category on *Entrepreneur* magazine's prestigious Franchise 500® list.
- Ranked No. 5 on the *Franchise Times* Top 200, the annual list of largest U.S. franchises by worldwide sales.
- Ranked No. 4 on the *Chicago Tribune*'s Top Workplaces of 2020.
- Ranked No. 27 in the National Retail Federation's 100 Top Retailers 2020 list.

Our Retailer Base

Ace has been able to attract and retain a strong base of experienced Retailers by offering a broad range of products at very competitive prices, providing exceptional product availability, service levels and assisting Retailers with numerous retail operational activities. As of January 2, 2021, Ace had approximately 2,700 domestic Retailers operating approximately 4,600 domestic retail locations.

Ace's network of Retailers covers all 50 states and the District of Columbia in the U.S. and, through our affiliated companies, customers in approximately 65 foreign countries. As of January 2, 2021, the largest concentrations of Ace Retailer stores were in California (approximately 9 percent), Florida and Texas (approximately 6 percent each), Illinois and Michigan (approximately 5 percent each), and New York and Georgia (approximately 4 percent each). Ace shipped the largest percentages of merchandise in fiscal year 2020 to California (approximately 12 percent), Florida (approximately 6 percent), Texas (approximately 5 percent), and Illinois, Michigan and New York (approximately 4 percent each).

New Store Growth

The Company continues to focus on attracting new Retailers and on identifying growth opportunities for the Company and its Retailers. The total number of Ace domestic locations during each of our past three fiscal years is summarized in the following table (excludes retail outlets served by AWH):

	2020	2019	2018
Retail outlets at beginning of period	4,556	4,476	4,418
New retail outlets added	167	168	174
Retail outlets terminated	(76)	(88)	(116)
Retail outlets at end of period	4,647	4,556	4,476
Retailers having a single outlet at end of period	2,017	2,038	2,089
Retailers having multiple outlets at end of period	687	671	643
Total Retailers at end of period	2,704	2,709	2,732
Retailer branch locations at end of period	1,741	1,661	1,621
Company operated retail outlets	202	186	123
Retail outlets at end of period	4,647	4,556	4,476

Ace's strong competitive posture translates into success for many Retailers who open new stores. The following charts show domestic new store continuations by year for "new investor" and existing Retailer "branch" stores, respectively, that Ace approved for membership in each of the last five years.

New Investor Stores

No. of Stores Continuing with Ace at the End of Each Year*

Year	No. of Stores Approved for Ace Membership	2020	2019	2018	2017	2016
2016	33	31	32	32	32	33
2017	32	29	31	32	32	
2018	30	29	30	30		
2019	23	22	23			
2020	32	32				

New Branch Stores

No. of Stores Continuing with Ace at the End of Each Year*

Year	No. of Stores Approved for Ace Membership	2020	2019	2018	2017	2016
2016	70	65	66	66	69	70
2017	59	55	58	59	59	
2018	70	69	70	70		
2019	90	90	90			
2020	77	77				

***** Excludes stores that convert to Ace from a competing brand and company-operated retail outlets.

Our Industry and Our Retailers' Core Customers

The overall U.S. home improvement industry 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. Sales within this U.S. market were estimated to be in excess of $457 billion in 2020 by the North American Retail Hardware Association. This industry is highly fragmented and encompasses "big box" home improvement centers (such as The Home Depot, Lowe's and Menards); retail hardware stores (such as stores affiliated with our Company as well as stores affiliated with True Value and Do It Best); traditional department stores and chains offering hardware merchandise (such as Walmart and Target); and regional lumber yards and builder-contractor shops (such as 84 Lumber and Carter Lumber).

Our domestic Retailers generally compete in what we call the "convenience hardware" segment of the overall home improvement industry. As differentiated from the overall home improvement industry, we consider the "convenience hardware" segment of the industry to be characterized by purchases primarily of products related to home improvement and repair. These products include paint and related products and lawn and garden equipment, as well as those products less focused on large-scale building, renovation and remodeling projects. According to a report by the North American Retail Hardware Association, U.S. convenience hardware store sales were estimated at approximately $61.8 billion in 2020. Ace estimates that its approximately 4,600 domestic outlets generated approximately $17.1 billion in retail sales in 2020, capturing an estimated 28 percent of the domestic convenience hardware market, up from an estimated 25 percent in 2019.

We believe the core customer of the convenience hardware market is a mission shopper who values helpful service, convenience and the feel and experience of a neighborhood hardware store. These customers' purchases are typically lower ticket-price items driven by do-it-yourself improvement, repair and maintenance projects and the need for everyday household and lawn and garden items. We believe our Retailers' core customer differs from the core customers of the large-format stores in that those stores typically value customers who are driven by larger scale home building and home improvement projects. Our internal analysis of customer purchases shows that the everyday improvement, maintenance and repair objectives of our Retailers' customers are a significant driver of our Retailers' sales.

Competitive Strengths

We believe the following competitive strengths distinguish Ace retail locations from our competitors and contribute to our continued success in the convenience hardware market:

Well-Regarded for Exceptional Customer Service and Convenience. Ace positions itself as "The Helpful Place" and our local Retailers differentiate themselves not only by providing high quality goods but also through their accessible, helpful and knowledgeable store staff. We believe that "The Helpful Place" is one of the most recognized slogans in the home improvement industry. In addition to helpfulness, we believe our Retailers benefit from their efficient store size and numerous, convenient locations. We believe that in comparison to larger home improvement centers and "big-box" competitors, Ace customers value our Retailers' accessible and friendly staff and the ease and speed with which they can find and purchase their desired products.

Strength of Distribution Operations. Our extensive distribution network includes 15 domestic RSCs as well as our fleet of tractors and trailers, which allows us to effectively supply our network of approximately 4,600 domestic stores. Our RSCs are equipped with information technology systems that efficiently manage and track inventory and contribute to the exceptional product availability and service levels that we have historically been able to offer to our retailer network. Our average service levels, or fill rates, were 96.3 percent and 96.2 percent for 2019 and 2018, respectively. We measure our fill rates as the percentage of units ordered that are shipped. Due to the global pandemic beginning in March 2020, supplier issues negatively impacted Ace's ability to meet the increased demand, resulting in a decrease in service levels for 2020 to 71.3 percent.

Ace's extensive distribution network is key to our Retailers' success. Our RSCs use an integrated information service system that enables us to monitor inventory turns and levels, and to forecast labor needs at various sales volumes. This system provides Ace with daily operational information and assists us in managing our inventory and workforce.

Ace transports products from our RSCs with our truck fleet of approximately 500 tractors and approximately 1,400 freight trailers. The size of the Company's owned and leased tractor-trailer fleet allows the Company to operate a significant backhaul business. Backhauling allows the Company to transport product from our suppliers to our crossdock facilities and our RSCs, reducing freight costs, shortening lead times and improving inventory turnover.

AWH is positioned to rapidly expand its footprint by leveraging existing Ace RSCs to become a national force for non-member retailers.

Consolidated Purchasing Enhances Competitiveness of our Retailers. Ace is able to obtain lower prices on products by pooling our Retailers' buying power. The Company further reduces Retailers' cost by importing many products directly from vendors. Under extended dating programs, the Company is given favorable payment terms on seasonal products, such as lawn and garden products and winter care products. The Company is able to pass along these extended terms to our Retailers, which helps with their working capital and cash flow.

Differentiated Product and Service Offerings. We attract and retain a strong base of experienced Retailers by offering a broad range of products at very competitive prices and assisting Retailers with improving their operational efficiency. Our Retailers and their customers value the selection of over 9,000 private label products available under the Ace brand and other proprietary brand names. We also offer our Retailers an extensive selection of some of the biggest brand names in the hardware industry including, but not limited to, Scotts® lawn and garden products, Weber®, Traeger® and Big Green Egg®grills, Stihl® and Toro® power equipment, and Yeti® coolers, many of which offer exclusive products and promotions only for Ace Retailers. Additional high-quality product offerings include Benjamin Moore® Paints which, together with Magnolia Home by Joanna Gaines® paint and Clark+Kensington® paint form our three-brand paint strategy.

Our service offerings allow our Retailers to benefit from best practices in all aspects of managing their business, including new store development, customer service, recommended pricing, inventory management, finance and insurance, labor scheduling and marketing. These services, in addition to ongoing educational and training programs, help enhance the overall efficiency and profitability of our Retailers' businesses and contribute to their loyalty to the Ace brand.

Diversified Network of Independent Retailers. We serve a geographically diverse network of Retailers who operate approximately 4,600 domestic stores located in all 50 states and the District of Columbia. This broad network of Retailers mitigates dependence on any one region of the country and reduces the impact of regional downturns. Moreover, the Company's performance is not reliant on any one Retailer. The largest Retailer owns 35 stores and represents approximately 1 percent of our merchandise sales. The Company's ten largest Retailers (by purchase volume) own 211 stores and represent approximately 7 percent of our merchandise sales. Ace-affiliated companies serve international retailers in approximately 65 foreign countries. In fiscal year 2020, approximately 4 percent of Ace's merchandise sales were made to locations outside the United States.

Long-Term, Stable Relationships with Retailers. We believe we benefit from the significant number of Retailers that are long-term members of the Ace cooperative. As of January 2, 2021, approximately 80 percent of our Retailers have been members for at least five years and approximately 62 percent and 41 percent have been members for at least 10 and 20 years, respectively.

Depth of Our Experienced Management Team. Our team of senior officers have extensive experience and long-term service with the Company. This group has an average of approximately 13 years of experience at Ace. In addition, we benefit from the functional expertise of our merchandise buying group, our retail support center managers and our extensive field support staff. Our leadership team has demonstrated its ability to manage Ace through past market cycles and has a successful track record of growing our business, delivering operational improvements and serving our Retailers.

Merchandise Sales to Our Network of Ace Domestic Retailers

Ace employs a business philosophy that focuses on purchasing high-quality products at the lowest cost available, providing high levels of customer service at retail stores and making strategic investments in our distribution network. This philosophy has enabled us to establish strong, long-term customer and Retailer relationships and to be viewed as a reliable and innovative performer in our respective markets.

We offer our Retailers a full line of hardware products including hand and power tools, plumbing and heating supplies, garden equipment, electrical supplies, housewares and appliances, and general merchandise such as paint, cleaning and related products. Items are regularly added to and deleted from our product lines based on market research, customer demand and sales volumes (at both wholesale and retail), recommendations of suppliers and other factors.

We offer approximately 114,000 Stock Keeping Units (SKUs), including nationally branded merchandise and private label products through our network of RSCs. Our extensive product line enables us to provide our Retailers with the majority of the products they need.

Ace sells merchandise to our Retailers in three ways:

- Warehouse sales of merchandise that we regularly carry in our inventory at our RSCs.
- Bulletin sales where we place a special order for merchandise after Retailers commit to buy specific quantities of it.
- Direct shipment sales where the merchandise is shipped directly to Retailers by vendors.

Warehouse sales involve the sale of merchandise that we stock at our RSCs. We purchase large quantities of merchandise (mainly from manufacturers), stock it in our RSCs and sell it in smaller lots to our Retailers. Most of these products are sold at a price based primarily on our cost, to which we add a variable handling charge of approximately 10 percent, plus freight charges. We maintain inventory quantities sufficient to meet normal replenishment orders, which enable us to keep our inventories at productive levels. Orders are usually filled within one day of receipt.

Warehouse sales accounted for approximately 80 percent of Ace's 2020 fiscal year domestic wholesale merchandise sales to Ace Retailers. The following is a breakdown of our total warehouse sales among various general classes of merchandise for each of the past three fiscal years:

Class of Merchandise	2020	2019	2018
Paint, cleaning and related supplies	19%	19%	20%
Plumbing and heating supplies	12	14	14
Garden, rural equipment and related supplies	18	17	17
Electrical supplies	8	9	9
Hand and power tools	12	11	11
General hardware	8	9	9
Grilling	7	5	4
Sundry	12	12	11
Housewares and small appliances	4	4	5

Bulletin sales (which are included in warehouse sales) involve special bulletin offers where we place a special order for merchandise after Retailers commit to buy specific quantities of it. Bulletin sales generally relate to retail promotional events and seasonal products and accounted for approximately 5 percent of Ace's 2020 fiscal year wholesale merchandise sales. We purchase merchandise for bulletin sales based upon Retailers' orders. When the bulletin shipment arrives, we break it up into smaller quantities and deliver it to the Retailers who ordered it. We generally apply a handling charge of approximately 6 percent to bulletin sales, plus freight charges.

Direct shipment sales include sales where the merchandise is shipped directly to Retailers by vendors. Direct shipment sales accounted for approximately 20 percent of Ace's 2020 fiscal year domestic wholesale merchandise sales to Ace Retailers. Retailers place direct shipment orders with our vendors. The vendors then bill Ace for these orders and ship the merchandise directly to Retailers. We, in turn, bill the ordering Retailers for the cost of the merchandise (including freight where applicable) plus a fixed percentage handling charge based on each Retailer's prior year direct shipment dollar volume. The handling charge begins at 2.0 percent and declines to 0.5 percent for those Retailers whose annual purchase volumes exceed $815,000. For vendors who participate in our ACENET Direct program, the handling charge is zero percent for direct shipment sales.

We charge freight to Retailers on all warehouse sales. The freight rate is billed as a fixed percentage of each Retailer's warehouse purchases. Additionally, a fuel surcharge may be applied to the freight charge if the national average cost of diesel exceeds

$2.05 per gallon based on an established matrix. Sales made by our affiliated companies to customers located outside of the continental United States may incur additional freight and handling charges related to ocean container transportation.

Private Label Programs

Our merchandise offering to our Retailers also includes privately labeled products. Ace's private label program provides our domestic Retailers with over 9,000 Ace private label and store branded SKUs. RSC sales of private label product were over $774 million in 2020. We have seven store brands in addition to Ace Brand, including: Celebrations, Fab Cordz, Grill Mark, Home Plus, Living Accents, Oak Brook and Steel Grip. Sales of all private brands represented approximately 14 percent of the Company's merchandise sales in 2020.

When choosing merchandise for the private label Ace brand, we target products that are not highly brand sensitive and offer our Retailers an opportunity to make more margin than the national brand equivalents. The Company purchases its private label products from over 290 suppliers on an item-specific basis. We ensure consistent quality in our private label products through various means including factory site visits, third-party laboratory testing for some products, and specific criteria for imported products. The Company changes suppliers from time to time when product quality or pricing improvements are available.

Retailer Conventions

Ace has historically hosted two conventions each year, one in the spring (usually early March) with an emphasis on Trim-a-Tree and holiday products, and one in the fall (usually in late September or early October) with an emphasis on lawn and garden products. The timing of these conventions offers Retailers ample time to prepare for the seasonal needs of the upcoming year. However, the conventions offer much more than a chance to get a jumpstart on seasonal needs. Year-round products are offered by hundreds of exhibitors, and Ace also hosts booths showcasing dozens of corporate services and programs. Speeches from Board members and corporate officers provide Retailers with key information, and valuable training sessions help Retailers and employees improve their business skills. A typical convention covers 820,000 square feet of display space and is visited by approximately 16,000 people. As a result of the global pandemic, the 2020 conventions were held virtually and the Spring 2021 convention will be as well.

Ace Service Offerings

In addition to hosting conventions as well as other shows and product exhibits for our Retailers, we also provide them with many special services. We offer all of these services at established charges. These services include inventory control systems, fact-based, market driven retail pricing recommendations, and a "checklist" service that provides current information about all of our product offerings. We also provide a choice of ongoing educational and training programs for Retailers. (See "Membership Information – Retailer Assessments and Charges.")

The Company's district and territory managers support Retailers with a detailed analysis of store operations, pricing, advertising, inventory control and merchandising plans to help Retailers enhance their competitive position. Other services we offer are provided through third party service providers. Our services include:

- *Pricing-Related Services*. While each of our Retailers determines the pricing strategy for his or her own stores, we offer Retailers an assortment of pricing-related services designed to help improve their gross margin dollars and enhance price competitiveness. These include services such as recommended localized pricing, item changes, as well as loyalty programs and promotions via electronic communications for each store.
- *Advertising.* We support Ace's strong brand name recognition by making significant investments in national television, audio (terrestrial radio and streaming), online marketing and digital display advertising. Lou Manfredini, a nationally known home improvement expert, serves as Ace's Home Expert. We provide tools to support our Retailers' regional and local advertising efforts. Ace offers a local marketing portal that our Retailers can use to create customized local marketing materials such as emails, postcards, billboards, signage and social and digital media assets. Retailers are able to download for free customizable TV and radio commercials.
- *Ace Rewards®*. To further promote the Ace brand name, Ace maintains a preferred customer loyalty program, Ace Rewards. The program is aimed at delivering consumer touch points which drive profitable revenues to Retailers and leverage the relationship between customers and their local Ace stores. As of January 2, 2021, Ace Rewards has approximately 54 million members. Average spending for Ace Rewards customers is higher than for non-Ace Rewards customers, as the average transaction amount for Ace Rewards customers is approximately 18 percent higher than non-Ace Rewards customers.
- *Market and Consumer Research.* We provide market and consumer research to our Retailers. In an effort to delineate the strengths and weaknesses of major competitors in the marketplace, the Company conducts consumer research on a national level. On the local level, the Company helps assess the trade area of existing stores, the potential of the trade area and the performance level of individual stores.

- *New Store Analysis.* In analyzing new or expanded store opportunities, the Company assists Retailers with site analysis, demographic information, store size and format recommendations, sales and other projections, décor, merchandising and advertising.
- *Bankcard Program.* We provide credit and debit card transaction processing for our Retailers. The Company acts as the merchant of record and processes credit and debit card settlements. Retailers' sales transactions are transmitted daily and automatically credited to their Ace statement.
- *Insurance Services.* Our wholly owned subsidiary, Ace Insurance Agency, Inc., provides a Retailer commercial insurance program. This program offers property, general liability, flood, business interruption, employment practices, rental, cyber, crime, wind and workers' compensation insurance. Ace Insurance Agency, Inc. is managed by experienced industry professionals and is licensed in all 50 states and the District of Columbia.
- *Analysis of Underperforming Stores.* The Company tracks the financial performance of all stores. When appropriate, we formulate marketing and operational recommendations targeted to improve individual store performance.
- *Retailer Credit.* Generally, the more collateral, guarantees or other evidence of financial strength, the higher the Ace credit limit for which that Retailer qualifies. We periodically review and establish credit limits for Retailers based on payment history and financial ratios, as well as other considerations relating to the performance of specific Retailers.
- *Retailer Loans.* The Company has various lending programs which are available to qualified Retailers. The notes bear interest at various rates based on market rates, the loan program or the Retailer's credit quality. Payments on these notes are primarily collected by the Company through the application of future patronage distributions, Retailer billings or stock repurchases.
- *Customer Insight Program.* The Company offers various optional services to Retailers to gain information about their customer service performance. The services include mystery shops (either in store, at a competitor, by telephone or by video) and customer and employee engagement surveys.
- *Visual Merchandising Services.* The Company offers visual merchandising services including the installation of fixtures and merchandising for new stores, conversions and remodels.
- *Workforce Management.* The Company offers Retailers the option to purchase a license and implement Workforce Management software. The software gives Retailers the ability to manage labor forecasts, scheduling, time and attendance.
- *Professional Retail Services.* The Company offers Retailers training programs (pre-opening and continuing) via in-store and virtual training and workshops to assist Retailers in addressing common Retailer processes and issues, including customer service, inventory management, store finances and operations.
- *Ace Hardware Corporation Cooperative Group Health Plan ("AHP").* The AHP is a multiple employer welfare arrangement ("MEWA") that provides medical insurance and other welfare benefits to employees of the Company and their families and employees and families of participating Ace Retailers that began January 1, 2020.

Other Ace Retailer Programs and Benefits

We offer other programs designed to maximize our Retailers' competitive position. These programs include:

- *New Store Incentives.* Ace's New Store Incentives help qualifying Retailers, including prospective conversion stores, open new locations by providing substantial merchandise credits in exchange for committing to remain an Ace Retailer for five years.
- *Payment Terms on Seasonal Merchandise.* Ace provides extended payment terms (datings) on seasonal and certain other merchandise purchases to assist Retailers with their cash flow. These datings are intended to allow the Retailer to capture the cash flow of the merchandise sale before being required to pay Ace.

Distribution

Ace's extensive distribution network is key to our Retailers' success. Our RSCs use an integrated information system that enables us to monitor inventory turns and levels, and to forecast labor needs at various sales volumes. This system provides Ace with daily operational information requirements and assists us in managing our inventory and workforce. Through this system, Ace is able to track every pallet of merchandise in our RSCs and coordinate our warehouse picking operation.

Ace also utilizes technology to ensure low cost distribution, including voice-picking and inbound and outbound radio frequency scanning. The result is improved order accuracy that enables most Retailers to avoid verifying quantities of merchandise received at the retail location. Additionally, our Retailers can check inventory availability, make special purchase requests and monitor prices on commodity items through ACENET, our intranet that serves as the primary communication vehicle between us and our Retailers.

Ace's RSC locations distribute merchandise to our Retailers in a timely fashion. Ace transports products from our RSCs with a truck fleet of approximately 500 tractors and approximately 1,400 freight trailers.

The size of the Company's owned and leased tractor-trailer fleet allows the Company to operate a significant backhaul business. Backhauling allows the Company to transport product from our suppliers to our crossdock facilities and our RSCs, reducing inbound freight costs, shortening lead times and improving inventory turnover. Our average RSC service levels, or fill rates, were 96.3 percent and 96.2 percent for 2019, and 2018, respectively. Due to the global pandemic beginning in March 2020, supplier issues negatively impacted Ace's ability to meet the increased demand, resulting in a decrease in service levels for 2020 to 71.3 percent.

Suppliers

Ace purchases merchandise from approximately 4,100 suppliers ranging from local companies to large corporations. No one supplier accounted for more than 4.1 percent of products purchased in fiscal 2020. Our top ten suppliers accounted for approximately 27.1 percent of our merchandise purchases in 2020. We maintain a staff of experienced merchants in each of our product departments who work closely with our suppliers.

Ace works with our suppliers to ensure a timely flow of products to our Retailers. We make RSC inventory and product sales information available electronically to suppliers who are then responsible for fulfilling orders complete and on time. As a result, we can maximize utilization of our RSC warehouse space and increase inventory turns.

Technology

Ace uses technology to maximize efficiency both in our Retailers' operations and in our RSCs. Among the computerized retail services developed or supported by Ace for our Retailers are: (i) retail store systems, including point-of-sale (POS) to manage pricing and product promotion; (ii) inventory, merchandising and pricing software (including category management and shelf-management); and (iii) other management information and productivity systems, including drop-ship support. Many in-store operations are enhanced and streamlined by using Ace supported programs. These programs include:

- Eagle for Windows – This third-party system is a distributed in-store computer that provides POS, inventory management, accounts receivable, accounts payable, general ledger and reporting capabilities. The system is provided directly from the vendor to Retailers, subject to the terms and fees included in an agreement between the vendor and Retailer. The system allows the Retailer to create computer-generated orders for stock replenishment, participate in the Ace Rewards customer loyalty program, and is integrated to a number of the enterprise systems at the Ace corporate headquarters.
- ACENET – This intranet site serves as the primary communication platform between Ace and our Retailers. In addition, a wealth of information such as product catalogs and special ordering functions can be accessed through this program. ACENET is a portal for the *Ace Way of Retailing,* which documents the best practices for operating an Ace store.
- www.acehardware.com – Ace Hardware's website is its branding, shopping and research solution for consumers, and it received over 231 million visits in 2020. The website offers online shoppers more than 80,000 SKUs that can be shipped directly to their home or to their local Ace store. Retailers are also able to create personalized web pages for their stores on this site. Using this website consumers can check product availability at their local Ace and if they choose, order online and pick up at their Ace store as early as the same day. If a product is not available at their local Ace store but is available in the Ace RSC, consumers can choose to have the product shipped to their local Ace store and delivered to their home by local Ace store personnel.

Ace has invested significantly in wholesale information technology to build and manage an enterprise architecture and high-speed telecommunications network that links manufacturers, wholesale distribution, Ace Retailers and consumers in the supply chain. We anticipate continued investment in technology for the foreseeable future.

Ace International

The first international Ace store opened in 1968 and since then we have developed a sizable international business. AIH has its own management team and board of directors. AIH is a majority-owned and controlled subsidiary of the Company with a noncontrolling interest owned by its international retailers. Ace-affiliated retailers located outside the U.S. do not own shares of stock in the Company nor do they receive patronage dividends.

AIH has retailer relationships in approximately 65 countries and U.S. territories. The major regions in which it does business include the Middle East, Caribbean, Latin America, the Pacific Rim and Asia. AIH plans to achieve its growth strategy by expanding into new markets and enhancing existing wholesale and retail support services for its international retailers.

The total number of retail outlets operated by AIH customers during each of the past three fiscal years is summarized in the following table:

	2020	2019	2018
Retail outlets at beginning of period	810	777	703
New retail outlets added	34	40	83
Retail outlets terminated	(28)	(7)	(9)
Retail outlets at end of period	816	810	777

AIH currently has offices located in Dubai, United Arab Emirates; Monterrey, Mexico; Panama City, Panama; and Shanghai, China, each providing in-country resources to international retailers in their respective regions. The China facility also serves as a buying office, sourcing direct-import products from Asia for both Ace domestic and international retailers. In addition, AIH manages warehouse operations through third-party providers located in Dubai, United Arab Emirates; Colon, Panama and Ningbo, China. These warehouses provide region-specific merchandise to AIH's retailers.

Currently, AIH operates two facilities in the U.S. that provide freight forwarding services to our affiliated international retailers: one is located in Medley, Florida and the other in Carson, California.

The Company's percentage of merchandise revenues by geographic region in fiscal years 2020, 2019 and 2018 are presented in the table below:

	2020	2019	2018
United States revenues	96.5%	95.4%	95.1%
Foreign revenues	3.5	4.6	4.9
Total revenues	100.0%	100.0%	100.0%

Trademark and Service Mark Registrations

The names "Ace Hardware" and "Ace" are used extensively by Retailers and us in the promotion, advertising and marketing of products and services that we and our Retailers sell. We have had various trademark and service mark registrations issued by the U.S. Patent and Trademark Office for these and other marks.

Employees

As of January 2, 2021, we had approximately 12,300 employees, of whom approximately 2,200 were salaried employees. In general, our employees are covered by non-negotiated benefit plans that include healthcare, death benefits and, with few exceptions, 401k retirement benefits.

Legal Proceedings

From time to time the Company is involved in various legal and administrative proceedings that are incidental to its business, including claims relating to product liability, general negligence, environmental issues, employment, intellectual property and other matters. It is not expected that the ultimate resolution of any of these matters will have, either individually or in the aggregate, a material adverse effect on the Company's consolidated financial position or results of operations.

Regulation

The Company is subject to federal, state and local laws and regulations governing businesses generally. Management believes that the Company is in substantial compliance with all federal, state and local laws and regulations governing its business.

Competition

The retail hardware business is highly fragmented and intensely competitive. Our Retailers' competitors include many large companies that have substantially greater market presence, name recognition, and financial, marketing and other resources than we or our Retailers do. The Company and its Retailers compete directly or indirectly with "big-box" home improvement centers (e.g., The Home Depot, Lowe's, Menards and others); retail hardware stores (e.g., True Value and Do It Best); regional lumber yards and builder-contractor shops (e.g., 84 Lumber and Carter Lumber); mass merchandisers, warehouse clubs and discount stores (e.g., Walmart, Sam's Club, Costco and Target); national, regional and local warehouse distributors such as Orgill and United Hardware; and catalog and Internet-based retailers (e.g., Amazon.com).

For over 95 years, Ace has successfully weathered competitive pressures and various economic cycles. We believe that Ace's longevity is due to our ability to adjust to changing market conditions and the diverse nature of our Retailer base.

The Company believes that its business strategy provides the Company and our Retailers with a significant competitive advantage. By leveraging the purchasing power of Ace's large Retailer base, we can obtain products at competitive prices from our vendors. In addition, the Company's Retailer-focused support services help our Retailers to compete in their local markets. The

Company believes that it achieves a significant competitive advantage by combining the purchasing and operating efficiencies from its centralized supply and support services with the local market flexibility and entrepreneurship of our independent Retailers.

The Company believes it can continue to compete successfully on the wholesale level and support the competitive efforts of our Retailers by continuing to provide them goods at competitive prices and the support services referred to above.

Properties

Ace's general offices are located at 2200 Kensington Court, Oak Brook, Illinois 60523. The following table lists our primary offices, distribution, warehousing and other facilities, and indicates whether each property is owned or leased.

Location	Square Feet of Facility	Owned or Leased
General Offices:		
Oak Brook, Illinois	206,030	Leased
Oak Brook, Illinois	35,254	Leased
Retail Support Centers:		
Wilton, New York	1,200,365	Owned
Princeton, Illinois	1,094,756	Owned
Fredericksburg, Pennsylvania	1,080,421	Leased
Rocklin, California	1,035,000	Owned
Prescott Valley, Arizona	905,445	Owned
Wilmer, Texas	900,870	Leased
West Jefferson, Ohio	843,108	Leased
Loxley, Alabama	798,698	Owned
Moxee, Washington	798,107	Leased
Colorado Springs, Colorado	721,668	Owned
Maumelle, Arkansas	597,253	Owned
LaCrosse, Wisconsin	591,254	Owned
Spokane, Washington	508,394	Leased
Gainesville, Georgia	481,013	Owned
Tampa, Florida	391,755	Owned
Freight Consolidation/Redistribution Facilities:		
Suffolk, Virginia	475,020	Leased
Kent, Washington	342,484	Leased
Carson, California	39,004	Leased
Summit, Illinois	37,236	Leased
Medley, Florida	34,020	Leased
Oakwood, Georgia	24,377	Leased
Fontana, California	24,156	Leased
St. Louis, Missouri	13,500	Leased
Bulk Distribution Centers:		
Joliet, Illinois	182,000	Leased
Lincoln, California	155,610	Leased
Aurora, Colorado	128,982	Leased
Flowery Branch, Georgia	114,240	Leased
Jacksonville, Arkansas	100,000	Leased
Tampa, Florida	48,000	Leased
Total distribution square feet	13,666,736	

We also lease divisional offices and storage space and own or lease a fleet of tractors, trailers and automobiles, as well as warehouse, computer and other equipment. The Company's ARH business leases 202 retail store locations ranging in size from 6,875 to 52,276 square feet.

COMPANY MANAGEMENT AND DIRECTORS

Members of the Board of Directors

The Company's business and affairs are governed by its Board of Directors. The current By-laws of the Company provide that the Board of Directors shall be comprised of no fewer than nine and no more than 12 directors, as fixed from time to time by the Board, and may consist of member directors and non-member directors. No fewer than eight of the directors shall be member directors. A maximum of 25 percent of the directors may be non-member directors.

The directors are divided into three classes, and each class of directors serves for a three-year term. The Board determines the number of directors in each class and the number of member directors and non-member directors who comprise each class. In no event may the term of any director exceed an aggregate of nine years, except that the Chairman may serve as a director for such additional time as shall be necessary to permit him or her to serve for up to five years as Chairman.

Each member director must be a stockholder or other equity owner of a retail business that owns capital stock of the Company or a manager, executive officer, general partner or general manager or other affiliate (as defined in the Company's current By-laws) of such retail business organization that owns capital stock of the Company.

As of March 1, 2021, the Board of Directors consists of ten directors: eight member directors and two non-member directors.

The Board of Directors held six formal meetings in 2020. No director attended fewer than 75 percent of the meetings of the Board and those committees on which he or she served during 2020. Directors are expected to attend annual meetings of stockholders. All incumbent directors attended the 2020 annual meeting of stockholders.

The Board of Directors acts collectively through meetings, committees and management members it appoints. In addition, the Company employs a staff of executives to manage the day-to-day business of the Company.

The members of the Board of Directors are identified below. Ages are as of March 1, 2021.

Name	Age	Position	Director Since	Term Expires
Directors				
Brett G. Stephenson	50	Chairman of the Board, Class I Member Director	2012	2021
Karen J. May	62	Class II Non-Member Director	2017	2023
Matthew V. Mazzone	44	Class II Member Director	2020	2023
Mark J. Schulein	51	Class II Member Director	2014	2023
David C. Barker	60	Class I Member Director	2018	2021
Richard W. Bennet III	68	Class I Non-Member Director	2014	2021
Steven H. Burggraf	52	Class III Member Director	2019	2022
Stewart C. Elliott Jr.	63	Class III Member Director	2013	2022
Kristin A. Grunder	48	Class III Member Director	2016	2022
Amy E. Kaplanis	51	Class III Member Director	2013	2022

Brett G. Stephenson is President of Ace Hardware Home Centers, Inc., a seven-store chain in Wyoming and Colorado, a position he has held since 2004. He was a national account executive for Starbucks Coffee Company from 2002 to 2004, and from 1993 to 2002, Mr. Stephenson was an employee of Ace Hardware Corporation, most recently as National Retail Operations Manager. He is an active member of Rocky Mountain Ace Stores where he serves as a board member. Mr. Stephenson earned a Bachelor of Science degree from Colorado State University. He is recognized as a Fellowship Director with the National Association of Corporate Directors.

Karen J. May joined the Board of Directors of Alcon, Inc., in 2019, a global eyecare company, and is the Chair of the Compensation Committee. She was a member of the Board of Directors, and the Chair of the Compensation Committee, of MB Financial, Inc., from 2004 until 2018 when the company was sold. From 2005 to 2018, Ms. May was Executive Vice President and Chief Human Resources Officer at Mondelez International, Inc. (whose name was changed from Kraft Foods, Inc. after the spinoff of selected Kraft North American businesses in 2012). Between 1990 and 2005, she held various positions in Human Resources and Finance at Baxter International Inc., including Chief Human Resources Officer, Vice President of Corporate Audit, Vice President, International Finance and Vice President of Finance (Controller) of the Hospital Supply Division. Prior to Baxter International Inc., Ms. May was a Certified Public Accountant in the audit practice of Price Waterhouse. Ms. May holds a Bachelor of Science in Accounting from the University of Illinois. Based on her extensive financial experience, Ms. May is qualified as an "audit committee financial expert" for SEC purposes.

Matthew V. Mazzone is President of Mazzone Hardware Corp., a four-store chain located in New York City. Three of the locations are Ace branded stores, and one location is an independently branded Benjamin Moore Paint Store. He obtained ownership of his family's business in 2003, and in 2013 joined Ace Hardware. He has been involved in many community organizations and events during his career, and in 2016 was named the Ace Hardware "All Star Retailer" for his work with The Children's Miracle Network Hospitals. During his time with Ace, Mr. Mazzone has served as a member of the Paint and CMN Retailer Input Teams, as well as the

Ace Retailer Group Leader Advisory Board. He also served on Benjamin Moore's local and national retailer advisory councils. Mr. Mazzone holds a Bachelor of Science degree in Business Management from St. John's University.

Mark J. Schulein is President of Crown Ace Hardware which owns or manages 21 stores across Southern California, Arizona and Hawaii, a position he has held since 2004. Mr. Schulein has worked in this family business since 1994. He is a member of Ace's Multi-Store Strategy Advisory Team, a founding member of the Progressive Ace Leaders and Pterodactyl Management Groups, and currently serves on the Board of Directors of Ace Hardware International Holdings, Ltd., a subsidiary of Ace. Mr. Schulein has a bachelor's degree from the University of San Diego and is a Fellow with the National Association of Corporate Directors.

David C. Barker is President of BBCO, LLC, a four-store chain located in Texas. In 2013, Mr. Barker became the owner of Spicewood Ace Hardware, located in Spicewood, Texas and since that time, opened three additional locations in the Austin, Texas, area. Mr. Barker is a member of the Board of Directors of Westlake Hardware, Inc., and Great Lakes Ace Hardware, Inc., wholly owned subsidiaries of Ace. From 2004 to 2013, Mr. Barker was Division Vice President for Dollar General, and from 2000 to 2003 he was Vice President – Information Systems of Everyday Stores. In 2009, Mr. Barker retired from the United States Air Force Reserve where he served as a logistics officer. Mr. Barker received a Bachelor of Arts degree in Business Information Systems from Saint Leo University.

Richard W. Bennet III is the Chief Executive Officer of CCA Global Partners ("CCA"), an international cooperative that provides retail infrastructure to over 3,000 independent and franchise operations in the flooring industry and other home improvement industries. He is also a member of the CCA Board of Directors and has prior experience as a member of both public and private company boards of directors. Mr. Bennet also has significant private equity experience and serves as the Executive Chairman of the Franklin Madison Group. He spent 27 years with May Department Stores, including serving as its Vice Chairman. Mr. Bennet received a Bachelor of Science degree in Business Administration from the University of Central Missouri and a Master of Business Administration degree from Washington University in St. Louis.

Steven H. Burggraf is President and Chief Executive Officer of ten Ace Hardware stores located in Minnesota and North Dakota, including Burggraf's Ace Hardware and Paint Company located in Grand Rapids, Minnesota, since 1989. Mr. Burggraf is active in several business and community organizations in the Grand Rapids area and serves on the Board of Directors of the Grand Rapids State Bank; the Minnesota Lakes Bank; the Grand Rapids Area Community Foundation, the Grand Itasca Clinic and Hospital, and The Northspan Group, Inc., a private, nonprofit business and community development consulting firm. He holds an Associate degree in Small Business Management and Sales and Marketing from the University of Minnesota.

Stewart C. Elliott Jr. is President of Elliott Ace Hardware, a four-store Ace chain located in the western suburbs of Milwaukee, Wisconsin, a position he has held since 1988. Prior to joining Elliott Ace Hardware, Mr. Elliott held a leadership sales role with Amerock, a vendor servicing the convenience hardware industry, for six years. Mr. Elliott is a member of the Board of Directors of Westlake Hardware, Inc., and Great Lakes Ace Hardware, Inc., wholly owned subsidiaries of Ace. He holds a Bachelor of Arts degree in Economics from the University of Michigan and is a National Association of Corporate Directors Governance Fellow.

Kristin A. Grunder is the co-owner of Rome Ace Hardware, a single Ace store located in Rome, New York, a position she has held since 1999. The store has been in operation since 1971. She has served as member of the Ace Paint RIT and as an Ace Retail Group Leader. Ms. Grunder has served on the Board of Directors of the Rome Hospital Foundation since 2013 and is a member of the Board of Trustees for the Rome Memorial Hospital. She graduated from Ithaca College with a Bachelor of Arts degree and is a National Association of Corporate Directors Governance Fellow.

Amy E. Kaplanis is the President of Country Ace Hardware, a single Ace store located in Granby, Colorado. She is a second generation Ace store owner who joined the business in 2006 and officially purchased the business from her parents in 2015. Prior to that, Ms. Kaplanis worked for Accenture, in its Consulting and Services practices, for nearly 10 years. Additionally, she worked for Black & Decker for six years. She is a member of the Rocky Mountain Ace Stores and was the 2010 NHRA Retailer Innovator of the Year for Training. She holds a Bachelor of Business Administration degree in International Business from George Washington University and a Master of Business Administration degree from the University of Denver. Ms. Kaplanis is also a National Association of Corporate Directors Governance Fellow.

Committees of the Board of Directors

The Board of Directors has five committees: Audit, Compensation and Human Resources, Finance, Retail Supply Chain and Nominating and Governance. Each holds regular meetings, generally in connection with scheduled Board meetings. Each committee operates under a written charter that may be found on ACENET, our intranet site, which is available and accessible by all Ace Retailers.

Audit Committee. The Audit Committee assists the Board in its oversight responsibilities with respect to the integrity of Ace's financial statements; Ace's compliance with legal and regulatory requirements; the effectiveness of internal controls and procedures; the independent auditors' qualifications and independence; and the performance of Ace's internal audit function and independent auditors. The Audit Committee met four times in 2020.

Compensation and Human Resources Committee. The Compensation and Human Resources Committee provides oversight and evaluation of the executive officers' relative pay, from both an internal and external point of view, and considers each officer's relative performance to support such compensation. This committee strives to ensure that our executives are compensated fairly compared to their peers within the retail sector. The Compensation and Human Resources Committee annually reviews data from Korn Ferry Retail Industry Total Remuneration Survey as its primary benchmark source of compensation data. The Compensation and Human Resources Committee met four times in 2020.

Finance Committee. The Finance Committee assists the Board in developing the Company's short and long-term financial goals, capital requirements, patronage distribution plan, credit policies and related matters. The Finance Committee met three times in 2020.

Retail Supply Chain Committee. The Retail Supply Chain Committee assists the Board in fulfilling its responsibilities relating to oversight of significant operational and retail focused initiatives affecting the Company and its Retailers. The Retail Supply Chain Committee met three times in 2020.

Nominating and Governance Committee. The Nominating and Governance Committee assists the Board in fulfilling its responsibilities with respect to corporate governance, Board organization and procedures, individual director and full Board performance evaluations and nomination of directors. The Nominating and Governance Committee met four times in 2020.

The Nominating and Governance Committee will consider nominees recommended by Retailers and its process for doing so is the same as its process for screening and evaluating candidates suggested by directors or management of the Company.

The procedures for election of directors to Ace's Board of Directors are set forth in the By-laws. The following describes the process of nominating board members from a practical perspective in layman's terms. It is, however, qualified in its entirety by reference to the By-laws.

The Nominating and Governance Committee maintains a list of potential candidates who have expressed interest, who have been recommended or who are otherwise believed to have the potential to contribute to the Board and the Ace enterprise. When a Board member is near to completing his or her term, it is customary for the Board to endorse a candidate to fill the seat in the next term. Endorsements are generally made at least four months – often six months in the case of continuing directors – prior to the annual meeting. Endorsements of continuing directors and Board member candidates are made by the full Board, after receiving a recommendation from the Nominating and Governance Committee.

Qualifications considered when evaluating potential candidates include their understanding of, and perceived likelihood of contributing to, the Ace enterprise at the Board level. Board members must be forward-thinking, innovative, articulate and financially astute. They must be able to think strategically versus tactically on a wide variety of issues. Participation in retailer groups, advisory groups, industry groups, etc., is desirable. A solid credit relationship, consistent with the "prompt payment" standards to which existing directors are held, is critical. Education and other outside experiences are also considered. Ultimately, a candidate must be able to perform financial and other oversight responsibilities and to engage in the formulation of the Company's strategic direction. Above all, candidates must have the ability to place the greater good of the organization and its Retailers generally over the needs or desire of any individual or special group. Because Board members are eligible to serve three terms, election to the Board is generally viewed as involving a nine-year commitment. Being a member of the Board requires a significant amount of effort and time to prepare for and attend meetings, Ace conventions and other events and otherwise to fulfill one's responsibilities.

It is also possible for an Ace Retailer to nominate himself or herself or another eligible person for election to the Board by giving written notice to the Secretary of the Company no less than 150 days before the annual meeting, in accordance with the specific requirements of the By-laws, and then nominating that individual at the annual meeting. Such a nominee would, in effect, run against the Board-endorsed candidate(s).

The table below provides membership information for each of the Board committees:

Name	Audit	Compensation and Human Resources	Finance	Nominating and Governance	Retail Supply Chain
Dave C. Barker			X	X	X
Richard W. Bennet, III		Chair			X
Steven H. Burggraf	X		Chair	X	
Stewart C. Elliott, Jr.	X		X	X	
Kristin A. Grunder	X		X	Chair	
Amy E. Kaplanis		X			Chair
Matthew V. Mazzone			X	X	X
Karen J. May	Chair	X			
Mark J. Schulein		X			X
Brett G. Stephenson	X	X			

How to Communicate with the Board of Directors

Any Ace stockholder that wishes to communicate with the Board of Directors may do so by sending a written communication addressed to the Board or to any director in care of Ace Hardware Corporation, 2200 Kensington Court, Oak Brook, IL 60523, Attention: Chairman. Stockholders also may contact a director directly by written communication, telephone or e-mail. Store contact information, telephone number and e-mail address for each director can be found on ACENET. Any communication addressed to a director received at Ace's corporate headquarters will be forwarded to such director as soon as practicable. Ace's practice is to forward all communications received from holders of its capital stock that are addressed simply to the Board of Directors to the chairman of the committee of the Board whose purpose and function is most closely related to the subject matter of the communication.

Senior Management

The Company's executive officers are identified below. Ages are as of March 1, 2021.

Name	Age	Position
John S. Venhuizen	50	President and Chief Executive Officer
Lori L. Bossmann	60	Executive Vice President, Chief Supply Chain Officer
William M. Guzik	61	Executive Vice President, Chief Financial Officer and Chief Risk Officer
John J. Surane	52	Executive Vice President, Chief Merchandising & Sales Officer
Kane C. Calamari	54	Senior Vice President, Chief Human Resources Officer
Kimberly S. Lefko	47	Senior Vice President, Chief Marketing Officer
Brian R. Wiborg	48	Senior Vice President, Merchandising
Richard G. Williams	55	Senior Vice President, Information Technology
Kirk E. Armstrong	56	Vice President, Retail Support & Supply Chain Innovation
J. Andrew Enright	38	Vice President, Retail Development & Strategy
Kerilyn M. Johnson	50	Vice President, General Counsel and Secretary
William R. Kiss, III	51	Vice President, Digital, Social & CRM
John H. Kittell	50	Vice President, Retail Operations & New Business
Steven G. Locanto	54	Vice President, Controller

John S. Venhuizen was named President and Chief Executive Officer in April 2013.

Lori L. Bossmann was named Executive Vice President, Chief Supply Chain Officer in May 2018. She was the Executive Vice President, Supply Chain, Inventory, Retail Support and Loss Prevention from June 2017 to May 2018. She was the Executive Vice President, Supply Chain and Retail Support from January 2014 to June 2017.

William M. Guzik was named Executive Vice President, Chief Financial Officer and Chief Risk Officer in January 2014.

John J. Surane was named Executive Vice President, Chief Merchandising and Sales Officer in May 2018. He was Executive Vice President, Merchandising, Retail Operations, Business to Business and Wholesale Holdings from January 2017 to May 2018. He was the Executive Vice President, Marketing, Merchandising and Sales from January 2014 to December 2016.

Kane C. Calamari was named Senior Vice President, Chief Human Resources Officer in May 2018. He was Senior Vice President, Human Resources, Organizational Development and Communications from December 2017 to May 2018. He was Vice President, Human Resources, Organizational Development, Communications and Customer Care from June 2015 to November 2017.

Kimberly S. Lefko joined Ace as the Senior Vice President, Chief Marketing Officer in July 2018. Prior to joining the Company, Ms. Lefko was the Chief Marketing Officer of Weber Stephen Products from June 2013 to December 2017.

Brian R. Wiborg was named Senior Vice President, Merchandising in July 2020. He was our Vice President, Merchandising from June 2018 to June 2020. He was Vice President of Marketing, Retail Training and Store Operations from January 2017 to June 2018. He was our Vice President, Retail Development and Supply from December of 2014 to December 2016.

Richard G. Williams was named Senior Vice President, Information Technology in February 2021. He was our Vice President, Information Technology from May 2015 to January 2021.

Kirk E. Armstrong joined Ace as the Vice President, Retail Support and Supply Chain Innovation in October 2019. Prior to joining the Company, he was Senior Vice President, Operations and Supply Chain of Owens and Minor, Inc. from May 2018 to October 2019. Mr. Armstrong was the Senior Vice President, Supply Chain Operations and Logistics for Essendant, Inc. from September 2003 to March 2018.

J. Andrew Enright was named Vice President, Retail Development & Strategy in March 2019. He was Senior Director, Retail Development from July 2018 to March 2019. He was Director, Retail Analytics from May 2017 to June 2018. He was One to One Channel Marketing Manager from July 2016 to April 2017. He was CRM Analytics Manager from August 2014 to June 2016.

Kerilyn M. Johnson was named Vice President, General Counsel and Secretary in April 2017. She joined Ace in 2013 as Senior Corporate Counsel and was promoted to Assistant General Counsel in 2015.

William R. Kiss III was named Vice President, Digital, Social & CRM in May 2018. From June 2016 to April 2018, he was Senior Director, Head of Ecommerce, Digital Marketing & Omni-Channel Strategy. Prior to joining Ace, he was the Chief Marketing Officer for Sears Holding Company.

John H. Kittell was named our Vice President, Retail Operations and New Business in December 2020. He was Director, Business Development and Retention from January 2018 to November 2020. From October 2016 to December 2017 he was the Director, Retail Operations – Eastern Division. From February 2014 to September 2016 he was Director, Retail Operations and Regional Buying.

Steven G. Locanto was named Vice President, Controller in December 2019. He was our Corporate Controller from November 2014 to November 2019.

Report of Independent Auditors

The Board of Directors
Ace Hardware Corporation

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Ace Hardware Corporation, which comprise the consolidated balance sheets as of January 2, 2021 and December 28, 2019, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the three fiscal years in the period ended January 2, 2021, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Ace Hardware Corporation at January 2, 2021 and December 28, 2019, and the consolidated results of its operations and its cash flows for each of the three fiscal years in the period ended January 2, 2021, in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

Chicago, Illinois
February 15, 2021

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

	January 2, 2021	December 28, 2019
Assets		
Cash and cash equivalents	$ 28.9	$ 18.2
Marketable securities	63.2	59.5
Receivables, net of allowance for doubtful accounts of $4.8 and $5.4, respectively	527.7	486.5
Inventories	1,133.0	930.8
Prepaid expenses and other current assets	55.1	45.5
Total current assets	1,807.9	1,540.5
Property and equipment, net	423.3	381.7
Operating lease right-of-use assets, net	455.5	-
Finance lease right-of-use assets, net	25.0	-
Goodwill and other intangible assets	100.3	90.5
Other assets	90.9	115.3
Total assets	$ 2,902.9	$ 2,128.0
Liabilities and Equity		
Current maturities of long-term debt	$ 31.7	$ 67.0
Accounts payable	1,109.4	791.8
Patronage distributions payable in cash	112.9	70.4
Patronage refund certificates payable	26.6	17.4
Current operating lease liabilities	64.5	-
Current finance lease liabilities	3.7	-
Accrued expenses	237.5	205.9
Total current liabilities	1,586.3	1,152.5
Long-term debt	24.8	209.9
Patronage refund certificates payable	95.3	107.3
Long-term operating lease liabilities	412.2	-
Long-term finance lease liabilities	20.8	-
Other long-term liabilities	73.6	92.5
Total liabilities	2,213.0	1,562.2
Member Retailers' Equity:		
Class A voting common stock, $1,000 par value, 10,000 shares authorized, 2,689 and 2,691 issued and outstanding, respectively	2.7	2.7
Class C nonvoting common stock, $100 par value, 10,000,000 shares authorized, 5,015,306 and 4,827,851 issued and outstanding, respectively	501.5	482.7
Class C nonvoting common stock, $100 par value, issuable to retailers for patronage distributions, 1,191,050 and 546,146 shares issuable, respectively	119.1	54.6
Contributed capital	19.0	18.8
Retained earnings (accumulated deficit)	32.3	(8.7)
Accumulated other comprehensive income	3.0	0.9
Equity attributable to Ace member retailers	677.6	551.0
Equity attributable to noncontrolling interests	12.3	14.8
Total equity	689.9	565.8
Total liabilities and equity	$ 2,902.9	$ 2,128.0

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(In millions)

	Years Ended		
	January 2, 2021 (53 Weeks)	**December 28, 2019 (52 Weeks)**	**December 29, 2018 (52 Weeks)**
Revenues:			
Wholesale revenues	$ 7,011.2	$ 5,564.5	$ 5,341.6
Retail revenues	751.5	506.7	375.4
Total revenues	7,762.7	6,071.2	5,717.0
Cost of revenues:			
Wholesale cost of revenues	6,132.1	4,898.6	4,707.4
Retail cost of revenues	417.1	280.0	214.5
Total cost of revenues	6,549.2	5,178.6	4,921.9
Gross profit:			
Wholesale gross profit	879.1	665.9	634.2
Retail gross profit	334.4	226.7	160.9
Total gross profit	1,213.5	892.6	795.1
Wholesale operating expenses:			
Distribution operations expenses	220.9	178.2	163.7
Selling, general and administrative expenses	210.8	195.1	187.7
Retailer success and development expenses	194.3	166.8	159.1
Retail operating expenses	253.1	201.5	154.4
Retail pre-opening expenses	1.3	8.7	1.7
Goodwill impairment charge	-	8.5	-
Total operating expenses	880.4	758.8	666.6
Operating income	333.1	133.8	128.5
Interest expense	(19.1)	(22.7)	(20.4)
Interest income	3.6	6.9	9.6
Other income, net	4.3	10.8	8.0
Income tax (expense) benefit	(5.0)	11.6	2.5
Net income	316.9	140.4	128.2
Less Net (loss) income attributable to noncontrolling interests	(0.7)	-	0.5
Net income attributable to Ace Hardware Corporation	$ 317.6	$ 140.4	$ 127.7
Patronage distributions accrued	$ 292.9	$ 182.2	$ 141.8
Patronage distributions accrued for third party retailers	$ 275.4	$ 172.5	$ 135.4

See accompanying notes to the consolidated financial statements.

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

	Years Ended		
	January 2, 2021 (53 Weeks)	**December 28, 2019 (52 Weeks)**	**December 29, 2018 (52 Weeks)**
Net income	$ 316.9	$ 140.4	$ 128.2
Other comprehensive income (loss), net of tax:			
Unrealized gain (loss) on investments	1.9	1.5	(6.5)
Unrealized gain (loss) on derivative financial instrument	0.2	(0.8)	1.1
Total other comprehensive income (loss), net	2.1	0.7	(5.4)
Comprehensive income	319.0	141.1	122.8
Less Comprehensive (loss) income attributable to noncontrolling interests	(0.7)	-	0.5
Comprehensive income attributable to Ace Hardware Corporation	$ 319.7	$ 141.1	$ 122.3

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION
CONSOLIDATED STATEMENTS OF EQUITY
(In millions)

	Shareholders of Ace Hardware Corporation								
	Capital Stock								
	Class A	Class C	Class C Stock Issuable to Retailers for Patronage Dividends	Additional Stock Subscribed	Contributed Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Total Equity
Balances at December 30, 2017	$ 2.7	$ 441.3	$ 48.9	$ -	$ 18.3	$ 33.2	$ 3.5	$ 13.0	$ 560.9
Net income	-	-	-	-	-	127.7	-	0.5	128.2
Other comprehensive loss	-	-	-	-	-	-	(5.4)	-	(5.4)
Net payments on subscriptions	-	-	-	1.2	-	-	-	-	1.2
Stock issued	0.1	49.1	(48.9)	(1.2)	-	-	-	-	(0.9)
Change in noncontrolling interests	-	-	-	-	(0.2)	-	-	0.7	0.5
Stock repurchased	(0.1)	(25.6)	-	-	-	-	-	-	(25.7)
Patronage distributions issuable	-	-	44.0	-	-	-	-	-	44.0
Patronage distributions payable	-	-	-	-	-	(135.4)	-	-	(135.4)
Adoption of accounting standard	-	-	-	-	-	(0.7)	0.7	-	-
Other	-	-	-	-	0.4	-	-	-	0.4
Balances at December 29, 2018	$ 2.7	$ 464.8	$ 44.0	$ -	$ 18.5	$ 24.8	$ (1.2)	$ 14.2	$ 567.8
Net income	-	-	-	-	-	140.4	-	-	140.4
Other comprehensive income	-	-	-	-	-	-	0.7	-	0.7
Net payments on subscriptions	-	-	-	1.1	-	-	-	-	1.1
Stock issued	0.1	43.8	(44.0)	(1.1)	-	-	-	-	(1.2)
Change in noncontrolling interests	-	-	-	-	(0.2)	-	-	0.6	0.4
Stock repurchased	(0.1)	(25.9)	-	-	-	-	-	-	(26.0)
Patronage distributions issuable	-	-	54.6	-	-	-	-	-	54.6
Patronage distributions payable	-	-	-	-	-	(172.5)	-	-	(172.5)
Adoption of accounting standard	-	-	-	-	-	(1.4)	1.4	-	-
Other	-	-	-	-	0.5	-	-	-	0.5
Balances at December 28, 2019	$ 2.7	$ 482.7	$ 54.6	$ -	$ 18.8	$ (8.7)	$ 0.9	$ 14.8	$ 565.8
Net income	-	-	-	-	-	317.6	-	(0.7)	316.9
Other comprehensive income	-	-	-	-	-	-	2.1	-	2.1
Net payments on subscriptions	-	-	-	1.1	-	-	-	-	1.1
Stock issued	0.1	54.3	(54.6)	(1.1)	-	(0.1)	-	-	(1.4)
Change in noncontrolling interests	-	-	-	-	-	-	-	(0.3)	(0.3)
Stock repurchased	(0.1)	(35.5)	-	-	-	-	-	-	(35.6)
Patronage distributions issuable	-	-	119.1	-	-	-	-	-	119.1
Patronage distributions payable	-	-	-	-	-	(275.4)	-	-	(275.4)
Other	-	-	-	-	0.2	(1.1)	-	(1.5)	(2.4)
Balances at January 2, 2021	$ 2.7	$ 501.5	$ 119.1	$ -	$ 19.0	$ 32.3	$ 3.0	$ 12.3	$ 689.9

See accompanying notes to the consolidated financial statements.

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

	Years Ended		
	January 2, 2021 (53 Weeks)	**December 28, 2019 (52 Weeks)**	**December 29, 2018 (52 Weeks)**
Operating Activities			
Net income	$ 316.9	$ 140.4	$ 128.2
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	64.9	60.1	55.7
Goodwill impairment charge	-	8.5	-
Amortization of deferred financing costs	0.4	0.4	0.5
Loss (gain) on disposal of assets, net	0.9	(5.5)	(4.9)
Credit for doubtful accounts	(0.2)	(0.9)	(0.3)
Other, net	2.5	0.8	1.1
Changes in operating assets and liabilities, exclusive of effect of acquisitions:			
Receivables	(73.2)	(69.7)	(45.2)
Inventories	(194.6)	30.0	(144.6)
Other current assets	(9.6)	4.2	(8.9)
Other long-term assets	9.5	(9.8)	6.7
Accounts payable and accrued expenses	337.3	56.2	66.6
Other long-term liabilities	3.9	12.9	10.9
Deferred taxes	2.5	(13.6)	(2.1)
Net cash provided by operating activities	461.2	214.0	63.7
Investing Activities			
Purchases of marketable securities	(22.2)	(46.5)	(27.8)
Proceeds from sale of marketable securities	20.8	41.4	25.4
Purchases of property and equipment	(99.0)	(76.5)	(61.1)
Cash paid for acquired businesses, net of cash acquired	(21.5)	(22.5)	(18.5)
Proceeds from sale of assets	0.2	22.0	0.1
Other, net	(7.1)	(9.8)	(7.0)
Net cash used in investing activities	(128.8)	(91.9)	(88.9)
Financing Activities			
Net (payments) borrowings under revolving lines of credit	(224.9)	(58.0)	104.8
Principal payments on long-term debt	(10.7)	(10.9)	(11.0)
Payments of debt issuance costs	-	(1.3)	-
Payments of cash portion of patronage distribution	(66.2)	(51.3)	(58.0)
Payments of patronage refund certificates	(9.7)	(5.3)	(6.4)
Repurchase of stock	(4.8)	(3.8)	(2.5)
Purchase of noncontrolling interests	(3.0)	(0.2)	(0.2)
Other, net	(2.4)	1.3	1.1
Net cash (used in) provided by financing activities	(321.7)	(129.5)	27.8
Increase (decrease) in cash and cash equivalents	10.7	(7.4)	2.6
Cash and cash equivalents at beginning of period	18.2	25.6	23.0
Cash and cash equivalents at end of period	$ 28.9	$ 18.2	$ 25.6
Supplemental disclosure of cash flow information:			
Interest paid	$ 16.6	$ 20.2	$ 17.7
Income taxes paid	$ 12.4	$ 1.4	$ 2.1

See accompanying notes to the consolidated financial statements.

(1) Summary of Significant Accounting Policies

The Company and Its Business

Ace Hardware Corporation ("the Company") is a wholesaler of hardware, paint and other related products. The Company also provides to its retail members ("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 20.7 percent noncontrolling interest owned by its international retailers. International retailers do not own shares of stock in the Company nor receive patronage dividends.

Ace Retail Holdings LLC ("ARH") is the owner of the 145 store Westlake Ace Hardware ("Westlake") and the 57 store Great Lakes Ace Hardware, Inc. ("GLA") retail chains. As a result, the Company is also a retailer of hardware, paint and other related products.

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

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

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

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). The Company's fiscal year ends on the Saturday nearest December 31. Accordingly, fiscal years 2020, 2019 and 2018 ended on January 2, 2021, December 28, 2019 and December 29, 2018, respectively. Unless otherwise noted, all references herein for the years 2020, 2019 and 2018 represent fiscal years ended January 2, 2021, December 28, 2019 and December 29, 2018, respectively. Fiscal year 2020 consists of 53 weeks. Fiscal years 2019 and 2018 consisted of 52 weeks each.

Subsequent events have been evaluated through February 15, 2021, the date these statements were issued.

Principles of Consolidation

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

Use of Estimates

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

Cash, Cash Equivalents and Marketable Securities

In the normal course of business, the Company has outstanding checks that exceed the cash balances in the Company's bank accounts, which create a book overdraft that are recorded as a liability. As of January 2, 2021 and December 28, 2019, the Company had outstanding checks in excess of bank balances totaling $92.4 million and $70.2 million, respectively, which have been included in accounts payable in the accompanying consolidated balance sheets. These outstanding amounts were subsequently funded through cash receipts and borrowings under the Company's debt facilities during the following fiscal year.

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

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

In the normal course of NAIL's operations, standby letters of credit totaling $14.3 million and $11.0 million at January 2, 2021 and December 28, 2019, respectively, were issued in favor of the insurance companies that reinsure a portion of NAIL's loss exposure. At January 2, 2021, NAIL has pledged substantially all of its cash and cash equivalents and marketable securities as collateral for these letters of credit. In fiscal 2019, the Company created a multiemployer welfare association (MEWA) to offer medical insurance and other welfare benefits to employees of the Company and Retailers and their employees at participating Ace retail locations, beginning January 1, 2020. The Company was required to provide a $10.0 million standby letter of credit to the State of Vermont in connection with the MEWA. See Note 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. Generally, customer billings for warehouse merchandise occur in bi-weekly intervals subsequent to revenue recognition. The Company considers shipping and handling as activities to fulfill its performance obligation for warehouse merchandise revenues. Billings for freight are accounted for as Revenues and shipping and handling costs are accounted for in Cost of revenues.

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

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

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

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

(In millions)

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

	Years Ended	
	January 2, 2021	December 28, 2019
Warehouse merchandise	$ 5,175.2	$ 4,125.2
Direct shipment merchandise	1,337.7	1,136.1
ARH revenues	704.4	466.9
E-commerce	303.8	111.2
Service revenues	267.6	258.9
Amortization of sales allowances under retailer incentive programs	(26.0)	(27.1)
Total revenues	$ 7,762.7	$ 6,071.2

Receivables

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

Notes Receivable

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

Allowance for Doubtful Accounts

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

Inventories

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

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

Vendor Funds

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

Vendor funds are treated as a reduction of inventory cost, unless they represent a reimbursement of specific, incremental and identifiable costs incurred by the 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.

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

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

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

Goodwill and Other Intangible Assets

Goodwill represents the excess of the cost of an acquired business over the fair value of the net tangible assets acquired and identified intangible assets. Goodwill is not amortized but is tested for impairment at a reporting unit level on an annual basis or more frequently, if circumstances change or an event occurs that would more likely than not reduce the fair value of a reporting unit below its carrying amount. See Note 8 for additional information regarding the Company's annual goodwill impairment testing.

The Company's other intangible assets primarily relate to trademarks, tradenames, customer and vendor relationships and developed technology. The intangibles are amortized over their estimated useful lives. See Note 8 for additional information.

Internal-Use Software

Included in fixed assets is the capitalized cost of internal-use software. The Company capitalizes costs incurred during the application development stage of internal-use software and amortizes these costs over its estimated useful life. Costs incurred related to design or maintenance of internal-use software are expensed as incurred. For fiscal year 2020, 2019 and 2018, the Company capitalized $10.4 million, $10.8 million and $8.1 million, respectively, of software development costs related to internal programming time. Amortization of these capitalized costs was $5.2 million, $4.1 million and $3.0 million for fiscal 2020, 2019 and 2018, respectively. As of January 2, 2021 and December 28, 2019, the Company had $4.4 million and $2.3 million, respectively, of capitalized costs for internal-use software that had not been placed into service.

Leases

The Company leases certain warehouse and distribution space, office space, retail locations, equipment and vehicles. On December 29, 2019, the first day of fiscal 2020, the Company adopted Accounting Standards Update ("ASU") No. 2016-02, "Leases (Topic 842)" which requires these leases to be recognized on the balance sheet (see Note 6 for additional details on the adoption of Topic 842). The Company elected to exclude the recognition requirements for short-term leases in all asset categories.

The Company also elected 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. Original terms for the Company's leases are generally between 3 and 25 years. 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.

Advertising Expense

The Company expenses advertising costs when incurred. Gross advertising expenses amounted to $240.7 million, $209.2 million, and $207.6 million in fiscal 2020, 2019 and 2018, respectively.

Gift Cards

The Company sells gift cards to customers through its Retailers, the Company website and select third parties. The gift cards do not expire. A liability is initially established for the value of the gift card when sold. Gift card breakage income is recognized proportionately as redemption occurs at the approximate monthly redemption rate and represents the balance of gift cards for which the Company believes the likelihood of redemption by the customer is remote. The breakage income calculation takes into account any legal obligation to remit the unredeemed portion to relevant jurisdictions. During fiscal years 2020, 2019 and 2018, the Company recognized gift card breakage income of $3.4 million, $1.1 million and $2.1 million, respectively. The Company does not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions that we use to record breakage.

Retirement Plans

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

Income Taxes

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

Self-Insurance

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

Concentration of Credit Risk

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

Impact of New Accounting Standards

Recently issued accounting pronouncements that are not yet effective and that were not discussed in the Company's 2019 Annual Report or 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 February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-02, "Leases (Topic 842)" along with amendments issued through 2019. The guidance requires that lessees recognize assets and liabilities for leases with lease terms greater than twelve months in the statement of financial position. The guidance also requires improved disclosures to help users of financial statements better understand the amount, timing and uncertainty of cash flows arising from leases.

On December 29, 2019 ("the effective date"), the Company adopted ASU 2016-02 and subsequent updates, collectively referred to as Topic 842, using the modified retrospective approach. In addition, the Company elected the package of practical expedients in transition, which permits the Company to not reassess prior conclusions pertaining to lease identification, lease classification and initial direct costs on leases that commenced prior to the adoption of the new standard. The Company also elected to treat the lease and non-lease components of leases as a single lease component and to exempt leases with an initial term of twelve months or less from balance sheet recognition.

As a result of adopting Topic 842, the Company recognized net operating right-of-use assets and operating lease liabilities of $454.2 million as of December 29, 2019. The adoption of the standard did not have a material impact on the Company's results of operations or cash flows. See Note 6 for additional details of the Company's leases.

(In millions)

New Accounting Pronouncements - Issued

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

(2) Acquisitions

During the year ended January 2, 2021, ARH acquired additional retail stores for consideration of $21.8 million, prior to working capital adjustments. These acquisitions resulted in ARH recording $13.4 million of goodwill. Goodwill has an indefinite life and, therefore, is not amortized. The goodwill is expected to be deductible for tax purposes.

(3) Receivables, net

Receivables, net include the following amounts:

	January 2, 2021	December 28, 2019
Trade	$ 395.6	$ 411.1
Other	120.4	64.5
Notes receivable – current portion	16.5	16.3
Less allowance for doubtful accounts	(4.8)	(5.4)
Receivables, net	$ 527.7	$ 486.5

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

(4) Inventories

Inventories consist of wholesale merchandise inventories held for sale to customers and retail merchandise inventory held for resale at ARH retail locations and at AEH's warehouse locations. Substantially all of the Company's wholesale inventories are valued on the LIFO method. The excess of replacement cost over the LIFO value of inventory was $109.1 million and $104.5 million at January 2, 2021 and December 28, 2019, respectively. Inventories at retail locations operated by ARH and at AEH's warehouses are valued at the lower of cost or net realizable value. Inventory cost is determined using the moving average method, which approximates the FIFO method. The Company regularly reviews its inventory and establishes a reserve for excess and obsolete inventory based on a number of factors, including historical sales, sales forecasts, obsolescence due to technology changes and defective goods.

Inventories consisted of:

	January 2, 2021	December 28, 2019
Wholesale merchandise inventory (LIFO)	$ 973.6	$ 773.9
Retail merchandise inventory at ARH stores and AEH warehouses (FIFO)	159.4	156.9
Inventories	$ 1,133.0	$ 930.8

(In millions)

(5) Property and Equipment, net

Property and equipment, net is summarized as follows:

	January 2, 2021	December 28, 2019
Land	$ 14.7	$ 14.7
Buildings and improvements	297.9	294.6
Warehouse equipment	226.7	186.9
Computer hardware and software and other office equipment	371.2	343.9
Transportation equipment	41.5	39.1
Leasehold improvements	63.1	56.3
Assets under construction	19.6	5.1
Property and equipment, gross	1,034.7	940.6
Accumulated depreciation and amortization	(611.4)	(558.9)
Property and equipment, net	$ 423.3	$ 381.7

Depreciation and amortization expense related to property and equipment for fiscal years 2020, 2019 and 2018 was $60.9 million, $55.1 million and $50.0 million, respectively.

(6) Leases

The Company leases certain warehouse and distribution space, office space, retail locations, equipment and vehicles under finance and operating leases. The Company determines if an arrangement is a lease at inception and recognizes a lease liability and right-of-use ("ROU") asset in the Company's Consolidated Balance Sheets upon commencement of a lease. Operating and finance lease assets represent the right to use an underlying asset for the lease term. Operating and finance lease liabilities represent the obligation to make lease payments arising from the lease. These assets and liabilities are recognized based on the present value of future payments over the lease term at commencement date which is the date the Company takes possession or control of the property or equipment. The Company has elected to use a risk-free discount rate at commencement date based upon the lease term.

Original terms for facility-related leases are generally between 5 and 25 years. Original terms for equipment and vehicle leases are generally between 3 and 7 years. The Company generally does not include options to extend or terminate leases unless it is reasonably certain that the option will be exercised.

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. The Company's lease agreements do not contain any material restrictions, covenants, or any material residual value guarantees.

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

	Income Statement Classification	January 2, 2021
Finance lease amortization	Cost of revenues	$ 2.9
Finance lease interest	Interest expense	0.1
Operating lease cost, net of sublease income	Cost of revenues, operating expenses	93.4
Short-term lease cost	Cost of revenues, operating expenses	6.6
Variable lease cost	Cost of revenues, operating expenses	20.4
Net lease cost		$ 123.4

(In millions)

The future minimum undiscounted lease payments under operating and finance leases at January 2, 2021 are as follows:

Fiscal Year	Operating Leases	Finance Leases
2021	$ 83.3	$ 4.7
2022	74.5	4.7
2023	67.3	4.6
2024	61.2	4.6
2025	51.5	4.5
Thereafter	170.5	1.8
Total future undiscounted lease payments	508.3	24.9
Less imputed interest	(31.6)	(0.4)
Total reported lease liability	476.7	24.5
Less current portion	(64.5)	(3.7)
Long-term lease liabilities	$ 412.2	$ 20.8

Additionally, the Company has excluded approximately $94.2 million of leases (undiscounted basis) that have not yet commenced. These leases will commence in 2021 with lease terms of up to fifteen years.

Other information related to operating and finance leases for the twelve months ended January 2, 2021, was as follows:

Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	$ (93.8)
Operating cash flows from finance leases	$ (3.5)
Lease assets obtained in exchange for new lease liabilities:	
Operating leases	$ 85.8
Finance leases	$ 27.9
Weighted average remaining lease term for operating leases	8.0 years
Weighted average discount rate for operating leases	1.53%
Weighted average remaining lease term for finance leases	5.5 years
Weighted average discount rate for finance leases	0.65%

Prior to the adoption of Topic 842, the Company's operating leases were accounted for under previous lease guidance. The future minimum lease payments under operating leases having initial or remaining non-cancellable lease terms in excess of one year were previously disclosed in our fiscal 2019 Annual Report in Note 15, Commitments and Contingencies and were as follows:

Fiscal Year	As of December 28, 2019
2020	$ 84.2
2021	71.6
2022	60.9
2023	55.3
2024	49.0
Thereafter	200.6
Minimum lease payments	$ 521.6

(In millions)

(7) Notes Receivable, net

The Company makes available to its Retailers various lending programs whose terms exceed one year. At January 2, 2021 and December 28, 2019, the outstanding balance of the notes was $18.9 million and $27.7 million, respectively, of which the current portion of $16.5 million and $16.3 million, respectively, was recorded in Receivables, net.

	January 2, 2021	December 28, 2019
Notes receivable, gross	$ 45.4	$ 43.4
Less estimated patronage applications from 2020 and 2019, respectively	(26.5)	(15.7)
Net	18.9	27.7
Less current portion	(16.5)	(16.3)
Less allowance for doubtful accounts	(1.3)	(1.5)
Notes receivable, net	$ 1.1	$ 9.9

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

	January 2, 2021
0 – 4 years	$ 13.2
5 – 8 years	20.1
9 – 10 years	12.1
Total	$ 45.4

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

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

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

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

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

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

	January 2, 2021	December 28, 2019
Corporate Credit Exposure:		
Low risk	$ 22.3	$ 20.9
Moderate risk	14.8	11.0
High risk	8.3	11.5
Total	$ 45.4	$ 43.4

(In millions)

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 $1.3 million and $1.5 million at January 2, 2021 and December 28, 2019, respectively. Management records the allowance for doubtful accounts based on the above information as well as judgments made considering a number of factors, primarily historical collection statistics, current Retailer credit information, the current economic environment and the offsetting amounts due to Retailers for stock, notes, interest and declared and unpaid patronage distributions. The components of changes to the Notes receivable allowance for doubtful accounts for 2020 and 2019 were as follows:

	January 2, 2021	December 28, 2019
Allowance for doubtful accounts:		
Beginning balance	$ 1.5	$ 2.8
Provision (Reversal)	0.2	(0.7)
Reclassifications to accounts receivable allowance for doubtful accounts	(0.4)	(0.8)
Reclassifications from accounts receivable allowance for doubtful accounts	-	0.2
Ending balance	$ 1.3	$ 1.5

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 2020, 2019 and 2018, $1.9 million, $2.5 million and $2.0 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 2020 and 2019, $6.7 million and $9.3 million, respectively, of Notes receivable were transferred to trade receivables as an event occurred which made the notes due immediately. Upon transfer of the Notes receivable to trade receivables, $0.4 million and $0.8 million in fiscal 2020 and 2019, respectively, of the Notes receivable allowance for doubtful accounts was transferred to the Receivables allowance for doubtful accounts to properly match the reserve against the asset on the Consolidated Balance Sheet.

(8) Goodwill and Other Intangible Assets

Changes in the carrying value of goodwill were as follows:

Balance at December 29, 2018	$ 74.0
Acquired goodwill	9.1
Impairment charge	(8.5)
Balance at December 28, 2019	$ 74.6
Acquired goodwill	13.3
Balance at January 2, 2021	$ 87.9

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

(In millions)

Identifiable intangible assets were as follows:

	January 2, 2021	December 28, 2019
Trademarks and trade name	$ 10.0	$ 9.9
Customer relationships	8.1	8.1
Maker relationships	7.7	7.7
Developed technology	2.2	2.2
Wholesale relationships	0.6	0.6
Total identifiable intangible assets	28.6	28.5
Less accumulated amortization	(16.2)	(12.6)
Identifiable intangible assets, net	$ 12.4	$ 15.9

The trademarks and trade name are being amortized over 10-20 years. The customer and maker relationships are being amortized over 3-10 years. Developed technology is being amortized over three years. Net amortization expense related to all intangible assets was $3.5 million, $4.3 million and $5.2 million for fiscal years 2020, 2019 and 2018, respectively. The estimated net amortization expense over the next five fiscal years is $8.0 million.

(9) Patronage Distributions and Refund Certificates Payable

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

The accrued patronage distributions composition is summarized as follows:

	Years Ended		
	January 2, 2021	December 28, 2019	December 29, 2018
Cash portion	$ 112.9	$ 70.4	$ 55.0
Class C stock	119.1	54.6	44.0
Patronage refund certificates	15.6	30.0	23.7
Patronage financing deductions	27.8	17.5	12.7
Total patronage distributions accrued for third party Retailers	$ 275.4	$ 172.5	$ 135.4

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

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

The patronage refund certificates outstanding at January 2, 2021 are payable as follows:

	Amount
2021	$ 26.6
2022	27.2
2023	23.2
2024	29.3
2025	15.6
Total patronage refund certificates payable	$ 121.9
Less current portion	(26.6)
Long-term patronage refund certificates payable	$ 95.3

(In millions)

(10) Accrued Expenses

Accrued expenses include the following components:

	January 2, 2021	December 28, 2019
Salaries and wages	$ 75.9	$ 62.8
Insurance reserves	18.2	20.9
Deferred income	6.1	3.9
Vendor funds	5.0	7.3
Taxes	23.2	16.3
Profit sharing	23.7	14.4
Gift card	11.5	10.1
Interest	5.7	5.0
Advertising and marketing	27.6	25.1
Other	40.6	40.1
Accrued expenses	$ 237.5	$ 205.9

(11) Debt

The Company has a $700.0 million line of credit facility. The facility is expandable to $1.0 billion through a $300.0 million accordion that is exercisable without the consent of existing lenders provided that the Company is not in default of the credit agreement and further provided that none of the existing lenders are required to provide any portion of the increased facility. At the Company's discretion, borrowings under the credit facility bear interest at a rate of either 0 to 75 basis points over the prime rate or 100 to 175 basis points over the London Interbank Offered Rate ("LIBOR") rate depending on the Company's leverage ratio as defined under the agreement. The credit facility was priced at LIBOR plus 125 basis points at January 2, 2021. The credit facility expires on February 1, 2024 and requires maintenance of certain financial covenants including a maximum allowable average leverage ratio and a minimum fixed charge coverage ratio. As of January 2, 2021, the Company was in compliance with its covenants and $7.9 million was outstanding under the credit facility.

The credit facility includes a $175.0 million sublimit for the issuance of standby and commercial letters of credit. As of January 2, 2021, a total of $19.8 million in letters of credit were outstanding. The credit facility requires the Company to pay fees based on the unused portion of the line of credit at a rate of 12.5 to 25 basis points per annum depending on the Company's leverage ratio.

The credit facility allows the Company to make revolving loans and other extensions of credit to AIH in an aggregate principal amount not to exceed $75.0 million at any time. As of January 2, 2021, there were no loans or other extensions of credit provided to AIH.

The Company was a party to an interest rate swap derivative agreement, which started on March 13, 2017 and expired on May 13, 2020. The swap agreement fixed the LIBOR rate on $150.0 million of the revolving credit facility borrowings at 2.18 percent, plus the then effective margin based on the then current pricing tier per the credit agreement. The swap arrangement was designated as a cash flow hedge and was evaluated to be highly effective throughout the term. As a result, the after-tax change in the fair value of the swap was recorded in AOCI as a gain or loss on derivative financial instruments.

The Company's Westlake subsidiary has a $100.0 million asset-based revolving credit facility ("Westlake Facility"). The Westlake Facility expires on October 24, 2022. Under this facility, Westlake has the right to issue letters of credit up to a maximum of $7.5 million. At Westlake's discretion, borrowings under this facility bear interest at a rate of either the prime rate plus an applicable spread of 25 to 50 basis points or LIBOR plus an applicable spread of 125 to 150 basis points, depending on Westlake's average availability under the Westlake Facility as measured on a trailing 12-month basis. The Westlake Facility was priced at LIBOR plus 125 basis points at January 2, 2021.

The Westlake Facility is collateralized by substantially all of Westlake's personal property and intangible assets. Borrowings under the facility are subject to a borrowing base calculation consisting of certain advance rates applied to eligible collateral balances (primarily consisting of certain receivables and inventories). This agreement requires maintenance of certain financial covenants including a minimum fixed charge coverage ratio. As of January 2, 2021, ARH was in compliance with its covenants and had $20.1 million 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

(In millions)

Arrangements and Subjective Acceleration Clauses," the borrowings under the Westlake Facility have been classified as a Current maturity of long-term debt. The GLA Facility was classified under this guidance in prior presented periods.

The Company's GLA subsidiary had a $20.0 million asset-based revolving credit facility ("GLA Facility") that had a maturity date of November 6, 2022. GLA terminated the facility effective August 31, 2020.

Total debt outstanding is comprised of the following:

	January 2, 2021	December 28, 2019
Revolving Credit Facility	$ 7.9	$ 196.5
Westlake Facility	20.1	52.0
GLA Facility	-	4.5
Installment notes with maturities through 2024 at a fixed rate of 6.00%	28.5	23.9
Total debt	56.5	276.9
Less maturities within one year	(31.7)	(67.0)
Long-term debt	$ 24.8	$ 209.9

The aggregate scheduled maturities of total debt at January 2, 2021 are as follows:

Fiscal Year	Amount
2021	$ 31.7
2022	7.9
2023	6.0
2024	10.9
Total debt	$ 56.5

(12) Commitments and Contingencies

Contingencies

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

Other guarantees

In the normal course of business, the Company enters into commercial commitments including standby letters of credit and guarantees that could become contractual obligations. Letters of credit are issued generally to insurance agencies and financial institutions in direct support of the Company's corporate and Retailer insurance programs as well as to international vendors for imported inventory purchases. As of January 2, 2021, the Company had outstanding standby letters of credit of $14.3 million issued in the normal course of NAIL's operations and commercial letters of credit of $19.8 million issued by the Company's credit facility.

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

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

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

(In millions)

(13) Fair Value

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

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

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

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

The tables below set forth, by level, the Company's financial assets, liabilities and derivative instruments that were accounted for at fair value as of January 2, 2021 and of December 28, 2019. 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 January 2, 2021	Level 1	Level 2	Level 3
Assets:				
Cash equivalents:				
Money market funds	$ 2.8	$ 2.8	$ -	$ -
Marketable securities:				
Corporate fixed income securities	35.1	-	35.1	-
Mortgage-backed securities	9.9	-	9.9	-
U.S. government notes	17.8	9.8	8.0	-
Other	0.4	-	0.4	-
Total marketable securities	$ 63.2	$ 9.8	$ 53.4	$ -

(In millions)

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

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

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

The fair value of the Company's marketable securities was greater than their cost by $3.7 million at January 2, 2021 and was greater than their cost by $1.3 million at December 28, 2019.

Gross proceeds from the sale of marketable securities and the related realized gains and losses for the fiscal years ended January 2, 2021, December 28, 2019 and December 29, 2018 were as follows:

	Years Ended		
	January 2, 2021	December 28, 2019	December 29, 2018
Gross proceeds	$ 20.8	$ 41.4	$ 25.4
Gross realized gains	0.4	0.8	5.6
Gross realized losses	(0.2)	(0.2)	(0.3)

Gross realized gains and losses were determined using the specific identification method. For the fiscal year ended January 2, 2021, the Company reclassified $0.4 million of unrealized gains and $0.1 million of unrealized losses on marketable securities that were recorded in AOCI as of December 28, 2019 into realized income. These amounts were recorded to Other income, net in the Consolidated Statement of Income.

The following table summarizes the contractual maturity distributions of the Company's debt securities at January 2, 2021. Actual maturities may differ from the contractual or expected maturities since borrowers may have the right to prepay obligations with or without prepayment penalties.

(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	$ 3.7	$ 16.9	$ 8.2	$ 6.3	$ 35.1
Mortgage-backed securities	0.2	0.4	0.8	8.5	9.9
U.S. government notes	3.2	4.3	3.8	6.5	17.8
Other	-	-	0.3	0.1	0.4
Total	$ 7.1	$ 21.6	$ 13.1	$ 21.4	$ 63.2

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

The Company was a party to an interest rate swap derivative agreement, which started on March 13, 2017 and expired on May 13, 2020. The swap agreement fixed the LIBOR rate on $150.0 million of the revolving credit facility borrowings at 2.18 percent, plus the then effective margin based on the then current pricing tier per the credit agreement – see Note 11 for more information.

Because the interest rate swap was designated as a cash flow hedge and was evaluated to be highly effective, the change in the fair value was recorded in AOCI as a gain or loss on derivative financial instruments. The net of tax amount recorded in AOCI for the fair value adjustment of the interest rate swap was an unrealized loss of $0.2 million as of December 28, 2019. There was no hedge ineffectiveness related to the interest rate swap in fiscal 2020 through the date of expiration.

The Company's debt instruments are recorded at cost on the Consolidated Balance Sheets. The fair value of the Company's debt approximated its carrying value at January 2, 2021. 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) benefit includes the following components:

	Years Ended		
Current:	January 2, 2021	December 28, 2019	December 29, 2018
Federal	$ 1.4	$ (0.4)	$ 1.6
State	(3.1)	(0.4)	(0.2)
Foreign	(0.9)	(1.1)	(1.1)
Current income tax (expense) benefit	(2.6)	(1.9)	0.3
Deferred:			
Federal	(2.8)	12.0	2.2
State	0.4	1.5	-
Deferred income tax (expense) benefit	(2.4)	13.5	2.2
Total income tax (expense) benefit	$ (5.0)	$ 11.6	$ 2.5

(In millions)

Income tax differs from the amount computed by applying the statutory U.S. Federal income tax rate of 21 percent for fiscal years ended January 2, 2021, December 28, 2019 and December 29, 2018 to pre-tax income because of the effect of the following items:

	Years Ended		
	January 2, 2021	December 28, 2019	December 29, 2018
Expected tax at U.S. Federal income tax rate	$ (67.6)	$ (27.1)	$ (26.4)
Patronage distribution deductions	57.8	36.2	28.4
NOL carryback – tax rate differential	6.3	-	-
Other, net	(1.5)	2.5	0.5
Income tax (expense) benefit	$ (5.0)	$ 11.6	$ 2.5

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

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

Deferred tax assets:	January 2, 2021	December 28, 2019
Foreign tax credits and other tax credit carryforwards	$ 12.8	$ 11.4
Net operating loss carryforwards	0.3	14.0
Unearned insurance premium and loss reserves	1.0	1.1
Allowance for doubtful accounts	1.1	1.4
Inventory reserves	8.0	4.6
Deferred vendor rebates	16.4	9.7
Accrued compensation and benefits expense	14.7	13.2
Other reserves	10.9	11.8
Total deferred tax assets	65.2	67.2
Less valuation allowance	(9.8)	(8.9)
Deferred tax assets	55.4	58.3
Deferred tax liabilities:		
Depreciation and deferred gains on property and equipment	8.7	8.4
Amortization of intangibles	2.4	2.0
Net unrealized gains	0.3	0.3
Fair market value of leases	-	0.5
Prepaid expenses and deferred income	4.5	4.6
Inventory valuation	16.7	16.6
Deferred tax liabilities	32.6	32.4
Net deferred tax assets	$ 22.8	$ 25.9

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

At January 2, 2021, the Company has state and foreign net operating loss carryforwards of $1.9 million available for offset against future taxable income. For those states not conforming to the indefinite federal carryforward provisions, the post-2018 state net operating losses can, generally, be carried forward through the 2038 and 2039 tax years.

At January 2, 2021, the Company has foreign tax credits of $2.3 million available to offset future tax expense. The foreign tax credits may be carried forward to tax years 2028 through 2030.

At January 2, 2021, the Company has state tax credit carryforwards of $10.5 million available to offset future state income tax expense. The state tax credits may be carried forward to tax years 2021 through 2025. A valuation allowance of $9.8 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 2016 through 2020 tax years remain subject to examination by the IRS. For state purposes, the 2015 through 2020 tax years remain subject to examination.

The Company recognizes interest and penalties related to uncertain tax positions in Income tax expense. Accrued interest and penalties included in the reserve for uncertain tax positions were $0.3 million at January 2, 2021 and December 28, 2019, respectively. The Company recognized immaterial amounts related to interest and penalties within Income tax expense for the years ended January 2, 2021, December 28, 2019 and December 29, 2018. It is reasonably possible that the total amount of unrecognized tax benefits will increase or decrease within the next twelve months. The Company currently estimates that such increases and decreases will not be significant.

(15) Capital Stock

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

	Number of Shares at	
	January 2, 2021	December 28, 2019
Class A stock, voting, redeemable at par value:		
Authorized	10,000	10,000
Issued and outstanding	2,689	2,691
Class C stock, nonvoting, redeemable at not less than par value:		
Authorized	10,000,000	6,000,000
Issued and outstanding	5,015,306	4,827,851
Issuable as patronage distributions	1,191,050	546,146

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 has healthcare plans under which a limited number of qualified retired employees receive certain health care, dental care, life insurance or related benefits. Amounts expensed under these plans were $0.1 million or less in each of the fiscal years 2020, 2019 and 2018.

The Company and its subsidiaries maintain profit sharing and 401k retirement plans for substantially all employees. Amounts expensed under these plans totaled $39.3 million, $28.8 million and $22.8 million during fiscal 2020, 2019 and 2018, respectively.

(17) Supplemental Disclosures of Cash Flow Information

During fiscal 2020, 2019 and 2018, accrued patronage distributions of $29.2 million, $19.1 million and $13.6 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 $17.0 million in patronage refund certificates which were included in Accounts payable pending payment in Fiscal 2021 as of January 2, 2021 and had no net impact in the Consolidated Statements of Cash Flows.

During fiscal 2020, 2019 and 2018, non-cash repurchases of stock from Retailers of $30.8 million, $20.7 million and $23.1 million, respectively, were offset against trade receivables of $9.9 million, $5.5 million and $5.2 million, respectively, and notes receivable of $5.6 million, $7.0 million and $6.0 million, respectively. The remaining $15.3 million, $8.2 million and $11.9 million, respectively, were primarily issued as notes payable with no net impact in the Consolidated Statements of Cash Flows.

(In millions)

During fiscal 2020, the Company received $9.4 million of property and equipment prior to year-end and accrued for these items as no cash payments were made. These capital expenditures were not included in the Purchases of property and equipment in the Consolidated Statement of Cash Flows for fiscal year 2020. During fiscal 2020, the Company paid $5.1 million for property and equipment that was purchased and accrued during the year ended December 28, 2019. These capital expenditures were included in the Purchases of property and equipment in the Consolidated Statement of Cash Flows for fiscal year 2020.

(18) Summary of Quarterly Results

The following table provides a summary of quarterly results (unaudited) for the eight quarters prior to and including the quarter ended January 2, 2021:

	2020			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Revenues	$ 2,052.7	$ 2,000.5	$ 2,279.1	$ 1,430.4
Gross profit	291.4	328.9	370.6	222.6
Operating expenses	243.5	220.4	232.2	184.3
Net income attributable to Ace Hardware Corporation	43.3	98.9	139.1	36.3

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

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

The following discussion and analysis summarizes the significant factors affecting Ace Hardware Corporation's ("the Company's") consolidated operating results and financial condition during the three-year period ended January 2, 2021 (the Company's fiscal years 2020, 2019 and 2018). Fiscal year 2020 contains 53 weeks of operating results. Fiscal years 2019 and 2018 each contain 52 weeks of operating results. Unless otherwise noted, all references herein for the years 2020, 2019 and 2018 represent fiscal years ended January 2, 2021, December 28, 2019 and December 29, 2018, respectively. This discussion and analysis should be read in conjunction with the consolidated financial statements and the related notes included in this annual report that have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP").

Company Overview

The Company is a wholesaler of hardware and other related products and provides services and best practices for its member retailers ("Retailers"). The overall home improvement industry is estimated to be almost $460 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 $62 billion "convenience hardware" segment which is characterized by purchases primarily of products related to home improvement and repair, including paint and related products, lawn and garden equipment, and those products less focused on large-scale building, renovation and remodeling projects. The Company believes that the following competitive strengths distinguish it from its peers and contribute to its success in the convenience hardware market: (1) strong consumer recognition of the Ace Brand; (2) well-regarded for exceptional customer service and convenience; (3) strength of distribution operations; (4) consolidated purchasing power; (5) differentiated and localized product and service offerings; and (6) a diversified network of independent retailers.

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

Ace Hardware International Holdings, Ltd. ("AIH") is a majority-owned and controlled subsidiary of the Company with a 20.7 percent noncontrolling interest owned by its international retailers. AIH has wholesale distribution capabilities in Ningbo, China; Colon, Panama; and Dubai, United Arab Emirates. AIH customers operate 816 stores located in approximately 65 countries.

Ace Retail Holdings LLC ("ARH") is the owner of the 145 store Westlake Ace Hardware retail chain. In March 2019, ARH acquired the remaining 58 percent of the outstanding stock of Great Lakes Ace Hardware, Inc. ("GLA") that it did not already own. GLA is the owner of the 57 store Great Lakes Ace retail chain. 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 and its related wholesale companies. AWH was formed in 2014 so that the Company could begin making wholesale hardware sales to non-member retailers.

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

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

Worldwide Store Count

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

	Fiscal Years		
	2020	2019	2018
Retail outlets at beginning of period	5,366	5,253	5,121
New retail outlets	201	208	257
Retail outlet cancellations	(104)	(95)	(125)
Retail outlets at end of period	5,463	5,366	5,253

Results of Operations

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

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

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

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

A reconciliation of consolidated revenues follows (in millions):

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

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

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

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

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

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

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

Retail gross profit for fiscal 2020 was $334.4 million, an increase of $107.7 million from fiscal 2019. The retail gross margin percentage was 44.5 percent of retail revenues in fiscal 2020, down slightly from 44.7 percent in fiscal 2019. For ARH, retail gross profit as reported in the Ace financial statements is based on the Ace wholesale acquisition cost of product, not ARH's acquisition cost which includes a markup from the Company.

Wholesale operating expenses increased $85.9 million, or 15.9 percent in fiscal 2020, as compared to fiscal 2019. The increase is due to higher distribution costs resulting from higher wholesale revenues and an increase in advertising expenses. As a percentage of wholesale revenues, wholesale operating expenses decreased to 8.9 percent in fiscal 2020 from 9.7 percent in fiscal 2019.

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

Retail pre-opening expenses decreased $7.4 million in fiscal 2020 due to expenses related to the eleven new California stores which opened in 2019.

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

Interest expense decreased $3.6 million or 15.9 percent compared to fiscal 2019 due a significant decrease in LIBOR rates during fiscal 2020.

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

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

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

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

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

A reconciliation of consolidated revenues follows (in millions):

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

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

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

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

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

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

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

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

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

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

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

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

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

Liquidity and Capital Resources

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

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

The Company has a $700.0 million line of credit that is expandable to $1.0 billion through a $300.0 million accordion that is exercisable without the consent of existing lenders provided that the Company is not in default of the credit agreement and further provided that none of the existing lenders are required to provide any portion of the increased facility. At the Company's discretion, borrowings under the credit facility bear interest at a rate of either 0 to 75 basis points over the prime rate or 100 to 175 basis points over the London Interbank Offered Rate ("LIBOR") depending on the Company's leverage ratio as defined under the agreement. The credit facility was priced at LIBOR plus 125 basis points at January 2, 2021. The credit facility expires on February 1, 2024 and requires maintenance of certain financial covenants including a maximum allowable average leverage ratio and a minimum fixed charge coverage ratio. As of January 2, 2021, the Company was in compliance with its covenants and $7.9 million was outstanding under the credit facility.

The credit facility includes a $175.0 million sublimit for the issuance of standby and commercial letters of credit. As of January 2, 2021, a total of $19.8 million in letters of credit were outstanding. The credit facility requires the Company to pay fees based on the unused portion of the line of credit at a rate of 12.5 to 25 basis points per annum depending on the Company's leverage ratio.

The credit facility allows the Company to make revolving loans and other extensions of credit to AIH in an aggregate principal amount not to exceed $75.0 million at any time. As of January 2, 2021, there were no loans or other extensions of credit provided to AIH.

The Company was a party to an interest rate swap derivative agreement, which started on March 13, 2017 and expired on May 13, 2020. The swap agreement fixed the LIBOR rate on $150.0 million of the revolving credit facility borrowings at 2.18 percent, plus the then effective margin based on the then current pricing tier per the credit agreement. The swap arrangement was designated as a cash flow hedge and was evaluated to be highly effective throughout the term. As a result, the after-tax change in the fair value of the swap was recorded in Accumulated other comprehensive income as a gain or loss on derivative financial instruments.

The Company's Westlake subsidiary has a $100.0 million asset-based revolving credit facility ("Westlake Facility"). The Westlake Facility expires on October 24, 2022. Under this facility, Westlake has the right to issue letters of credit up to a maximum of $7.5 million. At Westlake's discretion, borrowings under this facility bear interest at a rate of either the prime rate plus an applicable spread of 25 basis points to 50 basis points or LIBOR plus an applicable spread of 125 basis points to 150 basis points, depending on the Company's average availability under the Westlake Facility as measured on a trailing 12-month basis. The Westlake Facility was priced at LIBOR plus 125 basis points at January 2, 2021.

The Westlake Facility is collateralized by substantially all of Westlake's personal property and intangible assets. Borrowings under the facility are subject to a borrowing base calculation consisting of certain advance rates applied to eligible collateral balances (primarily consisting of certain receivables and inventories). This agreement requires maintenance of certain financial covenants including a minimum fixed charge coverage ratio. As of January 2, 2021, ARH was in compliance with its covenants and had $20.1 million in loans outstanding under the Westlake Facility.

The Company's GLA subsidiary had a $20.0 million asset-based revolving credit facility ("GLA Facility") that had a maturity date of November 6, 2022. GLA terminated the facility effective August 31, 2020. Borrowings under the terminated GLA Facility had been subject to a borrowing base calculation consisting of certain advance rates applied to eligible receivables and inventory. The interest rate was based on either the lender's prime rate plus 100 basis points or LIBOR plus 200 basis points.

The Westlake Facility includes a lender-controlled cash concentration system that results in all of Westlake's daily available cash being applied to the outstanding borrowings under their facility. Pursuant to Financial Accounting Standards Board ("FASB") Accounting Standards Codification Section 470-10-45, "Classification of Revolving Credit Agreements Subject to Lock-Box Arrangements and Subjective Acceleration Clauses," the borrowings under the Westlake Facility have been classified as a Current maturity of long-term debt. The GLA Facility was classified under this guidance in prior presented periods.

Total debt, the majority of which is comprised of the $28.0 million borrowed on lines of credit, was $56.5 million as of January 2, 2021, compared to $276.9 million as of December 28, 2019.

Cash Flows

The Company had $28.9 million and $18.2 million of cash and cash equivalents at January 2, 2021 and December 28, 2019, respectively. Following is a summary of the Company's cash flows from operating, investing and financing activities for fiscal years 2020 and 2019, respectively (in millions):

	2020	2019
Cash provided by operating activities before changes in assets and liabilities	$ 385.4	$ 203.8
Net changes in assets and liabilities	75.8	10.2
Net cash provided by operating activities	461.2	214.0
Net cash used in investing activities	(128.8)	(91.9)
Net cash used in financing activities	(321.7)	(129.5)
Net change in cash and cash equivalents	$ 10.7	$ (7.4)

The Company's operating activities generated $461.2 million of cash in fiscal 2020 compared to $214.0 million in fiscal 2019. Excluding the impact of net changes in assets and liabilities, cash provided by operating activities increased from $203.8 million in fiscal 2019 to $385.4 million in fiscal 2020. This $181.6 million increase was primarily the result of a $176.5 million increase in net income in 2020.

The net change in assets and liabilities provided $75.8 million of cash in fiscal 2020 compared to $10.2 in fiscal 2019. This $65.6 million increase in net working capital was primarily driven by the intentional buildup of inventory to improve fill rates. Cash flows used by receivables and inventories were a combined $267.8 million in fiscal 2020 compared to a combined use of cash of only $39.7 million in fiscal 2019. Offsetting this use of cash were cash flows from accounts payable and accrued expenses of $337.3 million in fiscal 2020 compared to $56.2 million in fiscal 2019. During fiscal 2019, cash flows from accounts payable and accrued expenses were $56.2 million which was consistent with the $39.7 million of cash flows used by receivables and inventories during that period. However, during 2020, cash flows from accounts payable and accrued expenses were $337.3 million compared to $267.8 million of cash flows used by receivables and inventories during that period. This $337.3 million of cash flows from accounts payable and accrued expenses was primarily the result of a $317.6 million increase in accounts payable that occurred as a result of the 26.0 percent increase in wholesale revenues during 2020. Because the Company generally has 60-day payments terms with its vendors, the substantial increase in wholesale revenues in 2020 resulted in a greater percentage of the inventory sold during the fourth quarter of 2020 not having been paid for at the end of the year as compared to 2019.

Net cash used for investing activities was $128.8 million in fiscal 2020 compared to $91.9 million in fiscal 2019. Investing activities in fiscal 2020 consisted of $99.0 million in capital expenditures and $21.5 million paid for the acquisition of additional retails stores by ARH. Investing activities in fiscal 2019 consisted of $76.5 million in capital expenditures which were partially offset by $22.0 million in proceeds from sale of assets, primarily from the sale of the Prince George RSC. There was also $22.5 million paid for the acquisition of GLA, Handyman Matters Inc., and additional retail stores by ARH.

Net cash used in financing activities was $321.7 million in fiscal 2020 compared to $129.5 million in fiscal 2019. During fiscal 2020, the Company had $224.9 million of net payments under the revolving lines of credit, paid $66.2 million for the cash portion of the 2019 patronage distributions, paid $9.7 million on patronage refund certificates and had $10.7 million in payments on long-term debt. During 2019, the Company had $58.0 million of net payments under the revolving lines of credit, paid $51.3 million for the cash portion of the 2018 patronage distributions, paid $5.3 million on patronage refund certificates and had $10.9 million in payments on long-term debt.

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. Due to the complexity and diversity of the individual vendor agreements, the Company performs analyses and reviews of historical trends throughout the year to ensure the amounts earned are appropriately recorded. As part of these analyses, the Company validates its accrual rates based on actual purchase trends and applies those rates to actual purchase volumes to determine the amount of funds that should be accrued by the Company and receivable from the vendor. Amounts accrued throughout the year could be impacted if actual purchase volumes differ from projected annual purchase volumes, especially in the case of programs that provide for increased funding when graduated purchase volumes are met. At year-end, the accrual reflects actual purchases made throughout the year.

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

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

The Company's allowance for doubtful accounts at January 2, 2021 and December 28, 2019 was $6.1 million and $6.9 million, respectively. Actual credit losses could vary materially from the Company's estimates.

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

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

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

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

The Company tests reporting units for impairment annually as of the first day of the fourth quarter, or more frequently if events or circumstances indicate it is more likely than not that the fair value of a reporting unit is less than its carrying value. No goodwill impairment charge was recorded during fiscal years 2020 and 2018. The Company recorded an impairment charge of $8.5 million in fiscal 2019.

Impact of New Accounting Standards

New Accounting Pronouncements – Adopted

In February 2016, the FASB issued Accounting Standards Update ("ASU") No. 2016-02, "Leases (Topic 842)" along with amendments issued through 2019. The guidance requires that lessees recognize assets and liabilities for leases with lease terms greater than twelve months in the statement of financial position. The guidance also requires improved disclosures to help users of financial statements better understand the amount, timing and uncertainty of cash flows arising from leases.

On December 29, 2019 ("the effective date"), the Company adopted ASU 2016-02 and subsequent updates, collectively referred to as Topic 842, using the modified retrospective approach. In addition, the Company elected the package of practical expedients in transition, which permits the Company to not reassess prior conclusions pertaining to lease identification, lease classification and initial direct costs on leases that commenced prior to the adoption of the new standard. The Company also elected to treat the lease and non-lease components of leases as a single lease component and to exempt leases with an initial term of twelve months or less from balance sheet recognition.

As a result of adopting Topic 842, the Company recognized net operating right-of-use assets and operating lease liabilities of $454.2 million as of December 29, 2019. The adoption of the standard did not have a material impact on the Company's results of operations or cash flows. See Note 6 for additional details of the Company's leases.

New Accounting Pronouncements – Issued

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

Qualitative and Quantitative Disclosure About Market Risk

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

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

Customer Credit Risk The Company is exposed to the risk of financial non-performance by customers. The Company's ability to collect on sales to its customers is dependent on the liquidity of its customer base. Volatility in credit markets may reduce the liquidity of the Company's customer base. To manage customer credit risk, the Company monitors historical collection statistics, current 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. In order to reduce the risk of interest rate volatility, the Company has historically entered into interest rate swap agreements to fix the LIBOR rate on a portion of its revolving credit facility. The Company was party to an interest rate derivative agreement, which started on March 13, 2017 and expired on May 13, 2020. The Company has no plans to replace or supplement it. The Company believes that its exposure to interest rate fluctuations is not significant to its financial condition and results of operations.

Disclosure Regarding Forward-Looking Statements

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

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

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

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

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

FIVE YEAR SUMMARY OF EARNINGS AND DISTRIBUTIONS

	Years Ended				
	January 2, 2021 (53 Weeks)	December 28, 2019 (52 Weeks)	December 29, 2018 (52 Weeks)	December 30, 2017 (52 Weeks)	December 31, 2016 (52 Weeks)
Revenues	$ 7,762.7	$ 6,071.2	$ 5,717.0	$ 5,388.4	$ 5,125.5
Cost of revenues	6,549.2	5,178.6	4,921.9	4,634.1	4,412.7
Gross profit	1,213.5	892.6	795.1	754.3	712.8
Total operating and other expenses, net	895.9	752.2	667.4	607.7	551.9
Net income attributable to Ace Hardware Corporation	$ 317.6	$ 140.4	$ 127.7	$ 146.6	$ 160.9

Distribution of net income:					
Patronage distributions to third party Retailers	$ 275.4	$ 172.5	$ 135.4	$ 150.6	$ 152.8
Net income (loss) of non-patronage activities	42.2	(32.1)	(7.7)	(4.0)	8.1
Net income attributable to Ace Hardware Corporation	$ 317.6	$ 140.4	$ 127.7	$ 146.6	$ 160.9

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

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

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

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

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

February 15, 2021

/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

MEMBERSHIP INFORMATION

Membership Application, Agreements and Stock Subscription

Membership Application and Agreements. All Retailers have membership agreements with us that entitle them to purchase merchandise and services from us at prices lower than the prices the Company charges other customers. Membership agreements entered prior to January 1, 2004, granted Retailers a license to use some of our trademarks. After January 1, 2004, new Retailers are granted a license to use some of our trademarks under a separate Ace brand agreement. Generally, Retailers whose membership agreements are dated August 1993 or later are subject to "general member standards," "Ace brand standards," "member operational requirements" and other important requirements.

Only prospects who submit membership applications to us for designated retail outlets that we choose to accept may become Ace Retailers and purchase our stock. If you apply to become an Ace Retailer, you must complete and submit for each store location a membership application that contains extensive information about yourself and your proposed location, as well as the actual membership agreement, a stock subscription agreement for the purchase of our stock and a number of other agreements and instruments that we require. These include the Ace brand agreement if you propose to operate your store using the Ace name.

You must also pay a $5,000 membership application processing fee. If we accept your application, we sign your stock subscription agreement and your membership agreement and, if applicable, your Ace brand agreement.

Ace Officers Control Membership. All membership decisions are subject to Officer approval. We employ various field sales personnel who contact and solicit existing and prospective Retailers and promote our business and programs; however, these individuals are not allowed to accept new Retailers. We may pay commissions or other incentives to our personnel in connection with the acceptance of new Retailers or the opening of new stores.

Stock Subscription Amount and Terms of Payment. To become a Retailer, you are required to subscribe for $5,000 of our stock per member store. For a first store location, the subscription is for one share of Class A voting stock at a price of $1,000 per share (par value) plus 40 shares of Class C non-voting stock at a price of $100 per share (par value). The subscription for shares for each additional store location owned or controlled by the same Retailer consists entirely of 50 shares of Class C nonvoting stock at a price of $100 per share. Billing for such shares in full will occur 30 days after the store's activation date, and the certificates for these shares will be issued at that time. You must promptly pay in full for your share purchases.

Use of Proceeds. We use the proceeds that we receive from sales of our stock mainly for general working capital purposes, including the purchase of merchandise for resale, and capital expenditures. We reserve the right to use such proceeds for any other proper corporate purpose, as well.

Termination of Membership upon Transfer of Shares. Unless we expressly consent to the continuation of your membership, it will automatically terminate if you attempt to transfer any of your shares of Ace stock (whether purchased or received as patronage distributions) to someone else. Your membership will also terminate if we repurchase your shares.

Retailer Assessments and Charges

In addition to the stock subscription amount and the membership application processing fee described above, we assess additional fees for both mandatory and optional services and programs. Our service and program offerings, and their respective fees, are listed below. All programs and fees are subject to change upon notice. Some of the services or programs listed below may not be available to our Individually Branded Retailers, or we may charge such Retailers different fees than those shown below. We also provide resources that enable you to operate your store, such as fixtures, signage, uniforms, marketing and advertising services, technology and communications products, office and retail store supplies, financial services, professional services, facility services, and construction/capital projects. You are not required to purchase or use any of the goods or services offered. You will contract directly with the vendor for the goods and services you purchase. In most instances, you will pay the vendor directly, but some vendors may bill through Ace.

Type of Fee (1)	**Amount**	**Due Date**	**Remarks**
Late Payment	0.77% of the past due bi-weekly billing statement balance.	10 days after billing	Payable on all overdue amounts. See further explanation in Note (2) below.
Low Volume Service Charge	$100 per bi-weekly billing period if annual volume purchased is less than $200,000.	10 days after billing	Payable if you fail to make the $200,000 minimum annual purchases. See further explanation in Note (3) below.

Type of Fee (1)	**Amount**	**Due Date**	**Remarks**
Freight Charge	The freight rate is billed as a fixed percentage of your warehouse purchases, adjusted annually.	10 days after billing	Freight percentages will be calculated and communicated in January and will become effective February 1st.
Fuel Surcharge	When the U.S. national average price for diesel fuel exceeds $2.05 per gallon, a 0.50% fuel charge applies. The surcharge is adjusted (i.e., increased or decreased) weekly, 0.50% for every five-cent change (increase or decrease) in fuel price.	10 days after billing	The fuel surcharge percentage is applied to the net freight charge.
Core Retail Services	$168 per month for all parent stores and $37 per month for each branch store.	10 days after billing	See further explanation in Note (4) below.
Regulatory	Varies by state and product (e.g., paint recycling fee).	10 days after billing	Ace may be required by state law to collect and remit regulatory fees on your behalf based on certain product purchases from Ace.
Business Insurance	Will vary depending upon coverage purchased. Estimated annual cost of required coverage: $2,500 - $30,000.	11-month installment plan with 2 months' premium paid in month 1 and balance equally billed monthly over the next 10 months	Business insurance is required and may be purchased from our affiliate Ace Insurance Agency, Inc., or from unaffiliated third parties. See further explanation in Note (5) below.
Annual Brand Assessment	Store's first calendar year: $6,000 flat fee per store. Subsequent years: 2% of prior year purchases subject to minimum and maximum assessments described in Note (6) below.	10 days after billing	See further explanation in Note (6) below.

Type of Fee (1)	**Amount**	**Due Date**	**Remarks**
Computer Hardware and Software for Point of Sale ("POS") System Computer Hardware and Software Maintenance	$45,000 - $85,000. You will also incur charges for ongoing computer hardware and software maintenance services. Costs for these services will vary depending on the services selected by you but are estimated to be $500 per month. If you use a point of sale system from Epicor Software Corporation, you will also pay $7.50 per payment device, per month, for transactional security (i.e. point to point encryption). If you use a different point of sale vendor, the fee for point to point encryption will vary.	Varies, depending upon the vendor you contract with	See further explanation in Note (7) below. We require that all merchandise orders be submitted to us through an electronic ordering process. You may purchase or lease (using your choice of leasing companies) or finance a computer system.
Ace Bankcard Program	$35 annual fee per store. A monthly non-qualified fee will be assessed to your statement based on card type and volume.	10 days after billing	This program is optional.
Customer Check Verification Service (Telecheck)	1% of the face value of your customer's check.	10 days after billing (if billed through Ace)	This service is optional. This service is available from Ace or from third parties (e.g., VISA, MasterCard, etc.).
Ace Rewards® Program	$850 initial fee; $75 per month, per store thereafter. Additional fees for direct mail per piece ($0.32 - $0.42) apply. Each participating store is required to participate in all mandatory promotions under the program.	10 days after billing	Provided your technology is capable.
Grocery Format Add-on to Ace Rewards Program	Grocery stores that add an Ace store as a store within a store (non-Epicor POS) must use AppCard. There is a one-time set-up fee of $1,000 and a weekly AppCard fee of $75.	10 days after billing	AppCard is required if you are a grocery format store (non-Epicor POS) and you wish to participate in the Ace Rewards program.

Type of Fee (1)	**Amount**	**Due Date**	**Remarks**
Ace Gift Card Program	$30 initial sign kit fee plus $0.25 per blank (inactivated) card stock. For stores using Epicor POS systems, there will be a $175 set up fee. If you have another POS provider, there may or may not be additional fees. Additional point-of-service processing fees apply per credit card transaction; such fees vary by card processor (VISA, MasterCard, etc.) and by number of transactions processed. Cost will also vary depending upon type of card, displays and accessories purchased. There is a 10% marketing fee per transaction for redemption on gift cards purchased through a Gift Card Mall display at a non-Ace store.	10 days after billing	
Regional Advertising	Will vary depending on regional advertising programs.	10 days after billing	This service is optional and the program is market-specific. See further explanation in Note (8) below.
Ace Marketing Muscle	Will vary based on the services utilized.	10 days after billing	This service is optional. An online portal for retailers to customize local advertising, order printed supplies and manage social media.
Group Preprint Program	Price varies by page count and group participation. For example, group pricing for an 8 tab is $50 per thousand copies, while individual store orders are $78 per thousand copies.	10 days after billing	This program is optional. See further explanation in Note (8) below.
New Movers Program	$0.38 per piece.	10 days after billing	This program is optional. You can join or opt out of the program at any time, subject to a three-month lag.
Monthly Sign Kit Program	$175 per month per store for full kit; $75 for mini-kit.	10 days after billing	This program is a recommended component of our overall marketing and advertising plan. The sign kit includes all point-of-purchase signage supporting Ace's consumer marketing plan.

Type of Fee (1)	**Amount**	**Due Date**	**Remarks**
Customer Insights Program (Mystery Shop, Customer Experience, Employee Engagement)	For each in-store, Buy Online Pick Up In Store, Curbside or competitor mystery shop the fee is $46. For each phone mystery shop the fee is $15. Employee Engagement and Customer Experience Surveys are sold as a bundle for $28/month	10 days after billing	This program is optional. The á la carte fee is assessed each month after the mystery shop service is completed. The bundled fee is assessed each month after customer surveys are returned.
Visual Merchandising Services	Price varies depending on project scope. All projects are set to bid to ensure lowest possible cost based on location and timeframes.	Project is billed upon completion. 10 days after billing	Services are provided by unaffiliated third parties.
Matching Funds	Member can contribute up to $2,400 annually for group advertising.	Quarterly assessment on Ace statement	This is optional. See further explanation in Note (8) below.
Ace Rental Place	Will vary depending upon the rental equipment offered, fixtures needed, maintenance/repair shop needs and any optional exterior signs selected. Minimum cost of implementation begins at approximately $30,000.	10 days after billing	This program is optional.
Business to Business	Will vary depending upon implementation method, marketing material and signage purchased to promote business to business.	10 days after billing	This program is optional.
Store Planning Services	Minimum $6,000 flat fee for Full Services Package. Additional fees will vary depending on project scope.	Completion of project or 180 days from start of fixture plan (26 equal installments for existing retailers upon request)	Store planning services are mandatory under certain new store incentive plans.
Retail Loss Prevention	Will vary depending upon equipment or services utilized. Estimated cost range per service is $30 - $4,000. Costs do not include expenses for meeting rooms, travel, lodging, meals or tax where applicable.	As incurred or as agreed	These services and products are optional. See further explanation in Note (9) below.

Type of Fee (1)	**Amount**	**Due Date**	**Remarks**
Training Programs (Pre-Opening and Continuing)	The cost will vary depending upon the type of training, duration, and location of sessions. Price does not include expenses for meeting rooms, travel, lodging, meals, or tax where applicable.	Upon receipt of bill	Training programs are mandatory under certain new store incentive agreements. Other training programs are optional.
National Accounts Program	Varies by Account	Varies by Account	Participation is optional. See further explanation in Note (10) below.
Ace Handyman Services Rebate Program	Varies. Member funds a 10% rebate on items less than $49.99 each purchased by Ace Handyman Services franchise owners.	Monthly	Participation is optional. See further explanation in Note (11) below.
Costs and Attorney's Fees	Will vary under circumstances.	As incurred	Payable upon your failure to comply with the Membership Agreement, Brand Agreement and/or other agreements you enter into with us.
Indemnification	Will vary under circumstances.	As incurred	You may have to reimburse us if we are held liable for claims arising from your store's operations.
Liquidated Damages	$10,000 per month.	As incurred	Payable on the first day of each month during which, for a period of one or more days, you fail to remove all Ace identification, signs, decals, displays or other materials bearing the Ace trademarks from your store after the termination of your membership. Such payments will continue until the first day of the month following the month in which all such Ace identification has been permanently removed from your store.

Notes:

(1) Except as to fees designated as optional or voluntary, all fees are imposed by and, unless otherwise noted, payable to us. All fees are nonrefundable. Fees that we impose are subject to change upon notice to you.

(2) Late payment fees apply on a national basis at the rate stated (i.e., 0.77 percent), except in Texas and Georgia, where the applicable bi-weekly percentage rates are 0.384 percent and 0.692 percent, respectively. Service charges are assessed on all past due balances according to the following guidelines: i) electronic payments must be initiated by 2 p.m. CST on Tuesday following the due date to avoid a past due service charge; and ii) manual checks must be posted in the bank lockbox by the bank cut-off time on Wednesday following the due date to avoid a past due service charge. Past due balances as of the end of day Wednesday will be assessed the past due service charge at the rate of 0.77 percent (with the same exceptions of 0.384 percent and 0.692 percent in Texas and Georgia, respectively). Certain charges are exempt from past due service charges where mandated by the state.

(3) You must pay a low volume service charge if your purchases from us during a calendar year are less than our minimum purchase levels. The charge currently applies on a bi-weekly basis if your annual purchases from us are less than $200,000. If your purchases are less than $200,000 in any given year, a $100 low volume service charge is billed to each of your bi-weekly billing statements during the following year. New stores must be active for a full calendar year before this charge is applicable. The minimum purchase threshold, as well as the amount and manner of calculating the low volume service charge, can be changed by our Board of Directors. Failure to meet our minimum purchase levels constitutes cause for termination of the membership agreement.

(4) Core Retail Services simplifies the billing process by bundling several important programs or services into one monthly charge. These include:

- ACENET: Our primary communications portal. ACENET provides back office and catalog applications such as product search, ordering, defective and returned goods processing, training, Ace statements, and numerous other applications.

- Safety Data Sheets (SDS): Communicates the hazards of hazardous chemicals. Access is available 24/7 with unlimited single requests included.

- Training Core Charge: This fee helps to fund the Ace Learning Place and the creation of educational content, as well as other selective strategic training.

- NRHA Membership: Because Ace is a member of the North American Retail Hardware Association ("NRHA"), Ace Retailers have access to NRHA online training and resources. From this site, Retailers can access member newsletters, project brochures, NRHA studies and a variety of associate training tools including the Basic and Advanced Courses in Hardware Retailing.

- Retail Pricing: Retailers have access to an assortment of pricing-related services designed to improve gross margin dollars and enhance price image. These include pricing services such as Tailored Pricing and Tailored Hotsheets, and the ongoing pricing research needed for establishing and maintaining suggested Ace retail prices.

(5) We must be named as a loss payee party on your store's contents-insurance coverage. Your store must also have automotive and general liability insurance, each with no less than a $1 million combined single limit, naming us as an additional insured. Your store's general liability insurance must also have a limit of no less than $2 million in the aggregate. Your store must also carry statutory workers' compensation insurance and furnish evidence of insurance that is acceptable to us. Your store's insurance must be written with a carrier with an AM Best Key Rating of at least an A- and must provide us with at least 10 days' notice of cancellation. You must provide evidence of such insurance to Ace's Corporate Risk Management Department.

(6) The amount of the initial brand assessment for a new store activated in 2021 is a flat fee of $6,000. If the new store is activated by Ace in the first three (3) calendar year quarters, the flat fee brand assessment will be billed on the store's bi-weekly statement issued on or after the date that is sixty (60) days following the date of the new store's activation. The store's annual brand assessment for subsequent years will be calculated based upon 2 percent of purchases made during the prior year, subject to the minimum and maximum assessments set forth below, which will be billed annually in twenty-six (26) equal installments on the store's bi-weekly statement from February to January.

If a new store is activated in the fourth (4th) calendar quarter, the billing of the $6,000 flat fee brand assessment will be deferred until the following year. In addition, a brand assessment charge of $6,000 for the calendar year following activation will be aggregated with the flat fee brand assessment for a total assessment of $12,000, which will be billed in twenty-six (26) equal installments on its bi-weekly statement starting in February of the year following activation. Thereafter, the annual brand assessment will be calculated based upon 2 percent of purchases made during the prior year, subject to the minimum and maximum assessments which will be billed annually in twenty-six (26) equal installments on the store's bi-weekly statement from February to January. The annual minimum assessment is $6,270 and the maximum assessment is $13,600. The annual brand assessment, including, without limitation, the minimum and maximum assessment, is subject to change by our Board of Directors.

(7) If you are opening a new store that is not a branch store or a conversion, and you do not also own an existing separate business that uses a point-of-sale computer system, we require that you purchase or lease or finance your point of sale computer system from Epicor Software Corporation.

(8) Participation in a regional advertising group is voluntary and each store decides whether or not to participate. Retailers from time to time form regional advertising groups that work together and contribute monies to fund regional marketing programs including television, radio (terrestrial & streaming,) digital, social and regional events. Print, sports sponsorships, digital circulars and website creation are not allowed within the Matching Funds program. We currently support retailers' regional advertising efforts by offering 100 percent Matching Funds of up to $2,400 per store per year for market level advertising plans. In addition, retailers participating in the 2021 Matching Funds program are eligible to receive additional funds under our Higher Ground strategy. If 50 percent of the regional advertising group achieves either Platinum or Pinnacle status, they receive one and one-half times the match. If 75 percent of the group achieves either Platinum or Pinnacle status, they receive two times the match. We retain the right to form, change, dissolve or merge groups of regional or local members for the purpose of advertising from time to time. Other than offering the Matching Funds program, which may be modified or discontinued at any time, our role in regional and local advertising is to help the retailers develop optional annual advertising strategies and plans. Ace bills the participating retailers on a quarterly basis and assists in the planning and execution of the advertising campaign.

(9) Retail Loss Prevention is a part of the Property/Loss Prevention Department. Participation in the programs or services or purchase of products offered is optional, most of which are offered by unaffiliated third-party vendors. Prices will vary depending upon the equipment desired or level of service requested. For example, prices for background screening range from $30 - $43 for a single search. In-store loss prevention products start at $50 and increase with product type, quality and quantity. Some of these services and products will be billed by Ace directly to your store statement. In-store consulting, auditing, training, and investigations are available for fees beginning at $500, with fees increasing for additional services, if any, that you request. All in-store investigations are provided by unaffiliated third-party vendors and are billed directly to you by the vendor. General consulting, auditing, training and services through the Professional Retailer Services program will be billed directly to your store's statement.

(10) The National Account Program is a business to business ("B2B") program. This is a negotiated discount/pricing program for national account B2B customers that shop at a Retailer's store. The terms of the negotiated discount/pricing offered to a B2B national account will vary by account. Retailers are automatically enrolled in the program but may opt out of the program in its entirety.

(11) The Ace Handyman Services Rebate Program participation is available to Retailers that have not opted out of the National Accounts Program. Participating Retailers fund a 10% rebate to Ace Handyman Services franchise owners on items priced at $49.99 or less purchased at the participating store or corresponding acehardware.com webpage. Rebates will be processed monthly in arrears and Ace will debit your store statement the appropriate rebate amount on a monthly basis.

Patronage Distributions

We operate as a Retailer-owned cooperative. As a cooperative, we derive the majority of our revenues from transactions with our Retailers who are entitled to purchase merchandise and services from us. On an annual basis, we currently distribute substantially all of our net earnings (other than non-patronage income as described below) to our Retailers in the form of patronage distributions consisting of cash, capital stock and Patronage Refund Certificates. The amount of patronage distributions each Retailer receives annually is based upon our net earnings and the volume of the patronage-based merchandise, if any, he or she purchases from us in the previous year.

Membership Interests. Under our cooperative structure, to become a member of Ace, a Retailer must subscribe to purchase one share of Class A common stock. Only our Class A common stock has voting rights, and each of our Retailers may hold only one share of Class A common stock. New Retailers and Retailers opening new stores are also required to subscribe for shares of Class C common stock, and additional shares of Class C common stock historically have been issued annually as part of the Company's patronage distribution. As is typical for a cooperative, Ace's common stock represents only the Retailers' participation and membership interests in Ace and does not entitle holders to participate, as stockholders, in the earnings of Ace or realize Ace's value as an enterprise to the extent that it exceeds the aggregate stated par value of our outstanding common stock.

Favorable Corporate Tax Treatment. Generally, under Subchapter T of the Internal Revenue Code, we can deduct from our income for federal income tax purposes the entire amount of the patronage we distribute each year so long as we pay (or make available in the case of an allocation against any indebtedness owed to us) at least 20 percent of the patronage in cash. A similar deduction also is generally available for state income taxes. The cash payments and stated dollar amounts of Class C common stock and Patronage Refund Certificates comprising the patronage distributions we make to each Retailer must be included in a Retailer's gross income for federal income tax purposes. However, Retailers operating in partnership, proprietorship or S Corporation form may be eligible for a deduction under IRC Section 199A of up to 20 percent of qualified business income, subject to certain limitation.

Form of Patronage Distributions. Historically, patronage has been distributed in three currencies – cash, shares of Class C stock and, if the Retailer has met the Company's stock requirements, interest-bearing five-year Patronage Refund Certificates. Patronage distributions are made annually according to a specific plan that is adopted by our Board of Directors. This plan can be changed from time to time by the Board as it deems appropriate.

Since 2011, the first 40 percent of the patronage distribution is made in cash for all Retailers. The cash portion of any patronage distribution payable to a past due or terminated Retailer is generally applied against the Retailer's indebtedness or other obligations to us, if any. The remainder is distributed in shares of Class C common stock until the Retailer meets the stock requirement. The stock requirement is equal to 20 percent of the most recent year purchases from the Company's RSCs (warehouses), including without limitation, bulletin, store-traffic-opportunity-program ("STOP") and private label liquid paint products plus 4 percent of the most recent year purchases shipped directly from the vendor to the Retailer without any physical "handling" by the Company (i.e., dropship and less-than-truckload-plus ("LTL Plus") purchases) (See "Patronage Distributions Determinations"). Once the stock requirement has been satisfied, the remainder of the distribution is made in the form of a Patronage Refund Certificate. For any Retailer that has an outstanding loan due to us that is eligible to be satisfied from patronage distributions, any current amounts due (including principal and interest) are paid from the non-cash portion of the patronage distribution before Class C common stock or Patronage Refund Certificates are issued.

Patronage Distribution Determinations. The total patronage income available for distribution to Retailers is determined after various expenses, including interest expense, and is based on net earnings on patronage business that we do with Retailers. Patronage distributions are allocated separately on each of our three basic categories of sales: handled sales (which include warehouse sales and bulletin sales), direct shipment sales and private label paint sales. The Company also maintains a fourth category of patronage-eligible sales (i.e., under the LTL Plus and STOP programs), for which the products' pricing incorporates the value of an 'upfront' dividend. Accordingly, this fourth category of sales generally operates at a break-even. However, were a net loss to occur with respect to this category (or any of the others), such loss would be offset against the profits of the primary handled sales pool in accordance with the Company's By-laws. Distribution percentage allocations are made with reference to our net earnings from each of the respective patronage pools.

The total patronage distributions distributed to Retailers are based on net earnings on patronage business that we do with Retailers, calculated in accordance with GAAP. Our computation of patronage distributions excludes all of our income and expenses from activities that are not directly related to patronage transactions. The excluded items primarily consist of (1) profits or losses generated from non-shareholder retailers, and (2) profits or losses realized from our Ace Insurance Agency, Inc., New Age Insurance Ltd., Ace Hardware International Holdings, Ltd. and subsidiaries, Ace Retail Holdings LLC and subsidiaries, Ace Wholesale Holdings LLC and subsidiaries, Ace Ecommerce Holdings LLC and subsidiaries and Ace Services Holdings LLC and subsidiaries.

Patronage distributions are usually paid to Retailers within four months after the close of Ace's fiscal year; however, the Internal Revenue Code permits distributions of patronage as late as eight and one-half months after the close of Ace's fiscal year, and Ace may elect to distribute the annual patronage distribution at such later time.

DESCRIPTION OF CAPITAL STOCK

Dividend Rights

Our Certificate of Incorporation and By-laws prohibit us from declaring dividends on any shares of any class of our stock. However, we may distribute shares of Class C Stock to you as a part of your annual patronage distribution based on your purchases.

Voting Rights

Our Class A Stock is voting stock. Class C Stock is non-voting, except that Retailers can vote upon any increase or decrease in the number of authorized shares of that class, any change in the par value of those shares, or anything that would change the power, preferences or special rights of that class so as to adversely affect its shares. Any class of stock that has the right to vote has one vote per share. Cumulative voting of shares for the election of directors or on other matters is not allowed.

Liquidation Rights

If Ace voluntarily or involuntarily liquidates, our net assets after paying or providing for our liabilities (including Patronage Refund Certificates) will be distributed among the shareholders of all classes of our issued and outstanding stock. In that case, holders of Class C Stock would first receive the total amounts that we would have had to pay to repurchase all outstanding shares of that class at the price previously set by our Board of Directors. Were our net assets not sufficient to pay that amount, then each outstanding share of Class C Stock would share in the distribution of our net assets in the proportion which its purchase or redemption price would bear to the total available for payment. Next, our net assets would be distributed equally to each Class A stockholder up to the par value of $1,000 per Class A share. Any remaining net assets would be distributed among the shareholders of all classes of stock proportionally in accordance with the amounts already allocated to them.

Preemptive Rights

Stockholders have no preemptive or similar rights to purchase shares of our stock or any securities that we might offer.

Redemption Provisions

Shares of Class A Stock are not redeemable. Shares of Class C Stock that have been issued as patronage distributions may be redeemed by the Company at any time. The redemption price for Class C Stock cannot be less than its $100 par value per share. Were we to redeem stock as discussed above, we would mail notices to each stockholder at least 30 days before the redemption date. If fewer than all of the outstanding Class C shares were being redeemed, then the number of shares and the method of redemption, whether by lot or prorata or some other way, would be determined by our Board of Directors.

Limitations on Ownership of Stock

Our Retailers own all of our outstanding shares of capital stock. Membership in Ace is limited to approved Retailers in hardware and related products who have membership agreements with us. These are the only persons eligible to own or purchase shares of any class of our stock.

No Retailer is allowed to own more than one share of our Class A voting stock, no matter how many store locations that Retailer owns or controls. This ensures that each Class A stockholder in our cooperative has equal voting power. We treat a Retailer that is a corporation, partnership or similar entity as being controlled by someone else if at least 50 percent of the capital stock (or 50 percent of the profit shares) of that Retailer is owned or controlled by another person or entity.

Other Restrictions and Rights

There is no market for the sale or trading of our stock, and the redemption prices last established by our Board of Directors have not been adjusted since 1974 when Ace first became a cooperative.

(a) As security for your indebtedness to Ace, we retain a first lien upon all your shares of Ace stock and all amounts that you pay us under your Stock Subscription Agreement before your shares are issued. Your interest in your Ace stock and the amounts paid under your Stock Subscription Agreement are always offset by the amount of any indebtedness that you owe us. We will not transfer any of your shares or any funds in your stock subscription account unless you are free from all indebtedness to us. When we repurchase shares from a terminated member as described in section (h) below, the cash portion we would normally pay toward those shares is first applied toward any indebtedness that the terminated member owed to us. The portion of the purchase price of those shares that we would normally pay with an installment note would then be applied toward any indebtedness that remained.

(b) You are not allowed to transfer your shares of our stock or to sell, assign or pledge them, or to post them as collateral or give lien rights in them to anyone other than Ace without our prior consent. If we refuse to consent to a transfer or assignment of your stock to another hardware retailer, then we must purchase that stock back from you as described in section (h) below. You are not entitled to make a transfer or assignment to anyone who is ineligible to become a Retailer of Ace. In other words, approved transfers can only be made to other Retailers who either have Membership Agreements with us or whom we are willing to accept as Retailers. Were you to propose to transfer the ownership of your store location to another Ace Retailer, or to someone whom we are willing to accept as a Retailer, you would have the option of either (i) selling or transferring to that person the same number of shares that we would have been required to offer him or her as a Retailer for that store location, or (ii) selling those shares back to us. However, there are certain types of transfers of your business where you do not have the option of selling those shares back to us. These situations involve (x) any transfer which is not complete, unconditional and irrevocable; (y) any transfer to an entity in which you retain an ownership interest; or (z) any transfer to your spouse.

(c) If your membership terminates for your store location, we must repurchase your shares of Ace stock. Our repurchase obligation is subject to our first lien and our right to set off your indebtedness to us as described in section (a) above. If your stock has not yet been paid for and your shares have not yet been issued, we would instead refund the amounts that you paid under your Stock Subscription Agreement, again subject to our first lien and offset rights described in section (a) above. Your membership can be terminated by a formal notice of termination, and it can also be terminated automatically under our By-laws in each of the following three situations without a formal notice:

(i) If your store permanently closes or ceases business, unless your store is relocated with our consent to another location, or unless your store is being acquired by another Ace Retailer or by someone whom we are willing to accept as a Retailer for operation under the same membership at another location;

(ii) If an individual holder of our shares or a member of a partnership that is a holder of our shares dies, except where the store location having the Ace membership continues, with our consent, to be operated by the deceased person’s estate, heirs or partnership successors. Changes in the legal form of ownership of the Retailer store from an individual proprietorship or partnership to a corporation or from a partnership to an individual proprietorship are not considered significant in these cases;

(iii) If a court or other official body rules that a Retailer is insolvent, or the Retailer assigns the business to be operated for the benefit of creditors, or a voluntary or involuntary bankruptcy or similar petition is filed under the U.S. Bankruptcy Code regarding the Retailer or the store or business unit for which our shares of stock are held.

(d) Under Delaware corporate law, we are not allowed to repurchase any of our shares if the value of our net assets is less than the aggregate par value of the outstanding shares of our capital stock or would be reduced below that amount by virtue of the repurchase.

(e) We do not need to consent to a transfer of shares of Ace stock that occurs when the shares are held jointly with others and the ownership of the shares automatically passes under law to the survivor(s), nor are we obligated to repurchase the shares in that case, unless the store location either (i) permanently closes, or (ii) stops being operated as a Retailer of Ace.

(f) If you hold your Ace membership in the form of a corporation (the "member corporation"), you must give us written notice of any proposal where the holders of 50 percent or more of the voting stock of the member corporation propose to sell or transfer all of their shares of capital stock (both voting and non-voting) of that member corporation. If there is a member corporation but another corporation (the "controlling company") holds 80 percent or more of the voting stock of the member corporation, then you must also give us written notice if the holders of 50 percent or more of the voting stock of the controlling company propose to sell or transfer all of their shares of capital stock (both voting and non-voting) in the controlling company. In these cases, when the sale or transfer occurs, the corporation whose shares were sold or transferred can either keep all the shares of Ace stock that it owns for the member corporation or sell all of those shares of Ace stock back to us. If it chooses to sell all of the shares of Ace stock back to us, it must give us notice within 15 days after the effective date of the sale or transfer and then the memberships for all of the store locations represented by that stock are considered terminated by the Retailer's voluntary action. Once terminated in this way, any store location that wishes to continue being a Retailer must submit a new application for our acceptance. However, there are certain types of transfers of their own company stock by the shareholders of member corporations that do not result in an obligation by Ace to buy back the shares. These situations involve (i) any transfer which is not complete, unconditional and irrevocable; (ii) any transfer to an entity in which the person making the transfer retains an ownership interest; or (iii) any transfer to the spouse of the person making the transfer.

(g) The price that we pay when we repurchase shares of Ace stock is as follows:

(i) For Class A Stock, the $1,000 par value of the shares;

(ii) For Class C Stock, the per share price last set by our Board of Directors, currently $100 per share. This price may not be less than the $100 par value of each of these shares.

As described above, any indebtedness owed us is set off against such proceeds.

(h) When we repurchase our stock from a terminated Retailer, we pay the repurchase amount in the following manner:

(i) we pay cash for the share of Class A stock and shares of Class C stock that the terminating Retailer subscribed for in connection with entering into a Membership Agreement and for which shares the terminating Retailer has already paid cash to us; and

(ii) we issue a non-negotiable, 4-year installment note with an interest rate of 6 percent per annum for a principal amount equal to the amount of the purchase price to be paid by us for (a) shares of Class C stock which exceeds the amount the terminating Retailer paid for such shares in cash, and (b) any shares of Class C stock issued to the terminating Retailer as part of a patronage distribution.

(i) If the repurchase price of a terminating Retailer's capital stock as described above is not enough to satisfy all of such terminating Retailer's indebtedness to Ace, we will apply the face value of the terminating Retailer's Patronage Refund Certificates against such remaining indebtedness as permitted by our By-laws. The terminating Retailer will receive cash for any remaining amount of any Patronage Refund Certificates used for this purpose.

(j) We do not have any conversion rights, sinking fund provisions, or liability to further calls or assessments for any shares of our stock.

FEDERAL INCOME TAXES

The following summaries are based on the Internal Revenue Code of 1986, as amended (the "Code"), legislative history, administrative pronouncements, judicial decisions and final, proposed and temporary Treasury Regulations, changes to any of which may affect the tax consequences that are described below. Any such changes may apply retroactively. You should consult with your own tax advisor with regard to the application of the United States federal income tax laws to your particular situation, as well as any tax consequences to you arising under the laws of any state, local or foreign taxing jurisdiction.

Status of Class A and Class C Shares

If your membership were to terminate for all of your Retailer store locations, and we were to repurchase your shares of Ace stock, that repurchase would include your one share of Class A voting stock. Any such repurchase of such share of Class A Stock would be at its $1,000 par value, the amount you paid for it. You would not realize taxable income from our repurchase of that share.

If we redeem or repurchase your shares of Class C Stock, you could realize taxable income under the Code if the price we paid were to exceed the $100 par value. This could occur if our Board of Directors were to set a higher purchase price for Class C shares at some future date. In this event, unless you still owned our stock for other store locations that remained Retailers, the taxable income you realized at the time of our redemption or repurchase of your Class C shares might qualify for capital gains treatment.

If you were to continue to own shares of Ace stock for other store locations after we redeemed or repurchased your shares for one or more of your locations, the amount we paid you for the redeemed or repurchased shares might be treated as a distribution under the Code and taxed to you as ordinary or dividend income. In that case, the income tax basis of your remaining Ace shares would be increased by an amount equal to your basis in the redeemed or repurchased shares.

"Unstated interest" that is taxable income to you under Section 483 of the Code could occur if your membership is terminated and you receive a four-year installment note from us in partial payment for your stock. (See "Description of Capital Stock – Other Restrictions and Rights.") This would most likely happen if the interest rate payable on the note you received (currently 6 percent) were less than the "applicable federal rate" in effect as of the date of such note.

Tax Treatment of Patronage Distributions

The shares of Class C non-voting stock and the Patronage Refund Certificates that we use to pay patronage distributions are "qualified written notices of allocation" within the meaning of Sections 1381 through 1388 of the Code. These Sections of the Code deal with the income tax treatment of cooperatives and their patrons. The dollar amount stated on a qualified written notice of allocation must be included in the gross income of the person to whom the notice is issued, even though this dollar amount may not actually be paid to the person in the same year that it is taxed.

We receive a deduction for federal income tax purposes for the patronage distributions we pay to patrons (that is, to our eligible and qualifying Retailers) in the form of qualified written notices of allocation if we pay (or apply against any indebtedness that a patron owes us) not less than 20 percent of each patron's total patronage distribution in cash and the patron has consented to including the written notice of allocation at its stated dollar amount in his or her gross income for the taxable year in which he or she receives it. We must also make our patronage distributions to patrons within eight and one-half months after the end of the taxable year.

If you become a "Retailer" by owning one share of Class A voting stock, you are deemed under the Company's By-laws to have consented to include in your gross income the amounts specified in the written notices of allocation that we distribute to you. Pursuant to the Stock Subscription Agreement, Retailers who have subscribed but not yet fully paid for shares of our stock are also deemed to have consented to include in their gross income the dollar amounts of the written notices of allocation distributed to them.

We may be required to backup withhold for federal income tax purposes with respect to your patronage distribution if (i) you have not provided us with a taxpayer identification number, (ii) we are notified by the IRS that your taxpayer identification number is incorrect, or (iii) we are notified by the IRS to subject your patronage distribution to backup withholding. In all instances where we are required to backup withhold, the amount subject to backup withholding is limited to the amount of the patronage distribution treated as paid in cash.

The portion of the patronage distribution that the Company pays you in cash may not be sufficient, depending upon your income tax bracket, to pay all of your income tax on your patronage distribution.

RISKS OF MEMBERSHIP

There are a number of risks that one should consider carefully before making a decision to open an Ace store. Some of the more important of those risks are described below. There may be other features, risks and benefits particularly relevant to you that are not summarized here. See additional risk factors discussed in the financial statements.

Risks Associated With Retail Businesses Generally

Success is highly dependent on your individual skills as an independent business person, including your ability to relate to, deal with and "sell to" retail consumers, and generally your ability to lead and manage your store(s). Your success is also dependent on the level of effort you and your store associates put forth.

Success is also dependent on numerous other variables including merchandise selection and pricing, customer service, consumer preferences, store location and appearance, competition, store operations, labor and other costs, lease terms and costs, interest rates, etc. Some but not all of these variables are within your control.

The retail environment is intensely competitive with many purveyors offering consumers a vast range of different products. In addition, internet-based shopping portals are taking an ever-growing share of consumer wallets, placing additional pressures on traditional brick-and-mortar retailers.

Risks Associated With the Retail Hardware Business

The retail hardware business is highly fragmented and intensely competitive. Our Retailers' competitors include many large companies that have substantially greater market presence, name recognition and financial, marketing and other resources than we do. They also include independent retail hardware stores, some of which are affiliated with other retailer-based hardware cooperatives but others of which are not. These stores often have a strong local following. (See "Ace's Business – Competition.")

Sales of hardware and home improvement goods historically depend to some extent on consumers' discretionary spending. An economic downturn in your local area, or in general, could reduce your customers' willingness or ability to purchase the products you sell. This could cause your business and financial results to suffer.

It is relatively easy for other competitors to enter your market. Increased competition could also occur if existing competitors expand their operations in your market, or adopt innovative pricing strategies, store formats or retail sales methods. Any of these developments could adversely affect your market share, sales and profitability.

Newly opened hardware stores can generally expect to experience negative cash flow and pre-tax losses during their early years as business develops and grows.

Risks Specifically Related to the Ace Retail Hardware Business

While many new stores open each year, and most have done so successfully, a significant number of Ace Retailers terminate their membership every year. A total of 76, 88 and 116 retail outlets terminated their membership in Ace in 2020, 2019 and 2018, respectively. These terminations include both stores that closed permanently and stores that left for a new supplier.

We believe that our trademarks and other proprietary rights are important to our success and our Retailers' competitive position. Our failure or inability to adequately protect these rights could adversely affect the value of our brands and, in turn, the value of your store's Ace branding.

The Ace brand can be adversely affected by negative publicity about product quality or by operating issues at Ace or at one or more Ace-branded stores. All Ace-branded stores (with the exception of the 202 stores owned and operated by ARH, as of January 2, 2021) are owned by our Retailers, not by Ace. Moreover, third parties could file lawsuits against Ace asserting claims for injuries or damages allegedly caused by products sold by us or by one of our Retailers, or other claims. Any one or more of these developments could have an adverse effect on the Ace brand and image and, in turn, on your business results.

Risks Particularly Associated With Your Prospective Store

Although we may have provided you with preliminary information (e.g., retail sales forecasts, site analyses, demographic data, target penetration surveys and similar information) regarding one or more potential sites for your store and the market in which it is or will be located, you assume all responsibility for evaluating and investigating the commercial viability of your store, including its location, the market in which it is located, and your site's lease or purchase terms.

The proforma financial statement and other financial projections (collectively "Projections") that may be prepared for your store are estimates only and are not guarantees of your store's future performance. It is your responsibility to determine whether these Projections are reasonable. Your store's actual financial results are likely to differ from those indicated in the Projections and may do so substantially.

The design and layout of your store can be expected to have a significant effect on its success or failure. While Ace can assist you with store design and layout, you assume responsibility for all aspects of your store's design and layout, including, without limitation, compliance with applicable laws, such as the Americans With Disabilities Act.

The assortment and prices of products you offer for sale in your store can be expected to have a significant effect on its success or failure. While Ace can assist you with recommended product assortment and pricing, you assume responsibility for all aspects of your store's product assortment and pricing.

We cannot predict the amount of funds that you will need in connection with the construction or conversion remodeling of your store or the ongoing operation of your business. You assume full responsibility for determining the amount and source of funds required to open and operate your store.

You will enjoy financial benefits if your store succeeds. However, if your store fails, you might lose your entire investment in the business. You may also owe others amounts in excess of the amount you invested, due to obligations you made to your landlord, your bank(s) and your suppliers, including Ace. We may repurchase merchandise from our retailers, but only in very limited circumstances and never in bulk.

Risks Associated With Ace as Wholesaler and Primary Supplier

You depend on Ace to anticipate and respond in a timely manner to changing consumer demand and preferences regarding hardware, paint and related home-improvement products. These products must appeal to a broad range of consumers whose preferences cannot be predicted with certainty and are subject to change. Additionally, Ace typically makes commitments to purchase products from our suppliers several months in advance of the proposed delivery. If we misjudge the market and fail to purchase the right products in the right quantities, you may not be able to obtain from us the types or quantities of merchandise best suited to your store location. This could cause your sales to decline and your financial results to suffer.

If our suppliers do not provide us with sufficient quantities of products, we may not be able to offer you competitively priced merchandise in the quantities or assortment that you desire. Although Ace purchases merchandise from approximately 4,100 suppliers and no such supplier represents more than 4.1 percent of our total purchases, our dependence on our principal suppliers involves risk. Ace does not have long-term agreements with our suppliers and cannot guarantee that we will be able to maintain our relationships with them. If there is a disruption in our supply sources, we may not be able to obtain the merchandise that you desire for your customers.

We import a significant portion of our inventory from manufacturers outside the United States, particularly in Asia. Importing involves risks including potential disruptions resulting from economic, social and political problems in countries from which merchandise is imported, and duties, tariffs and quotas on imported merchandise. Ace's 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. If we fail to manage our import activities well, you may not be able to purchase from us the products that your customers want to buy from you.

Ace needs to maintain substantial buying power in order to provide you with quality products at a competitive price so you can do the same for your customers. This requires Ace to continue to have a large number of Retailers who purchase in large quantities from Ace. If a significant number of our Retailers were to leave our cooperative for any reason, or were to remain as Retailers but significantly reduce their purchases from us, Ace's ability to purchase in high volume would be negatively affected. This reduction in our buying volume could reduce our leverage with our suppliers, resulting in higher supplier prices to Ace and, in turn, higher prices for the merchandise you purchase from us.

As a wholesaler, Ace must maintain a highly developed and efficient warehouse and distribution network which, in turn, requires Ace's continued investment in facilities, technology, trucking and other equipment. Although we expect that our ongoing operations will enable us to make such investments, there is no guarantee that we will be able to do so.

Risks Associated With Being a Member of the Ace Hardware Cooperative

Although we distribute "patronage distributions" or "patronage rebates" to our Retailers based on the volume of business done with them, we are prohibited from declaring dividends on shares of Ace stock. Your ability to transfer these shares is limited and there is no trading market for them. If you have a store location that is a Retailer of our cooperative and it permanently closes or if your Ace membership is terminated, you can sell your shares only to a new Ace Retailer we approve as a Retailer for your particular store location. If you do not sell your shares in this way, we must repurchase them at par value. We do not expressly set aside any funds to purchase these shares and repurchases can be made only as permitted under Delaware corporate law. Therefore, except for the voting rights which Class A stock has, our stock has financial value to you only if your membership terminates or if Ace is liquidated.

If you become an Ace Retailer, you must report the total amount of your patronage distributions from us as gross income on your federal income tax return. Therefore, your taxable income will include not only the cash portion of your distribution, but also the stated dollar amount of any shares of Class C Stock and Patronage Refund Certificates or the fair market value of any other property included in your patronage distributions. A minimum of 20 percent of your total annual patronage distributions must be paid in cash, unless this cash portion has been applied against your indebtedness to us. Depending on your income tax bracket, this cash portion may not be sufficient to pay all of your income tax liability on your patronage distributions. (See “Membership Information - Patronage Distributions” and “Federal Income Taxes – Tax Treatment of Patronage Distributions.”)

Our Board of Directors has the authority to establish reasonable reserves, thereby reducing or even eliminating the amount of our net earnings available for distribution as patronage distributions. Our Board of Directors also has the authority to change the patronage distribution plan and, if they were to do so, the cash portion of your patronage distribution could be adversely affected.

Risks Associated With Your Prospective Store and Ace as a Wholesaler

We rely 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 our business, we also rely 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 our Retailers. Our systems and the third-party systems on which we rely 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 we and our third-party service providers seek to maintain our 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 our or our service providers’ systems are damaged, breached or cease to function properly, this could significantly disrupt our operations and be costly, time consuming and resource-intensive to remedy. Any disruption in the operation of these management information systems, or our failure or inability to continue to upgrade, integrate and expend capital on them, could have a material adverse effect on Ace’s ability to sell merchandise and provide cost-effective services to you, and, in turn, on your ability to order merchandise, operate your POS system at retail and/or manage and track your inventory levels.

Ace, our third-party system providers and our individual retail stores 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.

Cyber threats are rapidly evolving and those threats and the means for obtaining access to information in digital and other storage media are becoming increasingly sophisticated. Any breach of Ace’s, our third-party system providers’ or our individual retail stores’ 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 Ace’s reputation and expose Ace to claims from customers, vendors, financial institutions, regulators, payment card associations, employees and others, any of which could have a material adverse effect on Ace, its financial condition and results of operations.

Risks Associated With the Current COVID-19 Pandemic

The pandemic and shelter-in-place orders caused a substantial increase in demand for many of the products sold at U.S. Ace stores, as consumers channeled a disproportionate amount of their discretionary spending into their homes and gardens. During this period, many of Ace’s suppliers have been and continue to be unable to meet the increase in demand for their products, which has negatively impacted Ace’s ability to fulfill Retailer orders for product. As a result, Ace’s service level to its Retailers fell from 96.3 percent in 2019 to 71.3 percent in 2020. As your primary supplier, you depend on Ace to provide you with most of the products you need to meet consumer demand in your store. If we are unable to obtain sufficient quantities of products from our suppliers to meet your demand, you may not be able to purchase from us the products that your customers want to buy from you.

Federal, state and local governmental orders have forced many retail businesses to close, reduce hours, limit occupancy and pay employees for time-off for health reasons. As an essential business, Ace retail stores were allowed to continue to operate throughout the pandemic in all 50 states albeit at reduced hours, reduced occupancy and reduced staffing levels in many cases. A resurgence of the virus could cause additional challenges for Retailers including and up to extended store closures.