ACE HARDWARE CORPORATION
Quarterly report for the period ended July 2, 2016

ACE HARDWARE CORPORATION
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

	Page
Review Report of Independent Auditors	2
Consolidated Balance Sheets as of July 2, 2016 (Unaudited), January 2, 2016 and July 4, 2015 (Unaudited)	3
Consolidated Statements of Income (Unaudited) for the three and six months ended July 2, 2016 and July 4, 2015	4
Consolidated Statements of Comprehensive Income (Unaudited) for the three and six months ended July 2, 2016 and July 4, 2015	5
Consolidated Statements of Equity (Unaudited) for the six months ended July 2, 2016 and July 4, 2015	6
Consolidated Statements of Cash Flows (Unaudited) for the six months ended July 2, 2016 and July 4, 2015	7
Notes to Consolidated Financial Statements (Unaudited)	8
Management's Discussion and Analysis of Financial Condition and Results of Operations	15
Management's Responsibility for Financial Statements	22

Review Report of Independent Auditors

The Board of Directors
Ace Hardware Corporation

We have reviewed the consolidated financial information of Ace Hardware Corporation, which comprise the consolidated balance sheets as of July 2, 2016 and July 4, 2015 and the related consolidated statements of income and comprehensive income for the three and six-month periods ended July 2, 2016 and July 4, 2015, and the consolidated statements of equity and cash flows for the six-month periods ended July 2, 2016 and July 4, 2015.

Management's Responsibility for the Financial Statements

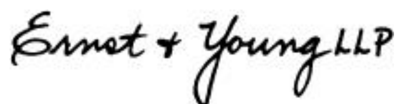
Management is responsible for the preparation and fair presentation of the interim financial information in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in conformity with U.S. generally accepted accounting principles.

Auditor's Responsibility

Our responsibility is to conduct our review in accordance with auditing standards generally accepted in the United States applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.

Conclusion

Based on our review, we are not aware of any material modifications that should be made to the consolidated financial information referred to above for it to be in conformity with U.S. generally accepted accounting principles.



Chicago, Illinois
August 15, 2016

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

	July 2, 2016 (Unaudited)	January 2, 2016 (Audited)	July 4, 2015 (Unaudited)
Assets			
Cash and cash equivalents	$ 19.1	$ 11.3	$ 35.3
Marketable securities	47.5	47.1	42.8
Receivables, net of allowance for doubtful accounts of $8.2, $8.3 and $7.9, respectively	440.5	375.3	469.5
Inventories	774.7	714.5	807.1
Prepaid expenses and other current assets	46.2	45.1	53.4
Total current assets	1,328.0	1,193.3	1,408.1
Property and equipment, net	321.5	318.1	316.8
Notes receivable, net of allowance for doubtful accounts of $8.0, $8.7 and $9.4, respectively	13.7	11.8	15.8
Goodwill and other intangible assets	35.0	35.3	35.7
Other assets	98.1	98.7	87.2
Total assets	$ 1,796.3	$ 1,657.2	$ 1,863.6
Liabilities and Equity			
Current maturities of long-term debt	$ 19.7	$ 27.2	$ 19.4
Accounts payable	786.5	552.5	799.0
Patronage distributions payable in cash	33.7	57.5	31.6
Patronage refund certificates payable	8.5	8.6	6.6
Accrued expenses	146.7	172.9	147.7
Total current liabilities	995.1	818.7	1,004.3
Long-term debt	162.2	242.2	282.4
Patronage refund certificates payable	55.4	41.3	42.2
Other long-term liabilities	65.6	58.9	56.8
Total liabilities	1,278.3	1,161.1	1,385.7
Member Retailers' Equity:			
Class A voting common stock, $1,000 par value, 10,000 shares authorized, 2,714; 2,734 and 2,739 issued and outstanding, respectively	2.7	2.7	2.7
Class C nonvoting common stock, $100 par value, 6,000,000 shares authorized, 4,204,885; 3,756,627 and 3,847,785 issued and outstanding, respectively	420.5	375.7	384.8
Class C nonvoting common stock, $100 par value, issuable to retailers for patronage distributions, 293,685; 564,155 and 300,284 shares issuable, respectively	29.4	56.4	30.0
Contributed capital	20.2	20.7	20.7
Retained earnings	35.4	28.4	26.0
Accumulated other comprehensive (loss) income	(2.0)	0.2	1.2
Equity attributable to Ace member retailers	506.2	484.1	465.4
Equity attributable to noncontrolling interests	11.8	12.0	12.5
Total equity	518.0	496.1	477.9
Total liabilities and equity	$ 1,796.3	$ 1,657.2	$ 1,863.6

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited, in millions)

	Three Months Ended		Six Months Ended	
	July 2, 2016 (13 Weeks)	**July 4, 2015 (13 Weeks)**	**July 2, 2016 (26 Weeks)**	**July 4, 2015 (26 Weeks)**
Revenues:				
Wholesale revenues	$ 1,338.8	$ 1,332.1	$ 2,525.0	$ 2,471.9
Retail revenues	87.4	85.4	138.0	131.7
Total revenues	1,426.2	1,417.5	2,663.0	2,603.6
Cost of revenues:				
Wholesale cost of revenues	1,166.3	1,168.6	2,219.2	2,170.3
Retail cost of revenues	49.1	48.3	75.7	72.3
Total cost of revenues	1,215.4	1,216.9	2,294.9	2,242.6
Gross profit:				
Wholesale gross profit	172.5	163.5	305.8	301.6
Retail gross profit	38.3	37.1	62.3	59.4
Total gross profit	210.8	200.6	368.1	361.0
Distribution operations expenses	34.2	33.5	67.6	64.5
Selling, general and administrative expenses	41.0	33.0	83.9	76.3
Retailer success and development expenses	42.4	39.0	71.4	69.7
Retail operating expenses	25.9	25.7	49.1	47.7
Warehouse facility closure costs	-	0.2	-	1.7
Total operating expenses	143.5	131.4	272.0	259.9
Operating income	67.3	69.2	96.1	101.1
Interest expense	(3.2)	(5.8)	(6.6)	(9.3)
Interest income	0.9	0.9	1.7	1.7
Other income, net	1.8	1.6	3.1	3.8
Income tax expense	(3.4)	(6.0)	(4.8)	(7.5)
Net income	63.4	59.9	89.5	89.8
Less: net income attributable to noncontrolling interests	0.2	2.4	0.3	2.4
Net income attributable to Ace Hardware Corporation	$ 63.2	$ 57.5	$ 89.2	$ 87.4
Patronage distributions accrued	$ 54.9	$ 43.9	$ 84.2	$ 78.4
Patronage distributions accrued for third party retailers	$ 53.9	$ 43.1	$ 82.2	$ 76.8

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited, in millions)

	Three Months Ended		Six Months Ended	
	July 2, 2016 (13 Weeks)	July 4, 2015 (13 Weeks)	July 2, 2016 (26 Weeks)	July 4, 2015 (26 Weeks)
Net income	$ 63.4	$ 59.9	$ 89.5	$ 89.8
Other comprehensive loss, net of tax:				
Unrealized gain (loss) on investments	0.2	(0.4)	0.5	(0.2)
Unrealized loss on derivative financial instrument	(0.8)	-	(2.7)	(0.3)
Total other comprehensive loss, net	(0.6)	(0.4)	(2.2)	(0.5)
Comprehensive income	62.8	59.5	87.3	89.3
Less: Comprehensive income attributable to noncontrolling interest	0.2	2.4	0.3	2.4
Comprehensive income attributable to Ace Hardware Corporation	$ 62.6	$ 57.1	$ 87.0	$ 86.9

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION
CONSOLIDATED STATEMENTS OF EQUITY
(Unaudited, 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 Other Comprehensive Income (Loss)	Noncontrolling Interests	Total Equity
Balances at January 3, 2015	$ 2.8	$ 342.5	$ 56.5	$ -	$ 20.6	$ 15.5	$ 1.7	$ 10.2	$ 449.8
Net income	-	-	-	-	-	87.4	-	2.4	89.8
Other comprehensive loss	-	-	-	-	-	-	(0.5)	-	(0.5)
Net payments on subscriptions	-	-	-	0.6	-	-	-	-	0.6
Stock issued	-	56.4	(56.5)	(0.6)	-	-	-	-	(0.7)
Repurchase of noncontrolling interest	-	-	-	-	0.1	-	-	(0.1)	-
Stock repurchased	(0.1)	(14.1)	-	-	-	-	-	-	(14.2)
Patronage distributions issuable	-	-	30.0	-	-	-	-	-	30.0
Patronage distributions payable	-	-	-	-	-	(76.8)	-	-	(76.8)
Other	-	-	-	-	-	(0.1)	-	-	(0.1)
Balances at July 4, 2015	$ 2.7	$ 384.8	$ 30.0	$ -	$ 20.7	$ 26.0	$ 1.2	$ 12.5	$ 477.9
Balances at January 2, 2016	$ 2.7	$ 375.7	$ 56.4	$ -	$ 20.7	$ 28.4	$ 0.2	$ 12.0	$ 496.1
Net income	-	-	-	-	-	89.2	-	0.3	89.5
Other comprehensive loss	-	-	-	-	-	-	(2.2)	-	(2.2)
Net payments on subscriptions	-	-	-	0.5	-	-	-	-	0.5
Stock issued	-	55.8	(56.4)	(0.5)	-	-	-	-	(1.1)
Issuance of noncontrolling interest	-	-	-	-	(0.2)	-	-	0.2	-
Repurchase of noncontrolling interest	-	-	-	-	(0.5)	-	-	(0.7)	(1.2)
Stock repurchased	-	(11.0)	-	-	-	-	-	-	(11.0)
Patronage distributions issuable	-	-	29.4	-	-	-	-	-	29.4
Patronage distributions payable	-	-	-	-	-	(82.2)	-	-	(82.2)
Other	-	-	-	-	0.2	-	-	-	0.2
Balances at July 2, 2016	$ 2.7	$ 420.5	$ 29.4	$ -	$ 20.2	$ 35.4	$ (2.0)	$ 11.8	$ 518.0

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in millions)

	Six Months Ended	
	July 2, 2016 (26 Weeks)	**July 4, 2015 (26 Weeks)**
Operating Activities		
Net income	$ 89.5	$ 89.8
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	25.3	25.4
Amortization of deferred financing costs	0.2	0.5
Loss on early extinguishment of debt	-	2.2
Gain on disposal of assets, net	(0.1)	(0.1)
Provision for doubtful accounts	(0.3)	2.5
Other, net	0.1	-
Changes in operating assets and liabilities, exclusive of effect of acquisitions:		
Receivables	(83.0)	(112.9)
Inventories	(59.7)	(110.5)
Other current assets	(1.1)	(1.7)
Other long-term assets	1.0	(0.8)
Accounts payable and accrued expenses	210.5	182.3
Other long-term liabilities	2.6	(10.6)
Deferred taxes	0.3	0.3
Net cash provided by operating activities	185.3	66.4
Investing Activities		
Purchases of marketable securities	(2.3)	(4.4)
Proceeds from sale of marketable securities	2.7	3.5
Purchases of property and equipment	(30.5)	(16.8)
Cash paid for acquired businesses, net of cash acquired	(0.6)	(5.6)
Decrease in notes receivable, net	1.1	0.8
Other	-	0.1
Net cash used in investing activities	(29.6)	(22.4)
Financing Activities		
Net (payments) borrowings under revolving lines of credit	(88.9)	186.7
Principal payments on long-term debt	(3.7)	(173.2)
Payments of deferred financing costs	-	(1.1)
Payments of cash portion of patronage distribution	(53.7)	(48.9)
Payments of patronage refund certificates	(0.2)	(0.1)
Repurchase of stock	(0.7)	(2.5)
Repurchase of noncontrolling interest	(1.2)	-
Other	0.5	0.6
Net cash used in financing activities	(147.9)	(38.5)
Increase in cash and cash equivalents	7.8	5.5
Cash and cash equivalents at beginning of period	11.3	29.8
Cash and cash equivalents at end of period	$ 19.1	$ 35.3
Supplemental disclosure of cash flow information:		
Interest paid	$ 6.2	$ 6.1
Income taxes paid	$ 0.6	$ 0.7

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited, in millions)

1) Summary of Significant Accounting Policies

The Company and Its Business

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

On December 31, 2014, Ace Wholesale Holdings LLC ("AWH") acquired all of the outstanding member units of Jensen-Byrd Co., LLC ("Jensen"), a wholesale hardlines distributor. On February 19, 2014, AWH acquired all of the outstanding shares of capital stock of Emery-Waterhouse ("Emery"), a distributor of hardlines products for independent lumber, paint, industrial and hardware outlets. Immediately following the acquisition of Emery, AWH sold a 5 percent noncontrolling interest in Emery to Emery's current Chief Executive Officer.

Ace Retail Holdings LLC ("ARH") is the owner of the 94 store Westlake Ace Hardware retail chain. As a result, the Company is also a retailer of hardware, paint and other related products.

The Company's international operations are a stand-alone legal entity with its own management team and board of directors. The entity Ace Hardware International Holdings, Ltd. ("AIH") is a majority-owned and controlled subsidiary of the Company with a noncontrolling interest owned by its international retailers. International retailers do not own shares of stock in the Company nor receive patronage dividends.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). Certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted. The unaudited consolidated financial statements and notes should be read in conjunction with the financial statements and notes thereto included in the Company's 2015 Annual Report. The unaudited consolidated financial statements for the three and six months ended July 2, 2016 and July 4, 2015 both cover a 13-week period and a 26-week period, respectively.

Subsequent events have been evaluated through August 15, 2016, the date these statements were available to be issued.

The financial information included herein reflects all adjustments (consisting only of normal recurring adjustments), which, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. The results of operations for the three and six months ended July 2, 2016 are not necessarily indicative of the results to be expected for the full fiscal year 2016.

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.

Impact of New Accounting Standards

New Accounting Pronouncements - Issued

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." The purpose of ASU 2014-09 is to develop a common revenue recognition standard for GAAP and International Financial Reporting Standards. The guidance in this update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 allows either full retrospective adoption, meaning the standard is applied to all periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements. In March 2016, the FASB issued ASU No. 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)." ASU 2016-08 clarifies the implementation guidance on principal versus agent considerations in the FASB Accounting Standards Codification Topic 606. Under ASU 2016-08, an entity assesses its control of goods or services before transfer to the customer to determine if it is acting as principal or agent. Both ASU 2014-09 and ASU 2016-08 are effective for the Company for annual reporting periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. The Company is evaluating the impact that ASU 2014-09 and 2016-08 will have on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." ASU 2016-02 requires that lessees recognize assets and liabilities for leases with lease terms greater than twelve months in the statement of financial position. ASU 2016-02 also requires improved disclosures to help users of financial statements better understand the amount, timing and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for the Company for annual reporting periods beginning after December 15, 2019, and interim periods within annual periods beginning after December 15, 2020. The Company is evaluating the impact that ASU 2016-02 will have on the Company's consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-04, "Liabilities – Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products." ASU 2016-04 amends the guidance for extinguishing financial liabilities for certain prepaid stored-value products. According to ASU 2016-04, breakage is recognized proportionally as the prepaid stored-value product is being redeemed or when the likelihood becomes remote that the holder will exercise its remaining rights. ASU 2016-04 is effective for the Company for annual reporting periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. The provisions of ASU 2016-04 will not have a material impact on the Company's balance sheet or operating results.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." ASU 2016-13 requires that 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 on 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 annual reporting periods beginning after December 15, 2020, and interim periods within annual periods beginning after December 15, 2021. The Company is evaluating the impact that ASU 2016-13 will have on the Company's consolidated financial statements.

(2) Inventories

Inventories consist of wholesale merchandise inventories held for sale to retailers and retail merchandise inventory held for resale at company-operated retail 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 $88.2 million, $88.2 million and $94.0 million at July 2, 2016, January 2, 2016 and July 4, 2015, respectively. The Company periodically reviews its inventory and establishes a reserve for excess and obsolete inventory based on a number of factors, including historical sales, sales forecast, obsolescence due to technology changes and defective goods.

Inventories consisted of:

	July 2, 2016	January 2, 2016	July 4, 2015
Wholesale merchandise inventory (LIFO)	$ 690.6	$ 637.5	$ 722.8
Retail merchandise inventory at Company-operated stores (FIFO)	84.1	77.0	84.3
Inventories	$ 774.7	$ 714.5	$ 807.1

(3) Debt

On May 29, 2015, the Company amended its secured credit facility which was originally dated April 13, 2012 and previously amended on July 29, 2013. The May 2015 amendment extended the maturity date to May 29, 2020 and lowered the interest rate credit spread by 25 basis points. The amended credit facility consists of a $600.0 million line of credit that is expandable to $750.0 million through a $150.0 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. Borrowings under the amended credit facility bear interest at a rate of either 25 to 100 basis points over the prime rate or 125 to 200 basis points over the London Interbank Offered Rate ("LIBOR") depending on the Company's leverage ratio as defined under the agreement. The amended credit facility was priced at LIBOR plus 150 basis points at July 2, 2016. The amended credit facility requires maintenance of certain financial covenants including a maximum allowable average leverage ratio and a minimum fixed charge coverage ratio. As of July 2, 2016, the Company was in compliance with its covenants and $149.2 million was outstanding under the amended credit facility.

The amended credit facility includes a $175.0 million sublimit for the issuance of standby and commercial letters of credit. As of July 2, 2016, a total of $27.5 million in letters of credit were outstanding. The revolving credit facility requires the Company to pay fees based on the unused portion of the line of credit at a rate of 15 to 30 basis points per annum depending on the Company's leverage ratio.

The amended 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 July 2, 2016, there were no loans or other extensions of credit provided to AIH.

In order to reduce the risk of interest rate volatility, the Company entered into an interest rate swap derivative agreement in June 2012, which expires on March 13, 2017. This swap agreement fixes the LIBOR rate on a portion of the revolving credit facility at 1.13%, resulting in an effective rate of 2.63% after adding the 1.50% margin based on the current pricing tier per the credit agreement. The notional amount of the derivative agreement decreases by $5.0 million each quarter through expiration of the interest rate swap derivative agreement in March 2017. As of July 2, 2016, the notional amount of the interest rate swap agreement remaining was $140.0 million. The Company entered into a forward interest rate swap derivative agreement in June 2015 to reduce the risk of interest rate volatility for the remaining term of the amended credit facility. The forward interest rate swap starts on March 13, 2017 and expires on May 13, 2020. The forward swap agreement fixes the LIBOR rate on $150.0 million of the revolving credit facility at 2.18%, resulting in an effective rate of 3.68% after adding the 1.50% margin based on the current pricing tier per the credit agreement. The swap arrangements have been designated as cash flow hedges and have been evaluated to be highly effective. As a result, the after-tax change in the fair value of the swaps are recorded in AOCI as a gain or loss on derivative financial instruments.

The Company's ARH subsidiary has a $60.0 million asset-based revolving credit facility ("ARH Facility"). The ARH Facility matures on June 28, 2019 and is expandable to $85.0 million under certain conditions. In addition, the Company has the right to issue letters of credit up to a maximum of $7.5 million. At the Company's discretion, borrowings under this facility bear interest at a rate of either the prime rate plus an applicable spread of 35 basis points to 75 basis points or LIBOR plus an applicable spread of 135 basis points to 175 basis points, depending on the Company's availability under the ARH Facility as measured on a quarterly basis.

The ARH Facility is collateralized by substantially all of ARH'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 July 2, 2016, ARH was in compliance with its covenants and had $12.1 million in loans outstanding under the ARH Facility.

The ARH Facility requirements include a lender-controlled cash concentration system that results in all of ARH's daily available cash being applied to the outstanding borrowings under this facility. Pursuant to FASB Accounting Standards Codification Section 470-10-45, "Classification of Revolving Credit Agreements Subject to Lock-Box Arrangements and Subjective Acceleration Clauses," the borrowings under the ARH Facility have been classified as a Current maturity of long-term debt as of July 2, 2016.

Total debt outstanding is comprised of the following:

	July 2, 2016	January 2, 2016	July 4, 2015
Revolving Credit Facility	$ 149.2	$ 230.1	$ 273.4
ARH Facility	12.1	20.1	13.3
Installment notes with maturities through 2020 at a fixed rate of 6.00%	20.6	19.2	15.1
Total debt	181.9	269.4	301.8
Less: maturities within one year	(19.7)	(27.2)	(19.4)
Long-term debt	$ 162.2	$ 242.2	$ 282.4

(4) Fair Value

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 July 2, 2016, January 2, 2016 and July 4, 2015. 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.

Items measured at fair value on a recurring basis	Carrying Value Measured at Fair Value July 2, 2016	Level 1	Level 2	Level 3
Assets:				
Cash equivalents:				
Money market funds	$ 3.8	$ 3.8	$ -	$ -
Marketable securities:				
Corporate fixed income securities	15.5	-	15.5	-
Fixed income and equity mutual fund securities	12.3	12.3	-	-
Mortgage-backed securities	5.2	-	5.2	-
U.S. government notes	13.0	13.0	-	-
Other	1.5	-	1.5	-
Total marketable securities	$ 47.5	$ 25.3	$ 22.2	$ -
Accrued expenses and Other long-term liabilities:				
Interest rate swap derivative	$ 7.2	$ -	$ 7.2	$ -

Items measured at fair value on a recurring basis	Carrying Value Measured at Fair Value January 2, 2016	Level 1	Level 2	Level 3
Assets:				
Cash equivalents:				
Money market funds	$ 3.0	$ 3.0	$ -	$ -
Marketable securities:				
Corporate fixed income securities	15.1	-	15.1	-
Fixed income and equity mutual fund securities	13.0	13.0	-	-
Mortgage-backed securities	6.0	-	6.0	-
U.S. government notes	11.5	11.5	-	-
Other	1.5	-	1.5	-
Total marketable securities	$ 47.1	$ 24.5	$ 22.6	$ -
Other long-term liabilities:				
Interest rate swap derivative	$ 2.8	$ -	$ 2.8	$ -

Items measured at fair value on a recurring basis	Carrying Value Measured at Fair Value July 4, 2015	Level 1	Level 2	Level 3
Assets:				
Cash equivalents:				
Money market funds	$ 9.0	$ 9.0	$ -	$ -
Marketable securities:				
Corporate fixed income securities	12.6	-	12.6	-
Fixed income and equity mutual fund securities	11.9	11.9	-	-
Mortgage-backed securities	6.0	-	6.0	-
U.S. government notes	11.4	11.4	-	-
Other	0.9	-	0.9	-
Total marketable securities	$ 42.8	$ 23.3	$ 19.5	$ -
Other long-term liabilities:				
Interest rate swap derivative	$ 1.6	$ -	$ 1.6	$ -

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

Corporate fixed income securities and Mortgage-backed securities - The Company's valuation techniques used to measure the fair values of corporate fixed income securities and mortgage-backed 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 exceeded their cost by $3.5 million and $3.4 million at July 2, 2016 and July 4, 2015, respectively. Gross proceeds from the sale of marketable securities and the related realized gains and losses for the three and six months ended July 2, 2016 and July 4, 2015 were as follows:

	Three Months Ended		**Six Months Ended**	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
Gross proceeds	$ 2.0	$ 1.9	$ 2.7	$ 3.5
Gross realized gains	0.1	-	0.1	0.1
Gross realized losses	-	-	-	-

Gross realized gains and losses were determined using the specific identification method. For the six months ended July 2, 2016, the Company reclassified $0.1 million of unrealized gains and an immaterial amount of unrealized losses on marketable securities that were recorded in AOCI as of January 2, 2016 into realized income. These amounts were recorded to Other income, net in the Consolidated Statements of Income.

The following table summarizes the contractual maturity distributions of the Company's debt securities at July 2, 2016. Actual maturities may differ from the contractual or expected maturities since borrowers may have the right to prepay obligations with or without prepayment penalties.

Fair value of available-for-sale debt securities	Due in One Year or Less	Due After One Year through Five Years	Due After Five Years through Ten Years	Due After Ten Years	Total
Corporate fixed income securities	$ 0.4	$ 6.2	$ 6.4	$ 2.5	$ 15.5
Mortgage-backed securities	-	0.3	1.0	3.9	5.2
U.S. government notes	0.4	8.3	1.1	3.2	13.0
Other	-	0.3	0.4	0.8	1.5
Total	$ 0.8	$ 15.1	$ 8.9	$ 10.4	$ 35.2

The Company uses variable-rate LIBOR debt to finance its operations. These debt obligations expose the Company to interest rate volatility risk. The Company attempts 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.

On June 5, 2012, the Company entered into a 58-month interest rate swap agreement, which expires on March 13, 2017, with an amortizing notional amount of $200.0 million. This instrument is being used to fix the LIBOR rate on a portion of the revolving credit facility at 1.13%, resulting in an effective rate of 2.63% after adding the 1.50% margin based on the current pricing tier per the credit agreement. As of July 2, 2016, the notional amount of the 58-month interest rate swap agreement remaining was $140.0 million. The Company entered into a forward interest rate swap derivative agreement in June 2015, which starts on March 13, 2017 and expires on May 13, 2020. The forward swap agreement fixes the LIBOR rate on $150.0 million of the revolving credit facility at 2.18%, resulting in an effective rate of 3.68% after adding the 1.50% margin based on the current pricing tier per the credit agreement.

The fair value of the Company's interest rate swaps are estimated using Level 2 inputs, which are based on model-derived valuations in which all significant inputs and significant value drivers are observable in active markets. The Company also considers counterparty credit-risk and bilateral or "own" credit risk adjustments in estimating fair value, in accordance with the requirements of GAAP. As of July 2, 2016, the fair values of the interest rate swap and forward interest rate swap were liability balances of $0.6 million and $6.6 million, respectively. The Company classifies current derivative liabilities as Accrued expenses and long-term derivative liabilities as Other long-term liabilities on the Consolidated Balance Sheets.

Because the interest rate swaps have been designated as cash flow hedges and have been evaluated to be highly effective, the change in the fair value is recorded in AOCI as a gain or loss on derivative financial instruments. The amount in AOCI is reclassified to earnings if the derivative instruments are sold, extinguished or terminated, or at the time they become expected to be sold, extinguished or terminated. As of July 2, 2016, the net of tax amount recorded in AOCI for the fair value adjustment of the interest rate swaps was an unrealized loss of $4.4 million. This unrealized loss is not expected to be reclassified into interest expense within the next 12 months. The impact of any ineffectiveness is recognized in earnings. However, there was no hedge ineffectiveness related to the interest rate swaps for the three and six months ended July 2, 2016.

The Company's debt instruments are recorded at cost on the Consolidated Balance Sheets. The fair value of long-term debt was approximately $189.0 million at July 2, 2016, compared to the carrying value, including accrued interest, of $182.5 million.

(5) Income Taxes

Income tax differs from the amount computed by applying the statutory U.S. Federal income tax rate of 35% to income before income taxes because of the effect of the following items:

	Three Months Ended		Six Months Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
Expected tax at U.S. Federal income tax rate	$ (23.4)	$ (23.1)	$ (33.0)	$ (34.1)
Patronage distribution deductions	18.8	15.1	28.7	26.9
Other, net	1.2	2.0	(0.5)	(0.3)
Income tax expense	$ (3.4)	$ (6.0)	$ (4.8)	$ (7.5)

(6) Supplemental Disclosures of Cash Flow Information

During the six months ended July 2, 2016 and July 4, 2015, accrued patronage distributions of $4.7 million and $5.2 million, respectively, were offset against receivables owed to the Company by its member retailers with no net impact in the Consolidated Statements of Cash Flows.

During the six months ended July 2, 2016 and July 4, 2015, non-cash repurchases of stock from retailers of $10.3 million and $11.7 million, respectively, were offset against receivables of $4.1 million and $4.4 million, respectively, and notes receivable of $1.2 million and $2.8 million, respectively. The remaining $5.0 million and $4.5 million, respectively, were primarily issued as notes payable with no net impact in the Consolidated Statements of Cash Flows.

During fiscal 2012, the Company entered into an interest rate swap derivative dated June 5, 2012. In June 2015, the Company entered into a forward interest rate swap derivative agreement, which starts on March 13, 2017 and expires on May 13, 2020. The fair value adjustments for the interest rate swap derivatives were recorded as Accrued expenses and Other long-term liabilities of $7.2 million as of July 2, 2016 and as Other long-term liabilities of $1.6 million as of July 4, 2015. The Company offset these adjustments in fair value, net of tax, against AOCI with no net impact in the Consolidated Statements of Cash Flows.

During the six months ended July 2, 2016, the Company received $0.9 million of property and equipment prior to quarter 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 the six months ended July 2, 2016. During the six months ended July 2, 2016, the Company paid $3.4 million for property and equipment that was purchased in fiscal 2015 and accrued as of January 2, 2016. These capital expenditures were included in the Purchases of property and equipment in the Consolidated Statement of Cash Flows for the six months ended July 2, 2016.

(7) Warehouse Facility Closure Costs

During the three and six months ended July 4, 2015, the Company recorded additional charges of $0.2 million and $1.7 million, respectively, related to the settlement of a withdrawal liability for the multi-employer pension fund that covers the former union employees at the closed Retail Support Center in Toledo, Ohio. The Company paid $6.4 million to settle its obligation with the multi-employer pension fund during the second quarter of 2015.

(8) Commitments and Contingencies

The Company has certain contingencies resulting from litigation and claims incident to the ordinary course of business. During the second quarter of 2015, the Company received a settlement related to the resolution of a gain contingency which was recorded as a $10.0 million reduction of Selling, general and administrative expenses.

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

The following discussion and analysis summarizes the significant factors affecting the Company's consolidated operating results and financial condition during the three- and six-month periods ended July 2, 2016 and July 4, 2015. This discussion and analysis should be read in conjunction with the Company's 2015 Annual Report, as well as the consolidated financial statements (unaudited) and notes thereto contained in this report that have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). Results of the interim periods presented are not necessarily indicative of the results to be expected for the full fiscal year due to seasonal and other factors.

Results of Operations

Comparison of the Three Months Ended July 2, 2016 to the Three Months Ended July 4, 2015

The following data summarizes the Company's performance in 2016 as compared to 2015 (in millions):

	2016		2015		Increase/(decrease)	
	$	% of Revenues*	$	% of Revenues*	$	%
Revenues:						
Wholesale revenues	1,338.8	93.9%	1,332.1	94.0%	6.7	0.5%
Retail revenues	87.4	6.1%	85.4	6.0%	2.0	2.3%
Total revenues	1,426.2	100.0%	1,417.5	100.0%	8.7	0.6%
Gross profit:						
Wholesale gross profit	172.5	12.9%	163.5	12.3%	9.0	5.5%
Retail gross profit	38.3	43.8%	37.1	43.4%	1.2	3.2%
Total gross profit	210.8	14.8%	200.6	14.2%	10.2	5.1%
Operating expenses:						
Wholesale operating expenses	117.6	8.8%	105.5	7.9%	12.1	11.5%
Retail operating expenses	25.9	29.6%	25.7	30.1%	0.2	0.8%
Warehouse facility closure costs	-	0.0%	0.2	0.0%	(0.2)	(100.0%)
Total operating expenses	143.5	10.1%	131.4	9.3%	12.1	9.2%
Operating income	67.3	4.7%	69.2	4.9%	(1.9)	(2.7%)
Interest expense	(3.2)	(0.2%)	(5.8)	(0.4%)	2.6	44.8%
Other income (expense)	(0.9)	(0.1%)	(5.9)	(0.4%)	5.0	84.7%
Net income attributable to Ace Hardware Corporation	63.2	4.4%	57.5	4.1%	5.7	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.

Consolidated revenues for the three months ended July 2, 2016, totaled $1.4 billion, an increase of $8.7 million, or 0.6%, as compared to the prior year. A reconciliation of consolidated revenues follows (in millions):

	Amount	% Change vs. 2015
2015 Revenues	$ 1,417.5	
Wholesale Merchandise Revenues change based on new and cancelled domestic stores:		
Revenues increase from new stores added since January 2015	29.1	2.1%
Net decrease from stores cancelled since January 2015	(14.1)	(1.0%)
Decrease in wholesale merchandise revenues to comparable domestic stores	(3.0)	(0.2%)
Increase in AWH revenues	4.1	0.3%
Increase in ARH revenues	2.0	0.1%
Decrease in AIH revenues	(5.2)	(0.4%)
Other wholesale revenue changes, net	(4.2)	(0.3%)
2016 Revenues	$ 1,426.2	0.6%

Total wholesale revenues were $1.3 billion, an increase of $6.7 million, or 0.5%, as compared to the prior year. The categories with the largest revenue gains were outdoor living, paint and lawn and garden.

New stores are defined as stores that were activated from January 2015 through June 2016. In 2016, the Company had an increase in wholesale merchandise revenues from new domestic stores of $29.1 million. This increase was partially offset by a

decrease in wholesale merchandise revenues due to domestic store cancellations of $14.1 million. As a result, the Company realized a net increase in wholesale merchandise revenues of $15.0 million related to the impact of both new stores affiliated with the Company and from stores that cancelled their membership in 2015 and 2016. Wholesale merchandise revenues to comparable domestic stores decreased $3.0 million.

The number of the Company's domestic retail outlets is summarized as follows:

	Three Months Ended	
	July 2, 2016	July 4, 2015
Retail outlets at beginning of period	4,302	4,252
New retail outlets added	42	31
Retail outlet cancellations	(29)	(27)
Retail outlets at end of period	4,315	4,256

Revenues from the Ace Wholesale Holdings LLC ("AWH") subsidiary were $97.9 million during the three months ended July 2, 2016. This is an increase of $4.1 million, or 4.4%, from the second quarter of 2015.

Retail revenues were $87.4 million during the second quarter of 2016. This is an increase of $2.0 million or 2.3% from the second quarter of 2015. Same-store-sales increased 1.6% compared to the prior year with the largest increases in outdoor living and lawn and garden.

Wholesale gross profit for the second quarter of 2016 was $172.5 million, an increase of $9.0 million from the second quarter of 2015. The wholesale gross margin percentage was 12.9% of wholesale revenues, an increase from the 2015 gross margin percentage of 12.3%. The increase in the wholesale gross margin percentage was primarily driven by the timing of income from vendors.

Retail gross profit for the second quarter of 2016 was $38.3 million, an increase of $1.2 million from the second quarter of 2015. Retail gross margin percentage was 43.8% of retail revenues in 2016, up from 43.4% in the prior year. The increase in the retail gross margin percentage was primarily the result of less clearance merchandise sold in the second quarter of 2016. Retail gross profit as reported in the Ace financial statements is based on the Ace wholesale acquisition cost of product rather than the ARH acquisition cost which includes Ace's normal markup from cost.

Wholesale operating expenses increased $12.1 million or 11.5% for the second quarter of 2016 as compared to the second quarter of 2015. The increase was primarily due to a one-time gain of $10.0 million that reduced operating expenses in the second quarter of 2015. As a percentage of wholesale revenues, wholesale operating expenses increased from 7.9% of wholesale revenues in the second quarter of 2015 to 8.8% of wholesale revenues in the second quarter of 2016. Excluding the one-time gain in 2015, wholesale operating expenses increased slightly from 8.7% of wholesale revenues in 2015 to 8.8% in 2016.

Retail operating expenses of $25.9 million increased $0.2 million, or 0.8%, in the second quarter of 2016 as compared to the second quarter of 2015. The increase was driven by higher expenses from new retail stores added in the third quarter of 2015 and the second quarter of 2016. However, retail operating expenses as a percentage of retail revenues decreased to 29.6% of retail revenues in the second quarter of 2016 from 30.1% of retail revenues in the second quarter of 2015.

In the second quarter of 2015, the Company recorded an additional charge of $0.2 million related to the final settlement of the withdrawal liability for the multi-employer pension fund that covers the former union employees at the closed Retail Support Center in Toledo, Ohio.

Interest expense decreased $2.6 million or 44.8%. The second quarter of 2015 included the write-off of $2.2 million of deferred financing fees related to the Company's prior credit facility and term loan that were refinanced in the second quarter of 2015.

Other income (expense) had a decrease in expense of $5.0 million primarily from decreases in income tax expense and net income attributable to noncontrolling interests. The second quarter of 2015 income tax expense included taxes that were recorded on the settlement of the gain contingency.

Comparison of the Six Months Ended July 2, 2016 to the Six Months Ended July 4, 2015

The following data summarizes the Company's performance in 2016 as compared to 2015 (in millions):

	2016		**2015**		**Increase/(decrease)**	
	$	% of Revenues*	$	% of Revenues*	$	%
Revenues:						
Wholesale revenues	2,525.0	94.8%	2,471.9	94.9%	53.1	2.1%
Retail revenues	138.0	5.2%	131.7	5.1%	6.3	4.8%
Total revenues	2,663.0	100.0%	2,603.6	100.0%	59.4	2.3%
Gross profit:						
Wholesale gross profit	305.8	12.1%	301.6	12.2%	4.2	1.4%
Retail gross profit	62.3	45.1%	59.4	45.1%	2.9	4.9%
Total gross profit	368.1	13.8%	361.0	13.9%	7.1	2.0%
Operating expenses:						
Wholesale operating expenses	222.9	8.8%	210.5	8.5%	12.4	5.9%
Retail operating expenses	49.1	35.6%	47.7	36.2%	1.4	2.9%
Warehouse facility closure costs	-	0.0%	1.7	0.1%	(1.7)	(100.0%)
Total operating expenses	272.0	10.2%	259.9	10.0%	12.1	4.7%
Operating income	96.1	3.6%	101.1	3.9%	(5.0)	(4.9%)
Interest expense	(6.6)	(0.2%)	(9.3)	(0.3%)	2.7	29.0%
Other income (expense)	(0.3)	(0.1%)	(4.4)	(0.2%)	4.1	93.2%
Net income attributable to Ace Hardware Corporation	89.2	3.3%	87.4	3.4%	1.8	2.1%

*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.

Consolidated revenues for the six months ended July 2, 2016 totaled $2.7 billion, an increase of $59.4 million, or 2.3%, as compared to the prior year. A reconciliation of consolidated revenues follows (in millions):

	Amount	% Change vs. 2015
2015 Revenues	$ 2,603.6	
Wholesale Merchandise Revenues change based on new and cancelled domestic stores:		
Revenues increase from new stores added since January 2015	60.6	2.3%
Net decrease from stores cancelled since January 2015	(26.7)	(1.0%)
Increase in wholesale merchandise revenues to comparable domestic stores	13.7	0.5%
Increase in AWH revenues	14.1	0.6%
Increase in ARH revenues	6.3	0.2%
Decrease in AIH revenues	(2.2)	(0.1%)
Other wholesale revenue changes, net	(6.4)	(0.2%)
2016 Revenues	$ 2,663.0	2.3%

Total wholesale revenues were $2.5 billion, an increase of $53.1 million, or 2.1%, as compared to the prior year. The categories with the largest revenue gains were outdoor living, lawn and garden and tools.

New stores are defined as stores that were activated from January 2015 through June 2016. In 2016, the Company had wholesale merchandise revenues from new domestic stores of $60.6 million. This increase was partially offset by a decrease in wholesale merchandise revenues due to domestic store cancellations of $26.7 million. As a result, the Company realized a net increase in wholesale merchandise revenues of $33.9 million related to the impact of both new stores affiliated with the Company and from stores that cancelled their membership in 2015 and 2016. Wholesale merchandise revenues to comparable domestic stores increased $13.7 million.

The number of the Company's domestic retail outlets is summarized as follows:

	Six Months Ended	
	July 2, 2016	July 4, 2015
Retail outlets at beginning of period	4,311	4,251
New retail outlets added	66	64
Retail outlet cancellations	(62)	(59)
Retail outlets at end of period	4,315	4,256

Revenues from the Ace Wholesale Holdings LLC ("AWH") subsidiary were $186.0 million during the six months ended July 2, 2016. This is an increase of $14.1 million, or 8.2%, from the first six months of 2015.

Retail revenues were $138.0 million during the six months ended July 2, 2016. This is an increase of $6.3 million or 4.8% from the six months ended July 4, 2015. Same-store-sales increased 2.6% compared to the prior year with the largest increases in outdoor living, lawn and garden and electrical.

Wholesale gross profit for the first six months of 2016 was $305.8 million, an increase of $4.2 million from the six months ended July 4, 2015. The wholesale gross margin percentage was 12.1% of wholesale revenues, a slight decrease from the 2015 gross margin percentage of 12.2%.

Retail gross profit for the six months ended July 2, 2016 was $62.3 million, an increase of $2.9 million from the six months ended July 4, 2015. Retail gross margin percentage was 45.1% of retail revenues in 2016 and 2015. Retail gross profit as reported in the Ace financial statements is based on the Ace wholesale acquisition cost of product rather than the ARH acquisition cost which includes Ace's normal markup from cost.

Wholesale operating expenses increased $12.4 million, or 5.9%, for the six months ended July 2, 2016 as compared to the six months ended July 4, 2015. The increase was primarily due to a one-time gain of $10.0 million that reduced operating expenses in 2015. As a percentage of wholesale revenues, wholesale operating expenses increased from 8.5% of wholesale revenues in 2015 to 8.8% of wholesale revenues in 2016. Excluding the one-time gain in 2015, wholesale operating expenses decreased slightly from 8.9% of wholesale revenues in 2015 to 8.8% in 2016.

Retail operating expenses of $49.1 million increased $1.4 million, or 2.9%, for the six months ended July 2, 2016 as compared to the six months ended July 4, 2015. The increase was driven by higher expenses from new retail stores added in the second quarter of 2015, the third quarter of 2015 and the second quarter of 2016. Retail operating expenses as a percentage of retail revenues decreased to 35.6% of retail revenues in the six months ended July 2, 2016 from 36.2% of retail revenues in the six months ended July 4, 2015.

In the six months ended July 4, 2015, the Company recorded an additional charge of $1.7 million related to the final settlement of the withdrawal liability for the multi-employer pension fund that covers the former union employees at the closed Retail Support Center in Toledo, Ohio.

Interest expense decreased $2.7 million or 29.0%. The six months ended July 4, 2015 included the write-off of $2.2 million of deferred financing fees related to the Company's prior credit facility and term loan that were refinanced in the second quarter of 2015.

Other income (expense) had a decrease in expense of $4.1 million primarily from decreases in income tax expense and net income attributable to noncontrolling interests. The six months ended July 4, 2015 income tax expense included taxes that were recorded on the settlement of the gain contingency.

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

On May 29, 2015, the Company amended its secured credit facility which was originally dated April 13, 2012 and previously amended on July 29, 2013. The May 2015 amendment extended the maturity date to May 29, 2020 and lowered the interest rate credit spread by 25 basis points. The amended credit facility consists of a $600.0 million line of credit that is expandable to $750.0 million through a $150.0 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. Borrowings under the amended credit facility bear interest at a rate of either 25 to 100 basis points over the prime rate or 125 to 200 basis points over the London Interbank Offered Rate (“LIBOR”) depending on the Company’s leverage ratio as defined under the agreement. The amended credit facility was priced at LIBOR plus 150 basis points at April 2, 2016. The amended credit facility requires maintenance of certain financial covenants including a maximum allowable average leverage ratio and a minimum fixed charge coverage ratio. As of July 2, 2016, the Company was in compliance with its covenants and $149.2 million was outstanding under the amended credit facility.

The amended credit facility includes a $175.0 million sublimit for the issuance of standby and commercial letters of credit. As of July 2, 2016, a total of $27.5 million in letters of credit were outstanding. The revolving credit facility requires the Company to pay fees based on the unused portion of the line of credit at a rate of 15 to 30 basis points per annum depending on the Company’s leverage ratio.

The amended 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 July 2, 2016, there were no loans or other extensions of credit provided to AIH.

In order to reduce the risk of interest rate volatility, the Company entered into an interest rate swap derivative agreement in June 2012, which expires on March 13, 2017. This swap agreement fixes the LIBOR rate on a portion of the revolving credit facility at 1.13%, resulting in an effective rate of 2.63% after adding the 1.50% margin based on the current pricing tier per the credit agreement. The notional amount of the derivative agreement decreases by $5.0 million each quarter through expiration of the interest rate swap derivative agreement in March 2017. As of July 2, 2016, the notional amount of the interest rate swap agreement remaining was $140.0 million. The Company entered into a forward interest rate swap derivative agreement in June 2015 to reduce the risk of interest rate volatility for the remaining term of the amended credit facility. The forward interest rate swap starts on March 13, 2017 and expires on May 13, 2020. The forward swap agreement fixes the LIBOR rate on $150.0 million of the revolving credit facility at 2.18%, resulting in an effective rate of 3.68% after adding the 1.50% margin based on the current pricing tier per the credit agreement. The swap arrangements have been designated as cash flow hedges and have been evaluated to be highly effective. As a result, the after-tax change in the fair value of the swaps are recorded in Accumulated other comprehensive income (“AOCI”) as a gain or loss on derivative financial instruments.

The Company’s ARH subsidiary has a $60.0 million asset-based revolving credit facility (“ARH Facility”). The ARH Facility matures on June 28, 2019 and is expandable to $85.0 million under certain conditions. In addition, the Company has the right to issue letters of credit up to a maximum of $7.5 million. At the Company’s discretion, borrowings under this facility bear interest at a rate of either the prime rate plus an applicable spread of 35 basis points to 75 basis points or LIBOR plus an applicable spread of 135 basis points to 175 basis points, depending on the Company’s availability under the ARH Facility as measured on a quarterly basis.

The ARH Facility is collateralized by substantially all of ARH’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 July 2, 2016, ARH was in compliance with its covenants and had $12.1 million in loans outstanding under the ARH Facility.

The ARH Facility requirements include a lender-controlled cash concentration system that results in all of ARH’s daily available cash being applied to the outstanding borrowings under this facility. Pursuant to FASB Accounting Standards Codification Section 470-10-45, “Classification of Revolving Credit Agreements Subject to Lock-Box Arrangements and Subjective Acceleration Clauses,” the borrowings under the ARH Facility have been classified as a Current maturity of long-term debt as of July 2, 2016.

Total debt, the majority of which is comprised of the $161.3 million borrowed on lines of credit, was $181.9 million as of July 2, 2016, compared to $269.4 million and $301.8 million as of January 2, 2016 and July 4, 2015.

Cash Flows

The Company had $19.1 million and $35.3 million of cash and cash equivalents at July 2, 2016 and July 4, 2015, respectively. Following is a summary of the Company's cash flows from operating, investing and financing activities for the first six months of 2016 and 2015 (in millions):

	2016	2015
Cash provided by operating activities before changes in assets and liabilities	$ 114.7	$ 120.3
Net changes in assets and liabilities	70.6	(53.9)
Net cash provided by operating activities	185.3	66.4
Net cash used in investing activities	(29.6)	(22.4)
Net cash used in financing activities	(147.9)	(38.5)
Net change in cash and cash equivalents	$ 7.8	$ 5.5

The Company's operating activities provided $185.3 million of cash in 2016 compared to providing $66.4 million in 2015. Excluding the impact of net changes in assets and liabilities, cash provided by operating activities was $114.7 million in 2016 compared to $120.3 million in 2015. This decrease was primarily the result of the $10.0 million gain contingency recorded in 2015.

The net change in assets and liabilities provided $70.6 million of cash in 2016 and used $53.9 million in 2015. In the first six months of 2016, receivables used $83.0 million of cash primarily as a result of higher trade receivables driven by seasonal dating programs, while inventories used $59.7 million of cash for seasonal build. Accounts payable and accrued expenses provided $210.5 million of cash during the first six months of 2016 primarily as a result of the timing of vendor payments. In the first six months of 2015, receivables used $112.9 million of cash due to seasonal dating programs and inventories increased $110.5 million for the intentional build-up of LED lighting inventories for planned resets and promotions, the seasonal inventory build and higher inventory levels to support higher sales volumes. The use of cash for receivables and inventory in 2015 was partially offset by a $182.3 million increase in accounts payable and accrued expenses. The $10.6 million use of cash in other long-term liabilities in 2015 primarily resulted from $6.4 million of payments related to the settlement of a withdrawal liability for the multi-employer pension fund that covers the former union employees at the closed Retail Support Center in Toledo, Ohio.

Net cash used for investing activities was $29.6 million in the first six months of 2016 compared to $22.4 million in the first six months of 2015. Investing activities in 2016 primarily consisted of $30.5 million in capital expenditures, including payments for the expansion of the Wilton, NY Retail Support Center. Investing activities in 2015 primarily consisted of $16.8 million in capital expenditures and $5.6 million paid for the acquisition of five retail stores by ARH.

Net cash used in financing activities was $147.9 million in the first six months of 2016 compared to $38.5 million in the first six months of 2015. During 2016, the Company had $88.9 million of net payments under the revolving lines of credit and paid $53.7 million for the cash portion of 2015 patronage distributions. During 2015, the Company decreased long-term debt by $173.2 million and paid $48.9 million for the cash portion of 2014 patronage distributions. This was partially offset by net borrowings under the revolving lines of credit of $186.7 million.

Contractual Obligations and Commitments

For the six months ended July 2, 2016, there have been no significant changes to the Company's contractual obligations and commitments as disclosed in its 2015 Annual Report.

Application of Critical Accounting Policies and Estimates

For a description of the Company's critical accounting policies and estimates, please see the Application of Critical Accounting Policies and Estimates section in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of the Company's 2015 Annual Report.

Qualitative and Quantitative Disclosure About Market Risk

The Company is exposed to market risk in the normal course of its business operations, including the risk of loss from inflation and changes in price, foreign currency, interest rates and customer credit risk.

There has been no material change in the Company's exposure to market risk from what was disclosed in the 2015 Annual Report.

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; 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.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The consolidated financial statements presented in this Quarterly 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 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.

August 15, 2016

/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
Corporate Controller

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

www.acehardware.com