

ACE HARDWARE CORPORATION  
Quarterly report for the period ended June 27, 2020



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

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## **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 June 27, 2020, December 28, 2019, and June 29, 2019, and the related consolidated statements of income and comprehensive income for the three and six-month periods ended June 27, 2020 and June 29, 2019, and the consolidated statements of equity and cash flows for the six-month periods ended June 27, 2020 and June 29, 2019.

### **Management's Responsibility for the Financial Information**

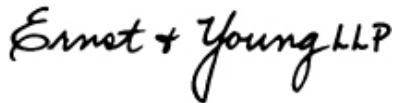
Management is responsible for the preparation and fair presentation of the interim financial information in conformity with U.S. generally accepted accounting principles; this responsibility includes the design, implementation, and maintenance of internal control sufficient to provide a reasonable basis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

The image shows a handwritten signature in black ink that reads "Ernst & Young LLP". The signature is written in a cursive, flowing style.

Chicago, Illinois  
August 18, 2020

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 27, 2020 (13 Weeks)</b>	<b>June 29, 2019 (13 Weeks)</b>	<b>June 27, 2020 (26 Weeks)</b>	<b>June 29, 2019 (26 Weeks)</b>
Revenues:				
Wholesale revenues	\$ 2,029.9	\$ 1,528.8	\$ 3,347.9	\$ 2,827.8
Retail revenues	249.2	158.7	361.6	238.2
Total revenues	2,279.1	1,687.5	3,709.5	3,066.0
Cost of revenues:				
Wholesale cost of revenues	1,766.3	1,350.7	2,914.5	2,495.9
Retail cost of revenues	142.2	89.4	201.8	132.1
Total cost of revenues	1,908.5	1,440.1	3,116.3	2,628.0
Gross profit:				
Wholesale gross profit	263.6	178.1	433.4	331.9
Retail gross profit	107.0	69.3	159.8	106.1
Total gross profit	370.6	247.4	593.2	438.0
Wholesale operating expenses:				
Distribution operations expenses	59.2	47.2	104.2	89.8
Selling, general and administrative expenses	50.4	44.9	101.7	95.7
Retailer success and development expenses	59.5	46.0	91.7	81.9
Retail operating expenses	63.0	51.5	118.5	89.1
Retail pre-opening expenses	0.1	3.7	0.4	4.0
Total operating expenses	232.2	193.3	416.5	360.5
Operating income	138.4	54.1	176.7	77.5
Interest expense	(5.4)	(6.0)	(11.2)	(12.3)
Interest income	0.8	1.5	2.2	4.6
Other income, net	2.5	1.4	4.0	3.0
Income tax benefit	2.6	2.8	3.4	3.6
Net income	138.9	53.8	175.1	76.4
Less: net (loss) income attributable to noncontrolling interests	(0.2)	0.1	(0.3)	0.2
Net income attributable to Ace Hardware Corporation	\$ 139.1	\$ 53.7	\$ 175.4	\$ 76.2
Patronage distributions accrued	\$ 115.6	\$ 55.0	\$ 169.0	\$ 89.5
Patronage distributions accrued for third party retailers	\$ 113.0	\$ 52.8	\$ 164.1	\$ 85.7

See accompanying notes to the consolidated financial statements.

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 27, 2020 (13 Weeks)</b>	<b>June 29, 2019 (13 Weeks)</b>	<b>June 27, 2020 (26 Weeks)</b>	<b>June 29, 2019 (26 Weeks)</b>
Net income	\$ 138.9	\$ 53.8	\$ 175.1	\$ 76.4
Other comprehensive income net of tax:				
Unrealized gain on investments	2.8	0.5	1.6	1.2
Unrealized gain (loss) on derivative financial instrument	0.2	(0.4)	0.2	(0.8)
Total other comprehensive income, net	3.0	0.1	1.8	0.4
Comprehensive income	141.9	53.9	176.9	76.8
Less: Comprehensive (loss) income attributable to noncontrolling interests	(0.2)	0.1	(0.3)	0.2
Comprehensive income attributable to Ace Hardware Corporation	\$ 142.1	\$ 53.8	\$ 177.2	\$ 76.6

See accompanying notes to the consolidated financial statements.

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

	June 27, 2020 (Unaudited)	December 28, 2019 (Audited)	June 29, 2019 (Unaudited)
<b>Assets</b>			
Cash and cash equivalents	\$ 40.3	\$ 18.2	\$ 50.2
Marketable securities	60.8	59.5	38.1
Receivables, net of allowance for doubtful accounts of \$6.2, \$5.4 and \$5.6, respectively	709.3	486.5	548.0
Inventories	972.6	930.8	961.6
Prepaid expenses and other current assets	61.8	45.5	53.2
Total current assets	1,844.8	1,540.5	1,651.1
Property and equipment, net	395.8	381.7	383.1
Operating lease right-of-use assets, net	471.1	-	-
Finance lease right-of-use assets, net	22.7	-	-
Notes receivable, net of allowance for doubtful accounts of \$0.9, \$1.5 and \$2.1, respectively	12.5	9.9	17.4
Goodwill and other intangible assets, net	91.9	90.5	97.3
Other assets	83.0	105.4	88.9
Total assets	<u>\$ 2,921.8</u>	<u>\$ 2,128.0</u>	<u>\$ 2,237.8</u>
<b>Liabilities and Equity</b>			
Current maturities of long-term debt	\$ 10.9	\$ 67.0	\$ 49.8
Accounts payable	1,304.7	791.8	907.5
Patronage distributions payable in cash	67.5	70.4	35.1
Patronage refund certificates payable	17.4	17.4	10.1
Current operating lease liabilities	72.6	-	-
Current finance lease liabilities	3.4	-	-
Accrued expenses	175.0	205.9	149.9
Total current liabilities	1,651.5	1,152.5	1,152.4
Long-term debt	14.8	209.9	319.6
Patronage refund certificates payable	142.3	107.3	111.7
Long-term operating lease liabilities	418.8	-	-
Long-term finance lease liabilities	19.3	-	-
Other long-term liabilities	69.0	92.5	84.5
Total liabilities	<u>2,315.7</u>	<u>1,562.2</u>	<u>1,668.2</u>
Member Retailers' Equity:			
Class A voting common stock, \$1,000 par value, 10,000 shares authorized, 2,682, 2,691 and 2,700 issued and outstanding, respectively	2.7	2.7	2.7
Class C nonvoting common stock, \$100 par value, 6,000,000 shares authorized, 5,189,905, 4,827,851 and 4,932,459 issued and outstanding, respectively	519.0	482.7	493.2
Class C nonvoting common stock, \$100 par value, issuable to retailers for patronage distributions, 462,804, 546,146 and 259,486 shares issuable, respectively	46.2	54.6	26.0
Contributed capital	18.9	18.8	18.6
Retained earnings (accumulated deficit)	2.3	(8.7)	13.7
Accumulated other comprehensive income	2.7	0.9	0.6
Equity attributable to Ace member retailers	591.8	551.0	554.8
Equity attributable to noncontrolling interests	14.3	14.8	14.8
Total equity	606.1	565.8	569.6
Total liabilities and equity	<u>\$ 2,921.8</u>	<u>\$ 2,128.0</u>	<u>\$ 2,237.8</u>

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 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
	Class A	Class C							
Balances at December 29, 2018	\$ 2.7	\$ 464.8	\$ 44.0	\$ -	\$ 18.5	\$ 24.8	\$ (1.2)	\$ 14.2	\$ 567.8
Net income	-	-	-	-	-	76.2	-	0.2	76.4
Other comprehensive income	-	-	-	-	-	-	0.4	-	0.4
Net payments on subscriptions	-	-	-	0.6	-	-	-	-	0.6
Stock issued	-	43.3	(44.0)	(0.6)	-	(0.1)	-	-	(1.4)
Change in noncontrolling interests	-	-	-	-	(0.1)	(0.1)	-	0.4	0.2
Stock repurchased	-	(14.9)	-	-	-	-	-	-	(14.9)
Patronage distributions issuable	-	-	26.0	-	-	-	-	-	26.0
Patronage distributions payable	-	-	-	-	-	(85.7)	-	-	(85.7)
Adoption of accounting standard	-	-	-	-	-	(1.4)	1.4	-	-
Other	-	-	-	-	0.2	-	-	-	0.2
Balances at June 29, 2019	\$ 2.7	\$ 493.2	\$ 26.0	\$ -	\$ 18.6	\$ 13.7	\$ 0.6	\$ 14.8	\$ 569.6
Balances at December 28, 2019	\$ 2.7	\$ 482.7	\$ 54.6	\$ -	\$ 18.8	\$ (8.7)	\$ 0.9	\$ 14.8	\$ 565.8
Net income (loss)	-	-	-	-	-	175.4	-	(0.3)	175.1
Other comprehensive income	-	-	-	-	-	-	1.8	-	1.8
Net payments on subscriptions	-	-	-	0.4	-	-	-	-	0.4
Stock issued	-	53.8	(54.6)	(0.4)	-	(0.1)	-	-	(1.3)
Change in noncontrolling interests	-	-	-	-	(0.1)	(0.1)	-	(0.2)	(0.4)
Stock repurchased	-	(17.5)	-	-	-	-	-	-	(17.5)
Patronage distributions issuable	-	-	46.2	-	-	-	-	-	46.2
Patronage distributions payable	-	-	-	-	-	(164.1)	-	-	(164.1)
Other	-	-	-	-	0.2	(0.1)	-	-	0.1
Balances at June 27, 2020	\$ 2.7	\$ 519.0	\$ 46.2	\$ -	\$ 18.9	\$ 2.3	\$ 2.7	\$ 14.3	\$ 606.1

See accompanying notes to the consolidated financial statements.

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

	<b>Six Months Ended</b>	
	<b>June 27, 2020 (26 Weeks)</b>	<b>June 29, 2019 (26 Weeks)</b>
<b>Operating Activities</b>		
Net income	\$ 175.1	\$ 76.4
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	31.7	29.1
Amortization of deferred financing costs	0.2	0.2
Loss (gain) on the disposal of assets, net	0.9	(0.7)
Provision for doubtful accounts	0.5	0.4
Other, net	0.9	(0.1)
Changes in operating assets and liabilities, exclusive of effects of acquisitions:		
Receivables	(250.3)	(121.6)
Inventories	(39.0)	(2.7)
Other current assets	(16.2)	0.2
Other long-term assets	45.4	(9.6)
Current liabilities	451.9	125.2
Other long-term liabilities	(0.8)	4.8
Deferred taxes	9.8	(3.6)
Net cash provided by operating activities	<u>410.1</u>	<u>98.0</u>
<b>Investing Activities</b>		
Purchases of marketable securities	(9.9)	(16.1)
Proceeds from sale of marketable securities	10.7	32.1
Purchases of property and equipment	(43.7)	(32.9)
Cash paid for acquired businesses, net of cash received	(6.6)	(19.0)
Increase in notes receivable, net	(3.0)	(5.7)
Proceeds from sale of assets	-	1.0
Other, net	0.3	(0.3)
Net cash used in investing activities	<u>(52.2)</u>	<u>(40.9)</u>
<b>Financing Activities</b>		
Net (payments) borrowings under revolving lines of credit	(253.0)	33.0
Principal payments on long-term debt	(5.3)	(5.9)
Payments of debt issuance costs	-	(1.3)
Payments of cash portion of patronage distribution	(66.2)	(51.3)
Payments of patronage refund certificates	(9.5)	(5.3)
Repurchase of stock	(1.2)	(2.1)
Purchase of noncontrolling interests	(0.2)	(0.2)
Other, net	(0.4)	0.6
Net cash used in financing activities	<u>(335.8)</u>	<u>(32.5)</u>
Increase in cash and cash equivalents	22.1	24.6
Cash and cash equivalents at beginning of period	18.2	25.6
Cash and cash equivalents at end of period	<u>\$ 40.3</u>	<u>\$ 50.2</u>
Supplemental disclosure of cash flow information:		
Interest paid	<u>\$ 12.6</u>	<u>\$ 12.4</u>
Income taxes paid	<u>\$ 0.7</u>	<u>\$ 0.7</u>

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.

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

Ace Retail Holdings LLC (“ARH”) is the owner of the 138 store Westlake Ace Hardware (“Westlake”) retail chain. As a result, the Company is also a retailer of hardware, paint and other related products.

In March 2019, ARH acquired the remaining 58 percent of the outstanding stock of Great Lakes Ace Hardware, Inc. (“GLA”) that it did not already own. GLA is based in Farmington Hills, Michigan and is the owner of 54 neighborhood hardware stores located in Michigan and Ohio. See Note 2 for additional details of this acquisition.

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

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”). 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 2019 Annual Report. The unaudited consolidated financial statements for the three and six months ended June 27, 2020 and June 29, 2019 both cover a 13-week and 26-week period, respectively.

Subsequent events have been evaluated through August 18, 2020, 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 June 27, 2020 are not necessarily indicative of the results to be expected for the full fiscal year 2020.

***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.

***Reclassifications***

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

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

***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 retailers 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 retailers to provide merchandise at negotiated prices with the vendors, assumes inventory risk if the product is returned by the retailers, and assumes all the credit risk for the vendors with the retailers. 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.

***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

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

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 3 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.

**(2) Acquisitions**

In March 2019, ARH acquired the remaining 58 percent of the outstanding stock of GLA in a series of transactions for \$11.3 million. The Company previously held a 42 percent interest in GLA which it acquired in 2017 for \$3.7 million.

The following table summarizes the final consideration, fair value of assets acquired and liabilities assumed:

Fair value of assets acquired and liabilities assumed:	
Cash	\$ 1.1
Receivables	2.4
Inventories	26.1
Other current assets	0.9
Property and equipment	5.6
Other assets	4.9
Short-term debt (GLA Facility – See Note 5)	(9.6)
Current liabilities	(12.8)
Acquisition purchase price	<u>\$ 18.6</u>

In addition, during the six months ended June 27, 2020, ARH acquired additional retail stores for consideration of \$6.6 million, prior to working capital adjustments. These acquisitions resulted in ARH recording \$3.5 million of goodwill. Goodwill has an indefinite life and, therefore, is not amortized. The goodwill is expected to be deductible for tax purposes.

**(3) Leases**

The Company leases certain warehouse and distribution space, office space, retail locations, equipment and vehicles under operating leases. On December 29, 2019, the Company adopted Topic 842 which requires these leases to be recognized on the balance sheet. The Company has adopted the accounting policy election to exclude the recognition requirement for short-term leases in all asset categories. Short-term leases primarily occur in the Company's equipment leases where trucks may be leased on a short-term basis for a seasonal need or because a truck is temporarily out of service. The Company has lease agreements that contain both lease and non-lease components. The Company has made the accounting policy election to not separate non-lease components from lease components for all asset categories.

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 chosen the accounting policy election to use a risk-free discount rate at commencement date based upon the lease term.

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

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 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 three months and six months ended June 27, 2020 were as follows:

	<u>Income Statement Classification</u>	Three Months Ended June 27, 2020	Six Months Ended June 27, 2020
Finance lease amortization	Cost of revenues	\$ 0.9	\$ 0.9
Finance lease interest	Interest expense	-	-
Operating lease cost, net of sublease income	Cost of revenues, operating expenses	22.5	45.7
Short-term lease cost	Cost of revenues, operating expenses	2.7	3.7
Variable lease cost	Cost of revenues, operating expenses	4.6	9.1
Net lease cost		<u>\$ 30.7</u>	<u>\$ 59.4</u>

The future minimum undiscounted lease payments under operating and finance leases at June 27, 2020 are as follows:

<u>Fiscal Year</u>	<u>Operating Leases</u>	<u>Finance Leases</u>
2020	\$ 51.9	\$ 2.3
2021	78.2	3.9
2022	64.3	3.9
2023	59.7	3.9
2024	56.6	3.9
Thereafter	215.8	5.3
Total future undiscounted lease payments	526.5	23.2
Less imputed interest	35.1	0.5
Total reported lease liability	<u>\$ 491.4</u>	<u>\$ 22.7</u>

Amounts presented above do not include payments relating to immaterial leases excluded from the consolidated balance sheets as part of the transition elections adopted upon implementation of Topic 842. 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.

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**(Unaudited, in millions)**

Other information related to operating and finance leases for the six months ended June 27, 2020, was as follows:

Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	\$ (44.2)
Operating cash flows from finance leases	\$ (1.0)
Lease assets obtained in exchange for new lease liabilities:	
Operating leases	\$ 53.9
Finance leases	\$ 23.6
Weighted average remaining lease term for operating leases	
	8.4 years
Weighted average discount rate for operating leases	
	1.62%
Weighted average remaining lease term for finance leases	
	6.0 years
Weighted average discount rate for finance leases	
	0.69%

**(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 \$106.8 million, \$104.5 million and \$91.3 million at June 27, 2020, December 28, 2019 and June 29, 2019, respectively. An actual valuation of inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs at that time. When interim LIFO calculations occur, they are based on management's estimates of expected year-end inventory levels and costs, and are subject to the final year-end LIFO inventory valuation. Inventories at retail locations operated by the Company 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 first-in, first-out ("FIFO") method. The Company regularly reviews its inventory and establishes a reserve for excess and obsolete inventory based on a number of factors, including historical sales, sales forecasts, obsolescence due to technology changes and defective goods.

Inventories consisted of:

	June 27, 2020	December 28, 2019	June 29, 2019
Wholesale merchandise inventory (LIFO)	\$ 825.3	\$ 773.9	\$ 816.0
Retail merchandise inventory at ARH stores and AEH warehouses (FIFO)	147.3	156.9	145.6
<b>Inventories</b>	<b>\$ 972.6</b>	<b>\$ 930.8</b>	<b>\$ 961.6</b>

**(5) 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 June 27, 2020. 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 June 27, 2020, the Company was in compliance with its covenants and had no borrowings outstanding under the credit facility.

The credit facility includes a \$175.0 million sublimit for the issuance of standby and commercial letters of credit. As of June 27, 2020, a total of \$8.4 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 June 27, 2020, there were no loans or other extensions of credit provided to AIH.

The Company entered into an interest rate swap derivative agreement to reduce the risk of interest rate volatility for the credit facility. The interest rate swap started on March 13, 2017 and expired on May 13, 2020. The swap agreement fixed the LIBOR rate on

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\$150.0 million of the revolving credit facility 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 (“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 basis points to 50 basis points or LIBOR plus an applicable spread of 125 basis points to 150 basis points, depending on Westlake’s average availability under the Westlake Facility as measured on a trailing 12-month basis. The Westlake Facility was priced at LIBOR plus 125 basis points at June 27, 2020.

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 June 27, 2020, ARH was in compliance with its covenants and had no borrowings outstanding under the Westlake Facility.

The Company’s GLA subsidiary (see Note 2 for additional details of this acquisition) has a \$20.0 million asset-based revolving credit facility (“GLA Facility”). The GLA Facility matures on November 6, 2022. Borrowings under the GLA Facility are subject to a borrowing base calculation consisting of certain advance rates applied to eligible receivables and inventory. The interest rate is based on either the lender’s prime rate plus 100 basis points or LIBOR plus 200 basis points. As of June 27, 2020, GLA was in compliance with its covenants and had no borrowings outstanding under the GLA Facility.

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

Total debt outstanding is comprised of the following:

	June 27, 2020	December 28, 2019	June 29, 2019
Revolving Credit Facility	\$ -	\$ 196.5	\$ 305.3
Westlake Facility	-	52.0	35.0
GLA Facility	-	4.5	3.6
Installment notes with maturities through 2024 at a fixed rate of 6.00%	25.7	23.9	25.5
Total debt	25.7	276.9	369.4
Less: maturities within one year	(10.9)	(67.0)	(49.8)
Long-term debt	\$ 14.8	\$ 209.9	\$ 319.6

**(6) Fair Value Measurements**

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 June 27, 2020, December 28, 2019 and June 29, 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.

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**(Unaudited, in millions)**

	Carrying Value Measured at Fair Value			
<b>Items measured at fair value on a recurring basis</b>	June 27, 2020	Level 1	Level 2	Level 3
<b>Assets:</b>				
Cash equivalents:				
Money market funds	\$ 4.4	\$ 4.4	\$ -	\$ -
Marketable securities:				
Corporate fixed income securities	31.8	-	31.8	-
Mortgage-backed securities	12.8	-	12.8	-
U.S. government notes	15.4	9.9	5.5	-
Other	0.8	-	0.8	-
Total marketable securities	<u>\$ 60.8</u>	<u>\$ 9.9</u>	<u>\$ 50.9</u>	<u>\$ -</u>

	Carrying Value Measured at Fair Value			
<b>Items measured at fair value on a recurring basis</b>	December 28, 2019	Level 1	Level 2	Level 3
<b>Assets:</b>				
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	<u>\$ 59.5</u>	<u>\$ 11.7</u>	<u>\$ 47.8</u>	<u>\$ -</u>

<b>Accrued expenses:</b>				
Interest rate swap derivative	\$ 0.3	\$ -	\$ 0.3	\$ -

	Carrying Value Measured at Fair Value			
<b>Items measured at fair value on a recurring basis</b>	June 29, 2019	Level 1	Level 2	Level 3
<b>Assets:</b>				
Cash equivalents:				
Money market funds	\$ 24.3	\$ 24.3	\$ -	\$ -
Marketable securities:				
Corporate fixed income securities	18.2	-	18.2	-
Mortgage-backed securities	7.2	-	7.2	-
U.S. government notes	10.0	9.3	0.7	-
Other	2.7	-	2.7	-
Total marketable securities	<u>\$ 38.1</u>	<u>\$ 9.3</u>	<u>\$ 28.8</u>	<u>\$ -</u>

<b>Accrued expenses:</b>				
Interest rate swap derivative	\$ 0.4	\$ -	\$ 0.4	\$ -

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
**(Unaudited, in millions)**

*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 exceeded their cost by \$3.4 million and \$0.9 million at June 27, 2020 and June 29, 2019, respectively.

Gross proceeds from the sale of marketable securities and the related realized gains and losses for the three and six months ended June 27, 2020 and June 29, 2019 were as follows:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	June 27, 2020	June 29, 2019	June 27, 2020	June 29, 2019
Gross proceeds	\$ 3.7	\$ 28.4	\$ 10.7	\$ 32.1
Gross realized gains	0.1	0.5	0.2	0.6
Gross realized losses	(0.1)	-	(0.1)	(0.1)

Gross realized gains and losses were determined using the specific identification method. For the six months ended June 27, 2020, the Company reclassified \$0.2 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 Interest income in the Consolidated Statement of Income.

The following table summarizes the contractual maturity distributions of the Company’s debt securities at June 27, 2020. Actual maturities may differ from the contractual or expected maturities since borrowers may have the right to prepay obligations with or without prepayment penalties.

<b>Fair value of available-for-sale debt securities</b>	<b>Due in One Year or Less</b>	<b>Due After One Year through Five Years</b>	<b>Due After Five Years through Ten Years</b>	<b>Due After Ten Years</b>	<b>Total</b>
Corporate fixed income securities	\$ 4.2	\$ 14.0	\$ 8.2	\$ 5.4	\$ 31.8
Mortgage-backed securities	-	0.2	1.3	11.3	12.8
U.S. government notes	1.3	4.8	4.3	5.0	15.4
Other	-	-	0.2	0.6	0.8
<b>Total</b>	<b>\$ 5.5</b>	<b>\$ 19.0</b>	<b>\$ 14.0</b>	<b>\$ 22.3</b>	<b>\$ 60.8</b>

The Company had 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 at 2.18 percent, plus the then effective margin based on the then current pricing tier per the credit agreement.

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 and \$0.3 million as of December 28, 2019 and June 29, 2019, respectively. There was no hedge ineffectiveness related to the interest rate swap for the six months ended June 27, 2020 and June 29, 2019.

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 June 27, 2020. 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.



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**(Unaudited, in millions)**

**(7) Income Taxes**

Income tax differs from the amount computed by applying the statutory U.S. Federal income tax rate of 21 percent to pre-tax income because of the effect of the following items:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	June 27, 2020	June 29, 2019	June 27, 2020	June 29, 2019
Expected tax at U.S. Federal income tax rate	\$ (28.6)	\$ (10.7)	\$ (36.0)	\$ (15.3)
Patronage distribution deductions	23.8	11.1	34.5	18.0
Other, net	7.4	2.4	4.9	0.9
Income tax benefit	\$ 2.6	\$ 2.8	\$ 3.4	\$ 3.6

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was enacted in response to the COVID-19 pandemic. The CARES Act, among other things, permits Net Operating Loss (“NOL”) carryovers and carrybacks to offset 100 percent of taxable income for taxable years beginning before 2021. In addition, the CARES Act allows NOLs incurred in 2018, 2019, and 2020 to be carried back to each of the five preceding taxable years to generate a refund of previously paid income taxes. The Company is planning to carry back the losses generated in the 2018 and 2019 tax years, calculated at a 21 percent tax rate, and receive a refund for taxes paid on income that was subject to a 35 percent tax rate. The tax benefit resulting from this carry back is estimated to be \$6.9 million and was recorded during the three months ended June 27, 2020.

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

During the six months ended June 27, 2020 and June 29, 2019, accrued patronage distributions of \$15.4 million and \$8.6 million, respectively, were offset against trade receivables and notes receivable owed to the Company by its member retailers with no net impact in the Consolidated Statements of Cash Flows.

During the six months ended June 27, 2020 and June 29, 2019, non-cash repurchases of stock from retailers of \$16.3 million and \$11.4 million, respectively, were offset against trade receivables of \$6.1 million and \$2.4 million, respectively, and notes receivable of \$3.0 million and \$4.1 million, respectively. The remaining \$7.2 million and \$4.9 million, respectively, were primarily issued as notes payable with no net impact in the Consolidated Statements of Cash Flows.

During the six months ended June 27, 2020, the Company received \$5.6 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 June 27, 2020. During the six months ended June 27, 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 the six months ended June 27, 2020.

**(9) Other Information**

In March 2020, the World Health Organization declared the outbreak of a novel coronavirus a global pandemic. The pandemic is having a significant effect on overall economic conditions and the preventative and protective measures taken by governments are resulting in global business disruptions, including the Company’s customers and vendors. Some of the Company’s customers have seen a temporary reduction of operating hours for their stores, as well as temporary store closures where government mandated. While the impact of the pandemic is currently expected to be temporary, there is uncertainty around the severity and duration of the disruption. Although the Company continues to see significant increases in revenues, the possibility still exists that the pandemic may negatively affect its 2020 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.

## 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 June 27, 2020 and June 29, 2019. This discussion and analysis should be read in conjunction with the Company's 2019 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 June 27, 2020 to the Three Months Ended June 29, 2019*

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

	2020		2019		Favorable/ (Unfavorable)	
	\$	% of Revenues*	\$	% of Revenues*	\$	%
<b>Revenues:</b>						
Wholesale revenues	2,029.9	89.1%	1,528.8	90.6%	501.1	32.8%
Retail revenues	249.2	10.9%	158.7	9.4%	90.5	57.0%
Total revenues	2,279.1	100.0%	1,687.5	100.0%	591.6	35.1%
<b>Gross profit:</b>						
Wholesale gross profit	263.6	13.0%	178.1	11.6%	85.5	48.0%
Retail gross profit	107.0	42.9%	69.3	43.7%	37.7	54.4%
Total gross profit	370.6	16.3%	247.4	14.7%	123.2	49.8%
<b>Operating expenses:</b>						
Wholesale operating expenses	169.1	8.3%	138.1	9.0%	(31.0)	(22.4%)
Retail operating expenses	63.0	25.3%	51.5	32.5%	(11.5)	(22.3%)
Retail pre-opening expenses	0.1	0.0%	3.7	2.3%	3.6	97.3%
Total operating expenses	232.2	10.2%	193.3	11.5%	(38.9)	(20.1%)
Operating income	138.4	6.1%	54.1	3.2%	84.3	155.8%
Interest expense	(5.4)	(0.2%)	(6.0)	(0.3%)	0.6	10.0%
Other income, net	6.1	0.2%	5.6	0.3%	0.5	8.9%
<b>Net income attributable to Ace Hardware Corporation</b>	<b>139.1</b>	<b>6.1%</b>	<b>53.7</b>	<b>3.2%</b>	<b>85.4</b>	<b>159.0%</b>

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

A reconciliation of consolidated revenues follows (in millions):

	Amount	% Change vs. 2019
<b>2019 Revenues</b>	<b>\$ 1,687.5</b>	
<i>Wholesale Merchandise Revenues change based on new and cancelled domestic stores:</i>		
Revenues increase from new stores added since January 2019	56.5	3.4%
Revenues decrease from stores cancelled since January 2019	(9.4)	(0.6%)
Increase in wholesale merchandise revenues to comparable domestic stores	394.6	23.4%
Increase in Acehardware.com revenues	95.5	5.7%
Increase in AWH wholesale revenues	0.4	-
Decrease in AIH wholesale revenues	(14.3)	(0.8%)
Increase in ARH retail revenues	88.5	5.2%
Increase in AEH retail revenues	2.0	0.1%
Other revenue changes, net	(22.2)	(1.3%)
<b>2020 Revenues</b>	<b>\$ 2,279.1</b>	<b>35.1%</b>

Consolidated revenues for the three months ended June 27, 2020 totaled \$2.3 billion, an increase of \$591.6 million, or 35.1 percent, as compared to the prior year second quarter. Total wholesale revenues were \$2.0 billion for the second quarter 2020, an increase of \$501.1 million, or 32.8 percent, as compared to the prior year second quarter. New stores are defined as stores that were activated from January 2019 through June 2020. In 2020, the Company had an increase in wholesale merchandise revenues from new domestic stores of \$56.5 million. This increase was partially offset by a decrease in wholesale merchandise revenues due to domestic store cancellations of \$9.4 million. As a result, the Company realized a net increase in wholesale merchandise revenues of \$47.1 million related to the impact of both new stores affiliated with the Company and from stores that cancelled their membership in 2019 and 2020. Wholesale merchandise revenues to comparable domestic stores increased \$394.6 million for the quarter. Increases were seen across nearly all departments with grilling, power tools, and outdoor power equipment showing the largest gains.

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

	<b>Three Months Ended</b>	
	June 27, 2020	June 29, 2019
Retailer outlets at beginning of period	5,381	5,278
New retailer outlets added	32	44
Retailer outlet cancellations	(27)	(24)
Retailer outlets at end of period	5,386	5,298

Ace Wholesale Holdings LLC ("AWH"), whose customer base includes a large number of paint and decorating stores that were not considered "essential" and were closed for much of the second quarter, reported a \$0.4 million increase in wholesale revenues from the second quarter of 2019.

Revenues from the Ace Hardware International Holdings, Ltd. ("AIH") subsidiary were \$49.6 million during the three months ended June 27, 2020, representing a \$14.3 million decrease in wholesale revenue from the second quarter of 2019. While hardware and home improvement stores were considered "essential" and were allowed to remain open throughout the United States, that was not the case across much of the world, as up to fifty percent of AIH stores were closed at some point during the quarter.

Total retail revenues for the quarter were \$249.2 million, an increase of \$90.5 million, or 57.0 percent, as compared to the prior year second quarter. Retail revenues from Ace Retail Holdings LLC ("ARH") were \$239.3 million in the second quarter of 2020, an increase of \$88.5 million, or 58.7 percent, from the second quarter of 2019. The Westlake Ace Hardware ("Westlake") retail chain experienced a 34.7 percent increase in same-store-sales while the Great Lakes Ace Hardware Inc. ("GLA") chain grew same-store-sales by 45.5 percent. The eleven new California stores opened by Westlake in 2019 contributed \$33.6 million of the increase. Westlake and GLA together operated 192 stores at the end of the second quarter of 2020 compared to 177 stores at the end of the second quarter of 2019. Retail revenues from Ace Ecommerce Holdings LLC ("AEH") were \$9.9 million in the second quarter of 2020. This was an increase of \$2.0 million, or 24.0 percent, from the second quarter of 2019. New customer acquisitions drove the increase during the second quarter.

Wholesale gross profit for the three months ended June 27, 2020 was \$263.6 million, an increase of \$85.5 million from the second quarter of 2019. The wholesale gross margin percentage was 13.0 percent of wholesale revenues in the second quarter of 2020, up from 11.6 percent in the second quarter of 2019. The increase in the wholesale gross margin percentage was due to the increased volume, which led to higher vendor funds earned.

Retail gross profit for the second quarter of 2020 was \$107.0 million, an increase of \$37.7 million from the second quarter of 2019. This increase was primarily the result of the eleven new California stores opened by ARH in 2019. The retail gross margin percentage was 42.9 percent of retail revenues in the second quarter of 2020, a decrease from 43.7 percent in the second quarter of 2019. For ARH, retail gross profit is based on the Company's wholesale acquisition cost of product, not ARH's acquisition cost which includes a markup from the Company.

Wholesale operating expenses increased \$31.0 million, or 22.4 percent, from the second quarter of 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 8.3 percent of wholesale revenues in the second quarter of 2020 from 9.0 percent of wholesale revenues in the second quarter of 2019.

Retail operating expenses increased \$11.5 million, or 22.3 percent, from the second quarter of 2019. This increase was primarily due to expenses related to the eleven new California stores and expenses incurred related to the pandemic. Retail operating expenses as a percentage of retail revenue decreased to 25.3 percent of retail revenues in the second quarter of 2020 from 32.5 percent in the second quarter of 2019.

Retail pre-opening expenses decreased \$3.6 million from the second quarter of 2019, due to expenses related to the eleven new California stores which opened in 2019.

**Comparison of the Six Months Ended June 27, 2020 to the Six Months Ended June 29, 2019**

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

	2020		2019		Favorable/ (Unfavorable)	
	\$	% of Revenues*	\$	% of Revenues*	\$	%
<b>Revenues:</b>						
Wholesale revenues	3,347.9	90.3%	2,827.8	92.2%	520.1	18.4%
Retail revenues	361.6	9.7%	238.2	7.8%	123.4	51.8%
<b>Total revenues</b>	<b>3,709.5</b>	<b>100.0%</b>	<b>3,066.0</b>	<b>100.0%</b>	<b>643.5</b>	<b>21.0%</b>
<b>Gross profit:</b>						
Wholesale gross profit	433.4	12.9%	331.9	11.7%	101.5	30.6%
Retail gross profit	159.8	44.2%	106.1	44.5%	53.7	50.6%
<b>Total gross profit</b>	<b>593.2</b>	<b>16.0%</b>	<b>438.0</b>	<b>14.3%</b>	<b>155.2</b>	<b>35.4%</b>
<b>Operating expenses:</b>						
Wholesale operating expenses	297.6	8.9%	267.4	9.5%	(30.2)	(11.3%)
Retail operating expenses	118.5	32.8%	89.1	37.4%	(29.4)	(33.0%)
Retail pre-opening expenses	0.4	0.1%	4.0	1.7%	3.6	90.0%
<b>Total operating expenses</b>	<b>416.5</b>	<b>11.2%</b>	<b>360.5</b>	<b>11.8%</b>	<b>(56.0)</b>	<b>(15.5%)</b>
Operating income	176.7	4.8%	77.5	2.5%	99.2	128.0%
Interest expense	(11.2)	(0.3%)	(12.3)	(0.3%)	1.1	8.9%
Other income, net	9.9	0.2%	11.0	0.3%	(1.1)	(10.0%)
<b>Net income attributable to Ace Hardware Corporation</b>	<b>175.4</b>	<b>4.7%</b>	<b>76.2</b>	<b>2.5%</b>	<b>99.2</b>	<b>130.2%</b>

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

A reconciliation of consolidated revenues follows (in millions):

	Amount	% Change vs. 2019
<b>2019 Revenues</b>	<b>\$ 3,066.0</b>	
<i>Wholesale Merchandise Revenues change based on new and cancelled domestic stores:</i>		
Revenues increase from new stores added since January 2019	105.4	3.4%
Revenues decrease from stores cancelled since January 2019	(18.0)	(0.6%)
Increase in wholesale merchandise revenues to comparable domestic stores	407.7	13.3%
Increase in Acehardware.com revenues	101.9	3.3%
Decrease in AWH wholesale revenues	(5.9)	(0.2%)
Decrease in AIH wholesale revenues	(23.8)	(0.7%)
Increase in ARH retail revenues	123.3	4.0%
Increase in AEH retail revenues	0.1	-
Other revenue changes, net	(47.2)	(1.5%)
<b>2020 Revenues</b>	<b>\$ 3,709.5</b>	<b>21.0%</b>

Consolidated revenues for the six months ended June 27, 2020 totaled \$3.7 billion, an increase of \$643.5 million, or 21.0 percent, as compared to the prior year. Total wholesale revenues were \$3.3 billion, an increase of \$520.1 million, or 18.4 percent, as compared to the prior year. New stores are defined as stores that were activated from January 2019 through June 2020. During the six months ended June 27, 2020, the Company had an increase in wholesale merchandise revenues from new domestic stores of \$105.4 million. This increase was partially offset by a decrease in wholesale merchandise revenues due to domestic store cancellations of \$18.0 million. As a result, the Company realized a net increase in wholesale merchandise revenues of \$87.4 million related to the impact of both new stores affiliated with the Company and from stores that cancelled their membership in 2019 and 2020. Wholesale merchandise revenues to comparable domestic stores increased \$407.7 million compared to the prior year. Increases were seen across nearly all departments with grilling, power tools, and outdoor power equipment showing the largest gains.

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

	<b>Six Months Ended</b>	
	<b>June 27, 2020</b>	<b>June 29, 2019</b>
Retailer outlets at beginning of period	5,366	5,253
New retailer outlets added	63	91
Retailer outlet cancellations	(43)	(46)
Retailer outlets at end of period	<u>5,386</u>	<u>5,298</u>

Revenues from AWH were \$190.4 million during the six months ended June 27, 2020, a decrease of \$5.9 million from the prior year. This decrease was primarily the result of several key customer cancellations along with a decision to reduce the number of products available for sale to certain customers due to low profitability.

Revenues from AIH were \$101.5 million during the six months ended June 27, 2020, representing a decrease of \$23.8 million from the prior year. This was the result of lower merchandise shipments due to the global COVID-19 pandemic causing temporary store closures.

Retail revenues from ARH were \$347.4 million during the six months ended June 27, 2020. This is an increase of \$123.3 million or 55.0 percent from the prior year. This increase was primarily the result of eleven new California stores added by Westlake since the second quarter of 2019 coupled with a 22.7 percent in Westlake same-store-sales. Additionally, the inclusion of GLA which became wholly-owned and was fully consolidated in March 2019 contributed \$30.8 million of the ARH increase. GLA reported a 29.4 percent increase in same-store-sales. Retail revenues from AEH were \$14.2 million during the six months ended June 27, 2020. This was an increase of \$0.1 million from the prior year primarily due to an increase in new customer acquisitions during the second quarter.

Wholesale gross profit for the first six months of 2020 was \$433.4 million, an increase of \$101.5 million from the first six months of 2019. The wholesale gross margin percentage was 12.9 percent of wholesale revenues for the six-month period ending June 27, 2020, up from 11.7 percent for the period ended June 29, 2019. The increase in the wholesale gross margin percentage was due to higher vendor funds earned.

Retail gross profit for the six months ended June 27, 2020 was \$159.8 million, an increase of \$53.7 million from the six months ended June 29, 2019. This increase was primarily the result of the eleven new California stores opened by ARH in 2019 and the inclusion of two additional months of GLA results in the current year. Retail gross margin percentage was 44.2 percent of retail revenues in 2020, down from 44.5 percent in 2019. The decrease in the gross margin percentage was primarily the result of the lower vendor funds earned. 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 \$30.2 million, or 11.3 percent, in the six months ended June 27, 2020 as compared to the six months ended June 29, 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 of wholesale revenues in 2020 from 9.5 percent of wholesale revenues in 2019.

Retail operating expenses of \$118.5 million increased \$29.4 million, or 33.0 percent, in the six months ended June 27, 2020 as compared to the six months ended June 29, 2019. This increase was primarily due to expenses related to the eleven new California stores and expenses incurred related to the pandemic. Retail operating expenses as a percentage of retail revenue decreased to 32.8 percent of retail revenues in the first six months of 2020 from 37.4 percent in the first six months of 2019.

Retail pre-opening expenses decreased \$3.6 million in the six months ended June 27, 2020, due to expenses related to the eleven new California stores which opened in 2019.

## Liquidity and Capital Resources

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 June 27, 2020. 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 June 27, 2020, the Company was in compliance with its covenants and had no borrowings outstanding under the credit facility.

The credit facility includes a \$175.0 million sublimit for the issuance of standby and commercial letters of credit. As of June 27, 2020, a total of \$8.4 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 June 27, 2020, there were no loans or other extensions of credit provided to AIH.

The Company entered into an interest rate swap derivative agreement to reduce the risk of interest rate volatility for the credit facility. The interest rate swap started on March 13, 2017 and expired on May 13, 2020. The swap agreement fixed the LIBOR rate on \$150.0 million of the revolving credit facility 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 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 June 27, 2020.

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 June 27, 2020, ARH was in compliance with its covenants and had no borrowings outstanding under the Westlake Facility.

The Company's GLA subsidiary (see Note 2 for additional details of this acquisition) has a \$20.0 million asset-based revolving credit facility ("GLA Facility"). The GLA Facility matures on November 6, 2022. Borrowings under the GLA Facility are subject to a borrowing base calculation consisting of certain advance rates applied to eligible receivables and inventory. The interest rate is based on either the lender's prime rate plus 100 basis points or LIBOR plus 200 basis points. As of June 27, 2020, GLA was in compliance with its covenants and had no borrowings outstanding under the GLA Facility.

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

Total debt was \$25.7 million as of June 27, 2020, compared to \$276.9 million and \$369.4 million as of December 28, 2019 and June 29, 2019, respectively.

## Cash Flows

The Company had \$40.3 million and \$50.2 million of cash and cash equivalents at June 27, 2020 and June 29, 2019, respectively. Following is a summary of the Company's cash flows from operating, investing and financing activities for the first six months of 2020 and 2019, respectively (in millions):

	2020	2019
Cash provided by operating activities before changes in assets and liabilities	\$ 209.3	\$ 105.3
Net changes in assets and liabilities	200.8	(7.3)
Net cash provided by operating activities	410.1	98.0
Net cash used in investing activities	(52.2)	(40.9)
Net cash used in financing activities	(335.8)	(32.5)
Net change in cash and cash equivalents	\$ 22.1	\$ 24.6

The Company's operating activities provided \$410.1 million of cash during the first six months of 2020 compared to \$98.0 million provided in 2019. Excluding the impact of net changes in assets and liabilities, cash provided by operating activities increased from \$105.3 million in the first six months of 2019 to \$209.3 million in the first six months of 2020. This \$104.0 million increase was primarily the result of a \$98.7 million increase in net income for the first six months of 2020 compared to the first six months of 2019.

The net change in assets and liabilities provided \$200.8 million of cash in the first six months of 2020 compared to the use of \$7.3 million in the first six months of 2019. The Company experienced its usual seasonal increase in receivables and inventories during the first six months of 2020, although the significant growth in revenues made the increases more pronounced. Receivables and inventories increased a combined \$289.3 million in the first six months of 2020 compared to a combined increase of \$124.3 million in the first six months of 2019. Offsetting this use of cash is the usual seasonal increase in accounts payable and accrued expenses. During the first six months of 2019, accounts payable and accrued expenses increased \$125.2 million which approximately equaled the \$124.3 million increase in receivables and inventories during that period. However, during the first six months of 2020, accounts payable and accrued expenses increased \$451.9 million compared to the \$289.3 million increase in receivables and inventories during that period. This \$451.9 million increase in accounts payable and accrued expenses was primarily the result of the 32.8 percent increase in wholesale revenues during the second quarter of 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 second quarter of 2020 not having been paid for at the end of the quarter as compared to 2019.

Net cash used in investing activities was \$52.2 million in the first six months of 2020 compared to \$40.9 million in the first six months of 2019. Investing activities in 2020 primarily consisted of \$43.7 million in capital expenditures and \$6.6 million paid for the acquisition of additional retail stores by ARH. Investing activities in 2019 primarily consisted of \$32.9 million in capital expenditures, \$19.0 million paid for the acquisition of GLA and additional retail stores by ARH and net proceeds of \$16.0 million from the purchase and sale of marketable securities.

Net cash used in financing activities was \$335.8 million in the first six months of 2020 compared to \$32.5 million used in financing activities in the first six months of 2019. During 2020, the Company fully repaid all amounts outstanding under all three of its revolving credit facilities. In addition, the Company paid \$66.2 million for the cash portion of the 2019 patronage distribution, paid \$9.5 million on patronage refund certificates and made payments on long-term debt of \$5.3 million. During 2019, the Company had \$33.0 million of net borrowings under the revolving lines of credit, paid \$51.3 million for the cash portion of the 2018 patronage distribution, paid \$5.3 million on patronage refund certificates and made payments on long-term debt of \$5.9 million.

## Contractual Obligations and Commitments

For the six months ended June 27, 2020, there have been no significant changes to the Company's contractual obligations and commitments as disclosed in its 2019 Annual Report.

## 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 2019 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 2019 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; civil unrest; pandemics; and acts of terrorism.

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

In March 2020, the World Health Organization declared the outbreak of a novel coronavirus a global pandemic. The pandemic is having a significant effect on overall economic conditions and the preventative and protective measures taken by governments are resulting in global business disruptions, including the Company’s customers and vendors. Some of the Company’s customers have seen a temporary reduction of operating hours for their stores, as well as temporary store closures where government mandated. While the impact of the pandemic is currently expected to be temporary, there is uncertainty around the severity and duration of the disruption. Although the Company continues to see significant increases in revenues, the possibility still exists that the pandemic may negatively affect its 2020 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.



## 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 18, 2020

/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



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