

ACE HARDWARE CORPORATION
Quarterly report for the period ended March 30, 2019



ACE HARDWARE CORPORATION
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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 March 30, 2019 and March 31, 2018, and the related consolidated statements of income, comprehensive income, equity and cash flows for the three-month periods ended March 30, 2019 and March 31, 2018.

Management's Responsibility for the Financial Statements

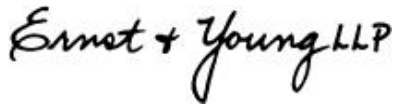
Management is responsible for the preparation and fair presentation of the interim financial information in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control sufficient to provide a reasonable basis for the preparation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

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
May 21, 2019

ACE HARDWARE CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(in millions)

	Three Months Ended	
	March 30, 2019 (13 Weeks)	March 31, 2018 (13 Weeks)
Revenues:		
Wholesale revenues	\$ 1,299.0	\$ 1,249.0
Retail revenues	79.5	63.1
Total revenues	1,378.5	1,312.1
Cost of revenues:		
Wholesale cost of revenues	1,145.2	1,109.4
Retail cost of revenues	42.7	34.0
Total cost of revenues	1,187.9	1,143.4
Gross profit:		
Wholesale gross profit	153.8	139.6
Retail gross profit	36.8	29.1
Total gross profit	190.6	168.7
Wholesale operating expenses:		
Distribution operations expenses	42.6	38.4
Selling, general and administrative expenses	50.8	48.1
Retailer success and development expenses	35.9	32.7
Retail operating expenses	37.9	34.4
Total operating expenses	167.2	153.6
Operating income	23.4	15.1
Interest expense	(6.3)	(4.4)
Interest income	3.1	0.9
Other income, net	1.6	0.2
Income tax benefit	0.8	0.1
Net income	22.6	11.9
Less: net income attributable to noncontrolling interests	0.1	0.1
Net income attributable to Ace Hardware Corporation	\$ 22.5	\$ 11.8
Patronage distributions accrued	\$ 34.5	\$ 24.7
Patronage distributions accrued for third party retailers	\$ 32.9	\$ 23.3

See accompanying notes to the consolidated financial statements.

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

	Three Months Ended	
	March 30, 2019 (13 Weeks)	March 31, 2018 (13 Weeks)
Net income	\$ 22.6	\$ 11.9
Other comprehensive income, net of tax:		
Unrealized gain (loss) on investments	0.7	(0.9)
Unrealized (loss) gain on derivative financial instrument	(0.4)	1.0
Total other comprehensive income, net	0.3	0.1
Comprehensive income	22.9	12.0
Less: Comprehensive income attributable to noncontrolling interests	0.1	0.1
Comprehensive income attributable to Ace Hardware Corporation	\$ 22.8	\$ 11.9

See accompanying notes to the consolidated financial statements.

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

	March 30, 2019	December 29, 2018	March 31, 2018
	(Unaudited)	(Audited)	(Unaudited)
Assets			
Cash and cash equivalents	\$ 31.0	\$ 25.6	\$ 24.0
Marketable securities	52.9	50.4	50.4
Receivables, net of allowance for doubtful accounts of \$7.4, \$6.7 and \$8.3, respectively	582.3	434.4	570.3
Inventories	1,021.9	931.8	973.1
Prepaid expenses and other current assets	52.3	50.4	44.4
Total current assets	1,740.4	1,492.6	1,662.2
Property and equipment, net	374.2	368.6	361.6
Notes receivable, net of allowance for doubtful accounts of \$2.4, \$2.8 and \$3.4, respectively	17.5	11.8	10.1
Goodwill and other intangible assets	98.2	94.2	96.4
Other assets	90.4	91.3	90.1
Total assets	<u>\$ 2,320.7</u>	<u>\$ 2,058.5</u>	<u>\$ 2,220.4</u>
Liabilities and Equity			
Current maturities of long-term debt	\$ 79.9	\$ 60.6	\$ 67.4
Accounts payable	908.2	748.9	932.8
Patronage distributions payable in cash	68.1	55.0	71.0
Patronage refund certificates payable	10.1	10.2	5.7
Accrued expenses	135.9	173.6	142.2
Total current liabilities	1,202.2	1,048.3	1,219.1
Long-term debt	376.8	267.1	291.4
Patronage refund certificates payable	101.2	95.6	86.9
Other long-term liabilities	81.3	79.7	75.4
Total liabilities	<u>1,761.5</u>	<u>1,490.7</u>	<u>1,672.8</u>
Member Retailers' Equity:			
Class A voting common stock, \$1,000 par value, 10,000 shares authorized, 2,718, 2,719 and 2,713 issued and outstanding, respectively	2.7	2.7	2.7
Class C nonvoting common stock, \$100 par value, 6,000,000 shares authorized, 4,558,530, 4,648,554 and 4,317,646 issued and outstanding, respectively	455.8	464.8	431.8
Class C nonvoting common stock, \$100 par value, issuable to retailers for patronage distributions, 540,809, 439,591 and 563,189 shares issuable, respectively	54.2	44.0	56.3
Contributed capital	18.4	18.5	18.3
Retained earnings	12.9	24.8	20.8
Accumulated other comprehensive income (loss)	0.5	(1.2)	4.3
Equity attributable to Ace member retailers	544.5	553.6	534.2
Equity attributable to noncontrolling interests	14.7	14.2	13.4
Total equity	<u>559.2</u>	<u>567.8</u>	<u>547.6</u>
Total liabilities and equity	<u>\$ 2,320.7</u>	<u>\$ 2,058.5</u>	<u>\$ 2,220.4</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	Additional Stock Subscribed	Contributed Capital	Retained Earnings	Accumulated Other Comprehensive Income	Noncontrolling Interests	Total Equity
	Class A	Class C	Issuable to Retailers for Patronage Dividends						
Balances at December 30, 2017	\$ 2.7	\$ 441.3	\$ 48.9	\$ -	\$ 18.3	\$ 33.2	\$ 3.5	\$ 13.0	\$ 560.9
Net income	-	-	-	-	-	11.8	-	0.1	11.9
Other comprehensive income	-	-	-	-	-	-	0.1	-	0.1
Net payments on subscriptions	-	-	-	0.4	-	-	-	-	0.4
Stock issued	-	0.4	-	(0.4)	-	-	-	-	-
Change in noncontrolling interests	-	-	-	-	(0.1)	(0.1)	-	0.3	0.1
Stock repurchased	-	(9.9)	-	-	-	-	-	-	(9.9)
Patronage distributions issuable	-	-	7.4	-	-	-	-	-	7.4
Patronage distributions payable	-	-	-	-	-	(23.3)	-	-	(23.3)
Adoption of accounting standard	-	-	-	-	-	(0.7)	0.7	-	-
Other	-	-	-	-	0.1	(0.1)	-	-	-
Balances at March 31, 2018	\$ 2.7	\$ 431.8	\$ 56.3	\$ -	\$ 18.3	\$ 20.8	\$ 4.3	\$ 13.4	\$ 547.6
Balances at December 29, 2018	\$ 2.7	\$ 464.8	\$ 44.0	\$ -	\$ 18.5	\$ 24.8	\$ (1.2)	\$ 14.2	\$ 567.8
Net income	-	-	-	-	-	22.5	-	0.1	22.6
Other comprehensive income	-	-	-	-	-	-	0.3	-	0.3
Net payments on subscriptions	-	-	-	0.3	-	-	-	-	0.3
Stock issued	-	0.3	-	(0.3)	-	-	-	-	-
Change in noncontrolling interests	-	-	-	-	(0.1)	(0.1)	-	0.4	0.2
Stock repurchased	-	(9.3)	-	-	-	-	-	-	(9.3)
Patronage distributions issuable	-	-	10.2	-	-	-	-	-	10.2
Patronage distributions payable	-	-	-	-	-	(32.9)	-	-	(32.9)
Adoption of accounting standard	-	-	-	-	-	(1.4)	1.4	-	-
Balances at March 30, 2019	\$ 2.7	\$ 455.8	\$ 54.2	\$ -	\$ 18.4	\$ 12.9	\$ 0.5	\$ 14.7	\$ 559.2

See accompanying notes to the consolidated financial statements.

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

	Three Months Ended	
	March 30, 2019 (13 Weeks)	March 31, 2018 (13 Weeks)
Operating Activities		
Net income	\$ 22.6	\$ 11.9
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	14.6	12.2
Amortization of deferred financing costs	0.1	0.1
(Gain) Loss on the disposal of assets, net	(0.1)	0.1
Provision for doubtful accounts	0.6	0.6
Other, net	(1.0)	0.2
Changes in operating assets and liabilities, exclusive of effects of acquisitions:		
Receivables	(155.4)	(164.8)
Inventories	(60.0)	(190.2)
Other current assets	(1.3)	(2.9)
Other long-term assets	(2.5)	3.6
Accounts payable and accrued expenses	109.3	224.9
Other long-term liabilities	1.6	6.5
Deferred taxes	(1.7)	-
Net cash used in operating activities	<u>(73.2)</u>	<u>(97.8)</u>
Investing Activities		
Purchases of marketable securities	(3.6)	(3.3)
Proceeds from sale of marketable securities	3.7	2.8
Purchases of property and equipment	(12.1)	(16.4)
Cash paid for acquired businesses, net of cash received	(16.2)	(11.0)
Increase in notes receivable, net	(3.9)	(1.9)
Other, net	0.7	-
Net cash used in investing activities	<u>(31.4)</u>	<u>(29.8)</u>
Financing Activities		
Net borrowings under revolving lines of credit	120.2	137.6
Principal payments on long-term debt	(3.4)	(2.8)
Payments of debt issuance costs	(1.3)	-
Payments of patronage refund certificates	(5.3)	(6.4)
Repurchase of stock	(0.4)	(0.1)
Purchase of noncontrolling interests	(0.1)	-
Other, net	0.3	0.3
Net cash provided by financing activities	<u>110.0</u>	<u>128.6</u>
Increase in cash and cash equivalents	5.4	1.0
Cash and cash equivalents at beginning of period	<u>25.6</u>	<u>23.0</u>
Cash and cash equivalents at end of period	<u>\$ 31.0</u>	<u>\$ 24.0</u>
Supplemental disclosure of cash flow information:		
Interest paid	<u>\$ 8.0</u>	<u>\$ 5.9</u>
Income taxes paid	<u>\$ 0.4</u>	<u>\$ 0.4</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 Ecommerce Holdings LLC (“AEH”), a majority-owned and controlled subsidiary of the Company, operates The Grommet, an e-commerce company that operates a website that markets and sells new and innovative products created by independent entrepreneurs.

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 Retail Holdings LLC (“ARH”) is the owner of the 124 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 ACO Inc. (“ACO”) that it did not already own. ACO, which operates under the name Great Lakes Ace Hardware, is based in Farmington Hills, Michigan and is the owner of 50 neighborhood hardware stores located in Michigan and Ohio. See Note 2 for additional details of this acquisition.

Ace Hardware International Holdings, Ltd. (“AIH”), is a majority-owned and controlled subsidiary of the Company with a 20.5 percent 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 2018 Annual Report. The unaudited consolidated financial statements for the three months ended March 30, 2019 and March 31, 2018 both cover a 13-week period.

Subsequent events have been evaluated through May 21, 2019, 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 months ended March 30, 2019 are not necessarily indicative of the results to be expected for the full fiscal year 2019.

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.

Revenue Recognition

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” along with amendments issued in 2015 and 2016. The purpose of the new guidance is to develop a common revenue recognition standard for GAAP and International Financial Reporting Standards. The guidance 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. This guidance is effective for the Company for fiscal

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

2019 year-end financial statements and quarterly financial statements in fiscal 2020. The Company adopted ASU 2014-09 in the first quarter of 2019 using the modified retrospective method. The impact of adopting the new standard had no impact to the consolidated financial statements. However, the Company has expanded revenue recognition disclosures based on the new qualitative and quantitative disclosure requirements as follows:

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

	Three Months Ended	
	March 30, 2019	March 31, 2018
Warehouse merchandise	\$ 917.5	\$ 886.8
Direct shipment merchandise	309.5	301.5
Retail revenues	73.3	57.0
E-commerce	16.5	12.9
Service revenues	68.3	60.1
Amortization of sales allowances under retailer incentive programs	(6.6)	(6.2)
Total revenues	\$ 1,378.5	\$ 1,312.1

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

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

Impact of New Accounting Standards

New Accounting Pronouncements – Adopted

In January 2016, the FASB issued ASU No. 2016-01, “Financial Instruments – Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Financial Liabilities.” ASU 2016-01 requires the change in fair value measurement for certain equity investments to be recognized in net income, simplifies the impairment assessment for equity investments without readily determinable fair values, eliminates disclosure requirements related to fair value of financial instruments measured at amortized cost for non-public entities, eliminates the requirement to disclose methods and assumptions used to estimate fair value of financial instruments measured at amortized cost for public entities and requires public entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. Additionally, ASU 2016-01 provides disclosure presentation guidance and clarification related to valuations allowances on deferred tax assets related to available-for-sale securities. ASU 2016-01 is effective for the Company for fiscal 2019 year-end financial statements and quarterly financial statements in fiscal 2020, with early adoption permitted in fiscal 2018. The Company adopted ASU 2016-01 in the first quarter of 2019. This resulted in a reclassification adjustment of a \$1.4 million net loss from accumulated other comprehensive income (“AOCI”) to retained earnings related to the unrealized loss on the Company’s equity investments.

New Accounting Pronouncements - Issued

In February 2016, the FASB issued 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. ASU 2016-02 is effective for the Company for fiscal 2020 year-end financial statements and quarterly financial statements in fiscal 2021. The Company has begun evaluating its contracts under this guidance to determine the impact ASU 2016-02 will have on its consolidated financial statements and believes the standard will have a material impact to the Company’s balance sheet.

(2) Acquisition

In March 2019, ARH acquired a controlling interest in ACO, an owner of a 50 hardware store chain that operates retail stores under the name Great Lakes Ace Hardware in Michigan and Ohio. In 2017, the Company acquired a 42 percent interest in ACO for \$3.7 million. The remaining 58 percent of the outstanding stock was acquired in a series of transactions for an additional \$11.3 million in consideration. As of March 30, 2019, \$2.6 million of consideration was still due to previous shareholders and was recorded as a liability within Accrued expenses. In April 2019, the Company settled the final \$2.6 million to extinguish this liability.

The Company has estimated the fair value of ACO to be \$18.3 million as of the acquisition date based upon the consideration per share paid to acquire the remaining 58 percent and has accounted for this transaction as a business combination. As of March 30, 2019, the Company recorded a preliminary allocation of the purchase price to acquired tangible assets and liabilities assumed based on their estimated fair value at the acquisition date. The Company is in the process of determining the value, if any, for identifiable intangible assets. The Company expects to complete the purchase price allocation by the end of the fourth quarter of 2019. Based on the preliminary purchase price allocation, the Company recorded no goodwill or other intangibles.

The following table summarizes the fair value of ACO based on the \$21.50 price per share Ace paid for the 58 percent in March 2019 and the preliminary purchase price allocation at the acquisition date:

Fair value of assets acquired and liabilities assumed:	
Cash	\$ 1.0
Receivables	2.4
Inventories	27.2
Other current assets	1.3
Property and Equipment	5.7
Other assets	3.6
Short-term debt (ACO Facility – See Note 4)	(9.8)
Other current liabilities	(13.1)
Fair value on acquisition date at \$21.50 per share	<u>\$ 18.3</u>

In addition, during the first three months of 2019, ARH acquired additional retail stores for consideration of \$8.5 million, prior to working capital adjustments. These acquisitions resulted in ARH recording \$5.1 million of goodwill.

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

(3) Inventories

Inventories consist of wholesale merchandise inventories held for sale to customers and retail merchandise inventory held for resale at Company-operated 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 \$87.4 million, \$85.7 million and \$80.7 million at March 30, 2019, December 29, 2018 and March 31, 2018, 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:

	March 30, 2019	December 29, 2018	March 31, 2018
Wholesale merchandise inventory (LIFO)	\$ 872.7	\$ 824.5	\$ 865.4
Retail merchandise inventory at Company-operated stores and AEH warehouses (FIFO)	149.2	107.3	107.7
Inventories	\$ 1,021.9	\$ 931.8	\$ 973.1

(4) Debt

On February 1, 2019, the Company amended its existing credit facility. Prior to February 2019, the Company had a \$600.0 million line of credit that was expandable to \$750.0 million through a \$150.0 million accordion feature. At the Company’s discretion, borrowings under the 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. The credit facility was due to expire on May 29, 2020.

On February 1, 2019, the Company amended its line of credit facility, increasing its borrowing capacity to \$700.0 million that is expandable to \$1.0 billion through a \$300.0 million accordion that is exercisable without the consent of existing lenders provided that the Company is not in default of the credit agreement and further provided that none of the existing lenders are required to provide any portion of the increased facility. At the Company’s discretion, borrowings under the credit facility bear interest at a rate of either 0 to 75 basis points over the prime rate or 100 to 175 basis points over the 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 March 30, 2019. 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 March 30, 2019, the Company was in compliance with its covenants and \$362.1 million was outstanding under the credit facility.

The credit facility includes a \$175.0 million sublimit for the issuance of standby and commercial letters of credit. As of March 30, 2019, a total of \$13.7 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 March 30, 2019, 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 expires on May 13, 2020. The swap agreement fixes the LIBOR rate on \$150.0 million of the revolving credit facility at 2.18 percent, resulting in an effective rate of 3.43 percent after adding the 1.25 percent margin based on the current pricing tier per the credit agreement. The swap arrangement has been designated as a cash flow hedge and has been evaluated to be highly effective. As a result, the after-tax change in the fair value of the swap is recorded in AOCI as a gain or loss on derivative financial instruments.

Prior to March 5, 2019, the Company’s Westlake subsidiary had a \$75.0 million asset-based revolving credit facility (“Westlake Facility”). The Westlake Facility was due to mature on October 24, 2022 and was expandable to \$100.0 million under certain conditions. 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

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(Unaudited, in millions)

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.

On March 5, 2019, Westlake amended its credit facility, increasing the Westlake Facility size by \$25 million to \$100 million and reduced the unused fees to 15 basis points. The Westlake Facility was priced at LIBOR plus 125 basis points at March 30, 2019.

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 March 30, 2019, ARH was in compliance with its covenants and had \$61.5 million in loans outstanding under the Westlake Facility.

The Company’s ACO subsidiary (see Note 2 for additional details of this acquisition) has a \$20.0 million asset-based revolving credit facility (“ACO Facility”). The ACO Facility matures on November 6, 2022. The interest rate is based on either the lender’s prime rate plus 100 basis points or LIBOR rate plus 200 basis points. The ACO Facility was priced at the prime rate plus 100 basis points at March 30, 2019. The ACO Facility is collateralized by its inventory and real estate assets. As of March 30, 2019, ACO was in compliance with its covenants and had \$7.6 million outstanding under the ACO Facility.

Both the ACO Facility and the Westlake Facility include a lender-controlled cash concentration system that results in all of ACO 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 ACO Facility and Westlake Facility have been classified as a Current maturity of long-term debt as of March 30, 2019.

Total debt outstanding is comprised of the following:

	March 30, 2019	December 29, 2018	March 31, 2018
Revolving Credit Facility	\$ 362.1	\$ 251.7	\$ 276.5
Westlake Facility	61.5	49.5	57.5
ACO Facility	7.6	-	-
Installment notes with maturities through 2023 at a fixed rate of 6.00%	25.5	26.5	24.8
Total debt	456.7	327.7	358.8
Less: maturities within one year	(79.9)	(60.6)	(67.4)
Long-term debt	<u>\$ 376.8</u>	<u>\$ 267.1</u>	<u>\$ 291.4</u>

(5) 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 March 30, 2019, December 29, 2018 and March 31, 2018. 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.

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

Items measured at fair value on a recurring basis	Carrying Value Measured at Fair Value			
	March 30, 2019	Level 1	Level 2	Level 3
Assets:				
Cash equivalents:				
Money market funds	\$ 8.4	\$ 8.4	\$ -	\$ -
Marketable securities:				
Corporate fixed income securities	14.7	-	14.7	-
Equity mutual fund securities	16.4	16.4	-	-
Mortgage-backed securities	7.3	-	7.3	-
U.S. government notes	11.7	11.1	0.6	-
Other	2.8	-	2.8	-
Total marketable securities	<u>\$ 52.9</u>	<u>\$ 27.5</u>	<u>\$ 25.4</u>	<u>\$ -</u>
Other assets:				
Interest rate swap derivative	\$ 0.3	\$ -	\$ 0.3	\$ -

Items measured at fair value on a recurring basis	Carrying Value Measured at Fair Value			
	December 29, 2018	Level 1	Level 2	Level 3
Assets:				
Cash equivalents:				
Money market funds	\$ 7.7	\$ 7.7	\$ -	\$ -
Marketable securities:				
Corporate fixed income securities	14.1	-	14.1	-
Equity mutual fund securities	14.5	14.5	-	-
Mortgage-backed securities	6.5	-	6.5	-
U.S. government notes	12.4	11.8	0.6	-
Other	2.9	-	2.9	-
Total marketable securities	<u>\$ 50.4</u>	<u>\$ 26.3</u>	<u>\$ 24.1</u>	<u>\$ -</u>
Other assets:				
Interest rate swap derivative	\$ 0.8	\$ -	\$ 0.8	\$ -

Items measured at fair value on a recurring basis	Carrying Value Measured at Fair Value			
	March 31, 2018	Level 1	Level 2	Level 3
Assets:				
Cash equivalents:				
Money market funds	\$ 7.9	\$ 7.9	\$ -	\$ -
Marketable securities:				
Corporate fixed income securities	14.9	-	14.9	-
Equity mutual fund securities	14.7	14.7	-	-
Mortgage-backed securities	5.6	-	5.6	-
U.S. government notes	12.0	11.4	0.6	-
Other	3.2	-	3.2	-
Total marketable securities	<u>\$ 50.4</u>	<u>\$ 26.1</u>	<u>\$ 24.3</u>	<u>\$ -</u>
Other assets:				
Interest rate swap derivative	\$ 0.6	\$ -	\$ 0.6	\$ -

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Money market funds, Equity mutual fund securities and U.S. government notes – The Company’s valuation techniques used to measure the fair values of money market funds, 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, 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 \$0.4 million and \$4.8 million at March 30, 2019 and March 31, 2018, respectively.

Gross proceeds from the sale of marketable securities and the related realized gains and losses for the three months ended March 30, 2019 and March 31, 2018 were as follows:

	Three Months Ended	
	March 30, 2019	March 31, 2018
Gross proceeds	\$ 3.7	\$ 2.8
Gross realized gains	0.1	-
Gross realized losses	(0.1)	(0.1)

Gross realized gains and losses were determined using the specific identification method. For the three months ended March 30, 2019, the Company reclassified \$0.1 million of unrealized gains and \$0.1 million of unrealized losses on marketable securities that were recorded in AOCI as of December 29, 2018 into realized income. These amounts were recorded to Other income, net in the Consolidated Statement of Income.

The following table summarizes the contractual maturity distributions of the Company’s debt securities at March 30, 2019. 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	\$ 1.4	\$ 5.2	\$ 4.3	\$ 3.8	\$ 14.7
Mortgage-backed securities	-	0.3	1.2	5.8	7.3
U.S. government notes	1.0	4.6	4.2	1.9	11.7
Other	-	0.3	0.5	2.0	2.8
Total	\$ 2.4	\$ 10.4	\$ 10.2	\$ 13.5	\$ 36.5

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.

The Company entered into an interest rate swap derivative agreement, which started on March 13, 2017 and expires on May 13, 2020. The swap agreement fixes the LIBOR rate on \$150.0 million of the revolving credit facility at 2.18 percent, resulting in an effective rate of 3.43 percent after adding the 1.25 percent margin based on the current pricing tier per the credit agreement.

The fair value of the Company’s interest rate swap is 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 March 30, 2019, December 29, 2018 and March 31, 2018, the fair value of the interest rate swap was an asset balance of

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\$0.3 million, \$0.8 million and \$0.6 million, respectively. The Company classifies long-term derivative assets as Other assets on the Consolidated Balance Sheets.

Because the interest rate swap has been designated as a cash flow hedge and has 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 instrument is sold, extinguished or terminated, or at the time it becomes expected to be sold, extinguished or terminated. The net of tax amount recorded in AOCI for the fair value adjustment of the interest rate swap was an unrealized gain of \$0.3 million, \$0.6 million and \$0.4 million as of March 30, 2019, December 29, 2018 and March 31, 2018, respectively. This unrealized gain 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 swap for the three months ended March 30, 2019 and March 31, 2018.

The Company's debt instruments are recorded at cost on the Consolidated Balance Sheets. The fair value of the Company's debt was approximately \$457.5 million at March 30, 2019, compared to the carrying value, including accrued interest, of \$457.8 million. 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.

(6) 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:

	Three Months Ended	
	March 30, 2019	March 31, 2018
Expected tax at U.S. Federal income tax rate	\$ (4.6)	\$ (2.5)
Patronage distribution deductions	6.9	4.9
Other, net	(1.5)	(2.3)
Income tax benefit	\$ 0.8	\$ 0.1

(7) Supplemental Disclosures of Cash Flow Information

During the three months ended March 30, 2019 and March 31, 2018, accrued patronage distributions of \$4.1 million and \$2.0 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 three months ended March 30, 2019 and March 31, 2018, non-cash repurchases of stock from retailers of \$6.6 million and \$9.8 million, respectively, were offset against trade receivables of \$2.0 million and \$5.1 million, respectively, and notes receivable of \$2.2 million and \$2.7 million, respectively. The remaining \$2.4 million and \$2.0 million, respectively, were primarily issued as notes payable with no net impact in the Consolidated Statements of Cash Flows. With the acquisition of ACO, the Company recorded a non-cash elimination of ACO's investment in the Class A and Class C shares of the Company of \$2.3 million with no net impact in the Consolidated Statement of Cash Flows.

In June 2015, the Company entered into a forward interest rate swap derivative agreement, which started on March 13, 2017 and expires on May 13, 2020. The fair value adjustments for the interest rate swap derivative were recorded as Other assets of \$0.3 million and \$0.6 million as of March 30, 2019 and March 31, 2018. 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 three months ended March 30, 2019, the Company received \$4.2 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 three months ended March 30, 2019. During the three months ended March 30, 2019, the Company paid \$2.5 million for property and equipment that was purchased and accrued during the year ended December 29, 2018. These capital expenditures were included in the Purchases of property and equipment in the Consolidated Statement of Cash Flows for the three months ended March 30, 2019.

(8) Warehouse Facility Closure Costs

The Company closed its crossdock operation near Baltimore, Maryland, ceased operations at its Prince George, Virginia Retail Support Center ("RSC"), closed its Emery wholesale distribution warehouse in Portland, Maine and intends to close the Emery wholesale distribution warehouse in Pittston, Pennsylvania. The Company had a remaining liability of \$1.5 million for post-employment benefits and \$1.0 million for inventory markdown reserves as of December 29, 2018. During the three months ended March 30, 2019, the

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

Company recorded a \$0.5 million benefit in Wholesale cost of revenues to offset the inventory markdowns and \$1.1 million in payments for post-employment benefits. The Company has ceased using the ARH distribution center in Lenexa, Kansas and had \$2.0 million and \$2.1 million of remaining net lease liability as of March 30, 2019 and December 29, 2018, respectively.

Accrued warehouse facility closure costs activity for the three months ended March 30, 2019 is as follows:

	Remaining Net Lease Liability	Post- employment Benefits	Inventory Markdown Reserves	Total
Balance at December 29, 2018	\$ 2.1	\$ 1.5	\$ 1.0	\$ 4.6
Reclass to wholesale cost of revenues	-	-	(0.5)	(0.5)
Payments	(0.1)	(1.1)	-	(1.2)
Balance at March 30, 2019	<u>\$ 2.0</u>	<u>\$ 0.4</u>	<u>\$ 0.5</u>	<u>\$ 2.9</u>

As a result of the closure of the Prince George RSC, as of December 29, 2018, the Company had concluded that the long-lived assets at its Prince George RSC (land and building) met the criteria to be classified as assets held for sale. The carrying value of these assets totaled \$15.8 million. As of March 30, 2019, the Prince George RSC continues to meet all of the requirements for held for sale presentation.

(9) Subsequent Event

The Company has acquired or is in the process of acquiring 11 store leases from a former home improvement retailer. The Company expects to acquire these store leases at various dates during the second quarter of 2019. The estimated future minimum lease payments of all 11 leases are approximately \$80.0 million as of March 30, 2019. ARH will operate 9 of the locations and 2 of the locations have been assigned to Ace retailers. The Company will remain contingently liable for payment of these assigned leases.

**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-month periods ended March 30, 2019 and March 31, 2018. This discussion and analysis should be read in conjunction with the Company's 2018 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 March 30, 2019 to the Three Months Ended March 31, 2018

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

	2019		2018		Favorable/ (Unfavorable)	
	\$	% of Revenues*	\$	% of Revenues*	\$	%
Revenues:						
Wholesale revenues	1,299.0	94.2%	1,249.0	95.2%	50.0	4.0%
Retail revenues	79.5	5.8%	63.1	4.8%	16.4	26.0%
Total revenues	1,378.5	100.0%	1,312.1	100.0%	66.4	5.1%
Gross profit:						
Wholesale gross profit	153.8	11.8%	139.6	11.2%	14.2	10.2%
Retail gross profit	36.8	46.3%	29.1	46.1%	7.7	26.5%
Total gross profit	190.6	13.8%	168.7	12.9%	21.9	13.0%
Operating expenses:						
Wholesale operating expenses	129.3	10.0%	119.2	9.5%	(10.1)	(8.5%)
Retail operating expenses	37.9	47.7%	34.4	54.5%	(3.5)	(10.2%)
Total operating expenses	167.2	12.1%	153.6	11.7%	(13.6)	(8.9%)
Operating income	23.4	1.7%	15.1	1.2%	8.3	55.0%
Interest expense	(6.3)	(0.5%)	(4.4)	(0.4%)	(1.9)	(43.2%)
Other income, net	5.4	0.3%	1.1	0.1%	4.3	390.9%
Net income attributable to Ace Hardware Corporation	22.5	1.6%	11.8	0.9%	10.7	90.7%

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

A reconciliation of consolidated revenues follows (in millions):

	Amount	% Change vs. 2018
2018 Revenues	\$ 1,312.1	
<i>Wholesale Merchandise Revenues change based on new and cancelled domestic stores:</i>		
Revenues increase from new stores added since January 2018	41.0	3.1%
Revenues decrease from stores cancelled since January 2018	(9.8)	(0.7%)
Increase in wholesale merchandise revenues to comparable domestic stores	16.5	1.3%
Increase in AWH wholesale revenues	7.3	0.6%
Increase in AIH wholesale revenues	1.1	0.1%
Increase in ARH retail revenues	16.3	1.2%
Increase in AEH retail revenues	0.1	0.0%
Other revenue changes, net	(6.1)	(0.5%)
2019 Revenues	\$ 1,378.5	5.1%

Consolidated revenues for the three months ended March 30, 2019 totaled \$1.4 billion, an increase of \$66.4 million, or 5.1 percent, as compared to the prior year first quarter. Total wholesale revenues were \$1.3 billion for the first quarter 2019, an increase of \$50.0 million, or 4.0 percent, as compared to the prior year first quarter. The categories with the largest revenue gains were winter goods, grilling and power tools. New stores are defined as stores that were activated from January 2018 through March 2019. In 2019,

the Company had an increase in wholesale merchandise revenues from new domestic stores of \$41.0 million. This increase was partially offset by a decrease in wholesale merchandise revenues due to domestic store cancellations of \$9.8 million. As a result, the Company realized a net increase in wholesale merchandise revenues of \$31.2 million related to the impact of both new stores affiliated with the Company and from stores that cancelled their membership in 2018 and 2019. Wholesale merchandise revenues to comparable domestic stores increased \$16.5 million.

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

	Three Months Ended	
	March 30, 2019	March 31, 2018
Retailer outlets at beginning of period	5,253	5,121
New retailer outlets added	47	44
Retailer outlet cancellations	(22)	(28)
Retailer outlets at end of period	<u>5,278</u>	<u>5,137</u>

Revenues from the Ace Wholesale Holdings LLC ("AWH") subsidiary were \$104.8 million during the three months ended March 30, 2019. This is an increase of \$7.3 million, or 7.5 percent, from the first quarter of 2018. This increase was primarily due to increased sales to AHD and higher sales from AWH's retailer convention, partially offset by lower sales in the business-to-business and dealer channels.

Revenues from the Ace Hardware International Holdings, Ltd. ("AIH") subsidiary were \$61.4 million during the three months ended March 30, 2019. This is an increase of \$1.1 million, or 1.8 percent, from the first quarter of 2018.

Total retail revenues for the quarter were \$79.5 million, an increase of \$16.4 million, or 26.0 percent, as compared to the prior year first quarter. Retail revenues from Ace Retail Holdings LLC ("ARH") were \$73.3 million in the first quarter of 2019, an increase of \$16.3 million, or 28.6 percent, from the first quarter of 2018. This increase was the result of new retail stores added since the first quarter of 2018 by the Westlake Ace Hardware ("Westlake") retail chain coupled with an 8.2 percent increase in comparable domestic stores of \$4.4 million. Westlake operated 124 stores at the end of the first quarter of 2019 compared to 116 stores at the end of the first quarter of 2018. The remaining increase in ARH revenues was the result of the acquisition of the remaining 58 percent of the outstanding stock of ACO Inc. ("ACO") in March 2019, which now requires Ace to include ACO's operating results in the statement of income. ACO, which operates 50 stores under the name of Great Lakes Ace Hardware in Michigan and Ohio, contributed \$6.1 million of revenue in the first quarter of 2019. Prior to March 2019 purchase Ace owned 42 percent of ACO. Retail revenues from AEH were \$6.2 million in the first quarter of 2019 compared to \$6.1 million in the first quarter of 2018.

Wholesale gross profit for the three months ended March 30, 2019 was \$153.8 million, an increase of \$14.2 million from the first quarter of 2018. The wholesale gross margin percentage was 11.8 percent of wholesale revenues in the first quarter of 2019, up from 11.2 percent in the first quarter of 2018. The increase in the wholesale gross margin percentage was largely the result of the timing of vendor funds earned.

Retail gross profit for the first quarter of 2019 was \$36.8 million, an increase of \$7.7 million from the first quarter of 2018. The retail gross margin percentage was 46.3 percent of retail revenues in the first quarter of 2019, a slight increase from 46.1 percent in the first quarter of 2018. For ARH, 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 \$10.1 million, or 8.5 percent, from the first quarter of 2018. The increase is primarily due to higher payroll expenses resulting from increased headcount in our Retail Support Centers ("RSC") to support increased retailer demand and lower RSC productivity due to continued employee turnover. As a percentage of wholesale revenues, wholesale operating expenses increased to 10.0 percent of wholesale revenues in the first quarter of 2019 from 9.5 percent of wholesale revenues in the first quarter of 2018.

Retail operating expenses increased \$3.5 million, or 10.2 percent, from the first quarter of 2018. This increase was primarily due to the inclusion of ACO operating expenses as a result of the acquisition of the remaining 58 percent of ACO in March 2019. Retail operating expenses as a percentage of retail revenue decreased to 47.7 percent of retail revenues in the first quarter of 2019 from 54.5 percent in the first quarter of 2018 primarily due to retail operating expense leverage resulting from Westlake's significant increase in sales and the timing of advertising expenditures.

Liquidity and Capital Resources

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

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

The Company has a \$700.0 million line of credit that is expandable to \$1.0 billion through a \$300.0 million accordion that is exercisable without the consent of existing lenders provided that the Company is not in default of the credit agreement and further provided that none of the existing lenders are required to provide any portion of the increased facility. At the Company's discretion, borrowings under the credit facility bear interest at a rate of either 0 to 75 basis points over the prime rate or 100 to 175 basis points over the London Interbank Offered Rate ("LIBOR") depending on the Company's leverage ratio as defined under the agreement. The credit facility was priced at LIBOR plus 125 basis points at March 30, 2019. 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 March 30, 2019, the Company was in compliance with its covenants and \$362.1 million was outstanding under the credit facility.

The credit facility includes a \$175.0 million sublimit for the issuance of standby and commercial letters of credit. As of March 30, 2019, a total of \$13.7 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 March 30, 2019, 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 expires on May 13, 2020. The swap agreement fixes the LIBOR rate on \$150.0 million of the revolving credit facility at 2.18 percent, resulting in an effective rate of 3.43 percent after adding the 1.25 percent margin based on the current pricing tier per the credit agreement. The swap arrangement has been designated as a cash flow hedge and has been evaluated to be highly effective. As a result, the after-tax change in the fair value of the swap is 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 matures 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 the Company's discretion, borrowings under this facility bear interest at a rate of either the prime rate plus an applicable spread of 25 basis points to 50 basis points or LIBOR plus an applicable spread of 125 basis points to 150 basis points, depending on the Company's average availability under the Westlake Facility as measured on a trailing 12-month basis. The Westlake Facility was priced at LIBOR plus 125 basis points at March 30, 2019.

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 March 30, 2019, ARH was in compliance with its covenants and had \$61.5 million in loans outstanding under the Westlake Facility.

On March 5, 2019, Westlake amended its credit facility. The March amendment increased the Westlake Facility size by \$25 million to \$100 million and reduced the unused fees to 15 basis points.

The Company's ACO subsidiary (see Note 2 for additional details of this acquisition) has a \$20.0 million asset-based revolving credit facility ("ACO Facility"). The ACO Facility matures on November 6, 2022. The interest rate is based on either the lender's prime rate plus 100 basis points or LIBOR rate plus 200 basis points. The ACO Facility was priced at the prime rate plus 100 basis points at March 30, 2019. The ACO Facility is collateralized by its inventory and real estate assets. As of March 30, 2019, ACO was in compliance with its covenants and had \$7.6 million outstanding under the ACO Facility.

Both the ACO Facility and the Westlake Facility include a lender-controlled cash concentration system that results in all of ACO 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 ACO Facility and Westlake Facility have been classified as a Current maturity of long-term debt as of March 30, 2019.

Total debt, the majority of which is comprised of the \$431.2 million borrowed on lines of credit, was \$456.7 million as of March 30, 2019, compared to \$327.7 million and \$358.8 million as of December 29, 2018 and March 31, 2018, respectively.

Cash Flows

The Company had \$31.0 million and \$24.0 million of cash and cash equivalents at March 30, 2019 and March 31, 2018, respectively. Following is a summary of the Company's cash flows from operating, investing and financing activities for the first three months of 2019 and 2018, respectively (in millions):

	2019	2018
Cash provided by operating activities before changes in assets and liabilities	\$ 36.8	\$ 25.1
Net changes in assets and liabilities	(110.0)	(122.9)
Net cash used in by operating activities	(73.2)	(97.8)
Net cash used in investing activities	(31.4)	(29.8)
Net cash provided by financing activities	110.0	128.6
Net change in cash and cash equivalents	<u>\$ 5.4</u>	<u>\$ 1.0</u>

The Company's operating activities used \$73.2 million of cash during the first three months ended 2019 compared to \$97.8 million used in 2018. Excluding the impact of net changes in assets and liabilities, cash provided by operating activities increased from \$25.1 million in the first three months of 2018 to \$36.8 million in the first three months of 2019. This \$11.7 million increase was the result of a \$10.7 million increase in net income for the first three months of 2019.

The net change in assets and liabilities used \$110.0 million of cash in the first three months of 2019 compared to \$122.9 million in the first three months of 2018. The lower usage was due to a smaller seasonal build of spring inventory in 2019 as a result of a higher beginning of the year inventory balance.

Net cash used in investing activities was \$31.4 million in the first three months of 2019 compared to \$29.8 million in the first three months of 2018. Investing activities in 2019 primarily consisted of \$12.1 million in capital expenditures and \$16.2 million paid for the acquisition of ACO and additional retail stores by ARH. Investing activities in the first three months of 2018 primarily consisted of \$16.4 million in capital expenditures, and \$11.0 million paid for the acquisition of retail stores by ARH.

Net cash provided by financing activities was \$110.0 million in the first three months of 2019 compared to \$128.6 million in the first three months of 2018. During 2019, the Company had \$120.2 million of net borrowings under the revolving lines of credit, paid \$5.3 million on patronage refund certificates and made payments on long-term debt of \$3.4 million. During 2018, the Company had \$137.6 million of net borrowings under the revolving lines of credit, paid \$6.4 million on patronage refund certificates and made payments on long term debt of \$2.8 million.

Contractual Obligations and Commitments

For the three months ended March 30, 2019, there have been no significant changes to the Company's contractual obligations and commitments as disclosed in its 2018 Annual Report other than what was described in Note 9 to the Financial Statements.

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 2018 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 2018 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.

May 21, 2019

/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



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