

ACE HARDWARE CORPORATION
Quarterly report for the period ended March 31, 2018



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 31, 2018 and April 1, 2017, and the related consolidated statements of income, comprehensive income, equity, and cash flows for the three-month periods ended March 31, 2018 and April 1, 2017.

Management's Responsibility for the Financial Statements

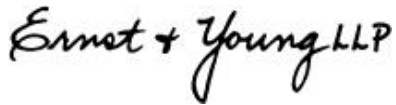
Management is responsible for the preparation and fair presentation of the interim financial information in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control sufficient to provide a reasonable basis for the preparation 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 22, 2018

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

	March 31, 2018	December 30, 2017	April 1, 2017
	(Unaudited)	(Audited)	(Unaudited)
Assets			
Cash and cash equivalents	\$ 24.0	\$ 23.0	\$ 19.4
Marketable securities	50.4	51.1	50.3
Receivables, net of allowance for doubtful accounts of \$8.3, \$5.8 and \$7.6, respectively	570.3	415.7	548.5
Inventories	973.1	777.5	845.9
Prepaid expenses and other current assets	44.4	41.5	39.9
Total current assets	<u>1,662.2</u>	<u>1,308.8</u>	<u>1,504.0</u>
Property and equipment, net	361.6	356.6	339.2
Notes receivable, net of allowance for doubtful accounts of \$3.4, \$5.4 and \$7.0, respectively	10.1	8.4	11.5
Goodwill and other intangible assets	96.4	90.7	35.6
Other assets	90.1	93.3	91.6
Total assets	<u>\$ 2,220.4</u>	<u>\$ 1,857.8</u>	<u>\$ 1,981.9</u>
Liabilities and Equity			
Current maturities of long-term debt	\$ 67.4	\$ 49.0	\$ 49.3
Accounts payable	932.8	685.0	818.3
Patronage distributions payable in cash	71.0	61.5	75.8
Patronage refund certificates payable	5.7	5.7	6.9
Accrued expenses	142.2	170.7	131.1
Total current liabilities	<u>1,219.1</u>	<u>971.9</u>	<u>1,081.4</u>
Long-term debt	291.4	173.0	234.4
Patronage refund certificates payable	86.9	82.5	66.9
Other long-term liabilities	75.4	69.5	64.8
Total liabilities	<u>1,672.8</u>	<u>1,296.9</u>	<u>1,447.5</u>
Member Retailers' Equity:			
Class A voting common stock, \$1,000 par value, 10,000 shares authorized, 2,713; 2,722 and 2,728 issued and outstanding, respectively	2.7	2.7	2.7
Class C nonvoting common stock, \$100 par value, 6,000,000 shares authorized, 4,317,646; 4,412,989 and 4,070,046 issued and outstanding, respectively	431.8	441.3	407.0
Class C nonvoting common stock, \$100 par value, issuable to retailers for patronage distributions, 563,189; 488,858 and 637,508 shares issuable, respectively	56.3	48.9	63.8
Contributed capital	18.3	18.3	18.1
Retained earnings	20.8	33.2	31.7
Accumulated other comprehensive income	4.3	3.5	1.5
Equity attributable to Ace member retailers	<u>534.2</u>	<u>547.9</u>	<u>524.8</u>
Equity attributable to noncontrolling interests	13.4	13.0	9.6
Total equity	<u>547.6</u>	<u>560.9</u>	<u>534.4</u>
Total liabilities and equity	<u>\$ 2,220.4</u>	<u>\$ 1,857.8</u>	<u>\$ 1,981.9</u>

See accompanying notes to the consolidated financial statements.

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

	Three Months Ended	
	March 31, 2018 (13 Weeks)	April 1, 2017 (13 Weeks)
Revenues:		
Wholesale revenues	\$ 1,249.0	\$ 1,186.2
Retail revenues	63.1	52.0
Total revenues	<u>1,312.1</u>	<u>1,238.2</u>
Cost of revenues:		
Wholesale cost of revenues	1,109.4	1,040.0
Retail cost of revenues	34.0	26.9
Total cost of revenues	<u>1,143.4</u>	<u>1,066.9</u>
Gross profit:		
Wholesale gross profit	139.6	146.2
Retail gross profit	29.1	25.1
Total gross profit	<u>168.7</u>	<u>171.3</u>
Distribution operations expenses	38.4	33.4
Selling, general and administrative expenses	48.1	46.9
Retailer success and development expenses	32.7	34.2
Retail operating expenses	34.4	25.6
Total operating expenses	<u>153.6</u>	<u>140.1</u>
Operating income	15.1	31.2
Interest expense	(4.4)	(3.5)
Interest income	0.9	0.8
Other income, net	0.2	1.0
Income tax benefit (expense)	0.1	(1.2)
Net income	<u>11.9</u>	<u>28.3</u>
Less: net income attributable to noncontrolling interests	0.1	0.2
Net income attributable to Ace Hardware Corporation	<u>\$ 11.8</u>	<u>\$ 28.1</u>
Patronage distributions accrued	<u>\$ 24.7</u>	<u>\$ 34.7</u>
Patronage distributions accrued for third party retailers	<u>\$ 23.3</u>	<u>\$ 33.5</u>

See accompanying notes to the consolidated financial statements.

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

	Three Months Ended	
	March 31,	April 1,
	2018	2017
	(13 Weeks)	(13 Weeks)
Net income	\$ 11.9	\$ 28.3
Other comprehensive income, net of tax:		
Unrealized (loss) gain on investments	(0.9)	0.8
Unrealized gain on derivative financial instrument	1.0	0.2
Total other comprehensive income, net	0.1	1.0
Comprehensive income	12.0	29.3
Less: Comprehensive income attributable to noncontrolling interests	0.1	0.2
Comprehensive income attributable to Ace Hardware Corporation	\$ 11.9	\$ 29.1

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 Other Comprehensive Income	Noncontrolling Interests	Total Equity
	Class A	Class C							
Balances at December 31, 2016	\$ 2.7	\$ 413.2	\$ 52.3	\$ -	\$ 18.2	\$ 37.2	\$ 0.5	\$ 9.2	\$ 533.3
Net income	-	-	-	-	-	28.1	-	0.2	28.3
Other comprehensive income	-	-	-	-	-	-	1.0	-	1.0
Net payments on subscriptions	-	-	-	0.3	-	-	-	-	0.3
Stock issued	-	0.3	-	(0.3)	-	-	-	-	-
Change in noncontrolling interests	-	-	-	-	(0.1)	(0.1)	-	0.2	-
Stock repurchased	-	(6.5)	-	-	-	-	-	-	(6.5)
Patronage distributions issuable	-	-	11.5	-	-	-	-	-	11.5
Patronage distributions payable	-	-	-	-	-	(33.5)	-	-	(33.5)
Balances at April 1, 2017	\$ 2.7	\$ 407.0	\$ 63.8	\$ -	\$ 18.1	\$ 31.7	\$ 1.5	\$ 9.6	\$ 534.4
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

See accompanying notes to the consolidated financial statements.

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

	Three Months Ended	
	March 31, 2018 (13 Weeks)	April 1, 2017 (13 Weeks)
Operating Activities		
Net income	\$ 11.9	\$ 28.3
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	12.2	12.6
Amortization of deferred financing costs	0.1	0.1
Loss on disposal of assets, net	0.1	0.1
Provision for doubtful accounts	0.6	0.1
Other, net	0.2	0.1
Changes in operating assets and liabilities, exclusive of effects of acquisitions:		
Receivables	(164.8)	(151.6)
Inventories	(190.2)	(105.1)
Other current assets	(2.9)	2.5
Other long-term assets	3.6	1.0
Accounts payable and accrued expenses	224.9	163.8
Other long-term liabilities	6.5	1.9
Net cash used in operating activities	<u>(97.8)</u>	<u>(46.2)</u>
Investing Activities		
Purchases of marketable securities	(3.3)	(2.0)
Proceeds from sale of marketable securities	2.8	1.9
Purchases of property and equipment	(16.4)	(13.2)
Cash paid for acquired business, net of cash received	(11.0)	-
Increase in notes receivable, net	(1.9)	(2.3)
Net cash used in investing activities	<u>(29.8)</u>	<u>(15.6)</u>
Financing Activities		
Net borrowings under revolving lines of credit	137.6	66.4
Principal payments on long-term debt	(2.8)	(2.1)
Payments of patronage refund certificates	(6.4)	-
Repurchase of stock	(0.1)	(0.2)
Other, net	0.3	0.3
Net cash provided by financing activities	<u>128.6</u>	<u>64.4</u>
Increase in cash and cash equivalents	1.0	2.6
Cash and cash equivalents at beginning of period	23.0	16.8
Cash and cash equivalents at end of period	<u>\$ 24.0</u>	<u>\$ 19.4</u>
Supplemental disclosure of cash flow information:		
Interest paid	\$ 5.9	\$ 3.7
Income taxes paid	<u>\$ 0.4</u>	<u>\$ 0.5</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.

In September 2017, the Company formed the Ace ecommerce Holdings LLC (“AEH”) legal entity. On September 30, 2017, AEH acquired 94.3 percent of the issued and outstanding capital stock of The Daily Grommet Inc. (“The Grommet”). See Note 2 for additional details of this acquisition.

In 2014, the Company formed the Ace Wholesale Holdings LLC (“AWH”) legal entity for sales to non-member retailers. During 2014, AWH acquired Emery-Waterhouse (“Emery”), a distributor of hardlines products for independent lumber, paint, industrial and hardware outlets, and Jensen-Byrd Co., LLC (“Jensen”), a wholesale hardlines distributor. In 2015, AWH formed Emery Jensen Distribution (“EJD”) for sales outside of Emery and Jensen territories. The Company believes that the integration of these acquisitions and the formation of EJD will serve as a catalyst to further leverage wholesale purchasing power and advance the Company’s strategic plans to be a leader in the wholesale distribution industry.

Ace Retail Holdings LLC (“ARH”) is the owner of the 116 store Westlake Ace Hardware retail chain. As a result, the Company is also a retailer of hardware, paint and other related products.

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

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”). Certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted. The unaudited consolidated financial statements and notes should be read in conjunction with the financial statements and notes thereto included in the Company’s 2017 Annual Report. The unaudited consolidated financial statements for the three months ended March 31, 2018 and April 1, 2017 both cover a 13-week period.

Subsequent events have been evaluated through May 22, 2018, 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 31, 2018 are not necessarily indicative of the results to be expected for the full fiscal year 2018.

Principles of Consolidation

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

Use of Estimates

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

Impact of New Accounting Standards

New Accounting Pronouncements - Adopted

In February 2018, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2018-02, “Income Statement—Reporting Comprehensive Income (Topic 220)”. ASU 2018-02 allows for the reclassification from accumulated other comprehensive income (“AOCI”) to retained earnings for the stranded tax effects resulting from the change in the U.S. federal statutory income tax rate to 21% from 35%. ASU 2018-02 is effective for the Company for fiscal 2019 quarterly and year-

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

end financial statements. The Company adopted ASU 2018-02 prospectively in the first quarter of 2018 as early adoption is permitted and elected to make the reclassification. This resulted in a reclassification adjustment of \$0.7 million from AOCI to retained earnings and is related to the unrealized gains and losses on the Company’s investments, postretirement benefits and derivative financial instruments. The Company’s policy for releasing income tax effects from AOCI is to utilize a portfolio approach.

New Accounting Pronouncements - Issued

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606).” The purpose of ASU 2014-09 is to develop a common revenue recognition standard for GAAP and International Financial Reporting Standards. The guidance in this update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 allows either full retrospective adoption, meaning the standard is applied to all periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements. This guidance is effective for the Company for fiscal 2019 year-end financial statements and quarterly financial statements in fiscal 2020. The FASB has also issued the following standards which clarify ASU 2014-09 and have the same effective date as the original standard: ASU No. 2016-12, “Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients,” ASU No. 2016-10, “Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing” and ASU No. 2016-08, “Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net).” The Company is currently evaluating this guidance to determine the impact it will have on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842).” ASU 2016-02 requires that lessees recognize assets and liabilities for leases with lease terms greater than twelve months in the statement of financial position. ASU 2016-02 also requires improved disclosures to help users of financial statements better understand the amount, timing and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for the Company for 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

On September 30, 2017, AEH acquired 94.3 percent of the issued and outstanding capital stock of The Grommet, an e-commerce startup that operates a website that markets and sells new and innovative products created by independent entrepreneurs, for \$45.8 million. The Grommet’s original founders retained a 5.7 percent noncontrolling voting interest. The acquisition has been accounted for as a business combination. The Company recorded a preliminary allocation of the purchase price to acquired tangible assets and liabilities assumed based on their fair value at the acquisition date. The Company has engaged a third party valuation specialist to assist in determining the fair value of the assets and liabilities assumed. The Company expects to complete the purchase price allocation by the end of the third quarter of 2018. Based on the preliminary purchase price allocation, the Company recorded \$48.6 million of goodwill and other intangibles. Goodwill has an indefinite life and, therefore, is not amortized. The goodwill is expected to be deductible for tax purposes.

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

Fair value of assets acquired and liabilities assumed:	
Cash	\$ 0.3
Receivables	0.7
Inventories	6.2
Other current assets	0.4
PP&E	0.2
Goodwill and other intangibles	48.6
Other assets	0.1
Current liabilities	(7.9)
	48.6
Less: noncontrolling interest	(2.8)
Acquisition purchase price	<u>\$ 45.8</u>

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 \$80.7 million, \$80.7 million and \$81.6 million at March 31, 2018, December 30, 2017 and April 1, 2017, 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. 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 periodically 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 31, 2018	December 30, 2017	April 1, 2017
Wholesale merchandise inventory (LIFO)	\$ 865.4	\$ 689.3	\$ 750.4
Retail merchandise inventory at Company-operated stores and AEH warehouses (FIFO)	107.7	88.2	95.5
Inventories	\$ 973.1	\$ 777.5	\$ 845.9

(4) Debt

The Company has a \$600.0 million line of credit that is expandable to \$750.0 million through a \$150.0 million accordion that is exercisable without the consent of existing lenders provided that the Company is not in default of the credit agreement and further provided that none of the existing lenders are required to provide any portion of the increased facility. 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 as defined under the agreement. The credit facility was priced at LIBOR plus 125 basis points at March 31, 2018. The credit facility expires on May 29, 2020 and requires maintenance of certain financial covenants including a maximum allowable average leverage ratio and a minimum fixed charge coverage ratio. As of March 31, 2018, the Company was in compliance with its covenants and \$276.5 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 31, 2018, a total of \$12.4 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 15 to 30 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 31, 2018, 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 remaining term of 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.

The Company’s ARH subsidiary has a \$75.0 million asset-based revolving credit facility (“ARH Facility”). The ARH Facility matures on October 23, 2022 and is expandable to \$100.0 million under certain conditions. In addition, the Company’s ARH subsidiary 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 ARH Facility as measured on a trailing 12 month basis. The ARH Facility was priced at LIBOR plus 125 basis points at March 31, 2018.

The ARH Facility is collateralized by substantially all of ARH’s personal property and intangible assets. Borrowings under the facility are subject to a borrowing base calculation consisting of certain advance rates applied to eligible collateral balances (primarily consisting of certain receivables and inventories). This agreement requires maintenance of certain financial covenants including a minimum fixed charge coverage ratio. As of March 31, 2018, ARH was in compliance with its covenants and had \$57.5 million in loans outstanding under the ARH Facility.

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

The ARH Facility requirements include a lender-controlled cash concentration system that results in all of ARH’s daily available cash being applied to the outstanding borrowings under this facility. Pursuant to FASB Accounting Standards Codification Section 470-10-45, “Classification of Revolving Credit Agreements Subject to Lock-Box Arrangements and Subjective Acceleration Clauses,” the borrowings under the ARH Facility have been classified as a Current maturity of long-term debt as of March 31, 2018.

Total debt outstanding is comprised of the following:

	March 31, 2018	December 30, 2017	April 1, 2017
Revolving Credit Facility	\$ 276.5	\$ 157.2	\$ 220.0
ARH Facility	57.5	39.2	40.1
Installment notes with maturities through 2022 at a fixed rate of 6.00%	24.8	25.6	23.6
Total debt	358.8	222.0	283.7
Less: maturities within one year	(67.4)	(49.0)	(49.3)
Long-term debt	<u>\$ 291.4</u>	<u>\$ 173.0</u>	<u>\$ 234.4</u>

(5) Fair Value

The tables below set forth, by level, the Company’s financial assets, liabilities and derivative instruments that were accounted for at fair value as of March 31, 2018, December 30, 2017 and April 1, 2017. The tables do not include cash on hand and also do not include assets and liabilities that are measured at historical cost or any basis other than fair value. The carrying values for other current financial assets and liabilities, such as accounts receivable and accounts payable, approximate fair value due to the short maturity of such instruments.

Items measured at fair value on a recurring basis	Carrying Value Measured at Fair Value			
	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	\$ -

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

Items measured at fair value on a recurring basis	Carrying Value Measured at Fair Value			
	December 30, 2017	Level 1	Level 2	Level 3
Assets:				
Cash equivalents:				
Money market funds	\$ 5.7	\$ 5.7	\$ -	\$ -
Marketable securities:				
Corporate fixed income securities	15.4	-	15.4	-
Equity mutual fund securities	15.1	15.1	-	-
Mortgage-backed securities	5.5	-	5.5	-
U.S. government notes	11.8	11.2	0.6	-
Other	3.3	-	3.3	-
Total marketable securities	<u>\$ 51.1</u>	<u>\$ 26.3</u>	<u>\$ 24.8</u>	<u>\$ -</u>
Other long-term liabilities:				
Interest rate swap derivative	\$ 0.7	\$ -	\$ 0.7	\$ -

Items measured at fair value on a recurring basis	Carrying Value Measured at Fair Value			
	April 1, 2017	Level 1	Level 2	Level 3
Assets:				
Cash equivalents:				
Money market funds	\$ 5.2	\$ 5.2	\$ -	\$ -
Marketable securities:				
Corporate fixed income securities	14.7	-	14.7	-
Equity mutual fund securities	15.0	15.0	-	-
Mortgage-backed securities	5.8	-	5.8	-
U.S. government notes	11.3	11.3	-	-
Other	3.5	-	3.5	-
Total marketable securities	<u>\$ 50.3</u>	<u>\$ 26.3</u>	<u>\$ 24.0</u>	<u>\$ -</u>
Other long-term liabilities:				
Interest rate swap derivative	\$ 2.4	\$ -	\$ 2.4	\$ -

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.

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

The fair value of the Company's marketable securities exceeded their cost by \$4.8 million and \$4.3 million at March 31, 2018 and April 1, 2017, respectively. Gross proceeds from the sale of marketable securities and the related realized gains and losses for the three months ended March 31, 2018 and April 1, 2017 were as follows:

	<u>Three Months Ended</u>	
	March 31, 2018	April 1, 2017
Gross proceeds	\$ 2.8	\$ 1.9
Gross realized gains	-	-
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 31, 2018, the Company reclassified an immaterial amount of unrealized gains and \$0.1 million of unrealized losses on marketable securities that were recorded in AOCI as of December 30, 2017 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 31, 2018. 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	\$ 1.0	\$ 6.1	\$ 4.4	\$ 3.4	\$ 14.9
Mortgage-backed securities	-	0.2	1.0	4.4	5.6
U.S. government notes	0.2	6.6	3.1	2.1	12.0
Other	-	0.4	0.7	2.1	3.2
Total	\$ 1.2	\$ 13.3	\$ 9.2	\$ 12.0	\$ 35.7

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. Prior to this swap arrangement taking effect on March 13, 2017, the Company had a separate swap arrangement that fixed the LIBOR rate on a portion of the debt facility at 1.13 percent.

The fair value of the Company's interest rate swaps 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 31, 2018, the fair value of the interest rate swap was an asset balance of \$0.6 million. As of December 30, 2017 and April 1, 2017, the fair value of the interest rate swaps were liability balances of \$0.7 million and \$2.4 million, respectively. The Company classifies long-term derivative assets as Other assets, current derivative liabilities as Accrued expenses and long-term derivative liabilities as Other long-term liabilities on the Consolidated Balance Sheets.

Because the interest rate swaps have been designated as cash flow hedges and have been evaluated to be highly effective, the change in the fair value is recorded in AOCI as a gain or loss on derivative financial instruments. The amount in AOCI is reclassified to earnings if the derivative instruments are sold, extinguished or terminated, or at the time they become expected to be sold, extinguished or terminated. The net of tax amount recorded in AOCI for the fair value adjustment of the interest rate swaps was an unrealized gain of \$0.4 million as of March 31, 2018 and an unrealized loss of \$0.5 million and \$1.5 million as of December 30, 2017 and April 1, 2017, respectively. This unrealized gain is not expected to be reclassified into interest expense within the next 12 months. The impact of any

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

ineffectiveness is recognized in earnings. However, there was no hedge ineffectiveness related to the interest rate swaps for the three months ended March 31, 2018 and April 1, 2017.

The Company's debt instruments are recorded at cost on the Consolidated Balance Sheets. The fair value of the Company's debt was approximately \$359.9 million at March 31, 2018, compared to the carrying value, including accrued interest, of \$359.8 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

The Tax Cuts and Jobs Act in the United States ("Tax Reform") was signed into law on December 22, 2017. The new law reduces the federal statutory income tax rate from 35 percent to 21 percent, effective January 1, 2018. As a result of this change, the Company reduced its net U.S. deferred tax assets on its Consolidated Balance Sheet in the quarter ending December 30, 2017 by \$4.1 million, with a corresponding net increase to its deferred income tax expense of the same amount, to reflect the impact of these new lower income tax rates. The Company's adjustment to deferred taxes are based on certain assumptions and the best available information, but are considered provisional as of March 31, 2018. The Company will refine these provisional adjustments and amounts in subsequent quarters of fiscal year 2018 based on its actual financial results and as more tax information becomes available.

The Company is still in the process of evaluating the income tax effect of certain provisions included in the Tax Reform. The final impact of the Tax Reform may differ from the current estimates due to the issuance of additional interpretive guidance, changes in assumptions made by the Company and actions the Company may take as a result of the Tax Reform.

Income tax differs from the amount computed by applying the statutory U.S. Federal income tax rate of 21 percent and 35 percent for March 31, 2018 and April 1, 2017 respectively, to pre-tax income because of the effect of the following items:

	Three Months Ended	
	March 31, 2018	April 1, 2017
Expected tax at U.S. Federal income tax rate	\$ (2.5)	\$ (10.3)
Patronage distribution deductions	4.9	11.7
Other, net	(2.3)	(2.6)
Income tax benefit (expense)	\$ 0.1	\$ (1.2)

(7) Supplemental Disclosures of Cash Flow Information

During the three months ended March 31, 2018 and April 1, 2017, accrued patronage distributions of \$2.0 million and \$2.4 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 31, 2018 and April 1, 2017, non-cash repurchases of stock from retailers of \$9.8 million, and \$6.3 million, respectively, were offset against trade receivables of \$5.1 million and \$0.1 million, respectively, and notes receivable of \$2.7 million and \$1.5 million, respectively. The remaining \$2.0 million and \$4.7 million, respectively, were primarily issued as notes payable with no net impact in the Consolidated Statements 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 long term assets of \$0.6 million as of March 31, 2018 and as Other long term liabilities of \$2.4 million as of April 1, 2017. 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 31, 2018, the Company received \$2.2 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 31, 2018. During the three months ended March 31, 2018, the Company paid \$2.2 million for property and equipment that was purchased and accrued during the year ended December 30, 2017. 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 31, 2018.

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

(8) Warehouse Facility Closure Costs

The Company intends to close its Prince George, Virginia retail support center, its crossdock operation near Baltimore, Maryland, the Emery wholesale distribution warehouses in Portland, Maine and Pittston, Pennsylvania. In connection with these actions, the Company had a remaining liability of \$3.6 million for post-employment benefits and \$2.4 million for inventory markdown reserves at March 31, 2018 and December 30, 2017. The Company has also ceased using the ARH distribution center in Lenexa, Kansas. The activity for the remaining net lease liability for the ARH distribution center for the three months ended March 31, 2018 is as follows:

	Remaining Net Lease Liability
Balance at December 30, 2017	\$ 2.3
Payments	(0.1)
Balance at March 31, 2018	\$ 2.2

**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 31, 2018 and April 1 2017. This discussion and analysis should be read in conjunction with the Company's 2017 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 March 31, 2018 to the Three Months Ended April 1, 2017

The following data summarizes the Company's performance in 2018 as compared to 2017 (in millions):

	2018		2017		Favorable/ (Unfavorable)	
	\$	% of Revenues*	\$	% of Revenues*	\$	%
Revenues:						
Wholesale revenues	1,249.0	95.2%	1,186.2	95.8%	62.8	5.3%
Retail revenues	63.1	4.8%	52.0	4.2%	11.1	21.3%
Total revenues	1,312.1	100.0%	1,238.2	100.0%	73.9	6.0%
Gross profit:						
Wholesale gross profit	139.6	11.2%	146.2	12.3%	(6.6)	(4.5%)
Retail gross profit	29.1	46.1%	25.1	48.3%	4.0	15.9%
Total gross profit	168.7	12.9%	171.3	13.8%	(2.6)	(1.5%)
Operating expenses:						
Wholesale operating expenses	119.2	9.5%	114.5	9.7%	(4.7)	(4.1%)
Retail operating expenses	34.4	54.5%	25.6	49.2%	(8.8)	(34.4%)
Total operating expenses	153.6	11.7%	140.1	11.3%	(13.5)	(9.6%)
Operating income	15.1	1.2%	31.2	2.5%	(16.1)	(51.6%)
Interest expense	(4.4)	(0.4%)	(3.5)	(0.3%)	(0.9)	(25.7%)
Other income, net	1.1	0.1%	0.4	0.1%	0.7	175.0%
Net income attributable to Ace Hardware Corporation	<u>11.8</u>	<u>0.9%</u>	<u>28.1</u>	<u>2.3%</u>	<u>(16.3)</u>	<u>(58.0%)</u>

*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. 2017
2017 Revenues	\$ 1,238.2	
<i>Wholesale Merchandise Revenues change based on new and cancelled domestic stores:</i>		
Revenues increase from new stores added since January 2017	37.8	3.1%
Revenues decrease from stores cancelled since January 2017	(8.8)	(0.7%)
Increase in wholesale merchandise revenues to comparable domestic stores	25.0	2.0%
Increase in AWH revenues	5.7	0.5%
Increase in AIH revenues	0.5	0.0%
Increase in ARH revenues	5.0	0.4%
Increase in AEH retail revenues	6.1	0.5%
Other revenue changes, net	2.6	0.2%
2018 Revenues	\$ 1,312.1	6.0%

Consolidated revenues for the three months ended March 31, 2018 totaled \$1.3 billion, an increase of \$73.9 million, or 6.0 percent, as compared to the prior year first quarter. Total wholesale revenues were \$1.2 billion for the first quarter 2018, an increase of \$62.8 million, or 5.3 percent, as compared to the prior year first quarter. The categories with the largest revenue gains were paint, electric and outdoor living. New stores are defined as stores that were activated from January 2017 through March 2018. In 2018, the Company had an increase in wholesale merchandise revenues from new domestic stores of \$37.8 million. This increase was partially

offset by a decrease in wholesale merchandise revenues due to domestic store cancellations of \$8.8 million. As a result, the Company realized a net increase in wholesale merchandise revenues of \$29.0 million related to the impact of both new stores affiliated with the Company and from stores that cancelled their membership in 2017 and 2018. Wholesale merchandise revenue to comparable domestic stores increased \$25.0 million.

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

	Three Months Ended	
	March 31, 2018	April 1, 2017
Retailer outlets at beginning of period	5,121	4,994
New retailer outlets added	44	30
Retailer outlet cancellations	(28)	(21)
Retailer outlets at end of period	<u>5,137</u>	<u>5,003</u>

Revenues from the Ace Wholesale Holdings LLC ("AWH") subsidiary were \$97.5 million during the three months ended March 31, 2018. This is an increase of \$5.7 million, or 6.2 percent, from the first quarter of 2017. The increase was primarily due to higher plumbing, seasonal, hardware and electric department sales.

Revenues from the Ace Hardware International Holdings, Ltd. ("AIH") subsidiary were \$60.3 million during the three months ended March 31, 2018. This is an increase of \$0.5 million, or 0.8 percent, from the first quarter of 2017.

Total retail revenues were \$63.1 million, an increase of \$11.1 million, or 21.3 percent from the first quarter of 2017. Retail revenues from Ace Retail Holdings ("ARH") were \$57.0 million during the first quarter of 2018, an increase of \$5.0 million or 9.6 percent from the first quarter of 2017. The increase was the result of new retail stores added since the first quarter of 2017 partially offset by a 4.9 percent decrease in same-store sales. Retail revenues from Ace Ecommerce Holdings LLC ("AEH"), which was formed in the third quarter of 2017 for the acquisition of The Grommet, were \$6.1 million during the three months ended March 31, 2018.

Wholesale gross profit for the first quarter of 2018 was \$139.6 million, a decrease of \$6.6 million from the first quarter of 2017. The wholesale gross margin percentage was 11.2 percent of wholesale revenues, down from 12.3 percent in the first quarter of 2017. This decrease was primarily driven by a reduction in vendor funds earned; base product margin remained essentially flat.

Retail gross profit for the first quarter of 2018 was \$29.1 million, an increase of \$4.0 million from the first quarter of 2017. Retail gross margin percentage was 46.1 percent of retail revenues in the first quarter of 2018, a decrease from 48.3 percent in the first quarter of 2017. The decline in the retail gross margin percentage was primarily the result of the inclusion of lower margin revenues realized by The Grommet. 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 \$4.7 million, or 4.1 percent, for the first quarter of 2018 as compared to the first quarter of 2017. The increase includes higher payroll expenses from prior year driven by higher revenues and labor costs incurred to setup the Fredericksburg retail support center. As a percentage of wholesale revenues, wholesale operating expenses decreased to 9.5 percent of wholesale revenues in the first quarter of 2018 from 9.7 percent of wholesale revenues in the first quarter of 2017.

Retail operating expenses of \$34.4 million increased \$8.8 million, or 34.4 percent, from the first quarter of 2017. The increase was primarily due to \$5.0 million of expenses from The Grommet, which was acquired in the third quarter of 2017. The remaining increase was primarily due to new retail stores added by ARH since the first quarter of 2017. Retail operating expenses increased to 54.5 percent of retail revenues in the first quarter of 2018 from 49.2 percent in the first quarter of 2017, primarily driven by an increased operating expense rate incurred by The Grommet.

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 \$600.0 million line of credit that is expandable to \$750.0 million through a \$150.0 million accordion that is exercisable without the consent of existing lenders provided that the Company is not in default of the credit agreement and further provided that none of the existing lenders are required to provide any portion of the increased facility. 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 as defined under the agreement. The credit facility was priced at LIBOR plus 125 basis points at March 31, 2018. The credit facility expires on May 29, 2020 and requires maintenance of certain financial covenants including a maximum allowable average leverage ratio and a minimum fixed charge coverage ratio. As of March 31, 2018, the Company was in compliance with its covenants and \$276.5 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 31, 2018, a total of \$12.4 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 15 to 30 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 31, 2018, 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 remaining term of 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 ARH subsidiary has a \$75.0 million asset-based revolving credit facility (“ARH Facility”). The ARH Facility matures on October 23, 2022 and is expandable to \$100.0 million under certain conditions. In addition, the Company’s ARH subsidiary 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 ARH Facility as measured on a trailing 12 month basis. The ARH Facility was priced at LIBOR plus 125 basis points at March 31, 2018.

The ARH Facility is collateralized by substantially all of ARH’s personal property and intangible assets. Borrowings under the facility are subject to a borrowing base calculation consisting of certain advance rates applied to eligible collateral balances (primarily consisting of certain receivables and inventories). This agreement requires maintenance of certain financial covenants including a minimum fixed charge coverage ratio. As of March 31, 2018, ARH was in compliance with its covenants and had \$57.5 million in loans outstanding under the ARH Facility.

The ARH Facility requirements include a lender-controlled cash concentration system that results in all of ARH’s daily available cash being applied to the outstanding borrowings under this facility. Pursuant to 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 ARH Facility have been classified as a Current maturity of long-term debt as of March 31, 2018.

Total debt, the majority of which is comprised of the \$334.0 million borrowed on lines of credit, was \$358.8 million as of March 31, 2018, compared to \$222.0 million and \$283.7 million as of December 30, 2017 and April 1, 2017, respectively.

Cash Flows

The Company had \$24.0 million and \$19.4 million of cash and cash equivalents at March 31, 2018 and April 1, 2017, respectively. Following is a summary of the Company’s cash flows from operating, investing and financing activities for the first three months of 2018 and 2017, respectively (in millions):

	2018	2017
Cash provided by operating activities before changes in assets and liabilities	\$ 25.1	\$ 41.3
Net changes in assets and liabilities	(122.9)	(87.5)
Net cash used in operating activities	(97.8)	(46.2)
Net cash used in investing activities	(29.8)	(15.6)
Net cash provided by financing activities	128.6	64.4
Net change in cash and cash equivalents	<u>\$ 1.0</u>	<u>\$ 2.6</u>

The Company’s operating activities used \$97.8 million of cash during the three months ended March 31, 2018 compared to \$46.2 million in 2017. Excluding the impact of net changes in assets and liabilities, cash provided by operating activities decreased from \$41.3 million in the first quarter 2017 to \$25.1 million in the first quarter of 2018. This \$16.2 million decrease was primarily the result of lower net income in the first quarter of 2018.

The net change in assets and liabilities used \$122.9 million of cash in the first quarter of 2018 compared to \$87.5 million in the first quarter of 2017. In the first quarter of 2018, accounts payable and accrued expenses provided \$224.9 million of cash primarily as

a result of an increase in vendor receipts for seasonal purchases as well as extended dating on grilling and lawn and garden invoices. Receivables used \$164.8 million of cash in the first quarter of 2018 primarily as a result of higher trade receivables driven by lawn and garden seasonal dating programs, while inventories used \$190.2 million of cash in the first quarter of 2018 primarily for seasonal build and to improve service levels. Receivables used \$151.6 million of cash in the first quarter of 2017 primarily as a result of an increase in trade receivables from seasonal dating programs, while inventories used \$105.1 million of cash primarily for seasonal inventory build. The use of cash for receivables and inventory was partially offset by \$163.8 million of cash provided by accounts payable and accrued expenses primarily as a result of extended dating for lawn and garden invoices.

Net cash used for investing activities was \$29.8 million in the first quarter of 2018 compared to \$15.6 million in the first quarter of 2017. Investing activities in the first quarter of 2018 primarily consisted of \$16.4 million in capital expenditures and \$11.0 million paid for the acquisition of eight retail stores by ARH. Investing activities in the first quarter of 2017 primarily consisted of \$13.2 million in capital expenditures.

Net cash provided by financing activities was \$128.6 million in the first quarter of 2018 compared to \$64.4 million in the first quarter of 2017. During the first quarter of 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. During the first quarter of 2017, the Company had \$66.4 million of net borrowings under the revolving lines of credit and made payments on long-term debt of \$2.1 million.

Contractual Obligations and Commitments

For the three months ended March 31, 2018, there have been no significant changes to the Company's contractual obligations and commitments as disclosed in its 2017 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 2017 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 2017 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 22, 2018

/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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