


Financials

ACE HARDWARE 2011 ANNUAL REPORT



ACE HARDWARE CORPORATION
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT AUDITORS

The Board of Directors of
Ace Hardware Corporation

We have audited the accompanying consolidated balance sheets of Ace Hardware Corporation as of December 31, 2011 and January 1, 2011, and the related consolidated statements of income, equity, and cash flows for each of the three fiscal years in the period ended December 31, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Ace Hardware Corporation at December 31, 2011 and January 1, 2011, and the consolidated results of its operations and its cash flows for each of the three fiscal years in the period ended December 31, 2011 in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

Chicago, Illinois
February 9, 2012

ACE HARDWARE CORPORATION

CONSOLIDATED BALANCE SHEETS

	December 31, 2011	January 1, 2011
	(In thousands, except share data)	
ASSETS		
Cash and cash equivalents	$15,817	$9,357
Marketable securities	50,980	49,358
Receivables, net of allowance for doubtful accounts of $9,836 and $10,369, respectively	307,550	295,349
Inventories	535,325	510,785
Prepaid expenses and other current assets	28,230	28,612
TOTAL CURRENT ASSETS	**937,902**	**893,461**
Property and equipment, net	307,073	320,195
Notes receivable, net of allowance for doubtful accounts of $12,126 and $12,051 respectively	41,206	43,892
Other assets	59,843	59,083
TOTAL ASSETS	**$1,346,024**	**$1,316,631**
LIABILITIES AND EQUITY		
Current maturities of long-term debt	$5,835	$4,441
Short-term borrowings	-	22,500
Accounts payable	464,304	419,609
Patronage distributions payable in cash	30,433	28,514
Patronage refund certificates payable	17,259	17,054
Accrued expenses	119,803	127,956
TOTAL CURRENT LIABILITIES	**637,634**	**620,074**
Long-term debt	293,511	292,617
Patronage refund certificates payable	15,798	25,609
Other long-term liabilities	51,344	49,993
TOTAL LIABILITIES	**$998,287**	**$988,293**
MEMBER RETAILERS' EQUITY		
Class A voting common stock, $1,000 par value, 10,000 shares authorized, 2,758 and 2,857 issued and outstanding, respectively	2,758	2,857
Class C nonvoting common stock, $100 par value, 4,000,000 shares authorized, 2,982,828 and 3,059,006 issued and outstanding, respectively	298,283	305,901
Class C nonvoting common stock, $100 par value, issuable to retailers for patronage distributions, 246,727 and 223,805 shares issuable, respectively	24,673	22,380
Additional stock subscribed, net	10	433
Contributed capital	20,888	6,986
Variance allocation	(484)	(1,687)
Accumulated deficit	(6,184)	(9,410)
Accumulated other comprehensive income	30	878
Equity attributable to Ace member retailers	339,974	328,338
Equity attributable to noncontrolling interests	7,763	-
TOTAL EQUITY	**$347,737**	**$328,338**
TOTAL LIABILITIES AND EQUITY	**$1,346,024**	**$1,316,631**

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

	Years Ended		
	December 31, 2011 (52 Weeks)	January 1, 2011 (52 Weeks)	January 2, 2010 (52 Weeks)
		(In thousands)	
Revenues	$3,709,203	$3,530,731	$3,457,182
Cost of revenues	3,261,869	3,086,418	3,009,599
GROSS PROFIT	**447,334**	**444,313**	**447,583**
Distribution operations expenses	95,152	87,263	91,030
Selling, general and administrative expenses	135,798	141,007	123,642
Retail success and development expenses	111,538	112,736	105,169
TOTAL OPERATING EXPENSES	**342,488**	**341,006**	**319,841**
Operating income	104,846	103,307	127,742
Interest expense	(36,415)	(35,199)	(35,397)
Loss on early extinguishment of debt	(62)	-	(85)
Interest income	5,054	5,151	4,183
Other income, net	7,625	4,809	3,531
Income tax expense	(3,122)	(2,963)	(4,247)
Net income	77,926	75,105	95,727
Less: net income attributable to noncontrolling interests	242	-	-
NET INCOME ATTRIBUTABLE TO ACE HARDWARE CORPORATION	**$77,684**	**$75,105**	**$95,727**
ACCRUED PATRONAGE DISTRIBUTIONS	**$74,458**	**$69,854**	**$89,031**

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION

CONSOLIDATED STATEMENTS OF EQUITY

	Shareowners of Ace Hardware Corporation											
	Capital Stock			Class C Stock Issuable to Retailers for Patronage Dividends	Additional Stock Sub-scribed	Contributed Capital	Variance Allocation	Accumulated Deficit	Accumulated Other Compre-hensive Income (loss)	Treasury Stock	Non-controlling Interests	Total Equity
	Class A	Class B	Class C									
BALANCES AT JANUARY 3, 2009	$2,989	$6,499	$287,915	$14,271	$148	$13,485	$(29,210)	$(19,716)	$(2,836)	$(10,406)	$ -	$263,139
Comprehensive income												
Net income	-	-	-	-	-	-	-	95,727	-	-	-	95,727
Unrecognized postretirement cost	-	-	-	-	-	-	-	-	60	-	-	60
Foreign currency translation adjustment	-	-	-	-	-	-	-	-	64	-	-	64
Net change in unrealized gain/loss on investments	-	-	-	-	-	-	-	-	2,732	-	-	2,732
Total Comprehensive Income												**98,583**
Change in accounting for income tax uncertainties	-	-	-	-	-	-	-	(849)	-	-	-	(849)
Net payments on subscriptions	-	-	-	-	1,015	-	-	-	-	-	-	1,015
Stock issued	104	-	15,808	(14,271)	(1,000)	-	-	-	-	-	-	641
Stock repurchased	(138)	(28)	(15,074)	-	-	(28)	-	-	-	-	-	(15,268)
Patronage distributions issuable	-	-	-	30,234	-	-	-	-	-	-	-	30,234
Patronage distributions payable	-	-	-	-	-	-	-	(68,761)	-	-	-	(68,761)
Variance allocation applications	-	-	(903)	-	-	-	23,250	(21,058)	-	-	-	1,289
Treasury stock retirement	-	(5,203)	-	-	-	(5,203)	-	-	-	10,406	-	-
Class B common stock redemption	-	(1,268)	-	-	-	(1,268)	-	-	-	-	-	(2,536)
BALANCES AT JANUARY 2, 2010	**$2,955**	**$ -**	**$287,746**	**$30,234**	**$163**	**$6,986**	**$(5,960)**	**$(14,657)**	**$20**	**$ -**	**$ -**	**$307,487**
Comprehensive income												
Net income	-	-	-	-	-	-	-	75,105	-	-	-	75,105
Unrecognized postretirement cost	-	-	-	-	-	-	-	-	(60)	-	-	(60)
Foreign currency translation adjustment	-	-	-	-	-	-	-	-	(49)	-	-	(49)
Net change in unrealized gain/loss on investments	-	-	-	-	-	-	-	-	967	-	-	967
Total Comprehensive Income												**75,963**
Net payments on subscriptions	-	-	-	-	761	-	-	-	-	-	-	761
Stock issued	47	-	30,091	(30,234)	(491)	-	-	-	-	-	-	(587)
Stock repurchased	(145)	-	(11,307)	-	-	-	-	-	-	-	-	(11,452)
Patronage distributions issuable	-	-	-	22,380	-	-	-	-	-	-	-	22,380
Patronage distributions payable	-	-	-	-	-	-	-	(66,440)	-	-	-	(66,440)
Variance allocation applications	-	-	(629)	-	-	-	4,273	(3,418)	-	-	-	226
BALANCES AT JANUARY 1, 2011	**$2,857**	**$ -**	**$305,901**	**$22,380**	**$433**	**$6,986**	**$(1,687)**	**$(9,410)**	**$878**	**$ -**	**$ -**	**$328,338**
Comprehensive income												
Net income	-	-	-	-	-	-	-	77,684	-	-	242	77,926
Unrecognized postretirement cost	-	-	-	-	-	-	-	-	114	-	-	114
Foreign currency translation adjustment	-	-	-	-	-	-	-	-	21	-	(1)	20
Net change in unrealized gain/loss on investments	-	-	-	-	-	-	-	-	(983)	-	-	(983)
Total Comprehensive Income												**77,077**
Net payments on subscriptions	-	-	-	-	817	-	-	-	-	-	-	817
Stock issued	115	-	23,879	(22,380)	(1,235)	-	-	-	-	-	-	379
Sale of noncontrolling interests	(63)	-	(13,065)	-	(5)	13,902	-	-	-	-	7,522	8,291
Stock repurchased	(151)	-	(18,405)	-	-	-	-	-	-	-	-	(18,556)
Patronage distributions issuable	-	-	-	24,673	-	-	-	-	-	-	-	24,673
Patronage distributions payable	-	-	-	-	-	-	-	(73,661)	-	-	-	(73,661)
Variance allocation applications	-	-	(27)	-	-	-	1,203	(797)	-	-	-	379
BALANCES AT DECEMBER 31, 2011	**$2,758**	**$ -**	**$298,283**	**$24,673**	**$10**	**$20,888**	**$(484)**	**$(6,184)**	**$30**	**$-**	**$7,763**	**$347,737**

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended		
	December 31, 2011 (52 Weeks)	January 1, 2011 (52 Weeks)	January 2, 2010 (52 Weeks)
		(In thousands)	
OPERATING ACTIVITIES			
Net income	$77,926	$75,105	$95,727
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	38,687	38,299	33,316
Amortization of deferred gain on sale leaseback	(1,234)	(1,234)	(1,269)
Amortization of deferred financing costs	2,884	2,778	2,728
Loss on early extinguishment of debt	62	-	85
Provision for doubtful accounts	4,524	6,666	5,544
(Gain) loss on disposal of assets, net	(1,616)	(495)	563
Other	36	-	-
Changes in operating assets and liabilities:			
Receivables	(35,795)	(85,105)	32,961
Inventories	(24,540)	(71,851)	21,497
Other current assets	7,644	(5,462)	(446)
Other long-term assets	(11,179)	(2,277)	(706)
Accounts payable and accrued expenses	36,723	17,755	(45,159)
Other long-term liabilities	2,719	(4,343)	(6,377)
Deferred taxes	(420)	1,960	1,438
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	**96,421**	**(28,204)**	**139,902**
Investing Activities			
Purchase of marketable securities	(41,483)	(24,133)	(29,011)
Proceeds from sale of marketable securities	40,447	22,662	16,865
Purchase of property and equipment	(25,589)	(35,969)	(53,707)
Decrease (increase) in notes receivable, net	344	1,041	(1,438)
Other	85	(577)	(583)
NET CASH USED IN INVESTING ACTIVITIES	**(26,196)**	**(36,976)**	**(67,874)**
Financing Activities			
(Payments of) proceeds from short-term borrowings, net	(22,500)	22,500	(1,100)
Principal payments on long-term debt	(6,516)	(5,271)	(5,019)
Payments of cash portion of patronage distribution	(26,422)	(29,208)	(15,599)
Payments of patronage refund certificates	(17,924)	(19,487)	(19,543)
Proceeds from sale of noncontrolling interests	8,780	-	-
Other	817	280	(5,370)
NET CASH USED IN FINANCING ACTIVITIES	**(63,765)**	**(31,186)**	**(46,631)**
Increase (decrease) in cash and cash equivalents	6,460	(96,366)	25,397
Cash and cash equivalents at beginning of period	9,357	105,723	80,326
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$15,817**	**$9,357**	**$105,723**
Supplemental disclosure of cash flow information:			
Interest paid (net of amounts capitalized)	**$34,429**	**$33,260**	**$34,693**
Income taxes paid	**$701**	**$1,224**	**$8,589**

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (IN THOUSANDS)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

THE COMPANY AND ITS BUSINESS

Ace Hardware Corporation ("the Company") is a wholesaler of hardware and other related products and is a manufacturer and wholesaler of paint products. The Company also provides to its retail members value-added services such as advertising, marketing, merchandising and store location and design services. Ace'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. See Note 6, Patronage Distributions and Refund Certificates Payable, for further discussion regarding patronage distributions.

Effective in 2011, the Company restructured its international operations into a stand-alone legal entity with its own management team and board of directors as opposed to a division within the Ace cooperative structure. This entity also has its own subsidiaries. The new entity ("Ace Hardware International Holdings, Ltd.") is a majority-owned and controlled subsidiary of the Company with a noncontrolling interest owned by its international retailers. International retailers no longer own shares of stock in the Company or receive patronage dividends.

BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). The Company's fiscal year ends on the Saturday nearest December 31st. Accordingly, fiscal years 2011, 2010 and 2009 ended on December 31, 2011, January 1, 2011 and January 2, 2010, respectively, and consisted of 52 weeks each.

Subsequent events have been evaluated through February 9, 2012, the date these statements were available to be issued.

PRINCIPLES OF CONSOLIDATION

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

USE OF ESTIMATES

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

RECLASSIFICATIONS

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

CASH, CASH EQUIVALENTS AND MARKETABLE SECURITIES

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

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

REVENUE RECOGNITION

The Company recognizes revenue when products are shipped and the retailer takes ownership and assumes risk of loss and when services are rendered, provided collection of the resultant receivable is probable, persuasive evidence of an arrangement exists and the sales price is fixed and determinable. The Company records shipping and handling amounts billed to retailers as revenues, with the related costs recorded in cost of revenues. Direct expenses related to retail services are included in cost of revenues and indirect expenses from these activities are included in operating expenses. The Company also records amounts billed to the retailers for advertising activities, brand building initiatives and fees generated for various retail services as revenues. Provisions for sales returns are provided at the time the related sales are recorded.

RECEIVABLES

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

NOTES RECEIVABLE

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

ALLOWANCE FOR DOUBTFUL ACCOUNTS

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

INVENTORIES

Inventories are valued at the lower of cost or net realizable value. Cost is determined primarily using the last-in, first-out ("LIFO") method for all inventories other than paint, for which the first-in, first-out method is used to determine cost.

VENDOR FUNDS

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

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

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost less accumulated depreciation and amortization. Expenditures for maintenance, repairs and renewals of relatively minor items are generally charged to expense. Significant improvements or renewals are capitalized. Depreciation expense is computed on the straight-line method based on estimated useful lives of 6 to 40 years for buildings and improvements and 3 to 20 years for equipment. Leasehold improvements are generally amortized on a straight-line basis over the lesser of the lease term or the estimated useful life of the asset.

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

INTERNAL-USE SOFTWARE

Included in fixed assets is the capitalized cost of internal-use software. The Company capitalizes costs incurred during the application development stage of internal-use software and amortizes these costs over its estimated useful life. Costs incurred related to design or maintenance of internal-use software are expensed as incurred. For the years ended 2011, 2010 and 2009, the Company capitalized $851, $2,805 and $3,482, respectively, of software development costs related to internal programming time. Amortization of these previously capitalized amounts was $1,086, $787 and $119 for 2011, 2010 and 2009, respectively.

DEFERRED CHARGES

Deferred charges consist of deferred financing costs related to the issuance of long-term debt and the revolving credit facility. Amortization is provided using the effective-interest method over the life of the related agreements.

LEASES

The Company leases certain warehouse and distribution space, office space, retail locations, equipment and vehicles. Most of the Company's leases are operating leases. As leases expire, management expects that in the normal course of business, certain leases will be renewed or replaced.

Certain lease agreements include escalating rent over the lease terms and rent holidays and concessions. The Company expenses rent on a straight-line basis over the life of the lease, which commences on the date the Company has the right to control the property. The cumulative expense recognized on a straight-line basis in excess of the cumulative payments is included in other long-term liabilities in the consolidated balance sheets.

ADVERTISING EXPENSE

The Company expenses advertising costs when incurred. Gross advertising expenses amounted to $98,648, $102,129 and $99,061 in 2011, 2010 and 2009, respectively.

RETIREMENT PLANS

The Company participates in a multi-employer defined benefit retirement plan covering a limited number of union employees. Costs with respect to the noncontributory pension plan are determined actuarially and consist of current costs and amounts to amortize unrecognized prior service costs and unrecognized gains and losses. The Company also sponsors health benefit plans for its retired officers and a limited number of non-officer employees. The Company also sponsors a defined contribution profit sharing plan for substantially all employees. The Company's contribution under this plan is determined annually by the Board of Directors and charged to expense in the period in which it is earned by employees.

INCOME TAXES

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

SELF INSURANCE

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

CONCENTRATION OF CREDIT RISK

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

NEW ACCOUNTING PRONOUNCEMENTS

In June 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income," ("ASU 2011-05") which was subsequently amended by Accounting Standards Update No. 2011-12 ("ASU 2011-12"). ASU 2011-05 eliminates the option the Company currently follows to report other comprehensive income and its components in the statement of changes in equity. ASU 2011-05 requires that all nonowner changes in stockholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. This new guidance will be effective for the Company's 2012 interim and annual financial statements and is to be applied retrospectively.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, "Fair Value Measurements (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs," ("ASU 2011-04"). ASU 2011-04 changes the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements to ensure consistency between U.S. GAAP and International Financial Reporting Standards ("IFRS"). ASU 2011-04 also expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. This new guidance is effective for the Company in 2012 and is not expected to materially impact the Company's consolidated financial statements.

(2) RECEIVABLES, NET

Receivables, net include the following amounts:

	December 31, 2011	January 1, 2011
Trade	$253,253	$244,812
Other	55,022	53,600
Notes receivable — current portion	9,111	7,306
Less: allowance for doubtful accounts	(9,836)	(10,369)
RECEIVABLES, NET	**$307,550**	**$295,349**

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

(3) INVENTORIES

Inventories consist primarily of merchandise inventories. Substantially all of the Company's inventories are valued on the LIFO method. The excess of replacement cost over the LIFO value of inventory was $93,861 and $79,856 at December 31, 2011 and January 1, 2011, respectively. During 2009, the Company incurred a LIFO decrement of $10,649. The liquidation of prior year layers resulted in a $1,794 increase in net income for 2009. There were no LIFO decrements in 2011 or 2010, respectively.

Inventories consisted of:

	December 31, 2011	January 1, 2011
Manufacturing inventories:		
Raw materials	$9,161	$5,339
Work-in-process and finished goods	19,989	15,336
	29,150	20,675
Merchandise inventories:		
Warehouse inventory	506,175	490,110
INVENTORIES	**$535,325**	**$510,785**

(4) PROPERTY AND EQUIPMENT, NET

Property and equipment, net is summarized as follows:

	December 31, 2011	January 1, 2011
Land	$17,186	$17,186
Buildings and improvements	280,708	280,346
Warehouse equipment	107,088	105,117
Office equipment	174,316	169,871
Manufacturing equipment	18,267	18,066
Transportation equipment	41,752	38,572
Leasehold improvements	14,255	14,044
Construction in progress	2,071	2,166
	655,643	645,368
Less: accumulated depreciation and amortization	(348,570)	(325,173)
PROPERTY AND EQUIPMENT, NET	**$307,073**	**$320,195**

Depreciation and amortization expense for fiscal years 2011, 2010 and 2009 was $38,687, $38,299 and $33,316, respectively.

(5) NOTES RECEIVABLE, NET

The Company makes available to its retailers various lending programs whose terms exceed one year. The notes bear interest at various rates based on the retailer's credit quality and are recorded at face value. Interest is recognized over the life of the note based on the outstanding balance and stated interest rate, which approximates the effective interest method. During fiscal years 2011, 2010 and 2009, $2,467, $2,408 and $2,239, respectively, were recorded as interest income related to the notes.

At December 31, 2011 and January 1, 2011, the outstanding balance of the notes was $62,443 and $63,249, respectively, of which the current portion of $9,111 and $7,306, respectively, was recorded in receivables, net. At December 31, 2011 and January 1, 2011, $37,331 and $42,464, respectively, of the notes receivable were from the Company's Equity Match Financing ("EMF") program, which offered financing to qualified retailers to facilitate new store growth. Pursuant to the Company's Amended and Restated Certificate of Incorporation and the Company's by-laws, the above referenced notes (like all obligations owed to the Company by the Company's retailers) are secured by the Company stock owned by the retailers. However, for some retailers, the redemption value of their stock does not fully cover their obligations. Payments on these notes are primarily collected by the Company through the application of future patronage distributions, retailer billings or stock repurchases. In the event a retailer cancels their membership with the Company, any outstanding notes receivable, and related allowance for doubtful accounts, are transferred to trade receivables as the retailer is billed for any unpaid principal and interest balances. During fiscal 2011 and 2010, $7,125 and $5,580 of notes receivable were transferred to trade receivables as an event occurred which made the note due immediately. Upon transfer of the notes receivable to accounts receivable, $1,380 and $4,648 of the notes receivable allowance for doubtful accounts was transferred to the accounts receivable allowance for doubtful accounts to properly match the reserve against the asset on the balance sheet. During 2011 and 2010, $3,009 and $2,248 of these notes were written-off.

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

Low – The retailer possesses a strong financial position, above average payment record to both Ace and other vendors, and the business is well established.
Medium – The retailer possesses an average financial position, an average payment record to both Ace and other vendors, and the business is somewhat established.
High – The retailer possesses a weak financial position, a substandard payment record to Ace or other vendors, or the business is somewhat new.

The Company has evaluated the collectability of the notes and has established an allowance for doubtful accounts of $12,126 and $12,051 at December 31, 2011 and January 1, 2011, respectively. Management records the allowance for doubtful accounts based on judgments made considering a number of factors, primarily historical collection statistics, current member retailer credit information, the current economic environment and the offsetting amounts due to members for stock, notes, interest and declared and unpaid patronage distributions.

The following table illustrates the balances related to the Company's notes receivable and related allowance for doubtful accounts:

	2011	2010
Allowance for doubtful accounts:		
Beginning balance	$12,051	$15,249
Charge-offs	-	(85)
Provision	1,455	2,718
Reclassified to A/R allowance	(1,380)	(4,648)
Other	-	(1,183)
ENDING BALANCE	**$12,126**	**$12,051**
Ending balance individually evaluated for impairment	9,589	9,682
Ending balance collectively evaluated for impairment	2,537	2,369
TOTAL ALLOWANCE	**12,126**	**12,051**
Notes receivable:		
Ending balance individually evaluated for impairment	9,902	10,453
Ending balance collectively evaluated for impairment	60,457	59,320
Ending principal balance	70,359	69,773
Less: estimated patronage applications	(7,916)	(6,524)
ENDING BALANCE	**62,443**	**63,249**
Corporate Credit Exposure:		
Low risk	49,694	49,248
Moderate risk	9,781	8,805
High risk	10,884	11,720
TOTAL	**$70,359**	**$69,773**

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

0 - 4 years	$19,328
5 - 8 years	41,839
9 - 12 years	9,192
TOTAL	**$70,359**

(6) PATRONAGE DISTRIBUTIONS AND REFUND CERTIFICATES PAYABLE

The Company operates as a cooperative organization and has paid or may pay patronage distributions to member retailers on a portion of patronage based income derived from business done with such retailers. Patronage distributions are allocated in proportion to the volume of purchases by member retailers during the period.

In December 2007, the Company's Board of Directors approved an Equity Restoration Plan to restore its equity position due to the loss of equity incurred from the inventory accounting error that the Company announced on September 5, 2007. Under the plan, the Company established a variance allocation account in the amount of $148,556, which allocates the overstatement of the Company's net income stemming from the inventory accounting error to the Company's retailer members, based on the retailer members' proportionate share of warehouse distribution pool purchases for the fiscal years 2002 through 2006. At December 31, 2011, the balance remaining in the variance allocation account was $484.

In 2009, the Board of Directors approved a revised patronage distribution plan which changed the amount of the patronage distribution paid in cash to 35% from 20% effective for the 2009 fiscal year which was paid in 2010. The remaining balance of the patronage distribution was applied to the retailer member's variance allocation account until the account was reduced to zero and any remaining patronage distribution was distributed in the Company's Class C stock. Additionally, member retailers may choose to use any patronage certificates, shares of Class C stock issued as part of the patronage distribution in prior years or cash to pay all or a portion of their variance allocation account balance.

In 2010, the Board of Directors revised the patronage distribution plan again which changed the amount of the patronage distribution paid in cash to 40% from 35% effective for the 2010 fiscal year which was paid in 2011. The cash portion of the patronage distribution will again be 40% for the 2011 patronage distribution to be paid in 2012.

The patronage distribution composition is summarized as follows:

	Years Ended		
	December 31, 2011	January 1, 2011	January 2, 2010
Cash portion	$30,433	$28,514	$32,018
Class C stock	24,673	22,380	30,234
Patronage refund certificates	9,076	7,582	-
Patronage financing deductions	9,479	7,964	6,509
Patronage distributions applied to variance allocation	797	3,414	20,270
TOTAL PATRONAGE DISTRIBUTIONS	**$74,458**	**$69,854**	**$89,031**

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

Prior to 2007 and in 2010, a portion of the patronage distribution was distributed in the form of a patronage refund certificate having maturity dates and bearing interest as determined by the Company's Board of Directors. The Company also plans to issue patronage refund certificates with maturity dates and bearing interest as determined by the Company's Board of Directors in those instances where the maximum Class C stock requirements have been met for the 2011 patronage distribution.

The patronage refund certificates outstanding at December 31, 2011 are payable as follows:

	Amount	Interest Rate
2012	$17,259	6.00%
2016	6,722	4.00%
2017	9,076	4.00%

(7) DEBT

LINE OF CREDIT

On May 15, 2008, the Company entered into a $300,000 senior secured revolving credit facility with a group of banks, which matures on May 15, 2013 and includes $175,000 available for letters of credit. Borrowings, if any, under this facility bear interest at a spread of 175 to 250 basis points over the London Interbank Offered Rate ("LIBOR") based on availability. Fees are assessed on a monthly basis for the unused portion of the line of credit at 50 basis points per annum. This fee decreases to 37.5 basis points when more than 50% of the line is outstanding.

This credit facility is available to fund short-term working capital needs. At December 31, 2011 and January 1, 2011, the Company had remaining availability under the credit facility of $264,034 and $209,731 as total availability of $264,034 and $232,231 was offset by outstanding borrowings of $0 and $22,500, respectively. The credit facility availability is calculated by considering the qualified underlying asset collateral and is reduced by outstanding letters of credit as defined by the credit facility agreement. At December 31, 2011, the credit facility availability was calculated by considering $300,000 of qualified pledged collateral less $35,966 of outstanding letters of credit. The credit agreement requires the Company to comply with various financial and nonfinancial covenants. The financial covenant is a minimum fixed charge coverage ratio triggered if borrowing availability, as determined under the credit agreement, is less than $30,000. The Company was in compliance with its covenants at December 31, 2011.

In connection with the restructuring of the Company's international operations, the Company amended its senior secured revolving credit facility to allow the Company to make revolving loans and other extensions of credit to Ace Hardware International Holdings, Ltd. in an aggregate principal amount not to exceed $50,000 at any time the amounts are outstanding. At December 31, 2011, there were no loans or other extensions of credit provided to this entity.

LONG-TERM DEBT

On May 15, 2008, the Company issued $300,000 of senior secured notes maturing June 1, 2016 and bearing an interest coupon of 9.125%. The effective interest rate on this debt is 9.37%.

Long-term debt is comprised of the following:

	December 31, 2011	January 1, 2011
$288,180 and $289,005 face value senior notes less unamortized discount of $2,216 and $2,725, due at maturity with interest payable semi-annually, bearing an interest coupon rate of 9.125% and a maturity date of June 1, 2016	$285,964	$286,280
Installment notes with maturities through 2015 at a fixed rate of 6.00%	13,382	10,778
Total long-term debt	299,346	297,058
Less: maturities within one year	(5,835)	(4,441)
LONG-TERM DEBT	**$293,511**	**$292,617**

The weighted average interest rate on long-term debt was 9.23% for both years ended December 31, 2011 and January 1, 2011, respectively.

The aggregate scheduled maturities of long-term debt at December 31, 2011 are as follows:

Fiscal Year	Amount
2012	$5,835
2013	4,017
2014	2,374
2015	1,156
2016	288,180
Thereafter	-
TOTAL LONG-TERM DEBT	**$301,562**

The indenture governing the 9.125% senior secured notes contains covenants, representations and events of default that management considers typical of an indenture of this nature. These covenants limit the Company's ability to: (i) incur additional indebtedness; (ii) create liens; (iii) pay dividends or make other restricted payments; and (iv) make asset sales and enter into sale and leaseback transactions. The Company was in compliance with these covenants at December 31, 2011.

During fiscal years 2011 and 2009, the Company repurchased $825 and $1,000, respectively, of senior secured notes on the open market for $866 and $1,050, respectively, plus accrued interest and recognized a loss of $62 in 2011 and $85 in 2009, net of the write-off of related deferred financing and bond discount costs. These amounts were recorded in loss on early extinguishment of debt in the consolidated statements of income. There were no debt repurchases in fiscal 2010.

(8) RETIREMENT PLANS

The Company has healthcare plans under which a limited number of qualified retired employees receive certain health care, dental care, life insurance or related benefits. Amounts expensed under these plans totaled $101, $105 and $129 in fiscal 2011, 2010 and 2009, respectively.

The Company participates in one multi-employer plan covering union employees. Amounts expensed for this plan totaled $163, $148 and $165 in fiscal years 2011, 2010 and 2009, respectively.

The Company also maintains a profit sharing plan for substantially all employees. The Company made cash contributions to the plan during fiscal 2011, 2010 and 2009 of $14,220, $16,378 and $17,857, respectively.

(9) ACCRUED EXPENSES

Accrued expenses include the following components:

	December 31, 2011	January 1, 2011
Salaries and wages	$38,080	$35,151
Insurance reserves	12,717	12,895
Profit sharing	8,283	6,029
Interest	3,927	4,839
Other	56,796	69,042
ACCRUED EXPENSES	**$119,803**	**$127,956**

(10) FAIR VALUE

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

There is a three-level hierarchy for disclosure to show the extent and level of judgment used to estimate fair value measurements.

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

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

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

The tables below set forth, by level, the Company's assets that were accounted for at fair value as of December 31, 2011 and January 1, 2011. 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 December 31, 2011	Level 1	Level 2	Level 3
Cash equivalents:				
Money market funds	$1,037	$1,037	$ -	$ -
Marketable securities:				
Corporate fixed income securities	8,806	-	8,806	-
Equity securities	20,344	20,344	-	-
Mortgage-backed securities	9,835	-	9,835	-
U.S. government notes	10,980	10,980	-	-
Other	1,015	-	1,015	-
TOTAL MARKETABLE SECURITIES	**$50,980**	**$31,324**	**$19,656**	**$ -**

Items measured at fair value on a recurring basis:	Carrying Value Measured at Fair Value January 1, 2011	Level 1	Level 2	Level 3
Cash equivalents:				
Money market funds	$962	$962	$ -	$ -
Marketable securities:				
Corporate fixed income securities	20,878	-	20,878	-
Equity securities	14,139	14,139	-	-
Mortgage-backed securities	11,958	-	11,958	-
U.S. government notes	1,803	1,803	-	-
Other	580	-	580	-
TOTAL MARKETABLE SECURITIES	**$49,358**	**$15,942**	**$33,416**	**$ -**

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

There were no material differences between the fair value and cost basis of the Company's marketable securities at December 31, 2011 and January 1, 2011, respectively. Gross proceeds from the sale of marketable securities were $40,447, $22,662 and $16,865 during the years ended December 31, 2011, January 1, 2011 and January 2, 2010, respectively. Gross realized gains and losses from the sale of marketable securities for the year ended December 31, 2011 were $2,022 and $203, respectively. Gross realized gains and losses from the sale of marketable securities for the years ended January 1, 2011 and January 2, 2010 were not material. The following table summarizes the contractual maturity distributions of the Company's debt securities at December 31, 2011. 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	$472	$3,375	$3,931	$1,028	$8,806
Mortgage-backed securities	-	-	6	9,829	9,835
U.S. government notes	3,478	3,095	1,503	2,904	10,980
Other	-	-	772	243	1,015
TOTAL	**$3,950**	**$6,470**	**$6,212**	**$14,004**	**$30,636**

The principal balance of the Company's senior secured notes outstanding at December 31, 2011 and January 1, 2011 was $288,180 and $289,005, respectively. Based on market activity, the fair value of the notes was $304,750 and $307,790 at December 31, 2011 and January 1, 2011, respectively.

(11) INCOME TAXES

Income tax expense includes the following components:

	Years Ended		
	December 31, 2011	January 1, 2011	January 2, 2010
CURRENT:			
Federal	$(2,439)	$(667)	$(2,496)
State	70	(188)	(288)
Foreign	(722)	(319)	(231)
TOTAL	**(3,091)**	**(1,174)**	**(3,015)**
DEFERRED:			
Federal	607	(1,415)	(1,451)
State	(662)	(374)	219
Foreign	24	-	-
TOTAL	**(31)**	**(1,789)**	**(1,232)**
INCOME TAX EXPENSE	**$(3,122)**	**$(2,963)**	**$(4,247)**

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

	Years Ended		
	December 31, 2011	January 1, 2011	January 2, 2010
Expected tax at U.S. Federal income tax rate	$(28,367)	$(27,324)	$(34,991)
Patronage distribution deductions	26,060	24,449	31,161
Other, net	(815)	(88)	(417)
INCOME TAX EXPENSE	**$(3,122)**	**$(2,963)**	**$(4,247)**

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

	December 31, 2011	January 1, 2011
DEFERRED TAX ASSETS:		
Capital loss carryforwards	$ -	$485
AMT and other tax credit carryforwards	12,694	12,535
Net operating loss carryforwards	8,200	-
Unearned insurance premium and loss reserves	1,532	1,280
Other reserves	48,225	48,020
Total deferred tax assets	70,651	62,320
Less: valuation allowance	(150)	(485)
Deferred tax assets	70,501	61,835
DEFERRED TAX LIABILITIES:		
Depreciation and deferred gains on property and equipment	13,395	8,344
Prepaid expenses and deferred income	193	(646)
Inventory valuation	26,948	24,993
Deferred tax liabilities	40,536	32,691
NET DEFERRED TAX ASSETS	**$29,965**	**$29,144**

A reconciliation of the net deferred tax assets to the consolidated balance sheets is as follows:

	December 31, 2011	January 1, 2011
Net deferred tax assets—current	$11,023	$3,761
Net deferred tax assets—noncurrent	18,942	25,383
NET DEFERRED TAX ASSETS	**$29,965**	**$29,144**

The current portion of the net deferred tax assets is included in prepaid expenses and other current assets. The noncurrent portion of the net deferred tax assets is included in other assets.

At December 31, 2011, the Company has federal and state net operating loss carryforwards available for offset against future taxable income. The net operating losses may be carried forward through the tax years 2030 and 2031. A valuation allowance has been established against the tax effects of the net operating loss with respect to its international subsidiary as management believes that it is more likely than not that the tax effect of the net operating loss will not be realized. No additional valuation allowances have been established against the effect of the remaining deferred tax assets as management believes that it is more likely that not that there will be future income sufficient to realize these deferred tax assets.

At December 31, 2011, the Company has alternative minimum tax credit carryforwards of $11,961 and foreign tax credits of $733 available to offset future tax expense. The carryforward period for alternative minimum tax credits is indefinite. Foreign tax credits may be carried forward to tax years 2016 through 2020.

The federal income tax returns of the consolidated group are subject to examination by the Internal Revenue Service, generally for three years after the returns are filed. The 2007 through 2011 tax years remain subject to examination by U.S. federal and state taxing authorities.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. Accrued interest and penalties included in the reserve for uncertain tax positions at December 31, 2011 and January 1, 2011 was $317 and $333, respectively. The Company recognized a benefit of $16, an expense of $79 and a benefit of $274 related to interest and penalties within income tax expense for the years ended December 31, 2011, January 1, 2011 and January 2, 2010. It is reasonably possible that the total amount of unrecognized tax benefits will increase or decrease within the next twelve months. The Company currently estimates that such increases and decreases will not be significant.

(12) CAPITAL STOCK

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

	Number of Shares at	
	December 31, 2011	January 1, 2011
Class A stock, voting, redeemable at par value:		
Authorized	10,000	10,000
Issued and outstanding	2,758	2,857
Class C stock, nonvoting, redeemable at not less than par value:		
Authorized	4,000,000	4,000,000
Issued and outstanding	2,982,828	3,059,006
Issuable as patronage distributions	246,727	223,805
Additional stock subscribed:		
Class A stock	-	44
Class C stock	100	3,890

No dividends can be declared on any shares of any class of the Company's stock.

Upon termination of the Company's membership agreement with any retail outlet, all shares of stock of the Company held by the retailer owning or controlling such outlet must be sold back to the Company, unless a transfer of such shares is made to another party accepted by the Company as a member retailer with respect to the same outlet.

A single Class A share is issued to a member retailer only when the share subscribed has been fully paid and Class C shares are issued only when all shares subscribed with respect to a retail outlet have been fully paid. Additional stock subscribed in the accompanying consolidated financial statements represents the paid portion of stock subscribed. All shares of stock are currently issued and repurchased at par value. The Company classifies the repurchase value of capital stock in accrued expenses when the redemption of shares is probable to occur.

During 2009, the Company's Board of Directors approved the retirement of the Company's treasury stock and, subject to certain conditions, the redemption of Class B stock. These conditions were satisfied and 1,268 shares of Class B stock were redeemed. The treasury stock retirement resulted in a reduction to treasury stock of $10,406, a reduction to Class B stock of $5,203 and a reduction to contributed capital of $5,203. The redemption of the Class B stock resulted in reductions to Class B stock and contributed capital of $1,268 each. The Company has an outstanding liability at December 31, 2011 of $192 for redeemable shares not yet surrendered. The retirement and redemption did not have a material impact on the consolidated statements of income or cash flows.

During 2011, the Company restructured its international operations into a stand-alone legal entity with its own management team and board of directors as opposed to a division within the Ace cooperative structure. As part of this restructuring, the Company received cash consideration of $8,780 and redeemed all shares of stock in the Company owned by its international retailers along with patronage refund certificates issued as part of the 2010 patronage distribution in exchange for stock in this new subsidiary.

(13) CHANGES IN EQUITY

In 2011, the Company restructured its international operations into a stand-alone legal entity with its own management team and board of directors as opposed to a division within the Ace cooperative structure. As part of this restructuring, the Company received cash consideration of $8,780 and redeemed all shares of stock in the Company owned by its international retailers along with patronage refund certificates issued as part of the 2010 patronage distribution in exchange for stock in this new subsidiary. The following table discloses the effects of changes in the Company's ownership interest in this new subsidiary on the Company's equity:

	Years Ended	
	December 31, 2011	January 1, 2011
Net income attributable to shareowners of Ace Hardware Corporation Transfers from the noncontrolling interests:	$77,684	$75,105
Increase in Ace Hardware Corporation contributed capital for sale of a 23% noncontrolling interest in subsidiary	13,902	-
CHANGE FROM NET INCOME ATTRIBUTABLE TO ACE HARDWARE CORPORATION AND TRANSFER FROM NONCONTROLLING INTERESTS	**$91,586**	**$75,105**

(14) SEGMENTS

The Company has two reportable segments based on the way that its chief operating decision maker organizes the Company's business activities for making operating decisions and assessing performance. The Company is principally engaged as a wholesaler of hardware and other related products and is a manufacturer and wholesaler of paint products. The Company identifies segments based on management responsibility and the nature of the business activities of each component of the Company. Corporate expenses are included in the wholesale segment. The Company measures segment profit as operating profit including an allocation of interest expense and income taxes based on sales.

	Year Ended December 31, 2011			
	Wholesale	Paint Manufacturing	Other	Consolidated
Revenues	$3,574,462	$128,941	$5,800	$3,709,203
Interest expense	35,124	1,105	186	36,415
Depreciation and amortization	36,822	1,864	1	38,687
Segment profit	65,611	10,868	1,447	77,926
Identifiable segment assets	1,225,876	64,836	55,312	1,346,024
Expenditures for long-lived assets	23,550	1,896	-	25,446

	Year Ended January 1, 2011			
	Wholesale	Paint Manufacturing	Other	Consolidated
Revenues	$3,399,293	$125,872	$5,566	$3,530,731
Interest expense	34,038	1,071	90	35,199
Depreciation and amortization	36,508	1,790	1	38,299
Segment profit	60,964	10,561	3,580	75,105
Identifiable segment assets	1,202,032	55,594	59,005	1,316,631
Expenditures for long-lived assets	29,708	2,567	-	32,275

	Year Ended January 2, 2010			
	Wholesale	Paint Manufacturing	Other	Consolidated
Revenues	$3,317,322	$133,128	$6,732	$3,457,182
Interest expense	34,358	947	92	35,397
Depreciation and amortization	30,932	2,376	8	33,316
Segment profit	84,048	8,672	3,007	95,727
Expenditures for long-lived assets	55,956	1,601	-	57,557

Revenues by geographic region and revenue type are as follows:

	Years Ended		
	December 31, 2011	January 1, 2011	January 2, 2010
Revenues by geographic region:			
United States	$3,485,534	$3,326,000	$3,281,546
Foreign countries	223,669	204,731	175,636
TOTAL	**$3,709,203**	**$3,530,731**	**$3,457,182**
Revenue type:			
Merchandise sales	$3,412,507	$3,250,642	$3,182,959
Retail services	296,696	280,089	274,223
TOTAL	**$3,709,203**	**$3,530,731**	**$3,457,182**

The Company has $5,122 of long-lived assets outside of the United States.

(15) COMMITMENTS AND CONTINGENCIES

LEASE COMMITMENTS

The Company rents certain warehouse and distribution space, office space, retail locations, equipment and vehicles under operating leases. At December 31, 2011, annual minimum rental commitments under leases that have initial or remaining noncancelable terms in excess of one year are as follows:

Fiscal Year	Amount
2012	$36,223
2013	31,398
2014	26,262
2015	15,557
2016	12,499
Thereafter	49,041
MINIMUM LEASE PAYMENTS	**$170,980**

Minimum lease payments include $10,867 of minimum lease payments for store leases that the Company has assigned to member retailers. As a condition of the sale of the former Company-owned stores, the Company remains contingently liable for payment under approximately 15 lease arrangements. The leases have varying terms, the latest of which expires in 2020. The Company believes that due to the nature of the agreements, the possibility of payment on a majority of the leases is remote. The Company has recorded a contingent liability of $2,133 as of December 31, 2011 for leases in which the Company is currently making payments or believes that it is probable that it will make payments before the lease term expires. These liabilities are included in accrued expenses in the consolidated balance sheet as of December 31, 2011.

All other leases expire prior to 2029. Under certain leases, the Company pays real estate taxes, insurance and maintenance expenses in addition to rental expense. With the exception of store leases assigned to member retailers, management expects that in the normal course of business, leases that expire will be renewed or replaced by other leases. Rent expense was $40,393, $40,997 and $37,302 in 2011, 2010 and 2009, respectively.

In connection with the restructuring of the Company's international operations, the Company has entered into service agreements for the receipt and handling, warehousing and re-dispatch of all shipments of merchandise for its Panama City, Panama, Shanghai, China and Dubai, United Arab Emirates operations. Annual minimum service payments under these agreements are not significant.

CONTINGENCIES

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

OTHER GUARANTEES

In the normal course of business, the Company enters into commercial commitments including standby letters of credit and guarantees that could become contractual obligations. Letters of credit are issued generally to insurance agencies and financial institutions in direct support of the Company's corporate and retailer insurance programs and retailer lending programs. As of December 31, 2011, the Company had outstanding standby letters of credit with expiration terms less than one year of $35,966.

(16) SUMMARY OF QUARTERLY RESULTS

The following table provides summary quarterly results (unaudited) for the eight quarters prior to and including the quarter ended December 31, 2011:

	2011				2010			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Revenues	$921,726	$911,958	$1,021,489	$854,030	$859,274	$824,856	$1,015,939	$830,662
Gross Profit	$109,119	$114,358	$125,077	$98,780	$107,035	$105,231	$134,999	$97,048
Operating Expenses	$83,416	$89,951	$83,709	$85,412	$78,203	$84,906	$99,349	$78,548
Net Income attributable to shareowners of Ace Hardware Corporation	$19,206	$17,047	$34,613	$6,818	$20,553	$13,873	$28,839	$11,840

(17) SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

In 2011 and 2010, the Company approved store improvement and multi-store financing programs that would provide for up to $15,000 in loans to retailers who desire to either retrofit their stores or open new stores. During fiscal 2011 and 2010, the Company issued $9,844 and $14,321, respectively, in loans to retailers. The Company offset these loans against current receivables owed to the Company by its member retailers with no net impact to the consolidated statements of cash flows.

During fiscal 2011, 2010 and 2009, patronage distributions of $11,662, $11,769 and $8,434, respectively, were offset against receivables owed to the Company by its member retailers with no net impact to the consolidated statements of cash flows.

During fiscal 2011, 2010 and 2009, repurchases of stock from retailer cancellations of $18,438, $12,005 and $12,008, respectively, were offset against current receivables of $5,309, $7,080 and $2,264, respectively, notes receivable of $4,849, $1,640 and $1,073, respectively, and variance allocation accounts of $27, $629 and $903, respectively. The remaining $8,253, $2,656 and $7,768, respectively, were issued as new notes payable with no net impact to the consolidated statements of cash flows.

In 2011, the Company restructured its international operations into a stand-alone legal entity with its own management team and board of directors as opposed to a division within the current Ace cooperative structure. During the year ended December 31, 2011, the Company redeemed all shares of stock in the Company owned by its international retailers along with patronage refund certificates issued as part of the 2010 patronage distribution in exchange for stock in this new subsidiary, with no net impact on the consolidated statement of cash flows. Class A shares of $63, Class C shares of $13,065, subscribed stock of $5 and patronage refund certificates of $485, respectively, were redeemed and are presented as either noncontrolling interests or additions to contributed capital on the consolidated balance sheet as of December 31, 2011. The Company also received $8,780 of cash consideration which is reflected in the financing activities section of the consolidated statement of cash flows.

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-year period ended December 31, 2011 (the Company's fiscal years 2011, 2010 and 2009). Each of the fiscal years presented contains 52 weeks of operating results. Unless otherwise noted, all references herein for the years 2011, 2010 and 2009 represent fiscal years ended December 31, 2011, January 1, 2011 and January 2, 2010, respectively. This discussion should be read in conjunction with the consolidated financial statements and the related notes included in this annual report that have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP").

EXECUTIVE OVERVIEW

The Company is a wholesaler of hardware and other related products, provides services and best practices for retail operations and is a manufacturer and wholesaler of paint products. The overall home improvement industry consists of a broad range of products and services, including lawn and garden products, paint and sundries, certain building supplies and general merchandise typically used in connection with home and property improvement, remodeling, repair and maintenance. The industry is fragmented and competition exists between the large home improvement centers, retail hardware stores and other chains offering hardware merchandise.

The Company's retailers generally compete in the "convenience hardware" segment which is characterized by purchases primarily of products related to home improvement and repair, including paint and related products and lawn and garden equipment, and those products less focused on large-scale building, renovation and remodeling projects. The Company believes that the following competitive strengths distinguish it from its peers and contribute to its success in the convenience hardware market: (1) well-regarded for exceptional customer service and convenience; (2) strength of distribution operations; (3) consolidated purchasing power; (4) differentiated product and service offerings; and (5) a diversified network of independent retailers.

The Company's revenues increased $178.5 million, or 5.1%, during the year ended December 31, 2011 as compared to the prior year. The Company's net income for the year ended December 31, 2011 increased $2.6 million, or 3.4%.

The Company focuses on executing strategies that address four primary objectives for future growth and success: (1) support successful retail operations of the Company's member retailers; (2) expand the number of stores in the Company's retail network; (3) strengthen the Company's distribution network; and (4) provide quality, low-cost products and services.

The Company has several initiatives underway related to the four primary objectives described above. The Company has expanded its product offerings through the introduction of the Clark+Kensington paint and primer in one. This new brand eliminates the need to prime surfaces and paint separately and underscores the Company's strategy and commitment to providing the most helpful experience for customers by delivering high quality service and products. The new paint and primer in one began shipping from the Company's distribution centers in September and was the primary reason for the $3.1 million increase in the Company's paint segment revenues during fiscal 2011. In addition, the Company's agreements with Sears Brands Management Corporation and Benjamin Moore which allow the Company's retailers to sell an assortment of Craftsman® tools, the number one tool brand in America, and Benjamin Moore paints has continued to drive significant increases across the tool and paint categories for the Company. These new products are reinforcing Ace stores as a premier destination for customers shopping for paint, tools, and other quality core hardware products.

In 2011, the Company completed the stabilization of its supply chain initiative which was implemented in 2010. The Company has strengthened its supply chain foundation by focusing on two objectives: 1) to provide the Company with a firm technology foundation to sustain its future growth and 2) to support its member retailers. These new systems replace many old legacy systems and integrate the Company's business operations and procurement, ordering, and reporting processes and solutions.

The Company also announced that it will be opening an import distribution facility in Suffolk, Virginia. This new facility is expected to help reduce import and logistics costs and provide an even higher level of service for the Company's east coast retailers, making it possible for these retailers to more effectively respond to consumer needs dictated by hurricanes and other weather emergencies in the region.

The Company restructured its international operations effective in the beginning of fiscal year 2011. International operations in 2011 are now conducted in a stand-alone legal entity with its own management team and board of directors as opposed to a division within the current Ace cooperative structure. The new entity is a majority-owned and controlled subsidiary of the Company with a minority interest owned by its international retailers. International retailers no longer own shares of stock in the Company or receive patronage dividends. The new entity plans to achieve its growth strategy by enhancing existing wholesale and retail support services for its international retailers as well as providing them additional resources such as regional distribution facilities, region-specific product assortments and services. This restructuring will not have a material impact on patronage distributions for the Company's domestic members.

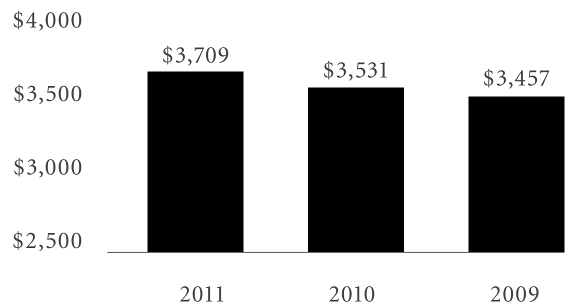
The Company paid $26.4 million of cash patronage distributions in 2011 related to net income of $75.1 million in 2010 compared to $29.2 million related to 2009 net income of $95.7 million in 2010. The Company increased the cash portion of the patronage distribution paid to retail shareholders from 35% to 40% for the 2010 patronage distribution which was paid in 2011 and increased the cash portion of the patronage distribution paid to retail shareholders from 20% to 35% for the 2009 patronage distribution which was paid in 2010.

The recent volatility in the capital markets has caused general concern over the valuations of investments, exposure to increased credit risk and pressures on liquidity. The Company continually reviews its investments, exposure to credit risk and sources of liquidity and does not currently expect any future material adverse impact relating to these items.

Management uses a variety of key performance measures to evaluate the performance of its business. These measures include revenues, store count, gross profit percentage, operating expenses and debt levels.

REVENUES

Revenue Comparison (In millions)



The Company's total revenues increased 5.1% and 2.1% in 2011 and 2010, respectively.

With regard to merchandise sales to comparable stores, the Company deems comparable stores to be those that opened at any time prior to the beginning of the preceding fiscal year. Merchandise sales to comparable domestic stores positively impacted revenues by 3.5% and 1.0% in 2011 and 2010, respectively. In 2012, Ace will seek to drive sales to comparable stores through existing and new alliances with vendors, new product additions and introductions, a strong in-stock position and various advertising, marketing and other initiatives.

Despite the challenging environment, the Company believes its foundation is solid, built on a strong, nationally recognized brand and an efficient distribution system. New Ace retail stores positively impacted revenues by 2.0% and 1.8% in 2011 and 2010, respectively, as a result of the Company's incremental sales to these members during their first and second years with the Company. Management also monitors the current year decline in sales from stores that have cancelled their membership with Ace in the current or prior year periods. Sales decreases from store cancellations negatively impacted revenues by 1.5% and 1.7% in 2011 and 2010, respectively. The Company realized a net increase in revenues of $18.8 million in 2011 compared to $5.4 million in 2010 related to the impact of new or cancelled stores.

DOMESTIC STORE COUNT

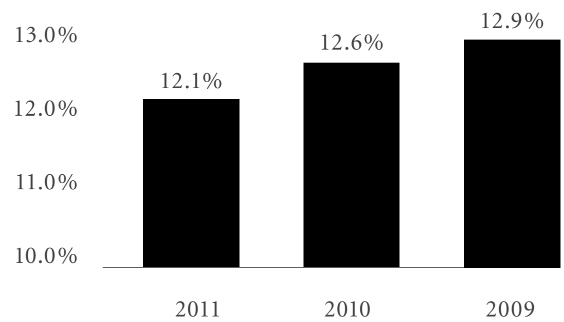
The number of Ace domestic retailer outlets during the past three fiscal years is summarized as follows:

	Fiscal Years Ended		
	2011	2010	2009
Retailer outlets at beginning of period	4,108	4,159	4,266
New retailer outlets	127	101	96
Retailer outlet cancellations	(163)	(152)	(203)
RETAILER OUTLETS AT END OF PERIOD	**4,072**	**4,108**	**4,159**

Management believes that new store count is a key metric in evaluating the health of Ace because of the sales it expects to make to these stores in future periods. Management also monitors the number of stores that have cancelled their membership with Ace in the current and prior year periods. The Company posted net domestic store count declines of 36 outlets, 51 outlets and 107 outlets in 2011, 2010 and 2009, respectively. Despite the challenging economy and its effect on store count, the Company believes that Ace's business model and variety of programs will encourage existing retailers to open branch locations and new investors to become Ace retailers.

GROSS PROFIT

Gross Profit as a Percent of Revenue

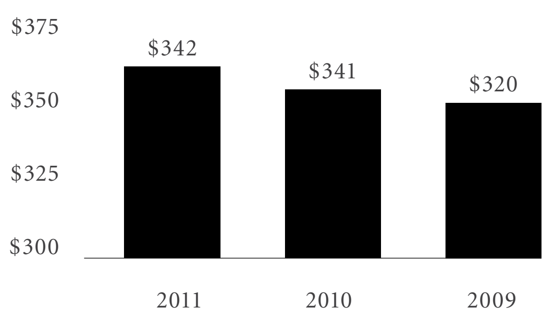


The decrease in gross profit percentage in 2011 was driven by higher LIFO expense in the current year reflecting inflationary price increases on inventory purchases and higher inbound freight costs. The decrease in gross profit percentage in 2010 was due to lower product margins driven by the absence of LIFO deflationary benefits and lower inbound freight costs that were realized in the prior year.

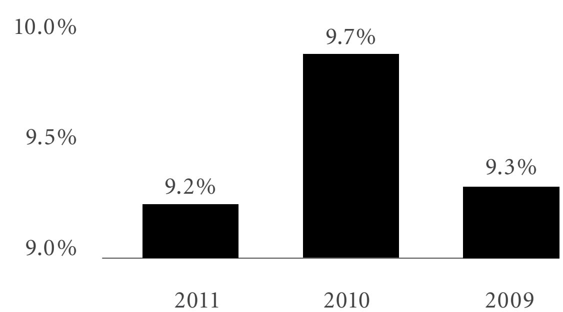
In order to better compete in today's challenging environment, the Company seeks to maintain competitive prices to its retailers. The Company's inventory line review process enables it to evaluate gross profit levels while creating profit opportunities at retail through product assortments, retail pricing services, opening stock order and inventory discounts, and reduced cost of goods in certain categories via direct importing. Direct import sourcing enables the Company to deliver high quality merchandise at a lower cost to its retailers.

EXPENSES

Operating Expenses (In millions)

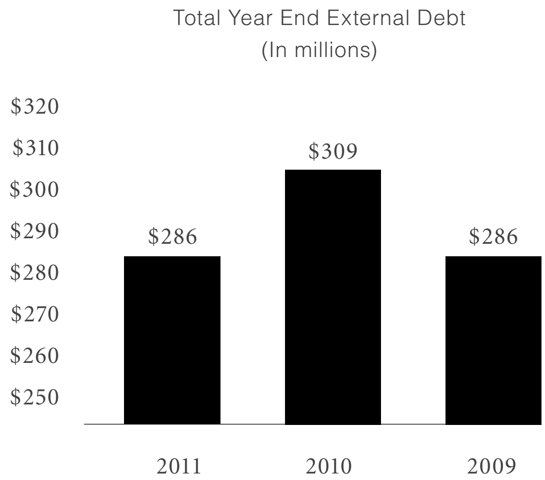


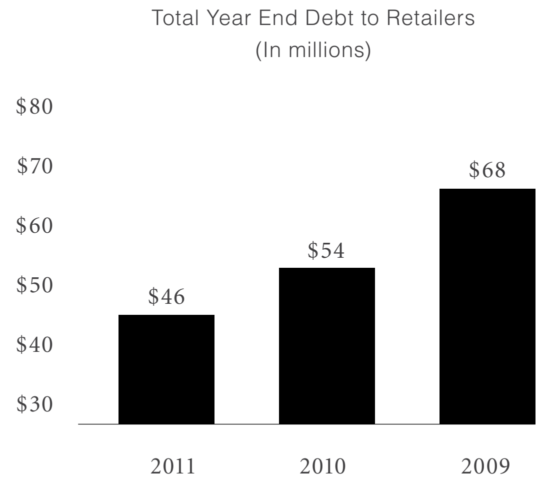
Operating Expenses as a Percent of Revenue



The Company manages its overall expense structure through high accountability of senior management, a comprehensive budget process and by monitoring operating metrics. These metrics include labor productivity, variances compared to prior years and budget and expense as a percent of revenue. Operating expenses were essentially flat in 2011 as higher distribution operations expenses associated with the Company's international expansion and higher insurance expenses due to increased claims activity were offset by lower bad debt expenses and reduced advertising and marketing costs. As a percentage of revenue, operating expenses were favorable in 2011 through effective cost controls. The Company is committed to assisting retailers and continues to make significant investments to drive retail growth and development.

DEBT





Total year end external debt includes borrowings under the Company's revolving line of credit facility and the Company's senior secured notes payable. The Company's external debt position decreased in 2011 primarily due to a reduction of borrowings under the Company's revolving line of credit facility.

Total year end debt to retailers includes patronage refund certificates payable and other notes payable to current and former retailers. The Company's debt to retailers decreased in the current year due to the maturity of previously issued patronage refund certificates, partially offset by new patronage refund certificates applicable to the 2011 patronage distribution.

RESULTS OF OPERATIONS

Comparison of Year Ended December 31, 2011 to Year Ended January 1, 2011

The following data summarizes the Company's performance in 2011 as compared to 2010 (in millions):

	2011		2010		Increase/(decrease)	
	$	% of revenues	$	% of revenues	$	%
Revenues	3,709.2	100.0%	3,530.7	100.0%	178.5	5.1%
Gross profit	447.3	12.1%	444.3	12.6%	3.0	0.7%
Operating expenses:						
Distribution operations expenses	95.2	2.6%	87.3	2.5%	7.9	9.0%
Selling, general and administrative expenses	135.8	3.7%	141.0	4.0%	(5.2)	-3.7%
Retail success and development expenses	111.5	3.0%	112.7	3.2%	(1.2)	-1.1%
TOTAL OPERATING EXPENSES	**342.5**	**9.2%**	**341.0**	**9.7%**	**1.5**	**0.4%**
Operating income	104.8	2.8%	103.3	2.9%	1.5	1.5%
Interest expense	(36.4)	-1.0%	(35.2)	-1.0%	(1.2)	3.4%
Other	9.3	0.3%	7.0	0.2%	2.3	32.2%
NET INCOME	**77.7**	**2.1%**	**75.1**	**2.1%**	**2.6**	**3.4%**

Note: Certain percentages may not sum to totals due to rounding.

Consolidated revenues for the year ended December 31, 2011 totaled $3.7 billion, an increase of $178.5 million or 5.1%, as compared to the prior year. Total merchandise sales were $3.4 billion, an increase of $161.9 million, or 5.0%, as compared to the prior year. A reconciliation of consolidated revenues follows (in millions):

		% Change vs. 2010
2010 Revenues	$3,530.7	
Merchandise sales change based on new and cancelled domestic stores:		
Sales increase from 2011/2010 new stores	70.1	2.0%
Net decrease in sales from 2011/2010 store cancellations	(51.3)	(1.5)%
Increase in merchandise sales to comparable domestic stores	123.7	3.5%
Increase in international merchandise sales	19.4	0.6%
Other revenue changes	16.6	0.5%
2011 REVENUES	**$3,709.2**	**5.1%**

New stores are defined as stores that were activated from January 2010 through December 2011. In 2011, the Company had an increase in sales from new domestic stores of $70.1 million. This increase was offset by a decrease in sales from domestic store cancellations of $51.3 million.

Merchandise sales to comparable domestic stores increased $123.7 million. On a regional basis, domestic sales were most positively impacted in the California, New York, Texas, Florida and Arizona markets. On a category basis, domestic sales were positively impacted in substantially all categories with the biggest increases in the tools, lawn and garden, paint, plumbing and electrical categories.

International merchandise sales increased $19.4 million due to strong sales to retailers in the Middle East and Asia regions, partially offset by lower sales in the Caribbean region.

Gross profit increased $3.0 million but the gross profit percentage decreased 50 basis points to 12.1% in 2011 from 12.6% in 2010. The decrease in gross profit percentage in 2011 was driven by higher LIFO expense in the current year reflecting inflationary price increases on inventory purchases and higher inbound freight costs. Warehouse sales represented 77.8% of merchandise sales in 2011 compared to 77.9% in 2010, while direct ship sales were 22.2%, up from 22.1%.

Operating expenses increased $1.5 million but decreased as a percent of revenues to 9.2% in 2011 from 9.7% in 2010. The primary driver for the increase in operating expenses was higher distribution operations expenses of $7.9 million primarily driven by higher expenses related to the Company's international expansion and higher insurance expenses as a result of increased claims activity. Partially offsetting the increase, selling, general and administrative expenses decreased $5.2 million primarily due to lower bad debt expenses and retail success and development expenses declined $1.2 million primarily due to a reduction in advertising and marketing costs.

Interest expense increased $1.2 million compared to the prior year primarily due to increased borrowings under the Company's revolving credit facility. Average interest rates on debt, excluding patronage refund certificates, decreased to 8.5% in 2011 from 9.1% in 2010, while average debt levels, excluding patronage refund certificates, increased $39.3 million to $347.8 million in 2011 from $308.5 million in 2010.

Other income and expense increased $2.3 million primarily due to gains realized on the sale of investment securities held by the Company's New Age Insurance, Ltd. ("NAIL") subsidiary. The Company sold investments as it reallocated its investment portfolio in accordance with its strategy to diversify and mitigate risk.

RESULTS OF OPERATIONS

Comparison of Year Ended January 1, 2011 to Year Ended January 2, 2010

The following data summarizes the Company's performance in 2010 as compared to 2009 (in millions):

	2010		2009		Increase/(decrease)	
	$	% of revenues	$	% of revenues	$	%
Revenues	3,530.7	100.0%	3,457.2	100.0%	73.5	2.1%
Gross profit	444.3	12.6%	447.6	12.9%	(3.3)	-0.7%
Operating expenses:						
Distribution operations expenses	87.3	2.5%	91.0	2.6%	(3.7)	-4.1%
Selling, general and administrative expenses	141.0	4.0%	123.6	3.6%	17.4	14.0%
Retail success and development expenses	112.7	3.2%	105.2	3.0%	7.5	7.2%
TOTAL OPERATING EXPENSES	**341.0**	**9.7%**	**319.8**	**9.3%**	**21.2**	**6.6%**
Operating income	103.3	2.9%	127.8	3.7%	(24.5)	-19.1%
Interest expense	(35.2)	-1.0%	(35.4)	-1.0%	0.2	-0.6%
Other	7.0	0.2%	3.3	0.1%	3.7	106.9%
NET INCOME	**75.1**	**2.1%**	**95.7**	**2.8%**	**(20.6)**	**-21.5%**

Note: Certain percentages may not sum to totals due to rounding.

Consolidated revenues for the year ended January 1, 2011 totaled $3.5 billion, an increase of $73.5 million or 2.1%, as compared to the prior year. Total merchandise sales were $3.3 billion, an increase of $67.7 million, or 2.1%, as compared to the prior year. A reconciliation of consolidated revenues follows (in millions):

		% Change vs. 2009
2009 Revenues	$3,457.2	
Merchandise sales change based on new and cancelled domestic stores:		
Sales increase from 2010/2009 new stores	62.7	1.8%
Net decrease in sales from 2010/2009 store cancellations	(57.3)	(1.7)%
Increase in merchandise sales to comparable domestic stores	34.8	1.0%
Increase in international merchandise sales	27.0	0.8%
Other revenue changes	6.3	0.2%
2010 REVENUES	**$3,530.7**	**2.1%**

New stores are defined as stores that were activated from January 2009 through December 2010. In 2010, the Company had an increase in sales from new domestic stores of $62.7 million. This increase was offset by a decrease in sales from domestic store cancellations of $57.3 million.

Merchandise sales to comparable domestic stores increased $34.8 million. On a regional basis, domestic sales were most positively impacted in the Florida and New York markets. On a category basis, domestic sales were positively impacted by increases in the hand and power tool, lawn and garden, heating and cooling, electrical, and seasonal categories.

International merchandise sales increased $27.0 million due to strong sales to retailers in the Middle East, Central and South America, and Asia.

Gross profit decreased $3.3 million and the gross profit percentage decreased 30 basis points to 12.6% in 2010 from 12.9% in 2009. The decrease in gross profit percentage in 2010 was largely attributable to the absence of LIFO inventory deflationary benefits and lower inbound freight costs that were realized in the prior year. Warehouse sales represented 77.9% of merchandise sales in 2010 compared to 77.8% in 2009, while direct ship sales were 22.1%, down from 22.2%.

Operating expenses increased $21.2 million and increased as a percent of revenues to 9.7% in 2010 from 9.3% in 2009. The primary driver for the increase in operating expenses was higher selling, general and administrative expenses of $17.4 million primarily driven by higher depreciation and labor expenses associated with recently implemented technology related to the Company's supply chain initiative. In addition, retail success and development expenses increased $7.5 million primarily due to an increase in advertising expenses. These increases were partially offset by a decrease in distribution operations expenses of $3.7 million primarily due to reduced property taxes and lower depreciation expenses.

Interest expense decreased slightly as compared to the prior year primarily due to a decrease in average interest rates on debt, excluding patronage refund certificates, partially offset by an increase in average debt levels. Average interest rates on debt, excluding patronage refund certificates decreased to 9.1% in 2010 from 9.2% in 2009, while average debt levels increased $10.6 million to $308.5 million in 2010 from $297.9 million in 2009.

Income tax expense decreased $1.3 million primarily due to lower pretax earnings from the Company's non-member business, including its e-commerce and non-member store activity.

LIQUIDITY AND CAPITAL RESOURCES

The Company expects that existing cash balances, along with the existing line of credit and long-term financing, will continue to be sufficient in the foreseeable future to finance the Company's working capital requirements, debt service, patronage rebates, capital expenditures, share redemptions from retailer cancellations and growth initiatives.

The Company's liquidity requirements have historically arisen from, and are expected to continue to arise from, working capital needs, debt service, capital improvements, patronage distributions, retailer loan programs 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 facility. The Company currently estimates that its cash flows from operating activities and working capital, together with its line 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.

CASH FLOWS

The Company had $15.8 million and $9.4 million of cash and cash equivalents at December 31, 2011 and January 1, 2011, respectively. Drivers of the increase in cash and cash equivalents during the year ended December 31, 2011 included operating cash flows of $96.4 million and the proceeds from the sale of noncontrolling interests of $8.8 million as a result of the Company's restructuring of its international operations into a stand-alone entity. Partially offsetting the increase in cash and cash equivalents was the payment of the 2011 patronage distribution of $26.4 million, payments for additions to property and equipment of $25.6 million, the repayment of borrowings under the Company's revolving credit facility of $22.5 million and the payment of patronage refund certificates of $17.9 million.

For the years ended December 31, 2011 and January 1, 2011, the changes in cash flows were primarily due to the following:

- Net cash provided by operating activities was $96.4 million compared to net cash used in operating activities of $28.2 million in 2010. The increase in 2011 was primarily due to a smaller increase in inventories in 2011 as compared to 2010. In 2010, the Company's inventory increased significantly to support new retail initiatives, such as Craftsman and Benjamin Moore, that began in 2010 as well as to maintain inventory availability during the implementation of the Company's supply chain initiative. In addition, less cash was used in receivables primarily due to the timing of collections and fewer receivables being offset against patronage distributions, retailer stock cancellations and notes receivable issuances in the current year as compared to the prior year.
- Net cash used in investing activities was $26.2 million and $37.0 million for 2011 and 2010, respectively. Net cash used in 2010 was primarily due to continued capital investments related to the Company's supply chain initiative.
- Net cash used in financing activities was $63.8 million and $31.2 million for 2011 and 2010, respectively. The increase was primarily due to the repayment of borrowings under the Company's revolving line of credit facility.

The decrease in cash and cash equivalents at January 1, 2011 as compared to January 2, 2010 was primarily due to the following:

- Net cash used in operating activities was $28.2 million in 2010 compared to cash provided by operating activities of $139.9 million in 2009. The decrease in 2010 was primarily due to an increase in inventory levels of $71.9 million in the current year as opposed to a decrease of $21.5 million in the prior year along with the timing of vendor payments. The incremental inventory investment was made primarily to support new retail initiatives, such as Craftsman and Benjamin Moore, that began in 2010 as well as to meet anticipated demand for certain seasonal inventory categories and to maintain inventory availability during the implementation of the Company's supply chain initiative. In addition, receivables increased $53.9 million during the year ended January 1, 2011 compared to a decrease in receivables of $32.2 million during the year ended January 2, 2010 primarily due to a higher receivable balance at the end of 2010 as a result of the timing of collections and higher revenues during December 2010. Finally, operating cash flows decreased as net income decreased $20.6 million during the year ended January 1, 2011 as compared to the prior year.
- Net cash used in investing activities was $37.0 million and $67.9 million for 2010 and 2009, respectively. Net cash used in 2010 and 2009 was primarily due to continued capital investments related to the Company's supply chain initiative.
- Net cash used in financing activities was $31.2 million and $46.6 million for 2010 and 2009, respectively. The decrease in net cash used was primarily due to the net proceeds from short-term borrowings in 2010 which were used primarily for general working capital purposes. There were no short-term borrowings during 2009. The decrease in net cash used in financing activities was partially offset by the increased payment of the cash portion of the patronage distribution. The Company increased the cash portion of the patronage distribution for 2009, paid in 2010, to 35% from 20% in the previous year.

In 2010 and 2011, the Company approved two new store financing programs that would provide for loans to retailers who desire to retrofit their stores or open additional stores. During 2011 and 2010, the Company issued loans totaling $9.8 and $14.3 million under these programs. The Company has also committed to issuing an additional $10.3 million of loans under these programs in future years.

DEBT

On May 15, 2008, the Company issued $300.0 million of senior secured notes maturing June 1, 2016 and bearing an interest coupon of 9.125%. The proceeds were used to retire existing debt and for general corporate purposes. The Company has repurchased $11.8 million of this debt with $288.2 million remaining outstanding.

The credit ratings of the Company as of December 31, 2011 are as follows:

	Standard & Poor's	Moody's
Senior Secured Debt	BB-	Ba2
Corporate Credit Rating	BB-	Ba3

LINE OF CREDIT

On May 15, 2008, the Company entered into a $300.0 million senior secured revolving credit facility with a group of banks, which matures on May 15, 2013 and includes $175.0 million available for letters of credit. Borrowings, if any, under this facility bear interest at a spread of 175 to 250 basis points over the London Interbank Offered Rate ("LIBOR") based on availability. Fees are assessed on a monthly basis for the unused portion of the line of credit at 50 basis points per annum. This fee decreases to 37.5 basis points when more than 50% of the line is outstanding.

This credit facility is available to fund short-term working capital needs. At December 31, 2011, the Company had total and remaining availability under the credit facility of $264.0 million as there were no outstanding borrowings. The credit facility availability is calculated by considering the qualified underlying asset collateral and is reduced by outstanding letters of credit as defined by the credit facility agreement. At December 31, 2011, the credit facility availability was calculated by considering $300.0 million of qualified pledged collateral less $36.0 million of outstanding letters of credit. The credit agreement requires the Company to comply with various financial and nonfinancial covenants. The financial covenant is a minimum fixed charge coverage ratio triggered if borrowing availability, as determined under the credit agreement, is less than $30.0 million. The Company was in compliance with its covenants at December 31, 2011.

In connection with the restructuring of the Company's international operations, the Company amended its senior secured revolving credit facility to allow the Company to make revolving loans and other extensions of credit to Ace Hardware International Holdings, Ltd. in an aggregate principal amount not to exceed $50.0 million at any time the amounts are outstanding. At December 31, 2011, there were no loans or other extensions of credit provided to this entity.

OFF-BALANCE SHEET ARRANGEMENTS

In accordance with GAAP, operating leases for the Company's real estate and other assets are not reflected in the consolidated balance sheets. In addition, the Company has certain other guarantees, as further described in the Notes to the Consolidated Financial Statements—Note 15—Commitments and Contingencies. The Company believes the likelihood of any such payment under these guarantees is remote.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

Contractual obligations and commitments at December 31, 2011 are as follows:

	Payments Due by Period				
	Total	1 Year	Less than 1-3 Years	3-5 Years	More than 5 Years
			(In millions)		
Long-term debt (1)	$301.6	$5.8	$6.4	$289.4	$ -
Interest payments on long-term debt	124.5	31.7	54.5	38.3	-
Patronage refund certificates payable	33.1	17.3	-	6.7	9.1
Operating leases (2)	171.0	36.2	57.7	28.1	49.0
Purchase commitments (3)	34.3	25.5	8.7	0.1	-
TOTAL	**$664.5**	**$116.5**	**$127.3**	**$362.6**	**$58.1**

(1) Reflects principal payments.

(2) Total operating lease payments include $10.9 million of minimum lease payments for store leases that the Company has assigned to member retailers.

(3) Represents minimum purchase commitments pursuant to contracts primarily with hardware, software and service providers.

The table above does not include any reserves for uncertain tax positions (including penalties and interest) as the Company is unable to make a reasonably reliable estimate of the timing of payments due to uncertainties in the timing of the effective settlement of tax positions.

APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses in the consolidated financial statements. On an ongoing basis, the Company evaluates its estimates and judgments based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates, and these estimates would vary under different assumptions or conditions. Management believes these estimates and assumptions are reasonable.

The Company annually reviews its financial reporting and disclosure practices and accounting policies to ensure that they provide accurate and comprehensive information relative to the current economic and business environment. Ace's significant accounting policies are described in the Notes to the Consolidated Financial Statements. The following represents those critical accounting policies which involve a relatively higher degree of judgment, estimation and complexity and where materially different amounts could be reported under different conditions or using different assumptions.

VALUATION OF INVENTORIES. When necessary, the Company provides allowances to adjust the carrying value of inventories to the lower of cost or market, including costs to sell or dispose of surplus or damaged/obsolete inventory, and for estimated shrinkage. Estimates of the future demand for the Company's products are key factors used by management in assessing the net realizable value of the inventories. While management believes that the estimates used are appropriate, an unanticipated decline in sales at retail outlets or a significant decline in demand for products in selected product categories could result in valuation adjustments.

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

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

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

The Company's allowance for doubtful accounts at December 31, 2011 and January 1, 2011 was $22.0 million and $22.4 million, respectively. Actual credit losses could vary materially from the Company's estimates.

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

NEW ACCOUNTING PRONOUNCEMENTS

In June 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income," ("ASU 2011-05") which was subsequently amended by Accounting Standards Update No. 2011-12 ("ASU 2011-12"). ASU 2011-05 eliminates the option the Company currently follows to report other comprehensive income and its components in the statement of changes in equity. ASU 2011-05 requires that all nonowner changes in stockholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. This new guidance will be effective for the Company's 2012 interim and annual financial statements and is to be applied retrospectively.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, "Fair Value Measurements (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs," ("ASU 2011-04"). ASU 2011-04 changes the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements to ensure consistency between U.S. GAAP and International Financial Reporting Standards ("IFRS"). ASU 2011-04 also expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. This new guidance is effective for the Company in 2012 and is not expected to materially impact the Company's consolidated financial statements.

QUALITATIVE AND QUANTITATIVE DISCLOSURE ABOUT MARKET RISK

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

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

CUSTOMER CREDIT RISK. The Company is exposed to the risk of financial non-performance by customers. The Company's ability to collect on sales to its customers is dependent on the liquidity of its customer base. Continued volatility in credit markets may reduce the liquidity of the Company's customer base. To manage customer credit risk, the Company monitors credit ratings of customers. From certain customers, the Company also obtains collateral as considered necessary to reduce risk of loss. The Company does not believe the loss of any single customer would have a material adverse effect on its results of operations.

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 filing. 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 release.

NON-GAAP FINANCIAL MEASURES

The Company defines "EBITDA" as earnings before interest, loss on early extinguishment of debt, taxes, depreciation and amortization. The Company defines "adjusted EBITDA" as EBITDA adjusted to exclude certain items which the Company considers non-comparable and which the Company believes are not indicative of future performance. The Company cautions investors that amounts presented in accordance with its definitions of EBITDA and adjusted EBITDA may not be comparable to similar measures disclosed by other companies, because not all companies calculate EBITDA or adjusted EBITDA in the same manner.

EBITDA and adjusted EBITDA, as presented in this annual report, are supplemental measures of the Company's performance that are not required by or presented in accordance with GAAP. They are not measurements of the Company's financial performance under GAAP and should not be considered as alternatives to net income or any other performance measures derived in accordance with GAAP or as alternatives to cash flows from operating activities as measures of the Company's liquidity.

The Company presents EBITDA and adjusted EBITDA because the Company considers it an important supplemental measure of its performance and believes it is frequently used in the evaluation of companies in its industry. In addition, the instruments governing the Company's indebtedness use EBITDA (with additional adjustments) to measure the Company's compliance with covenants such as interest coverage and debt incurrence. The Company also includes a quantitative reconciliation of EBITDA and adjusted EBITDA to the most directly comparable GAAP financial performance measure, which is net income.

	Years Ended		
	December 31, 2011 (52 Weeks)	January 1, 2011 (52 Weeks)	January 2, 2010 (52 Weeks)
	(Unaudited, in thousands)		
EBITDA RECONCILIATION:			
Net income	$77,926	$75,105	$95,727
Income tax expense	3,122	2,963	4,247
Interest expense (including loss on early extinguishment of debt in 2011 and 2009)	36,477	35,199	35,482
Depreciation and amortization	38,687	38,299	33,316
EBITDA	**$156,212**	**$151,566**	**$168,772**

FIVE-YEAR SUMMARY OF EARNINGS AND DISTRIBUTIONS

	Years Ended				
	December 31, 2011 (52 Weeks)	January 1, 2011 (52 Weeks)	January 2, 2010 (52 Weeks)	January 3, 2009 (53 Weeks)	December 29, 2007 (52 Weeks)
			(In thousands)		
Revenues	$3,709,203	$3,530,731	$3,457,182	$3,857,002	$3,970,644
Cost of revenues	3,261,869	3,086,418	3,009,599	3,392,586	3,515,574
Gross profit	447,334	444,313	447,583	464,416	455,070
Total operating and other expenses, net	369,650	369,208	351,856	378,576	368,136
NET INCOME ATTRIBUTABLE TO ACE HARDWARE CORPORATION	$77,684	$75,105	$95,727	$85,840	$86,934
Distribution of net income:					
Patronage distributions	$74,458	$69,854	$89,031	$78,334	$81,192
Accumulated earnings	3,226	5,251	6,696	7,506	5,742
NET INCOME ATTRIBUTABLE TO ACE HARDWARE CORPORATION	**$77,684**	**$75,105**	**$95,727**	**$85,840**	**$86,934**

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

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

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

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

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

February 9, 2012

/s/ Ray A. Griffith

Ray A. Griffith
President and Chief Executive Officer

/s/ Erik D. Gast

Erik D. Gast
Vice President - Finance

Ace Hardware Corporation

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