FINANCIALS

ACE HARDWARE 2013 ANNUAL REPORT

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This Annual Report contains information about our company. Unless otherwise indicated or required by the context, the terms "Ace," "we," "our," "us" and the "Company" refer to Ace Hardware Corporation and all of its subsidiaries that are consolidated under U.S. generally accepted accounting principles ("GAAP"). The terms "member," "retailer," "member retailer," "dealer," "you," "your" and similar words refer to someone who becomes a member of Ace and purchases our stock. In this Annual Report, we reference some of our own trademarked products (e.g., Clark + Kensington® paints) and services, as well as those of unrelated third parties with whom we do business (e.g., Valspar® paints); all trademarks appearing in this Annual Report are the property of their respective owners. Our fiscal years for the years 2013, 2012 and 2011 ended on December 28, 2013, December 29, 2012, and December 31, 2011, respectively. When we refer to a year, we are referring to the fiscal year ended on those respective dates. Data in this summary is as of December 28, 2013 unless indicated otherwise.

SUMMARY

Our Company

Ace Hardware Corporation markets and distributes hardware products and paint to our network of independent retailers around the world. We also provide value-added services such as advertising, market research, merchandising assistance, promotion support, assistance with site location, store format design, retail training services, insurance and store technology services. We have been an important part of the American business landscape for 90 years and are the largest cooperative, by sales, in the hardware industry. Ace today serves approximately 2,800 individual domestic retailers who operate approximately 4,200 domestic stores located in all 50 states and the District of Columbia. Ace-affiliated companies also serve international retailers in approximately 60 foreign countries.

Ace positions itself as "The Helpful Place"—a conveniently located hardware store that provides not only quality goods but also knowledgeable store staff. We believe that "The Helpful Place" is one of the most recognized slogans in the hardware and home improvement industry.

In 2013, Ace ranked "Highest in Customer Satisfaction with Home Improvement Retail Stores, Seven Years in a Row," according to J.D. Power and Associates. (For J.D. Power and Associates award information, visit jdpower.com.) We believe that we earned this award for the seventh consecutive year because helpfulness is a promise that all associates at local Ace stores seek to fulfill by serving their retail customers across the United States and around the world.

As the principal supplier to our retailer network, Ace purchases hardware and related products in quantity lots and resells this merchandise in smaller lots to our retailers. Ace's aggregate purchasing volume and supplier relationships enable us to realize substantial purchasing savings and to pass such savings on to our retailers. This enables Ace's retailers to have consistent access to a broad range of hardware and related products and to better compete in their local markets.

We operate 14 retail support centers ("RSCs") and six freight consolidation/redistribution facilities across the United States that total almost 10 million square feet of distribution space. Eleven of these facilities, for a total of approximately 8.2 million square feet of distribution space, are Company-owned. In addition, Ace subsidiaries also have distribution capabilities in Dubai, United Arab Emirates; Panama City, Panama; and Shanghai, China. In 2014 the Company will start shipping product out of new RSCs in Ohio and Texas which will replace existing facilities in those same areas. These new leased facilities will increase Ace's total distribution space without any increase to the total number of RSCs. Additionally, in February 2014, the Company added warehouse facilities in Portland, Maine and Pittston, Pennsylvania through the acquisition of The Emery Waterhouse Company.

To help foster our retailers' continued success, fuel their entrepreneurial spirit and enhance their viability in an increasingly competitive home improvement marketplace, Ace provides two basic programs for its member retailers—Ace Branded and Individually Branded.

Approximately 500 stores, or 12%, of our network of domestic stores are individually branded. Sales to these retailers represented approximately 8% of our 2013 fiscal year domestic merchandise sales. Our Individually Branded Retailer program is ideal for retailers who have strong individual name recognition in their local communities and do not rely as much on the Ace brand for their success. While they do not participate in Ace's marketing programs, as members of Ace they still rely on Ace's broad product assortment (including Ace private label products), low product pricing, extensive distribution network, and eligibility for patronage distributions. They go to market under their own business name and identity.

The remaining approximately 3,700 domestic stores, or 88%, of our network of domestic stores operate under the Ace brand. Sales to these retailers represented approximately 92% of our 2013 fiscal year domestic merchandise sales.

Ace also supports 20/20 Vision, its long-term retail growth strategy. The strategy builds on Ace's commitments to enhance retailer performance and ensure retailer growth, not only today, but long term. 20/20 Vision provides Ace and our retailers with a clear path to the future. The strategy is consumer-focused, aligned with our corporate strategy and contains two paths for growth that can be implemented separately or concurrently. The two paths for growth are Pinnacle Performance Retailing and Accelerated Store Growth. Pinnacle Performance Retailing is designed to help Ace retailers improve their store performance by increasing sales and net profits. Accelerated Store Growth is designed to encourage Ace retailers with the desire and ability to open new stores. It is also intended to increase store count through new investors, conversions of competitors' stores and by reducing the number of stores that leave Ace or close.

Ace's Capital Stock Structure

Our capital stock is divided into two classes: Class A and Class C. Only Class A Stock has voting rights. Class C Stock is issued in connection with all store memberships and annually as part of our patronage distribution. Our Board of Directors has the right to redeem portions or all of the outstanding shares of Class C Stock that have been issued as patronage distributions. If Ace is ever liquidated, the outstanding shares of Class C Stock have priority over the outstanding shares of Class A Stock in the distribution of our net assets. Were our net assets to exceed that priority amount, they would be distributed proportionately among the stockholders of both classes of our stock. (See "Description of Capital Stock—Voting Rights," "—Liquidation Rights" and "—Redemption Provisions.")

Ace operates as a cooperative. Accordingly, the declaring of dividends on any shares of any class of our stock is prohibited. (See "Description of Capital Stock—Dividend Rights.")

Membership Applications – Subscriptions for Class A and Class C Stock

The purchase of our stock enables retailers to obtain membership in Ace. Membership entitles our retailers to purchase merchandise and services from us. Members are also eligible to receive patronage distributions based on the volume of merchandise they purchase from us, but these distributions are dependent on Ace's patronage-based business being profitable. (See "Membership Information—Patronage Distributions—Patronage Distribution Determinations.") We cannot guarantee that patronage distributions will be made for any year.

Our stock is sold only to approved retailers of hardware and related products who apply for membership in Ace Hardware Corporation. The purchase price for each share of Class A Stock is $1,000 and the purchase price for each share of Class C Stock is $100.

For an initial membership, you must subscribe and pay for one share of Class A Stock plus 40 shares of Class C Stock, with an aggregate subscription price of $5,000. You must also pay a $5,000 charge for processing your membership application. If you apply for membership for an additional store location that you own or control, you must subscribe and pay for 50 shares of Class C Stock ($5,000) for that location and pay another $5,000 processing charge.

Your membership may generally be terminated upon various notice periods and for various reasons, including voluntary termination, as provided in the Membership Agreement.

Ace may also sell merchandise to retailers that are not members of Ace, but such non-member retailers do not own any Ace stock and are not eligible to receive any patronage distributions.

Repurchase of Shares by Ace

If your membership for a store location terminates, all of your Class A and Class C shares for that location must be sold back to us, generally at par value, unless the shares are transferred to another party whom we agree to accept as a retailer for that location. We generally pay the repurchase price in a combination of cash and an interest-bearing four-year installment note. (See "Description of Capital Stock—Other Restrictions and Rights.")

Under Delaware corporate law, we are not allowed to repurchase any of our shares if our net assets are less than the par value of our aggregate outstanding shares of capital stock or if our net assets would be reduced below that amount by virtue of the repurchase.

Patronage Distributions and Income Tax Treatment

As a cooperative, we distribute patronage annually to member retailers based on their merchandise purchases from us. Under our current plan, which can be modified by our Board of Directors, 40% of the total annual patronage distribution to each retailer is paid in cash. The remainder is paid in shares of Class C Stock and in Patronage Refund Certificates. The cash portion of any patronage distribution payable to a past due or terminated retailer is generally applied against that retailer's indebtedness or other obligations to us, if any. (See "Membership Information—Patronage Distributions.")

The cash payments and stated dollar amounts of Class C Stock and Patronage Refund Certificates along with the fair market value of any other property that we distribute as patronage, must be taken into your gross income for federal income tax purposes. (See "Federal Income Taxes—Tax Treatment of Patronage Distributions.")

Risks of Membership

Owning and operating a retail hardware store as an Ace retailer, especially a group of such stores, can be rewarding, both financially and otherwise. There are, however, a number of risks that one should consider carefully before making a decision to become an Ace retailer. See "Risks of Membership" for some of the more important risks. There may be other issues, risks and benefits particularly relevant to you that are not summarized in the "Risks of Membership" section.

ACE'S BUSINESS

Company History

Our company traces its history to the early 1920s, when the traditional way of buying hardware merchandise was to purchase these items from a middleman or "jobber." This distribution method drove up the price on every hardware item, thereby cutting into the retailer's profit. In response, a group of Chicago-area hardware retailers—Richard Hesse, William Stauber, Frank Burke, Gern Lindquist, and Oscar Fisher—decided they would pool their hardware buying needs, which allowed them to buy directly from manufacturers and to eliminate the jobber. This strategy enabled those retailers to realize considerable savings, decrease inventory costs and compete more effectively with the larger stores in their markets—a concept still valid today.

In 1928, this group of retailers incorporated their business in Illinois as Ace Stores (later re-named Ace Hardware Corporation). The Company was named in honor of the superior World War I fliers dubbed "aces." We opened our first warehouse in 1929, and by 1934, our membership had grown to 41 retailers and our annual sales exceeded $650,000. During the 1960s, we expanded into the south and west regions of the country, and by 1969, we had opened distribution centers in Georgia and California—our first such facilities outside Chicago. We opened our first international store, in Guam, in 1968.

By the early 1970s, large home center chains began to take market share from small independent retailers. In response, Ace and our retailers began operating as a cooperative. In 1976, our retailers took full control when shareholders elected the first Board of Directors comprised solely of retailers. By this time, our wholesale sales had reached $382 million. Ace had retailers in all 50 states and the District of Columbia by 1979. By 1985, Ace had reached $1 billion in sales. Ace reached $2 billion in sales in 1993, $3 billion in sales in 1998, and $4 billion in sales in 2013. The 2013 fiscal year also marked Ace's first year with over $100 million in net income.

Although Ace has had a retail presence outside the United States since the late 1960s, we began to make great strides in the implementation of our international growth strategy during the 1990s. In 2011, the Company restructured its international operations so that they are no longer a division within Ace's cooperative, but rather a stand-alone entity, Ace Hardware International Holdings, LTD. ("Ace International") with its own board of directors and management team. The new entity is a majority-owned and controlled subsidiary of the Company with a noncontrolling interest owned by its international retailers, and currently has a retail presence in approximately 60 countries, with third-party distribution facilities in Dubai, United Arab Emirates; Panama City, Panama; and Shanghai, China.

In December 2012, Ace sold its paint manufacturing facilities to The Valspar Corporation ("Valspar") and entered into a long term agreement with Valspar to further our two brand paint strategy. In 2013, Ace embarked on the process of remodeling and re-equipping the paint departments at over 3,000 Ace stores across the U.S. The Company expects to have over 3,000 stores completed by the time of the grand reopening of the Paint Studio in May 2014.

In December 2012, Ace Retail Holdings LLC (a newly-formed subsidiary of the Company) acquired all of the outstanding shares of capital stock of WHI Holding Corp. ("WHI"). WHI owns all outstanding shares of Westlake Hardware, Inc. ("Westlake").

Westlake is based in Kansas City, Missouri and operates 85 neighborhood hardware stores located throughout the Midwest under the name Westlake Ace Hardware.

In February 2014, Ace Wholesale Holdings LLC (a newly-formed subsidiary of the Company) acquired a majority interest in and control of The Emery Waterhouse Company ("Emery"). Emery is based in Portland, Maine and operates as a hardware wholesaler throughout the New England and New York metropolitan areas. It maintains its own warehouse facilities in Portland and in Pittston, Pennsylvania.

Ace's customer loyalty program, Ace Rewards®, boasts more than 27 million members. Acehardware.com is the online face of our brand and trusted destination for online products and project solutions, and averages more than 80,000 daily visitors. Ace has invested in other digital media such as Twitter, YouTube and Facebook, and currently has approximately 370,000 Facebook fans. Ace also has a full-functioning mobile website that allows consumers to shop right from their smart phone. Ace continues to rank highly on national scales of service and customer satisfaction, and has earned numerous other awards and accolades, including:

- In 2013, Ace ranked "Highest in Customer Satisfaction with Home Improvement Retail Stores, Seven Years in a Row," according to J.D. Power and Associates. (Ace Hardware received the highest numerical score among retail stores in the proprietary J.D. Power and Associates 2007-2013 Home Improvement Retail Store Study℠. The 2013 Study was based on responses from 4,129 consumers measuring six stores and opinions of consumers who purchased a home improvement product or service within the previous 12 months. Proprietary study results are based on experiences and perceptions of consumers surveyed January-February, 2013. Your experiences may vary. For J.D. Power and Associates award information, visit jdpower.com)

- In 2013, Clark + Kensington® interior paint was ranked No. 1 by a leading consumer magazine taking the top spot among semi-gloss finishes.

- In 2013, The Helpful 101 retail training program won the Brandon Hall Bronze Award for "Best Onboarding Program".

Our Retailer Base

Ace has been able to attract and retain a strong base of experienced retailers by offering a broad range of products at very competitive prices, providing exceptional product availability, service levels and assisting retailers with numerous retail operational activities. As of December 28, 2013, Ace had approximately 2,800 domestic retailers operating approximately 4,200 domestic retail locations.

Ace's network of retailers covers all 50 states and the District of Columbia in the U.S. and, through our affiliated companies, in approximately 60 foreign countries. As of December 28, 2013, the largest concentrations of Ace retailer stores were in California (approximately 9%), Florida (approximately 6%), Illinois and Texas (approximately 5% each), and Georgia, Michigan and New York (approximately 4% each). Ace shipped the largest percentages of merchandise in fiscal year 2013 to California (approximately 12%), Florida (approximately 6%), and Illinois, New York and Texas (approximately 5% each).

New Store Growth

The Company has a focused effort on attracting new retailers and on identifying growth opportunities for the Company and its retailers. The total number of Ace domestic locations during each of our past three fiscal years is summarized in the following table:

	2013	2012	2011
Retail outlets at beginning of period	4,104	4,072	4,108
New retail outlets added	152	159	127
Retail outlets terminated	(85)	(127)	(163)
Retail outlets at end of period	4,171	4,104	4,072
Retailers having single or multiple outlets at end of period	2,773	2,755	2,765
Retailer branch locations at end of period	1,313	1,264	1,307
Company operated retail outlets	85	85	-
Retail outlets at end of period	4,171	4,104	4,072

Ace's strong competitive posture translates into success for many retailers who open new stores. The following charts show domestic new store continuations by year for, respectively, "new investor" and existing retailer "branch" stores that Ace approved for membership in each of the last ten years.

New Investor Stores
No. of Stores Continuing with Ace at the End of Each Year

Year	No of Stores Approved for Ace Membership	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004
2004	18	10	11	11	11	13	14	14	17	18	18
2005	30	21	21	21	21	25	25	26	27	30	
2006	68	37	38	38	42	50	60	62	68		
2007	50	31	31	34	39	40	46	49			
2008	33	21	21	26	31	32	33				
2009	41	32	33	34	35	39					
2010	25	23	24	24	25						
2011	30	29	30	30							
2012	31	28	30								
2013	31	31									

New Branch Stores
No. of Stores Continuing with Ace at the End of Each Year

Year	No of Stores Approved for Ace Membership	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004
2004	75	60	62	62	64	65	69	72	72	75	75
2005	87	60	60	67	70	73	79	82	85	87	
2006	98	69	71	74	79	86	94	97	98		
2007	83	64	67	71	75	77	82	83			
2008	46	39	39	41	44	45	46				
2009	41	40	40	41	41	41					
2010	53	51	52	52	53						
2011	56	54	56	56							
2012	51	50	51								
2013	66	66									

Our Industry and Our Retailers' Core Customers

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. Sales within this larger market were estimated to be in excess of $300 billion in 2013 by the North American Retail Hardware Association. This industry is highly fragmented and encompasses "big box" home improvement centers (such as The Home Depot, Lowe's and Menards); retail hardware stores (such as stores affiliated with our Company as well as stores affiliated with TrueValue and Do it Best); traditional department stores and chains offering hardware merchandise (such as Sears); and regional lumber yards and builder-contractor shops (such as 84 Lumber and United Building Centers). It also includes mass merchandisers, warehouse clubs and discount stores (such as Wal-Mart, Sam's Club, Costco, Target and Kmart); and catalog and internet-based retailers (such as Amazon.com).

Our retailers generally compete in what we call the "convenience hardware" segment of the overall home improvement industry. As differentiated from the overall home improvement industry, we consider the "convenience hardware" segment of the industry to be 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. According to a report of the North American Retail Hardware Association, convenience hardware store sales were estimated at approximately $40 billion in 2013.

We believe the core customer of the convenience hardware market is a mission shopper who values helpful service, convenience and the feel and experience of a neighborhood hardware store. These customers' purchases are typically lower ticket-price items driven by do-it-yourself improvement, repair and maintenance projects and the need for everyday home improvement and lawn and garden items. We believe our retailers' core customer differs from the core customers of the large-format stores in that those stores typically value customers who are driven by larger scale home building and home improvement objectives. Our internal analysis of customer purchases shows that the everyday improvement, maintenance and repair objectives of our retailers' customers are a significant driver of our retailers' sales.

Competitive Strengths

We believe the following competitive strengths distinguish Ace from our peers and contribute to our continued success in the convenience hardware market:

Well-Regarded for Exceptional Customer Service and Convenience. Ace positions itself as "The Helpful Place" and our local retailers differentiate themselves not only by providing high quality goods but also through their accessible, helpful and knowledgeable store staff. We believe that "The Helpful Place" is one of the most recognized slogans in the home improvement industry. In addition to helpfulness, we believe our retailers benefit from their efficient store size and numerous, convenient locations. We believe that in comparison to larger home improvement centers and "big-box" competitors, Ace customers value our retailers' accessible and friendly staff and the ease and speed with which they can find and purchase their desired products.

Strength of Distribution Operations. Our extensive distribution network includes 14 domestic RSCs as well as our fleet of tractors and trailers, which allows us to effectively supply our network of approximately 4,200 domestic stores. Our RSCs are equipped with information technology systems that efficiently manage and track inventory and contribute to the exceptional product availability service levels that we are able to offer to our retailer network. Our average service levels, or fill rate, were 97.1%, 96.9% and 96.2% for 2013, 2012, and 2011, respectively.

Ace's extensive distribution network is key to our members' success. Our RSCs use an integrated information service system that enables us to monitor inventory turns and levels, and to forecast labor needs at various sales volumes. This system provides Ace with daily operational information and assists us in managing our inventory.

Ace transports products from our RSCs with our truck fleet of approximately 400 tractors and approximately 1,200 dry freight trailers. The size of the Company's owned and leased tractor-trailer fleet allows the Company to operate a significant backhaul business. Backhauling allows the Company to transport product from the vendor to our crossdock facilities and our RSCs, reducing freight costs, shortening lead times and improving inventory turnover.

Consolidated Purchasing Enhances Competitiveness of our Retailers. Ace is able to obtain lower prices on products by pooling our retailers' buying power. The Company further reduces retailers' cost by importing many products from overseas vendors. Under extended dating programs, the Company is given favorable payment terms on seasonal products, such as lawn and garden products, holiday promotional items and winter care products. The Company is able to pass along these extended terms to our retailers, which helps with their working capital and cash flow.

Differentiated Product and Service Offerings. We attract and retain a strong base of experienced retailers by offering a broad range of products at very competitive prices and assisting retailers with improving their operational efficiency. Our retailers and their customers value the selection of over 11,000 private label products available under the Ace brand, including specialty product offerings such as Clark + Kensington® Paint. We also offer our retailers an extensive selection of Scotts® Lawn and Garden products and Weber® grills. Additional high-quality product offerings include Valspar® Paints which, together with Ace Paints, form our two brand paint strategy. Since 2010, an agreement with Sears Holdings has enabled our participating retailers to sell an assortment of Craftsman® tools that they buy from us through our RSCs. In addition, all Ace stores can participate in our national promotions of selected Craftsman® products. In 2013, a further agreement was reached with Sears Holdings allowing Ace retailers to purchase and sell Kenmore® vacuum cleaners and vacuum cleaner replacement accessories. Also in 2013, Ace and East Penn Manufacturing entered into an agreement allowing retailers to purchase and sell Diehard® automotive, lawn & garden, marine, and power sport batteries.

Our service offerings allow our retailers to benefit from best practices in all aspects of managing their business, including new store development, customer service, pricing, inventory management, finance and insurance, labor scheduling and marketing. These services, in addition to ongoing educational and training programs, help enhance the overall efficiency and profitability of our member retailers' businesses and contribute to their loyalty to the Ace brand.

Diversified Network of Independent Retailers. We serve a geographically diverse network of retailers who operate approximately 4,200 domestic stores located in all 50 states and the District of Columbia. This broad network of retailers mitigates dependence on any one region of the country and reduces the impact of regional downturns. Moreover, the Company's performance is not reliant on any one retailer. The largest retailer owns 33 stores and represents approximately 1% of our merchandise sales. The Company's ten largest retailers (by purchase volume) own 158 stores and represent approximately 6% of our merchandise sales. Ace-affiliated companies serve international retailers in approximately 60 foreign countries. In fiscal year 2013, approximately 6% of Ace's merchandise sales were made to locations outside the United States.

Long-Term, Stable Relationships with Retailers. We believe we benefit from the significant number of retailers that are long-term members of the Ace cooperative. As of December 28, 2013, approximately 82% of our retailers have been members for at least five years and approximately 66% and 38% have been members for at least 10 and 20 years, respectively.

Depth of Our Experienced Management Team. Our team of senior officers has extensive experience and long-term service with the Company. This group has an average of approximately 16 years of experience at Ace. In addition, we benefit from the functional expertise of our merchandise buying group, our retail support center managers and our extensive field support staff. Our leadership team has demonstrated its ability to manage Ace through past market cycles and has a successful track record of growing our business, delivering operational improvements and serving our member retailers.

Merchandise Sales to Our Network of Retailers

Ace employs a business philosophy that focuses on purchasing high-quality products at the lowest cost available, providing high levels of customer service at retail stores and making strategic investments in our distribution network. This philosophy has enabled us to establish strong, long-term customer and retailer relationships and to be viewed as a reliable and innovative performer in our respective markets.

We offer our retailers a full line of hardware products including hand and power tools, plumbing and heating supplies, garden equipment, electrical supplies, housewares and appliances, and general merchandise such as paint, cleaning and related products. The Company does not engage in basic or substantive product research and development activities. Items are regularly added to and deleted from our product lines on the basis of market research, customer demand and sales volumes (at both wholesale and retail), recommendations of suppliers and other factors.

We offer approximately 76,000 SKUs, including nationally branded merchandise and private label products through our network of RSCs. Our extensive product line enables us to provide our hardware store retailers' with the majority of the products they need.

Ace sells merchandise to our retailers in three ways:

- Warehouse sales involve the sale of merchandise that we regularly carry in our inventory at our RSCs.
- Bulletin sales involve special bulletin offers where we place a special order for merchandise after retailers commit to buy specific quantities of it.
- Direct shipment sales involve sales where the merchandise is shipped directly to retailers by vendors.

Warehouse sales involve the sale of merchandise that we inventory at our RSCs. We purchase large quantities of merchandise (mainly from manufacturers), warehouse it in our RSCs and sell it in smaller lots to our retailers. Most of these products are sold at a price based primarily on our cost, to which we add freight charges and a variable handling charge of approximately 10%. We maintain inventories sufficient to meet normal replenishment orders, which enable us to keep our inventories at productive levels. Orders are usually filled within one day of receipt.

Warehouse sales accounted for approximately 77% of Ace's 2013 fiscal year domestic merchandise sales. The following is a breakdown of our total warehouse sales among various general classes of merchandise for each of the past three fiscal years:

Class of Merchandise	2013	2012	2011
Paint, cleaning and related supplies	21%	21%	20%
Plumbing and heating supplies	15	15	17
Garden, rural equipment and related supplies	17	16	16
Electrical supplies	10	11	10
Hand and power tools	11	11	10
General hardware	8	8	9
Sundry	11	11	11
Housewares and small appliances	7	7	7

Bulletin sales (which are included in warehouse sales) involve special bulletin offers where we place a special order for merchandise after retailers commit to buy specific quantities of it. Bulletin sales generally relate to retail promotional events and seasonal products, and accounted for approximately 7% of Ace's 2013 fiscal year domestic merchandise sales. We purchase merchandise for bulletin sales based upon retailers' orders. When the bulletin shipment arrives, we break it up into smaller quantities and deliver it to the retailers who ordered it. We generally apply a handling charge of approximately 6% to bulletin sales, plus freight charges.

Direct shipment sales include sales where the merchandise is shipped directly to retailers by vendors. Direct shipment sales accounted for approximately 23% of Ace's 2013 fiscal year domestic merchandise sales. Retailers place direct shipment orders with our vendors. The vendors then bill Ace for these orders and ship the merchandise directly to retailers. We, in turn, bill the ordering retailers for the cost of the merchandise plus a fixed percentage handling charge based on each retailer's prior year direct shipment dollar volume. The handling charge begins at 2.0% and declines to 0.5% for those retailers whose annual purchase volumes exceed $815,000.

We charge freight to retailers on all warehouse sales. The freight rate is billed as a fixed percentage of each retailers' warehouse purchases. Additionally, a fuel surcharge may be applied to the freight charge if the national average cost of diesel exceeds $2.05 per gallon based on an established matrix. Sales made by our affiliated companies to retailers located outside of the continental United States may incur additional freight and handling charges related to ocean container transportation.

Private Label Programs

Our merchandise offering to our retailers also includes privately labeled products. Ace's private label program provides our domestic retailers with over 11,000 "Ace" branded SKUs, and domestic RSC private label sales were $598 million in 2013. Sales of private label merchandise represented approximately 15% of the Company's merchandise sales in 2013.

When choosing merchandise for the private label Ace brand, we target products that are not highly brand sensitive. In 2013 over 3,000 SKUs, were converted to new packaging. This packaging will differentiate Ace core and Ace premium products for the consumer. This roll out is being conducted as buyers are completing category reviews, and is scheduled to be completed in 2016.

The Company purchases its private label products from over 290 suppliers on an item-specific basis. We ensure consistent quality in our private label products through various means including factory site visits, third-party laboratory testing for some products, and specific criteria for imported products. The Company changes suppliers from time to time when product quality or pricing improvements are available.

In addition to the Ace private label, there are 6 house brands that are exclusive to Ace Hardware.

- Celebrations - holiday trim and decor
- Grill Mark - grill and outdoor cooking accessories
- Home Plus - Opening price point (OPP) household consumables, L&G tools, decorative plumbing, tarps and door locks
- Living Accents - home and garden décor

- Oak Brook Collection - decorative plumbing
- Steel Grip - OPP tools

Retailer Conventions and Special Merchandise Programs

Twice per year at various locations in the U.S., Ace hosts a convention and trade show for Ace retailer owners and their store employees. Ranked individually as some of the largest trade shows in the U.S., these conventions offer invaluable opportunities for show attendees, including discounted offers on product orders, preview looks at new products and services, and targeted training on a wide variety of subjects. We invite existing and prospective retailers and vendors. Our conventions also provide our retailers with the ability to view the newest store planograms and displays in order to get their stores updated with the latest suggested layouts. Vendors display regular, new and seasonal merchandise. Retailers generally place orders for merchandise that we will deliver to them before the next convention.

Ace's Store Traffic Opportunity Program ("STOP") offers our retailers the opportunity to purchase specific products for which we have assigned a "competitive price sales" classification. We deliver these products from our RSCs with little to no handling charges determined on an item-by-item basis. We may add and withdraw items from the STOP program, or establish reasonable minimum or multiple item purchase requirements. Our LTL Plus Program allows retailers to purchase full or partial truckloads of products from specific vendors for direct shipment delivery by the vendor to the retailer's store with no handling charges.

Ace Service Offerings

In addition to hosting conventions as well as other shows and product exhibits for our retailers, we also provide them with many special services. We offer all of these services at established charges. These services include inventory control systems, fact-based, market driven retail pricing recommendations, and a "checklist" service that provides current information about all of our product offerings. We also provide a choice of ongoing educational and training programs for retailers. (See "Membership Information—Retailer Assessments and Charges.")

The Company's district managers support retailers with a detailed analysis of store operations, pricing, advertising, inventory control and merchandising plans to help retailers enhance their competitive position. Our services include:

- *Pricing-Related Services*. While each of our retailers determines the pricing strategy for his or her own stores, we offer retailers an assortment of pricing-related services designed to help improve their gross margin dollars and enhance price competitiveness. These include services such as recommended pricing and hotsheets for each store.

- *Advertising*. We support Ace's strong brand name recognition and advertising effectiveness by making significant investments in national television, radio, online and print advertisements. Lou Manfredini, a nationally known home improvement expert, serves as Ace's "Helpful Hardware Man" and is also a media spokesperson for Ace. We also provide tools to support our retailers' regional and local advertising efforts. Ace also offers a local portal called Ace Brand Place that our retailers can use to create customized marketing materials such as emails to send to their store customers.

- *Ace Rewards®*. To further promote the Ace brand name, Ace maintains a preferred customer loyalty program, Ace Rewards. The program is aimed at delivering consumer touch points which drive profitable revenues to retailers and leverage the relationship between customers and their local Ace stores. As of December 28, 2013, Ace Rewards reaches more than 27 million members linked to approximately 2,900 Ace stores. Average spending for Ace Rewards customers tends to be higher than for non-Ace Rewards customers, as the average transaction amount for Ace Rewards customers is 14% higher than non-Ace Rewards customers. The Company's co-branded Visa credit card, affiliated with U.S. Bank and launched in 2010, enables customers to earn additional rewards points. As of December 28, 2013, Ace has nearly 75,000 Ace Rewards Visa card holders.

- *Market and Consumer Research*. We provide market and consumer research to our retailers. In an effort to delineate the strengths and weaknesses of major competitors in the marketplace, the Company conducts consumer research on a national level. On the local level, the Company helps assess the trade area of existing stores, the potential of the trade area and the performance level of individual stores.

- *New Store Analysis.* In analyzing new or expanded store opportunities, the Company assists retailers with site analysis, demographic information, store size and format, sales and other projections, décor, merchandising and advertising.

- *Insurance Services.* Our wholly owned subsidiary, Ace Insurance Agency, Inc., offers a Retailer Insurance Program so that retailers can purchase different types of insurance coverage. This program offers property insurance and business interruption, flood, employment practices, crime, liability and workers' compensation insurance. The Company's insurance subsidiary is managed by experienced industry professionals and is licensed in all 50 states and the District of Columbia.

- *Analysis of Underperforming Stores.* The Company tracks the financial performance of all stores. When appropriate, we formulate marketing and operational recommendations targeted to improve individual store performance.

- *Retailer Credit.* Generally, the more collateral, guarantees or other evidence of financial strength, the higher the Ace credit limit for which that retailer qualifies. We periodically review and establish credit limits for retailers based on payment history and financial ratios, as well as other considerations relating to the performance of specific retailers.

- *Retailer Loans.* The Company has various lending programs which are available to qualified retailers. The notes bear interest at various rates based on market rates, the loan program or retailer's credit quality. Payments on these notes are primarily collected by the Company through the application of future patronage distributions, retailer billings or stock repurchases.

Other Ace Retailer Programs and Benefits

We offer other programs designed to maximize our retailers' competitive position. These programs include:

- *New Store Incentives.* Ace's New Store Incentives help qualifying retailers, including prospective conversion stores, open new locations by providing substantial merchandise credits that reduce the cost of the opening stock order.

- *Payment Terms on Seasonal Merchandise.* Ace provides extended payment terms (datings) on seasonal and certain other merchandise purchases to assist retailers with their cash flow. These datings are intended to allow the retailer to capture the cash flow of the merchandise sale before being required to pay Ace.

Distribution

Ace's extensive distribution network is key to our members' success. Our RSCs use an integrated information system that enables us to monitor inventory turns and levels, and to forecast labor needs at various sales volumes. This system provides Ace with daily operational information requirements and assists us in managing our inventory. Through this system, Ace is able to track every pallet of merchandise in our RSCs and coordinate our warehouse picking operation.

Ace also utilizes technology to ensure low cost distribution, including inbound and outbound scanning and radio frequency. The result is improved order accuracy that enables most retailers to avoid checking shipped merchandise at the retail location. Additionally, our retailers can check inventory availability, make special purchase requests and monitor prices on commodity items through ACENET, our internet-based intranet that serves as the primary communication vehicle between us and our retailers.

Ace's RSC locations distribute merchandise to our retailers in a timely fashion. Ace transports products from our RSCs with our own truck fleet of approximately 400 tractors and approximately 1,200 freight trailers. Our tractor and trailer fleet includes both owned and leased units.

The size of the Company's owned and leased tractor-trailer fleet allows the Company to operate a significant backhaul business. Backhauling allows the Company to transport product from the vendor to our crossdock facilities and our RSCs, reducing inbound freight costs, shortening lead times and improving inventory turnover. Our average service levels, or fill rates, were 97.1%, 96.9% and 96.2 % for 2013, 2012 and 2011, respectively.

Suppliers

Ace purchases merchandise from approximately 4,700 suppliers ranging from local suppliers to large multinational corporations. No one supplier accounted for more than 3% of products purchased in fiscal 2013. Our top ten vendors accounted for approximately 18% of our merchandise purchases in 2013. We maintain a staff of experienced buyers in each of our product departments who work closely with our suppliers' merchandising staffs.

Ace teams up with our suppliers to ensure a timely flow of products to our retailers. Through collaborative replenishment programs, Ace communicates inventory and product sales information electronically to certain suppliers who are then responsible for generating orders automatically as needed. These programs are advantageous to Ace, our retailers, and our suppliers. We can maximize utilization of our warehouse space and increase inventory turns, while our suppliers are provided with current and accurate demand data for their products, and our retailers are not overloaded with merchandise.

Technology

Ace uses technology to maximize efficiency both in our retailers' operations and in our RSCs. Among the computerized retail services developed or supported by Ace for our retailers are: (i) retail store systems, including POS to manage pricing and product promotion; (ii) inventory, merchandising and pricing (including category management and shelf-management) software; and (iii) other management information and productivity systems, including drop-ship support. Many in-store operations are enhanced and streamlined by using Ace's computer-based programs. These programs include:

- Eagle for Windows—This third-party system is a distributed in-store computer that provides POS, inventory management, accounts receivable, reporting, accounts payable and general ledger capabilities. The system allows the retailer to create computer-generated orders for stock replenishment, participate in the Ace Rewards customer loyalty program, and is integrated to a number of the enterprise systems at the Ace Corporate headquarters.

- ACENET—This intranet site serves as the primary communication platform between Ace and our retailers. In addition, a wealth of information such as product catalogs and special ordering functions can be accessed through this program. ACENET is a portal for the *Ace Way of Retailing,* which documents the best practices for operating an Ace store.

- www.acehardware.com—Acehardware.com is Ace's branding, shopping and research solution for consumers, and received over 33 million visitors in 2013. The web site offers online shoppers more than 43,000 SKUs that can be shipped directly to their home or to their local Ace store. Retailers are also able to create personalized web pages for their stores on this site. Acehardware.com is the primary consumer portal for our customers. In 2013, Ace began piloting an In-Store Pickup feature that allows consumers to check product availability at their local Ace and if they chose, order online and pickup as early as the same day. The program is scheduled for rollout in early 2014.

- TheSupplyPlace.com – this business – to – business ("B2B") ecommerce site supports the Ace Retailer in growing their B2B customer base and increasing their business with existing B2B accounts. This site will integrate with the Eagle in-store system and provide customer specific pricing, ability to display non-Ace items, and support account inquiry for the store's B2B customers. This ecommerce site was rolled out in January of 2014.

Ace has invested significantly in wholesale information technology to build and manage an enterprise architecture and high-speed telecommunications network that links manufacturers, wholesale distribution, Ace retailers and consumers in the supply chain. We anticipate continued investment in technology for the foreseeable future.

Ace International

We opened our first international store in 1968 and since then have made great strides in implementing an international growth strategy. In early 2011, we restructured our international operations into a new stand-alone legal entity as opposed to a division within the Ace cooperative structure. Ace International 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. Ace International has its own management team and board of directors. Ace International is a majority-owned and controlled subsidiary of the Company with a noncontrolling interest owned by its international retailers. Ace-affiliated retailers located outside the U.S. no longer own shares of stock in the Company or receive patronage dividends.

Ace International has retailer relationships in approximately 60 countries and U.S. territories. The major regions in which it does business include the Middle East, Caribbean, Latin America/Mexico, the Pacific Rim and Asia.

Ace International currently has offices located in Dubai, United Arab Emirates; Panama City, Panama; and Shanghai, China, each providing in-country resources to international retailers in their respective regions. The China facility also serves as a buying office, sourcing direct-import products from Asia for both Ace and international retailers. In addition, Ace International manages warehouse operations through third-party providers located in Dubai, Shanghai and Panama City. These warehouses provide region-specific merchandise to Ace International's retailers.

Currently, two Ace International owned and operated facilities in the U.S. provide freight forwarding services to our affiliated international retailers: one is located in Miami, Florida and the other in Carson, California.

The Company's percentage of merchandise revenues by geographic region in fiscal years 2013, 2012 and 2011 are presented in the table below:

	2013	2012	2011
United States revenues	93.9%	93.9%	94.0%
Foreign revenues	6.1	6.1	6.0
Total revenues	100.0%	100.0%	100.0%

Trademark and Service Mark Registrations

The names "Ace Hardware" and "Ace" are used extensively by retailers and us in the promotion, advertising and marketing of products and services that we and our retailers sell. We have had various trademark and service mark registrations issued by the U.S. Patent and Trademark Office for these and other marks.

Employees

As of December 28, 2013, we had approximately 4,000 full-time employees, of whom approximately 1,250 were salaried employees. We also have one union contract, covering fewer than 50 employees. We consider our employee relations with both union and non-union employees to be good, and we have had no strikes in nearly twenty-five years. In general, our employees are covered by either negotiated or non-negotiated benefit plans that include healthcare, death benefits and, with few exceptions, 401k retirement benefits.

Legal Proceedings

From time to time the Company is involved in various legal and administrative proceedings that are incidental to its business, including claims relating to product liability, general negligence, environmental issues, employment, intellectual property and other matters. It is not expected that the ultimate resolution of any of these matters will have, either individually or in the aggregate, a material adverse effect on the Company's consolidated financial position or results of operations.

Regulation

The Company is subject to federal, state and local laws and regulations governing businesses generally. As required by the federal Bioterrorism Act of 2002, the Company has registered each of its RSCs, which store and handle certain food products intended for human or animal consumption, with the U.S. Food and Drug Administration. Management believes that the Company is in substantial compliance with all federal, state and local laws and regulations governing its business.

Competition

The retail hardware business is highly fragmented and intensely competitive. Our retailers' competitors include many large companies that have substantially greater market presence, name recognition, and financial, marketing and other resources than we or our retailers do. We and they compete directly or indirectly with "big-box" home improvement centers (e.g., The Home Depot, Lowe's, Menards and others); retail hardware stores, some of which are affiliated with other large retailer-based hardware cooperatives but others of which are not (e.g., True Value and Do it Best); traditional department stores and chains offering hardware merchandise (e.g., Sears); regional lumber yards and builder-contractor shops (e.g., 84 Lumber, United Building Centers); mass merchandisers, warehouse clubs and discount stores (e.g., Wal-Mart, Sam's Club, Costco, Target, Kmart); and catalog and Internet-based retailers (e.g., Amazon.com).

For 90 years, Ace has successfully weathered competitive pressures and various economic cycles. We believe that Ace's longevity is due to our ability to adjust to changing market conditions.

The Company believes that its business strategy provides the Company and our retailers with a significant competitive advantage. By leveraging the purchasing power of Ace's large retailer base, we can obtain products at competitive prices from our vendors. In addition, the Company's retailer-focused support services help our retailers to compete in their local markets. The

Company believes that it achieves a significant competitive advantage by combining the purchasing and operating efficiencies from its centralized supply and support services with the local market flexibility and entrepreneurship of our independent retailers.

The Company believes it can continue to compete successfully on the wholesale level and support the competitive efforts of our retailers by continuing to provide them goods at competitive prices and the support services referred to above.

Properties

Ace's general offices are located at 2200 Kensington Court, Oak Brook, Illinois 60523. The following table lists our primary offices, distribution, warehousing and other facilities, and indicates whether each property is owned or leased.

Location	Square Feet of Facility	Owned or Leased
General Offices:		
Oak Brook, Illinois	206,030	Leased
Oak Brook, Illinois	70,508	Leased
Retail Support Centers:		
Princeton, Illinois	1,094,756	Owned
Rocklin, California	1,035,000	Owned
Wilton, New York	800,525	Owned
Prince George County, Virginia	798,786	Owned
Loxley, Alabama	798,698	Owned
Moxee, Washington	798,107	Leased
Colorado Springs, Colorado	721,596	Owned
Prescott Valley, Arizona	905,445	Owned
Maumelle, Arkansas	599,005	Owned
LaCrosse, Wisconsin	591,742	Owned
Gainesville, Georgia	481,013	Owned
Perrysburg, Ohio	393,720	Leased
Tampa, Florida	391,755	Owned
Arlington, Texas	314,091	Leased

We also lease freight consolidation centers, divisional offices and storage space and own or lease a fleet of tractors, trailers and automobiles, as well as warehouse, computer and other equipment. In 2014, the Company will begin distribution from new leased RSCs in West Jefferson, Ohio, and Wilmer, Texas. These 2 new RSCs will take the place of the Perrysburg, Ohio and Arlington, Texas facilities.

COMPANY MANAGEMENT AND DIRECTORS

Members of the Board of Directors

The Company's business and affairs are governed by its Board of Directors. The current By-laws of the Company provide that the Board of Directors shall be comprised of no fewer than nine and no more than 12 directors, as fixed from time to time by the Board, and may consist of member directors and non-member directors. No fewer than eight of the directors shall be member directors. A maximum of 25% of the directors may be non-member directors.

The directors are divided into three classes, and each class of directors serves for a three-year term. The Board determines the number of directors in each class and the number of member directors and non-member directors who comprise each class. In no event may the term of any director exceed an aggregate of nine years, except that the Chairman may serve as a director for such additional time as shall be necessary to permit him or her to serve for up to six years as Chairman.

Each member director must be a stockholder or other equity owner of a retail business that owns capital stock of the Company or a manager, executive officer, general partner or general manager or other affiliate (as defined in the Company's current By-laws) of such retail business organization that owns capital stock of the Company.

As of March 1, 2014, the Board of Directors currently consists of ten directors: nine member directors and one non-member director.

The Board of Directors held six formal meetings in 2013. No director attended fewer than 75% of the meetings of the Board and those committees on which he or she served during 2013. Directors are expected to attend annual meetings of stockholders. All incumbent directors attended the 2013 annual meeting of stockholders.

The Board of Directors acts collectively through meetings, committees and management members it appoints. In addition, the Company employs a staff of executives to manage the day-to-day business of the Company.

The members of the Board of Directors are identified below. Ages are as of March 1, 2014.

Name	Age	Position	Director Since	Term Expires
Directors				
David S. Ziegler	58	Chairman of the Board, Class II Member Director	2001	2014
James W. Ackroyd	57	Vice Chairman of the Board, Class II Member Director	2008	2014
Jeffrey C. Girard	66	Class II Non-Member Director	2008	2014
David F. Karsten	49	Class II Member Director	2011	2014
Gina M. Schafer	43	Class II Member Director	2008	2014
James T. Hatcher, III	52	Class I Member Director	2006	2015
Todd S. Steadman	43	Class I Member Director	2009	2015
Brett G. Stephenson	43	Class I Member Director	2012	2015
Stewart C. Elliott, Jr.	56	Class III Member Director	2013	2016
Amy E. Kaplanis	44	Class III Member Director	2013	2016

David S. Ziegler is Vice President and co-owner of Z Hardware Company in Elgin, Illinois, a nine-store chain in the Northwest suburban Chicago, Illinois area, a position he has held since 1979. Mr. Ziegler earned a Bachelor of Science degree in business administration from Drake University and is a certified public accountant.

James W. Ackroyd is Chief Executive Officer of Vision Ace Hardware LLC, an eleven-store chain in southwest Florida, a position he has held since November 1999. Mr. Ackroyd holds a Bachelor of Science degree in accounting from Bentley College (Massachusetts) and is a certified public accountant.

Jeffrey C. Girard is retired, but as an entrepreneur owns and manages Beam Dynamics, Inc., a private business that manufactures precision metal components and testing equipment used in scientific research. Mr. Girard is qualified as an "audit committee financial expert" for SEC purposes based on his ten-year CFO tenure at two Fortune 500 companies, Supervalu Inc. and Supermarkets General Corp. Mr. Girard received a Bachelor of Science degree in economics from Michigan State University and a Master of Business Administration (MBA) from Columbia University Graduate School of Business.

David F. Karsten is the President and Chief Executive Officer of a three-store chain in the suburban Arizona towns of Cave Creek, Goodyear, and Care Free, a position he has held since 2002. Mr. Karsten attended Scottsdale College, Northern Arizona University and Arizona State University.

Gina M. Schaefer, through an affiliated entity, owns and manages Logan Hardware, the parent store of a nine-store chain in the Washington, D.C. and Baltimore areas, a position she has held since 2002. Ms. Schaefer holds a Bachelor of Arts degree from Wittenberg University (Ohio).

James T. Hatcher, III is President of Pleasants Hardware, Inc., a nine-store chain with eight stores in Richmond, Virginia, and one in Chesterfield, Virginia, a position he has held since 1999. Mr. Hatcher is a graduate of the University of Virginia and holds a Bachelor of Science degree from their McIntire school of Commerce. He also earned a Master of Business Administration (MBA) degree from the College of William and Mary.

Todd S. Steadman is Vice President of Steadman's Hardware, Inc., a 47-year-old family business that owns an Ace store in Miles City, Montana, a position he has held since 1993. Mr. Steadman holds a Bachelor's degree from Montana State University.

Brett G. Stephenson is President of Ace Hardware Home Centers, Inc., a five-store chain in Wyoming and Colorado, a position he has held since 2004. Mr. Stephenson earned a Bachelor of Science degree from Colorado State University.

Stewart C Elliott, Jr. is President of Elliot Ace Hardware, a five-store chain located in the Milwaukee, Wisconsin area, a position he has held since 1988. Mr. Elliott holds a Bachelor of Science degree in economics from the University of Michigan.

Amy E. Kaplanis is the Vice President of Country Ace Hardware in Granby, Colorado, a position she has held since 2006. Ms. Kaplanis holds a Bachelor of Business Administration degree in international business from George Washington University and a Master of Business Administration (MBA) degree from the University of Denver.

Committees of the Board of Directors

The Board of Directors has five committees: (1) Audit, (2) Compensation and Human Resources, (3) Finance, (4) Retail Supply Chain and (5) Nominating and Governance. Each holds regular meetings, generally in connection with scheduled Board meetings. Each committee operates under a written charter that may be found on ACENET, our intranet site, which is available and accessible by all Ace members.

Audit Committee. The Audit Committee assists the Board in its oversight responsibilities with respect to (a) the integrity of Ace's financial statements, (b) Ace's compliance with legal requirements, (c) the effectiveness of internal controls and procedures, (d) the independent auditors' qualifications and independence and (e) the performance of Ace's internal audit function and independent auditors. The Audit Committee met eight times in 2013.

Compensation and Human Resources Committee. The Compensation and Human Resources Committee provides oversight and evaluation of the executive officers' relative pay, from both an internal and external point of view, and considers the officer's relative performance to support such compensation. This committee strives to ensure that our executives are compensated fairly compared to their peers within the retail sector. The Compensation and Human Resources Committee annually reviews data from The Hay Group, Inc.'s Retail Industry Total Remuneration Survey as our primary benchmark source of compensation data. The Compensation and Human Resources Committee chair works closely with the Senior Vice President, Human Resources, Organizational Development and Ace Foundation, as well as with the President and CEO, to set the agenda for forthcoming meetings. The Compensation and Human Resources Committee met four times in 2013.

Finance Committee. The Finance Committee assists the Board in developing the Company's short- and long-term financial goals, capital requirements, patronage distribution plan, credit policies and related matters. The Finance Committee met four times in 2013.

Retail Supply Chain Committee. The Retail Supply Chain Committee assists the Board in fulfilling its responsibilities relating to oversight of significant operational and retail focused initiatives affecting the Company and its member retailers. The Retail Supply Chain Committee met four times in 2013.

Nominating and Governance Committee. The Nominating and Governance Committee assists the Board in fulfilling its responsibilities with respect to Board organization and procedures, individual director and full Board performance evaluations and nomination of directors. The Nominating and Governance Committee met four times in 2013.

The Nominating and Governance Committee will consider nominees recommended by member retailers, and its process for doing so is no different than its process for screening and evaluating candidates suggested by directors or management of the Company.

The procedures for election of directors to Ace's Board of Directors are set forth in the By-laws. The following describes the process of nominating board members from a practical perspective in layman's terms. It is, however, qualified in its entirety by reference to the By-laws.

The Nominating and Governance Committee maintains a list of candidates who have expressed interest, who have been recommended or who are believed to have the potential to bring a fresh perspective to the Board. When a Board member is near to completing his or her term, it is customary for the Board to endorse a candidate to fill the seat in the next term. Endorsements are generally made at least four months – often nine months in the case of continuing directors – prior to the annual meeting. Endorsements of continuing directors and new directors are made by the full Board, after receiving a recommendation from the Nominating and Governance Committee.

Qualifications considered when evaluating potential candidates include their understanding of, and perceived likelihood of contributing to, the Ace enterprise at the Board level. Board members must be forward-thinking, innovative, articulate and financially astute. They must be able to think strategically versus tactically on a wide variety of issues. Participation in retailer groups, advisory groups, industry groups, etc., is desirable. A solid credit relationship, consistent with the "prompt payment" standards to which

existing directors are held, is critical. Education and other outside experiences are also considered. Ultimately, a candidate must be seen as able to perform his or her financial and other oversight responsibilities and to engage in the formulation of the Company's strategic direction. Above all, candidates must have the ability to place the greater good of the organization and its members generally over the needs or desire of any individual or special group. Because Board members are eligible to serve three terms, election to the Board is generally viewed as involving a nine year commitment. Being a member of the Board requires a great deal of effort and time to prepare for and attend meetings, Ace conventions and other events and otherwise to fulfill one's responsibilities.

It is also possible for an Ace retailer to nominate himself or herself or another eligible person for election to the Board by giving written notice to the Secretary of the Company no less than 150 days before the annual meeting, in accordance with the specific requirements of the By-laws, and then nominating that individual at the annual meeting. Such a nominee would, in effect, run against the Board-endorsed candidate(s).

The table below provides membership information for each of the Board committees:

Name	Audit	Compensation and Human Resources	Finance	Retail Supply Chain	Nominating and Governance
David S. Ziegler		X	X		X
James W. Ackroyd	X				
Stewart C. Elliott Jr.	X		X		X
Jeffrey C. Girard	Chair		X		X
James T. Hatcher, III		Chair		X	
Amy E. Kaplanis		X			
David F. Karsten	X		Chair		X
Gina M. Schaefer		X		Chair	
Todd S. Steadman	X		X		Chair
Brett G. Stephenson		X		X	

How to Communicate with the Board of Directors

Any Ace stockholder that wishes to communicate with the Board of Directors may do so by sending a written communication addressed to the Board or to any director in care of Ace Hardware Corporation, 2200 Kensington Court, Oak Brook, IL 60523, Attention: Chairman. Stockholders also may contact a director directly by written communication, telephone or e-mail. Store contact information, telephone number and e-mail address for each director may be found on ACENET. Any communication addressed to a director received at Ace's corporate headquarters will be forwarded to such director as soon as practicable. Ace's practice is to forward all communications received from holders of its capital stock that are addressed simply to the Board of Directors to the chairman of the committee of the Board whose purpose and function is most closely related to the subject matter of the communication.

Senior Management

The Company's executive officers are identified below. Ages are as of March 1, 2014.

Name	Age	Position
John S. Venhuizen	43	President and Chief Executive Officer
Lori L. Bossmann	53	Executive Vice President, Supply Chain and Retail Support
William M. Guzik	54	Executive Vice President, Chief Financial Officer and Chief Risk Officer
John J. Surane	45	Executive Vice President, Merchandising, Advertising, Marketing, and Paint
Jimmy Alexander	57	Senior Vice President, Human Resources, Organizational Development and Ace Foundation
Kane C. Calamari	48	Vice President, Retail Operations and New Business
Howard E. Japlon	61	Vice President, General Counsel and Secretary
Peter M. Ting	42	Vice President, Treasury and International Finance
Rick Whitson	60	Vice President, Distribution

John S. Venhuizen was named President and Chief Executive Officer in April 2013. He was the President and Chief Operating Officer from September 2012 to March 2013. From January 2012 to September 2012 he was the Chief Operating Officer. From January 2011 to December 2011 he was Executive Vice President, International, Supply Chain, Distribution and Information Technology. From January 2010 to December 2010, he was Vice President, Business Development, International and Retail Training. From September 2006 to December 2009, he was Vice President, Business Development.

Lori L. Bossmann was named Executive Vice President, Supply Chain and Retail Support in January 2014. From January 2011 to December 2013, she was Senior Vice President, Supply Chain and Retail Support. From January 2010 to December 2010, she was Vice President, Supply Chain and Retail Support. From February 2009 to December 2010, she was Vice President, Supply Chain Planning.

William M. Guzik was named Executive Vice President, Chief Financial Officer and Chief Risk Officer in January 2014. From July 2012, when he joined Ace, to December 2013 he was Senior Vice President, Chief Financial Officer. From December 1999 to April 2012, he was the Executive Vice President and Chief Financial Officer of Midas International Corporation.

John J. Surane was named Executive Vice President, Merchandising, Advertising, Marketing and Paint in January 2014. From January 2011 to December 2013, he was Senior Vice President, Merchandising, Advertising, Marketing and Paint. From January 2010 to December 2010, he was Vice President, Merchandising, Marketing, Advertising and Paint. He was Vice President, Merchandising, Marketing and Advertising from March 2009 to December 2009.

Jimmy Alexander was named Senior Vice President, Human Resources, Organizational Development and Ace Foundation in January 2011. From January 2010 to December 2010, he was Vice President, Human Resources and Communications. He was Vice President, Human Resources, Communications and Retail Training from June 2007 to December 2009.

Kane C. Calamari was named Vice President, Retail Operations and New Business in January 2010. He was Vice President of Retail Operations from May 2008 to December 2009.

Howard E Japlon assumed the role of Vice President General Counsel and Secretary in June 2013 when he joined Ace. From April 2011 to January 2013 he was Vice President, General Counsel for RG Steel, LLC, located in Baltimore, MD. Prior to that, he was Senior Vice President, General Counsel and Secretary Americas of Schneider Electric S.A., located in Palatine, IL.

Peter M. Ting was named Vice President, Treasury and International Finance in September 2011. From February 2010 to August 2011, he was Vice President, International Finance of Ace's international division.

Rick A. Whitson was named Vice President, Distribution in January 2011. From December 2008 to December 2010, he was Vice President, Retail Support.

FINANCIAL INFORMATION

Report of Independent Auditors

The Board of Directors
Ace Hardware Corporation

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Ace Hardware Corporation, which comprise the consolidated balance sheets as of December 28, 2013 and December 29, 2012, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the three years in the period ended December 28, 2013, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

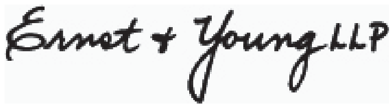
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 28, 2013 and December 29, 2012, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 28, 2013, in conformity with U.S. generally accepted accounting principles.



Chicago, Illinois
February 18, 2014

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

	December 28, 2013	December 29, 2012
Assets		
Cash and cash equivalents	$ 17.9	$ 13.1
Marketable securities	53.8	54.1
Receivables, net of allowance for doubtful accounts of $9.3 and $7.2, respectively	335.9	296.7
Inventories	505.5	557.7
Prepaid expenses and other current assets	41.8	45.2
Total current assets	954.9	966.8
Property and equipment, net	324.7	320.0
Notes receivable, net of allowance for doubtful accounts of $11.4 and $13.9, respectively	21.2	32.4
Goodwill and other intangible assets	24.1	24.2
Other assets	63.6	69.6
Total assets	$ 1,388.5	$ 1,413.0
Liabilities and Equity		
Current maturities of long-term debt	$ 23.4	$ 49.5
Accounts payable	491.7	505.5
Patronage distributions payable in cash	39.9	30.0
Accrued expenses	165.9	144.8
Total current liabilities	720.9	729.8
Long-term debt	178.6	240.7
Patronage refund certificates payable	28.4	22.6
Other long-term liabilities	66.3	64.8
Total liabilities	994.2	1,057.9
Member Retailers' Equity:		
Class A voting common stock, $1,000 par value, 10,000 shares authorized, 2,764 and 2,736 issued and outstanding, respectively	2.8	2.7
Class C nonvoting common stock, $100 par value, 4,000,000 shares authorized, 3,156,908 and 3,008,903 issued and outstanding, respectively	315.7	300.9
Class C nonvoting common stock, $100 par value, issuable to retailers for patronage distributions, 408,684 and 257,613 shares issuable, respectively	40.9	25.7
Contributed capital	20.0	19.7
Retained earnings (accumulated deficit)	6.3	(0.1)
Accumulated other comprehensive income (loss)	0.3	(1.2)
Equity attributable to Ace member retailers	386.0	347.7
Equity attributable to noncontrolling interests	8.3	7.4
Total equity	394.3	355.1
Total liabilities and equity	$ 1,388.5	$ 1,413.0

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(In millions)

	Years Ended		
	December 28, 2013 (52 Weeks)	December 29, 2012 (52 Weeks)	December 31, 2011 (52 Weeks)
Revenues:			
Wholesale revenues	$ 3,928.6	$ 3,832.9	$ 3,709.2
Retail revenues	225.6	8.0	-
Total revenues	4,154.2	3,840.9	3,709.2
Cost of revenues:			
Wholesale cost of revenues	3,450.2	3,367.0	3,261.9
Retail cost of revenues	127.1	4.8	-
Total cost of revenues	3,577.3	3,371.8	3,261.9
Gross profit:			
Wholesale gross profit	478.4	465.9	447.3
Retail gross profit	98.5	3.2	-
Total gross profit	576.9	469.1	447.3
Distribution operations expenses	100.0	98.1	95.2
Selling, general and administrative expenses	142.3	138.1	135.8
Retailer success and development expenses	124.3	117.6	111.5
Retail operating expenses	90.6	3.3	-
Retail support center closure costs	6.2	-	-
Gain on sale of paint assets, net of acquisition and disposition costs	-	(7.0)	-
Total operating expenses	463.4	350.1	342.5
Operating income	113.5	119.0	104.8
Interest expense	(14.1)	(23.9)	(36.4)
Loss on early extinguishment of debt	-	(19.9)	(0.1)
Interest income	3.9	4.2	5.1
Other income, net	6.3	6.3	7.6
Income tax expense	(4.5)	(3.5)	(3.1)
Net income	105.1	82.2	77.9
Less: net income attributable to noncontrolling interests	0.6	0.4	0.2
Net income attributable to Ace Hardware Corporation	$ 104.5	$ 81.8	$ 77.7
Accrued patronage distributions	$ 100.7	$ 75.5	$ 74.5
Accrued patronage distributions to third party retailers	$ 98.2	$ 75.5	$ 74.5

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In millions)

	Years Ended		
	December 28, 2013 (52 Weeks)	December 29, 2012 (52 Weeks)	December 31, 2011 (52 Weeks)
Net income	$ 105.1	$ 82.2	$ 77.9
Other comprehensive income (loss), net of tax:			
Foreign currency translation	(0.1)	(0.1)	-
Unrecognized postretirement cost	0.1	-	0.1
Unrealized gain (loss) on investments	-	1.5	(1.0)
Unrealized gain (loss) on derivative financial instrument	1.5	(2.6)	-
Total other comprehensive income (loss), net	1.5	(1.2)	(0.9)
Comprehensive income	106.6	81.0	77.0
Less: Comprehensive income attributable to noncontrolling interest	0.6	0.4	0.2
Comprehensive income attributable to Ace Hardware Corporation	$ 106.0	$ 80.6	$ 76.8

See accompanying notes to the consolidated financial statements.

ACE HARDWARE CORPORATION
CONSOLIDATED STATEMENTS OF EQUITY
(In millions)

	Shareholders of Ace Hardware Corporation								
	Capital Stock								
	Class A	Class C	Class C Stock Issuable to Retailers for Patronage Dividends	Additional Stock Subscribed	Contributed Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Total Equity
Balances at January 1, 2011	$ 2.9	$ 305.9	$ 22.4	$ 0.4	$ 7.0	$ (11.1)	$ 0.9	$ -	$ 328.4
Net income	-	-	-	-	-	77.7	-	0.2	77.9
Other comprehensive loss	-	-	-	-	-	-	(0.9)	-	(0.9)
Net payments on subscriptions	-	-	-	0.8	-	-	-	-	0.8
Stock issued	0.1	23.9	(22.4)	(1.2)	-	-	-	-	0.4
Sale of noncontrolling interests	(0.1)	(13.1)	-	-	13.9	-	-	7.6	8.3
Stock repurchased	(0.1)	(18.4)	-	-	-	-	-	-	(18.5)
Patronage distributions issuable	-	-	24.7	-	-	-	-	-	24.7
Patronage distributions payable	-	-	-	-	-	(73.7)	-	-	(73.7)
Other	-	-	-	-	-	0.4	-	-	0.4
Balances at December 31, 2011	$ 2.8	$ 298.3	$ 24.7	$ -	$ 20.9	$ (6.7)	$ -	$ 7.8	$ 347.8
Net income	-	-	-	-	-	81.8	-	0.4	82.2
Other comprehensive loss	-	-	-	-	-	-	(1.2)	-	(1.2)
Net payments on subscriptions	-	-	-	0.9	-	-	-	-	0.9
Stock issued	0.1	24.2	(24.7)	(0.9)	-	-	-	-	(1.3)
Sale of noncontrolling interests	-	-	-	-	0.3	-	-	-	0.3
Stock repurchased	(0.2)	(21.6)	-	-	(1.6)	-	-	(0.8)	(24.2)
Patronage distributions issuable	-	-	25.7	-	-	-	-	-	25.7
Patronage distributions payable	-	-	-	-	-	(75.3)	-	-	(75.3)
Other	-	-	-	-	0.1	0.1	-	-	0.2
Balances at December 29, 2012	$ 2.7	$ 300.9	$ 25.7	$ -	$ 19.7	$ (0.1)	$ (1.2)	$ 7.4	$ 355.1
Net income	-	-	-	-	-	104.5	-	0.6	105.1
Other comprehensive income	-	-	-	-	-	-	1.5	-	1.5
Net payments on subscriptions	-	-	-	0.9	-	-	-	-	0.9
Stock issued	0.1	26.0	(25.7)	(0.9)	0.1	-	-	-	(0.4)
Sale of noncontrolling interests	-	-	-	-	(0.3)	-	-	0.3	-
Stock repurchased	-	(11.2)	-	-	-	-	-	-	(11.2)
Patronage distributions issuable	-	-	40.9	-	-	-	-	-	40.9
Patronage distributions payable	-	-	-	-	-	(98.1)	-	-	(98.1)
Other	-	-	-	-	0.5	-	-	-	0.5
Balances at December 28, 2013	$ 2.8	$ 315.7	$ 40.9	$ -	$ 20.0	$ 6.3	$ 0.3	$ 8.3	$ 394.3

See accompanying notes to the consolidated financial statements.

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

	Years Ended		
	December 28, 2013 (52 Weeks)	**December 29, 2012 (52 Weeks)**	**December 31, 2011 (52 Weeks)**
Operating Activities			
Net income	$ 105.1	$ 82.2	$ 77.9
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	45.6	40.1	38.7
Amortization of deferred gain on sale leaseback	(1.1)	(1.2)	(1.2)
Amortization of deferred financing costs	1.2	1.9	2.8
Loss (gain) on disposal of assets, net	-	0.4	(1.6)
Provision for doubtful accounts	3.4	2.6	4.5
Loss on early extinguishment of debt	-	19.9	0.1
Gain on sale of paint assets, net of acquisition and disposition costs	-	(7.0)	-
Retail support center closure costs	6.2	-	-
Other, net	0.5	0.2	0.1
Changes in operating assets and liabilities, exclusive of effect of acquisitions and dispositions:			
Receivables	(53.6)	(7.8)	(35.8)
Inventories	52.2	24.9	(24.5)
Other current assets	6.2	(4.4)	7.6
Other long-term assets	(1.1)	(9.9)	(11.2)
Accounts payable and accrued expenses	2.0	30.7	36.7
Other long-term liabilities	(0.5)	1.2	2.7
Deferred taxes	1.9	2.9	(0.4)
Net cash provided by operating activities	168.0	176.7	96.4
Investing Activities			
Purchases of marketable securities	(27.1)	(12.0)	(41.5)
Proceeds from sale of marketable securities	27.6	11.0	40.4
Purchases of property and equipment	(45.0)	(46.4)	(25.6)
Cash paid for acquired business, net of cash acquired	-	(52.0)	-
Proceeds from sale of paint manufacturing assets	-	34.8	-
Decrease in notes receivable, net	2.9	1.8	0.4
Other	0.2	0.2	0.1
Net cash used in investing activities	(41.4)	(62.6)	(26.2)
Financing Activities			
Net (payments) borrowings under revolving lines of credit	(78.6)	43.6	(22.5)
Proceeds from issuance of long-term debt	-	200.0	-
Redemption of senior notes	-	(301.3)	-
Principal payments on long-term debt	(16.3)	(9.5)	(6.5)
Payments of deferred financing costs	(0.7)	(5.2)	-
Payments of cash portion of patronage distribution	(27.1)	(27.7)	(26.4)
Payments of patronage refund certificates	(0.1)	(17.4)	(17.9)
Proceeds from sale of noncontrolling interests	0.1	0.3	8.7
Other	0.9	0.4	0.8
Net cash used in financing activities	(121.8)	(116.8)	(63.8)
Increase (decrease) in cash and cash equivalents	4.8	(2.7)	6.4
Cash and cash equivalents at beginning of period	13.1	15.8	9.4
Cash and cash equivalents at end of period	$ 17.9	$ 13.1	$ 15.8
Supplemental disclosure of cash flow information:			
Interest paid	$ 11.3	$ 22.5	$ 34.1
Income taxes paid	$ 1.4	$ 1.0	$ 0.7

See accompanying notes to the consolidated financial statements

1) Summary of Significant Accounting Policies

The Company and Its Business

Ace Hardware Corporation ("the Company") is a wholesaler of hardware, paint and other related products. The Company also provides to its retail members value-added services such as advertising, marketing, merchandising and store location and design services. The Company's goods and services are sold predominately within the United States, primarily to retailers that operate hardware stores and with whom the Company has a retail membership agreement. As a retailer-owned cooperative, the Company distributes substantially all of its patronage sourced income in the form of patronage distributions to member retailers based on their volume of merchandise purchases. See Note 7, Patronage Distributions and Refund Certificates Payable, for further discussion regarding patronage distributions.

Effective December 16, 2012, Ace Retail Holdings LLC ("ARH," a newly-formed subsidiary of the Company) acquired all of the outstanding shares of capital stock of WHI Holding Corp. ("WHI"), the indirect owner of the 85 store Westlake Ace Hardware retail chain. The acquisition results in the consolidation of WHI's financial statements into Ace's financial statements for 2013. This affects the comparability of the 2013 and 2012 financial statements and results in a reduction of reported wholesale revenues, as wholesale revenues from Ace to WHI are now eliminated. These eliminations totaled $83.7 million and $2.2 million in wholesale revenues for the years ended December 28, 2013 and December 29, 2012, respectively. As a result of the acquisition of its largest Ace-branded customer, the Company is now also a retailer of hardware, paint and other related products. For more information on this acquisition, see Note 2.

Until December 2012, the Company was also in the paint manufacturing business. In December 2012, the Company sold all of its paint manufacturing assets, including two manufacturing facilities located near Chicago, to The Valspar Corporation ("Valspar"). As a result, the Company is no longer engaged in the business of manufacturing paint. For more information on the sale, see Note 2.

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 entity Ace Hardware International Holdings, Ltd. ("AHI") 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 31. Accordingly, fiscal years 2013, 2012 and 2011 ended on December 28, 2013, December 29, 2012 and December 31, 2011, respectively, and consisted of 52 weeks each.

Subsequent events have been evaluated through February 18, 2014, 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.

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 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 (loss). Realized gains and losses on securities are determined using the specific identification method.

In the normal course of NAIL's operations, letters of credit of $31.2 million and $29.3 million at December 28, 2013 and December 29, 2012, respectively, were issued in favor of the insurance companies that reinsure a portion of NAIL's loss exposure. At December 28, 2013, NAIL has pledged substantially all of its cash and cash equivalents and marketable securities as collateral for these letters of credit.

Revenue Recognition

The Company recognizes wholesale 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 wholesale 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 wholesale revenues. Revenues at retail locations operated by the Company are recognized when the customer takes ownership of the products sold and assumes ownership and the risk of loss. Provisions for sales returns are provided at the time the related sales are recorded.

Receivables

Receivables from retailers include amounts invoiced for the sale of merchandise, 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

Wholesale 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.

Inventories at retail locations operated by the Company are valued at the lower of cost or net realizable value. Inventory cost is determined using the moving average method, which approximates the first-in, first-out ("FIFO") method.

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 that should be 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. At year end, the accrual reflects actual purchases made throughout the year.

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, in which case the costs would be netted. 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.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the aggregate purchase price over the fair value of the net assets acquired in a business combination. The Company reviews its goodwill at least annually in the fourth quarter or when conditions indicate that the fair value of the acquired business is more likely than not below its carrying value. No impairment charges were recorded for any periods presented.

The Company's other intangible assets primarily relate to the Westlake Ace Hardware trade name acquired in the WHI acquisition. The trade name is amortized over its 20 year useful life. For additional information, see Note 2.

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 2013, 2012 and 2011, the Company capitalized $3.7 million, $1.6 million and $0.9 million, respectively, of software development costs related to internal programming time. Amortization of these previously capitalized amounts was $1.5 million, $1.4 million and $1.1 million for 2013, 2012 and 2011, respectively. As of December 28, 2013 and December 29, 2012, the Company had $3.0 million and $0.7 million, respectively, of capitalized costs for internal-use software that had not been placed into service.

Leases

The Company leases certain warehouse and distribution space, office space, retail locations, equipment and vehicles. All 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 $108.6 million, $103.8 million and $98.6 million in 2013, 2012 and 2011, 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. See Note 15 for detail on the withdrawal from this plan in future years.

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, which 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.

Impact of New Accounting Standards

New Accounting Pronouncements - Issued

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2013-02, "Comprehensive Income (Topic 220), Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income," ("ASU 2013-02"). ASU 2013-02 requires the Company to report, in one place, information about reclassifications out of accumulated other comprehensive income (AOCI). The Company is also required to present reclassifications by component when reporting changes in AOCI balances. For significant items reclassified out of AOCI to net income in their entirety in the period, the Company must report the effect of the reclassifications on the respective line items in the statement when net income is presented. ASU 2013-02 is effective for the Company for fiscal years and interim periods beginning after December 15, 2013. The Company does not expect that ASU 2013-02 will have a material impact on the Company's consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-11, "Income Taxes (Topic 740), Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists," ("ASU 2013-11"). ASU 2013-11 requires the Company to present in the financial statements an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward

except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statement as a liability and should not be combined with deferred tax assets. ASU 2013-11 is effective for the Company for fiscal years and interim periods beginning after December 15, 2014 with early adoption permitted. The Company does not expect that ASU 2013-11 will have a material impact on the Company's consolidated financial statements.

(2) Acquisition and Dispositions

Effective December 16, 2012, ARH acquired all of the outstanding shares of capital stock of WHI. WHI owns all outstanding shares of Westlake Hardware, Inc. ("Westlake"). Westlake is based in Kansas City, Missouri and operates 85 neighborhood hardware stores located throughout the Midwest under the name Westlake Ace Hardware. The total purchase price of approximately $90.0 million consisted of approximately $55.0 million paid in cash at closing and the assumption of approximately $35.0 million of bank debt owed by Westlake. By securing the Company's largest customer, the Company has preserved the Ace brand in these markets and believes that ARH is a vehicle for growth and profit. The Company incurred transaction costs of $1.9 million which were included in Gain on sale of paint assets, net of acquisition and disposition costs in the Consolidated Statement of Income.

As a result of this acquisition the Company recorded $15.9 million of goodwill and $7.6 million for an intangible trade name. Goodwill has an indefinite life and, therefore, is not amortized. The intangible trade name will be amortized over its 20 year estimated useful life. The goodwill and intangible trade name are not expected to be deductible for tax purposes. During 2013, the Company recognized $0.4 million of amortization related to the trade name, which had a remaining balance of $7.2 million as of December 28, 2013.

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

Cash paid	$ 55.0
Fair value of assets acquired and liabilities assumed:	
Cash	$ 3.0
Receivables	8.8
Inventories	68.8
Other current assets	3.3
PP&E	20.0
Goodwill	15.9
Trade name	7.6
Other long-term assets	12.7
Current liabilities	(33.0)
Long-term liabilities	(17.1)
Bank debt assumed	(35.0)
	$ 55.0

On December 28, 2012, the Company sold its paint manufacturing assets, including two manufacturing facilities located near Chicago, to Valspar in exchange for consideration of approximately $45.0 million. As a result of the sale the Company recorded a gain of $8.9 million. The gain was included in Gain on sale of paint assets, net of acquisition and disposition costs in the Consolidated Statement of Income and was net of transactions costs of $1.8 million. In addition to the asset sale, the Company and Valspar announced a long-term strategic supply relationship where Valspar will manufacture and supply Ace-branded paint products as well as make a comprehensive line of Valspar-branded paints available to the Company's retail locations.

(3) Receivables, net

Receivables, net include the following amounts:

	December 28, 2013	December 29, 2012
Trade	$ 277.8	$ 238.9
Other	55.8	54.9
Notes receivable – current portion	11.6	10.1
Less: allowance for doubtful accounts	(9.3)	(7.2)
Receivables, net	$ 335.9	$ 296.7

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

(4) Inventories

Inventories consist of wholesale merchandise inventories held for sale to retailers and retail merchandise inventory held for resale at company-operated retail locations. Substantially, all of the Company's wholesale inventories are valued on the LIFO method. The excess of replacement cost over the LIFO value of inventory was $96.3 million and $99.0 million at December 28, 2013 and December 29, 2012, respectively.

Inventories consisted of:

	December 28, 2013	December 29, 2012
Wholesale merchandise inventory (LIFO)	$ 439.2	$ 490.9
Retail merchandise inventory at Company-operated stores (FIFO)	66.3	66.8
Inventories	$ 505.5	$ 557.7

(5) Property and Equipment, net

Property and equipment, net is summarized as follows:

	December 28, 2013	December 29, 2012
Land	$ 15.9	$ 16.1
Buildings and improvements	263.8	261.2
Warehouse equipment	122.4	119.9
Office equipment	203.0	185.0
Transportation equipment	45.3	45.7
Leasehold improvements	29.7	24.9
Construction in progress	23.1	11.0
Property and equipment, gross	703.2	663.8
Less: accumulated depreciation and amortization	(378.5)	(343.8)
Property and equipment, net	$ 324.7	$ 320.0

Depreciation and amortization expense for fiscal years 2013, 2012 and 2011 was $44.7 million, $40.1 million and $38.7 million, respectively.

(6) Notes Receivable, net

The Company makes available to its retailers various lending programs whose terms exceed one year. At December 28, 2013 and December 29, 2012, the outstanding balance of the notes was $44.2 million and $56.4 million, respectively, of which the current portion of $11.6 million and $10.1 million, respectively, was recorded in Receivables, net. Payments on these notes are primarily collected by the Company through the application of future patronage distributions, retailer billings or stock repurchases.

At December 28, 2013 and December 29, 2012, $27.1 million and $33.2 million, 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. These loans are repaid by the application of the non-cash portion of the annual patronage distribution. As a result, the company reduces the Note receivable balance in the Consolidated Balance Sheets by the amount of the non-cash portion of the annual patronage distribution that it expects to apply against outstanding EMF loans. Notes receivable consist of the following components:

	December 28, 2013	December 29, 2012
Notes receivable, gross	$ 54.1	$ 65.3
Less: estimated patronage applications	(9.9)	(8.9)
Net	44.2	56.4
Less: current portion	(11.6)	(10.1)
Less: allowance for doubtful accounts	(11.4)	(13.9)
Notes receivable, net	$ 21.2	$ 32.4

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:

	December 28, 2013
0 – 4 years	$ 16.3
5 – 8 years	34.5
9 – 12 years	3.3
Total	$ 54.1

Pursuant to the Company's Amended and Restated Certificate of Incorporation and the Company's by-laws, notes receivable (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.

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.

Based upon these criteria, the Company has classified its loan portfolio as follows:

	December 28, 2013	December 29, 2012
Corporate Credit Exposure:		
Low risk	$ 31.7	$ 41.1
Moderate risk	9.6	8.4
High risk	12.8	15.8
Total	$ 54.1	$ 65.3

The Company applies a consistent practice of establishing an allowance for notes that it feels may become uncollectible by monitoring the financial strength of its retailers. The collectability of certain notes is evaluated on an individual basis while the remaining notes are evaluated on a collective basis. The breakdown at December 28, 2013 and December 29, 2012 of notes evaluated individually versus notes evaluated collectively was as follows:

	December 28, 2013	December 29, 2012
Notes receivable:		
Ending balance individually evaluated for impairment	$ 9.2	$ 11.9
Ending balance collectively evaluated for impairment	44.9	53.4
Ending principal balance	$ 54.1	$ 65.3

The Company has evaluated the collectability of the notes and has established an allowance for doubtful accounts of $11.4 million and $13.9 million at December 28, 2013 and December 29, 2012, respectively. Management records the allowance for doubtful accounts based on the above information as well as 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 components of changes to the notes receivable allowance for doubtful accounts for 2013 and 2012 were as follows:

	December 28, 2013	December 29, 2012
Allowance for doubtful accounts:		
Beginning balance	$ 13.9	$ 12.1
Charge offs	(2.9)	-
Provision	0.4	1.1
Reclassifications to accounts receivable allowance for doubtful accounts	(0.5)	(1.0)
Reclassifications from accounts receivable allowance for doubtful accounts	0.5	1.3
Other	-	0.4
Ending balance	$ 11.4	$ 13.9

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 2013, 2012 and 2011, $2.3 million, $2.4 million and $2.5 million respectively, were recorded as interest income related to the notes.

Generally, 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 and the retailer is billed for any unpaid principal and interest balances. In 2013 and 2012, $3.7 million and $7.1 million, respectively, 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, $0.5 million and $1.0 million of the notes receivable allowance for doubtful accounts for December 28, 2013 and December 29, 2012, respectively, was transferred to the accounts receivable allowance for doubtful accounts to properly match the reserve against the asset on the Consolidated Balance Sheet.

(7) 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. The cash portion of the patronage distribution was 40% for all years presented.

The patronage distribution composition is summarized as follows:

	Years Ended		
	December 28, 2013	December 29, 2012	December 31, 2011
Cash portion	$ 39.9	$ 30.0	$ 30.4
Class C stock	40.9	25.7	24.7
Patronage refund certificates	5.9	7.2	9.1
Patronage financing deductions	11.4	10.6	9.5
Patronage distributions applied to variance allocation	0.1	0.2	0.8
Patronage due to subsidiary	-	1.8	-
Total patronage distributions to third party retailers	$ 98.2	$ 75.5	$ 74.5

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

In 2010, 2011 and 2012, 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 2013 patronage distribution.

The patronage refund certificates outstanding at December 28, 2013 are payable as follows:

	Amount	Interest Rate
2016	$ 6.6	4.00%
2017	8.8	4.00%
2018	7.1	4.00%
2019	5.9	4.00%

(8) Debt

On July 29, 2013, the Company amended its secured credit facility with a group of banks. The amendment extended the maturity date to July 27, 2018 and lowered the interest rate credit spread by 25 basis points. The amended credit facility consists of a $187.5 million amortizing term loan and a $400.0 million revolving credit facility. The facility is expandable to $737.5 million via a $150.0 million accordion that is exercisable without the consent of existing lenders provided that the Company is not in default of the credit agreement and further provided that none of the existing lenders are required to provide any portion of the increased facility. Borrowings under this amended facility bear interest at a rate of either the prime rate plus an applicable spread of 50 basis points to 150 basis points or 150 to 250 basis points over the London Interbank Offered Rate ("LIBOR") depending on the Company's leverage ratio as defined under the agreement. The facility was priced at LIBOR plus 175 basis points at December 28, 2013. This facility requires maintenance of certain financial covenants including a maximum allowable average leverage ratio, a minimum fixed charge coverage ratio and a minimum asset coverage ratio. As of December 28, 2013, the Company was in compliance with its covenants and a total of $187.5 million was outstanding under the credit facility.

The amended term loan requires the Company to make principal repayments of $2.5 million per quarter through September 2014 and $5.0 million per quarter thereafter through March 2017, with no required principal repayments in the final year. Any remaining principal balance will be repaid at the maturity of the amended agreement on July 27, 2018.

The revolving credit facility includes a $175.0 million sublimit for the issuance of standby and commercial letters of credit. As of December 28, 2013, a total of $21.7 million in letters of credit were outstanding. The revolving credit facility also requires the Company to pay fees based on the unused portion of the line of credit at a rate of 15 to 35 basis points per annum depending on the Company's leverage ratio.

The credit facility allows the Company to make revolving loans and other extensions of credit to AHI in an aggregate principal amount not to exceed $75.0 million at any time. As of December 28, 2013, there were no loans or other extensions of credit provided to AHI.

In order to reduce the risk of interest rate volatility, the Company entered into an interest rate swap derivative agreement in June 2012, which expires on March 13, 2017. This swap agreement fixes the LIBOR rate on the full balance of the term loan at 1.13%, resulting in an effective rate of 2.88% after adding the 1.75% margin based on the current pricing tier per the credit agreement. The notional amount of the derivative agreement will decrease to match the principal balance remaining as principal payments are made throughout the term of the loan agreement. The swap arrangement has been designated as a cash flow hedge and has been evaluated to be highly effective. As a result, the after-tax change in the fair value of the swap is recorded in Accumulated other comprehensive income (loss) as a gain or loss on derivative financial instruments. See Note 11 for more information.

As part of the WHI acquisition, the Company assumed a $60.0 million asset-based revolving credit facility with an outstanding balance of $35.0 million on December 16, 2012 (the "ARH Facility"). The ARH Facility matures on December 16, 2017 and is expandable to $85.0 million under certain conditions. In addition, the Company has the right to issue letters of credit up to a maximum of $7.5 million. At the Company's discretion, borrowings under this facility bear interest at a rate of either the prime rate plus an applicable spread of 75 basis points to 100 basis points or LIBOR plus an applicable spread of 175 basis points to 200 basis points, depending on the Company's availability under the ARH Facility and measured on a quarterly basis.

The ARH Facility is collateralized by substantially all of ARH's personal property and intangible assets. Borrowings under the facility are subject to a borrowing base calculation consisting of certain advance rates applied to eligible collateral balances (primarily consisting of certain receivables and inventories). This agreement requires maintenance of certain financial covenants including a minimum fixed charge coverage ratio. As of December 28, 2013, ARH was in compliance with its covenants, there were no loans outstanding under the ARH Facility and there were outstanding letters of credit of $2.0 million.

The ARH Facility requirements include a lender-controlled cash concentration system that results in all of ARH's daily available cash being applied to the outstanding borrowings under this facility. Pursuant to FASB Accounting Standards Codification Section 470-10-45, "Classification of Revolving Credit Agreements Subject to Lock-Box Arrangements and Subjective Acceleration Clauses," the borrowings under the ARH Facility have been classified as a Current maturity of long-term debt as of December 28, 2013.

Long-term debt is comprised of the following:

	December 28, 2013	December 29, 2012
Term Loan Facility, installments of $2.5 million quarterly through September 2014 and $5.0 million thereafter through March 2017, with no additional installments through maturity on July 27, 2018, bearing interest at the prime rate plus an applicable spread and/or LIBOR plus an applicable spread	$ 187.5	$ 197.5
$400.0 million Revolving Credit Facility maturing on July 27, 2018 and bearing interest at the prime rate plus an applicable spread and/or LIBOR plus an applicable spread	-	45.0
$60.0 million Asset-Based Revolving Credit Facility maturing on December 16, 2017 and bearing interest at the prime rate plus an applicable spread and/or LIBOR plus an applicable spread	-	33.6
Installment notes with maturities through 2017 at a fixed rate of 6.00%	14.5	14.1
Total debt	202.0	290.2
Less: maturities within one year	(23.4)	(49.5)
Long-term debt	$ 178.6	$ 240.7

The aggregate scheduled maturities of long-term debt at December 28, 2013 are as follows:

Fiscal Year	Amount
2014	$ 23.4
2015	24.5
2016	22.8
2017	6.3
2018	125.0
Total debt	$ 202.0

(9) 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 $0.1 million in fiscal years 2013, 2012 and 2011.

The Company participates in one multi-employer plan covering union employees. Amounts expensed for this plan totaled $0.2 million in fiscal years 2013, 2012 and 2011, respectively. See Note 15 for detail on the withdrawal from this plan in future years.

The Company also maintains a profit sharing and 401k retirement plan for substantially all employees. Amounts expensed under these plans totaled $17.2 million, $17.1 million and $16.5 million during fiscal 2013, 2012 and 2011, respectively.

(10) Accrued Expenses

Accrued expenses include the following components:

	December 28, 2013	December 29, 2012
Salaries and wages	$ 47.0	$ 43.7
Insurance reserves	15.9	15.8
Deferred income	14.0	6.3
Vendor funds	13.4	14.9
Taxes	10.3	14.6
Profit sharing	8.6	8.6
Interest	1.3	1.2
Other	55.4	39.7
Accrued Expenses	$ 165.9	$ 144.8

(11) 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 financial assets, liabilities and derivative instruments that were accounted for at fair value as of December 28, 2013 and December 29, 2012. 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 28, 2013	Level 1	Level 2	Level 3
Assets:				
Cash equivalents:				
Money market funds	$ 1.7	$ 1.7	$ -	$ -
Marketable securities:				
Corporate fixed income securities	13.1	-	13.1	-
Equity securities	24.7	24.7	-	-
Mortgage-backed securities	8.1	-	8.1	-
U.S. government notes	6.9	6.9	-	-
Other	1.0	-	1.0	-
Total marketable securities	$ 53.8	$ 31.6	$ 22.2	$ -
Other long-term liabilities:				
Interest rate swap derivative	$ 1.8	$ -	$ 1.8	$ -

Items measured at fair value on a recurring basis	Carrying Value Measured at Fair Value December 29, 2012	Level 1	Level 2	Level 3
Assets:				
Cash equivalents:				
Money market funds	$ 1.0	$ 1.0	$ -	$ -
Marketable securities:				
Corporate fixed income securities	11.2	-	11.2	-
Equity securities	22.5	22.5	-	-
Mortgage-backed securities	9.1	-	9.1	-
U.S. government notes	10.3	10.3	-	-
Other	1.0	-	1.0	-
Total marketable securities	$ 54.1	$ 32.8	$ 21.3	$ -
Other long-term liabilities:				
Interest rate swap derivative	$ 4.3	$ -	$ 4.3	$ -

Money market funds, Equity securities and U.S. government notes - 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, are derived from quoted market prices for identical instruments, as active markets for these instruments exist.

Corporate fixed income securities and Mortgage-backed securities - The Company's valuation techniques used to measure the fair values of corporate fixed income securities and mortgage-backed securities, that were classified as Level 2 in the tables above, are derived from the following: non-binding market consensus prices that are corroborated by observable market data, quoted market prices for similar instruments, or pricing models, such as discounted cash flow techniques, with all significant inputs derived from or corroborated by observable market data.

The Company uses variable-rate LIBOR debt to finance its operations. These debt obligations expose the Company to interest rate volatility risk. The Company attempts to minimize this risk and fix a portion of its overall borrowing costs through the utilization of interest rate swap derivatives. Variable cash flows from outstanding debt are converted to fixed-rate cash flows by entering into receive-variable, pay-fixed interest-rate swaps. The Company does not use derivative instruments for trading or speculative purposes, and all derivative instruments are recognized in the Consolidated Balance Sheet at fair value. Hedge ineffectiveness is eliminated by matching all terms of the hedged item and the hedging derivative at inception and on an ongoing basis. The Company does not exclude any terms from consideration when applying the matched terms method.

On June 5, 2012, the Company entered into a 58-month interest rate swap agreement, which expires on March 13, 2017, with an amortizing notional amount of $200.0 million. This instrument is being used to fix the LIBOR rate on the full balance of the term loan amount at 1.13%, resulting in an effective rate of 2.88% after adding the 1.75% margin based on the current pricing tier per the credit agreement — see Note 8 for more information. As of December 28, 2013 the notional amount of the 58-month interest rate swap agreement remaining was $187.5 million, matching the outstanding balance of the term loan.

The fair value of the Company's interest rate swap is estimated using Level 2 inputs, which are based on model-derived valuations in which all significant inputs and significant value drivers are observable in active markets. The Company also considers counterparty credit-risk and bilateral or "own" credit risk adjustments in estimating fair value, in accordance with the requirements of GAAP. As of December 28, 2013 and December 29, 2012, the fair value of the interest rate swap was a liability balance of $1.8 million and $4.3 million, respectively. The Company classifies derivative liabilities as Other long-term liabilities on the Consolidated Balance Sheet.

Because the interest rate swap has been designated as a cash flow hedge and has been evaluated to be highly effective, the change in the fair value is recorded in Accumulated other comprehensive income (loss) ("AOCI") as a gain or loss on derivative financial instruments. The amount in AOCI is reclassified to earnings if the derivative instrument is sold, extinguished or terminated, or at the time it becomes expected to be sold, extinguished or terminated. As of December 28, 2013 and December 29, 2012, the net of tax amount recorded in AOCI for the fair value adjustment of the interest rate swap was an unrealized loss of $1.1 million and $2.6 million, respectively. This unrealized loss is not expected to be reclassified into interest expense within the next 12 months. The impact of any ineffectiveness is recognized in earnings. However, there was no hedge ineffectiveness related to the interest rate swap for the years ended December 28, 2013 and December 29, 2012.

There were no material differences between the fair value and cost basis of the Company's marketable securities at December 28, 2013 and December 29, 2012. Gross proceeds from the sale of marketable securities and the related realized gains and losses for the fiscal years ended December 28, 2013, December 29, 2012, and December 31, 2011 were as follows:

	Years Ended		
	December 28, 2013	December 29, 2012	December 31, 2011
Gross proceeds	$ 27.6	$ 11.0	$ 40.4
Gross realized gains	0.5	0.2	2.1
Gross realized losses	(0.2)	(0.1)	(0.2)

Gross realized gains and losses were determined using the specific identification method.

The following table summarizes the contractual maturity distributions of the Company's debt securities at December 28, 2013. Actual maturities may differ from the contractual or expected maturities since borrowers may have the right to prepay obligations with or without prepayment penalties.

Fair value of available-for-sale debt securities	Due in One Year or Less	Due After One Year through Five Years	Due After Five Years through Ten Years	Due After Ten Years	Total
Corporate fixed income securities	$ 0.9	$ 5.1	$ 6.1	$ 1.0	$ 13.1
Mortgage-backed securities	-	-	-	8.1	8.1
U.S. government notes	1.4	2.8	0.9	1.8	6.9
Other	-	0.8	-	0.2	1.0
Total	$ 2.3	$ 8.7	$ 7.0	$ 11.1	$ 29.1

The Company's debt instruments are recorded at cost on the Consolidated Balance Sheets. The fair value of long-term debt was approximately $207.5 million at December 28, 2013, compared to the carrying value, including accrued interest, of $202.7 million.

(12) Income Taxes

Income tax expense includes the following components:

	Years Ended		
Current:	December 28, 2013	December 29, 2012	December 31, 2011
Federal	$ (1.6)	$ (0.1)	$ (2.5)
State	(0.6)	(0.1)	0.1
Foreign	(0.5)	(0.5)	(0.7)
Current income tax expense	(2.7)	(0.7)	(3.1)
Deferred:			
Federal	(2.0)	(2.6)	0.6
State	0.1	(0.3)	(0.6)
Foreign	0.1	0.1	-
Deferred income tax expense	(1.8)	(2.8)	-
Total income tax expense	$ (4.5)	$ (3.5)	$ (3.1)

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

	Years Ended		
	December 28, 2013	December 29, 2012	December 31, 2011
Expected tax at U.S. Federal income tax rate	$ (38.4)	$ (30.0)	$ (28.4)
Patronage distribution deductions	34.4	26.4	26.1
Other, net	(0.5)	0.1	(0.8)
Income tax expense	$ (4.5)	$ (3.5)	$ (3.1)

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 28, 2013	December 29, 2012
Deferred tax assets:		
AMT and other tax credit carryforwards	$ 10.2	$ 10.7
Net operating loss carryforwards	5.8	6.4
Unearned insurance premium and loss reserves	0.6	1.0
Allowance for doubtful accounts	7.6	7.9
Inventory reserves	2.8	3.7
Deferred vendor rebates	8.5	8.5
Accrued compensation and benefits expense	19.4	17.0
Other reserves	18.1	14.9
Total deferred tax assets	73.0	70.1
Less: valuation allowance	(1.5)	-
Deferred tax assets	71.5	70.1
Deferred tax liabilities:		
Depreciation and deferred gains on property and equipment	17.4	18.6
Amortization of intangibles	2.0	2.1
Fair market value of leases	1.2	1.3
Prepaid expenses and deferred income	6.5	1.1
Inventory valuation	25.9	25.9
Deferred tax liabilities	53.0	49.0
Net deferred tax assets	$ 18.5	$ 21.1

A reconciliation of the net deferred tax assets to the Consolidated Balance Sheets is as follows:

	December 28, 2013	December 29, 2012
Net deferred tax assets – current	$ 15.3	$ 12.3
Net deferred tax assets – noncurrent	3.2	8.8
Net deferred tax assets	$ 18.5	$ 21.1

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 28, 2013, the Company has federal net operating loss carryforwards available of $5.4 million for offset against future taxable income. The net operating losses may be carried forward to the tax years 2031 through 2032. The Company has international net operating losses of $0.4 million that can be carried forward indefinitely.

At December 28, 2013, the Company has alternative minimum tax credit carryforwards of $8.1 million and foreign tax credits of $0.4 million 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 2019 through 2020.

At December 28, 2013, the Company has state tax credit carryforwards of $1.7 million available to offset future state income tax expense. The state tax credits may be carried forward to tax years 2014 through 2018. A valuation allowance of $1.5 million has been established against the state tax credits as it is more likely than not that the benefit of the tax credits will not be realized.

The federal income tax returns of the consolidated group are subject to examination by the Internal Revenue Service ("IRS"), generally for three years after the returns are filed. The 2010 through 2013 tax years remain subject to examination by the IRS. For state purposes, the 2009 through 2013 tax years remain subject to examination.

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 28, 2013 and December 29, 2012 was $0.1 million and $0.1

million, respectively. The Company recognized a benefit of $0.2 million related to interest and penalties within income tax expense for the years ended December 29, 2012. 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.

(13) Capital Stock

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

	Number of Shares at	
	December 28, 2013	December 29, 2012
Class A stock, voting, redeemable at par value:		
Authorized	10,000	10,000
Issued and outstanding	2,764	2,736
Class C stock, nonvoting, redeemable at not less than par value:		
Authorized	4,000,000	4,000,000
Issued and outstanding	3,156,908	3,008,903
Issuable as patronage distributions	408,684	257,613
Additional stock subscribed:		
Class A stock	-	-
Class C stock	50	50

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 for stores that have not opened. 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.

(14) 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 28, 2013, annual minimum rental commitments under leases that have initial or remaining noncancelable terms in excess of one year, net of sublease income, are as follows:

Fiscal Year	Amount
2014	$ 49.3
2015	42.8
2016	37.3
2017	30.5
2018	23.9
Thereafter	137.0
Minimum lease payments	$ 320.8

Minimum lease payments include $5.4 million 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 11 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 $0.5 million as of December 28, 2013 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 28, 2013.

All other leases expire prior to the end of 2028. Under certain leases, the Company pays real estate taxes, insurance and maintenance expenses in addition to rental expense. ARH rents a majority of its retail store location properties, as well as its corporate headquarters and distribution center, under long-term operating leases that generally provide for payment of minimum annual rent payments, real estate taxes, insurance and maintenance and, in some cases, contingent rent (calculated as a percentage of sales) in excess of minimum rent. The amount of contingent rent paid since the date of the acquisition of ARH was not material. 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 $53.7 million, $39.4 million and $40.4 million in 2013, 2012 and 2011, respectively.

In connection with the restructuring of the Company's international operations, the Company has entered into service agreements for the receipt, 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 well as international vendors. As of December 28, 2013, the Company had outstanding standby letters of credit of $34.9 million and commercial letters of credit of $20.1 million.

(15) Retail Support Center Closure

In June 2013, as part of the continued effort to support retail growth, the Company decided to cease its operations at the Toledo, Ohio, Retail Support Center (RSC) when its lease expires in December 2014 and replace it with a larger new RSC in West Jefferson, Ohio. The Company recorded a charge of $6.2 million in 2013 for estimated expenses related to this RSC closure. This charge includes $1.7 million for severance and employee related costs and $4.5 million for future payments that are expected to be paid to the multi-employer pension fund that covers the union employees at the Toledo, Ohio RSC.

(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 28, 2013:

	2013			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Revenues	$ 1,022.4	$ 1,034.3	$ 1,174.3	$ 923.2
Gross profit	136.0	148.8	174.4	117.7
Operating expenses	111.7	111.8	128.5	111.4
Net income attributable to Ace Hardware Corporation	23.4	34.4	42.3	4.4

	2012			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Revenues	$ 911.9	$ 949.9	$ 1,070.9	$ 908.2
Gross profit	104.4	123.8	133.5	107.4
Operating expenses	79.7	86.8	93.1	90.5
Net income attributable to Ace Hardware Corporation	22.4	34.3	14.9	10.2

(17) Supplemental Disclosures of Cash Flow Information

During fiscal 2013, 2012 and 2011, current year patronage distributions of $11.4 million, $10.6 million and $9.5 million, respectively, were offset against current receivables owed to the Company by its member retailers with no net impact in the Consolidated Statements of Cash Flows. In addition, at the retailers request, fiscal 2013, 2012 and 2011, had $3.4 million, $3.7 million and $2.2 million, respectively, of the prior year's patronage distributions offset against current receivables owed to the Company by its member retailers with no net impact in the Consolidated Statements of Cash Flows.

During fiscal 2013, 2012 and 2011, repurchases of stock from retailers of $11.3 million, $21.7 million and $18.4 million, respectively, were offset against current receivables of $2.3 million, $8.3 million and $5.3 million, respectively, and notes receivable of $2.3 million, $5.7 million and $4.8 million, respectively. The remaining $6.7 million, $7.7 million and $8.3 million, respectively, were primarily issued as notes payable with no net impact in the Consolidated Statements of Cash Flows.

During fiscal 2012, the Company entered into an interest rate swap derivative dated June 5, 2012. The fair value adjustments for the interest rate swap derivative were recorded as Other long-term liabilities of $1.8 million and $4.3 million in 2013 and 2012 respectively. The Company offset these adjustments in fair value, net of tax, against AOCI with no net impact in the Consolidated Statements of Cash Flows.

During fiscal 2013, the Company received $5.3 million of property and equipment prior to year end, and accrued for these items as no cash payments were made. These capital expenditures were not included in the purchases of property and equipment, but were included in the changes in accounts payable and accrued expenses in the Consolidated Statement of Cash Flows as of December 28, 2013.

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 28, 2013 (the Company's fiscal years 2013, 2012 and 2011). Each of the fiscal years presented contains 52 weeks of operating results. Unless otherwise noted, all references herein for the years 2013, 2012 and 2011 represent fiscal years ended December 28, 2013, December 29, 2012 and December 31, 2011, respectively. This discussion and analysis 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").

Company Overview

The Company is a wholesaler of hardware and other related products and provides services and best practices for retail operations. The overall home improvement industry is estimated to be over $300 billion and 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 $40 billion "convenience hardware" segment which is characterized by purchases primarily of products related to home improvement and repair, including paint and related products, 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) strong consumer recognition of the Ace Brand; (2) well-regarded for exceptional customer service and convenience; (3) strength of distribution operations; (4) consolidated purchasing power; (5) differentiated product and service offerings; and (6) a diversified network of independent retailers.

The Company strives to be the best provider of products, services and operating methods for convenience hardware retailers. The four main drivers that support that goal and the Company's efforts to grow the business are improving the store model, accelerating new store openings, introducing store projects that drive store sales and profitability, and reducing the number of store closings.

Effective December 16, 2012, Ace Retail Holdings LLC ("ARH" a newly-formed subsidiary of the Company) acquired all of the outstanding shares of capital stock of WHI Holding Corp. ("WHI"). WHI owns all outstanding shares of Westlake Hardware, Inc. ("Westlake"). Westlake is based in Kansas City, Missouri and operates 85 neighborhood hardware stores located throughout the Midwest under the name Westlake Ace Hardware. The WHI acquisition affects the comparability of the 2013 and 2012 financial statements and results in a reduction of reported wholesale revenues, as wholesale revenues from Ace to WHI are now eliminated. This elimination totaled $83.7 million for 2013 and $2.2 million for 2012.

Domestic Store Count

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

	Fiscal Years Ended		
	2013	2012	2011
Retailer outlets at beginning of period	4,104	4,072	4,108
New retailer outlets	152	159	127
Retailer outlet cancellations	(85)	(127)	(163)
Retailer outlets at end of period	4,171	4,104	4,072

Results of Operations

Comparison of the Year Ended December 28, 2013 to the Year Ended December 29, 2012

The following data summarizes the Company's performance in 2013 as compared to 2012 (in millions):

	2013		2012		Increase/(decrease)	
	$	% of Revenues*	$	% of Revenues*	$	%
Revenues:						
Wholesale revenues	3,928.6	94.6%	3,832.9	99.8%	95.7	2.5%
Retail revenues	225.6	5.4%	8.0	0.2%	217.6	100.0%
Total revenues	4,154.2	100.0%	3,840.9	100.0%	313.3	8.2%
Gross profit:						
Wholesale gross profit	478.4	12.2%	465.9	12.2%	12.5	2.7%
Retail gross profit	98.5	43.7%	3.2	40.0%	95.3	100.0%
Total gross profit	576.9	13.9%	469.1	12.2%	107.8	23.0%
Operating expenses:						
Distribution operations expenses	100.0	2.5%	98.1	2.6%	1.9	1.9%
Selling, general and administrative expenses	142.3	3.6%	138.1	3.6%	4.2	3.0%
Retailer success and development expenses	124.3	3.2%	117.6	3.1%	6.7	5.7%
Retail operating expenses	90.6	40.2%	3.3	41.3%	87.3	100.0%
Retail support center closure costs	6.2	0.2%	-	-	6.2	100.0%
Gain on sale of paint assets, net of acquisition and disposition costs	-	-	(7.0)	(0.2%)	7.0	100.0%
Total operating expenses	463.4	11.2%	350.1	9.1%	113.3	32.4%
Operating income	113.5	2.7%	119.0	3.1%	(5.5)	(4.6%)
Interest expense	(14.1)	(0.3%)	(23.9)	(0.6%)	9.8	41.0%
Loss on early extinguishment of debt	-	-	(19.9)	(0.5%)	19.9	100.0%
Other	5.1	0.1%	6.6	0.1%	(1.5)	(22.7%)
Net income	104.5	2.5%	81.8	2.1%	22.7	27.8%

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

Consolidated revenues for the year ended December 28, 2013 totaled $4.2 billion, an increase of $313.3 million, or 8.2%, as compared to the prior year. Total wholesale revenues were $3.9 billion for fiscal 2013, an increase of $95.7 million, or 2.5%, as compared to the prior year. (Excluding the elimination of wholesale revenues to WHI of $83.7 million and $2.2 million in 2013 and 2012, respectively, the increase in wholesale revenues would have been $177.2 million or 4.6%.) A reconciliation of consolidated revenues follows (in millions):

	Amount	% Change vs. 2012
2012 Revenues	$ 3,840.9	
Wholesale Merchandise Revenues change based on new and cancelled domestic stores:		
Revenues increase from new stores added since January 2012	91.4	2.4%
Net decrease from stores cancelled since January 2012	(38.2)	(1.0%)
Increase in wholesale merchandise revenues to comparable domestic stores	95.5	2.5%
Increase in international merchandise revenues	19.2	0.5%
Increase in retail revenues	217.6	5.7%
Elimination of Ace sales to WHI	(81.5)	(2.1%)
Other revenue changes	9.3	0.2%
2013 Revenues	$ 4,154.2	8.2%

New stores are defined as stores that were activated from January 2012 through December 2013. In 2013, the Company had an increase in wholesale merchandise revenues from new domestic stores of $91.4 million. This increase was partially offset by a decrease in wholesale merchandise revenues due to domestic store cancellations of $38.2 million. As a result, the Company realized a net increase in wholesale merchandise revenues of $53.2 million related to the impact of both new stores affiliated with the Company and from stores that cancelled their membership in 2012 and 2013.

Wholesale merchandise revenues to comparable domestic stores increased $95.5 million. The categories with the largest revenues increases were plumbing, heating/cooling, paint supplies and sundries, and live goods. International merchandise revenues increased $19.2 million primarily due to higher revenues to retailers in the Middle East and Latin American markets. Wholesale service revenues were up $9.3 million primarily due to increased delivery and advertising revenues.

Retail revenues were $225.6 million for fiscal 2013. This is an increase of $217.6 million from fiscal 2012 which resulted from the timing of the December 2012 acquisition of WHI. Same store sales at WHI's stores were down 0.8% primarily due to a decrease in the lawn and garden category in the first and second quarters of 2013.

Wholesale gross profit for the year ended December 28, 2013 was $478.4 million, an increase of $12.5 million. Gross margin percentage was 12.2% of wholesale revenues, flat with 2012. Warehouse sales represented 77.4% of wholesale merchandise revenue in 2013 compared to 78.0% in 2012, while direct ship sales were 22.6%, up from 22.0% in 2012.

Retail gross profit was $98.5 million, or 43.7% of retail revenues for the year ended December 28, 2013. Retail gross profit as reported in the Ace financial statements is based on the Ace wholesale acquisition cost of product rather than the WHI acquisition cost which includes Ace's normal markup from cost.

Wholesale operating expenses increased $12.8 million, or 3.6% as compared to 2012. The increase was primarily driven by higher employee benefit and salary expenses of $6.3 million and higher advertising and marketing expenses of $3.4 million.

The addition of retail operating expenses of $90.6 million was a result of the acquisition of WHI in December 2012. This included approximately $5.9 million of non-cash depreciation and amortization expense for assets and liabilities established as a part of the opening balance sheet of WHI.

The Company recorded a charge of $6.2 million for estimated expenses related to the previously announced closure of the Toledo, Ohio, RSC. This charge includes estimated severance and employee related costs as well as future payments that are expected to be paid to the multi-employer pension fund that covers the union employees at this facility.

The 2012 Gain on sale of paint assets, net of acquisition and disposition costs of $7.0 million consisted of an $8.9 million gain related to the sale of paint assets to The Valspar Corporation and $1.9 million of expenses related to the acquisition of WHI.

Interest expense decreased $9.8 million or 41.0%, due to the refinancing of the Company's credit facility and the redemption of the Company's senior secured notes during the second quarter of 2012, as well as lower average outstanding balances and lower interest rates in 2013.

The 2012 loss on the early extinguishment of debt of $19.9 million resulted from the refinancing of the Company's credit facility and the redemption of the Company's senior secured notes. The $19.9 million loss consisted of a $13.1 million premium payment on the buyback of the notes and the non-cash write-off of $6.8 million in unamortized deferred financing costs and bond discount costs related to the previous credit facility and senior secured notes.

Other income and expense declined $1.5 million mainly as a result of an increase of income tax expense of $1.0 million which was primarily caused by the acquisition of WHI.

Comparison of Year Ended December 29, 2012 to Year Ended December 31, 2011

The following data summarizes the Company's performance in 2012 as compared to 2011 (in millions):

	2012		2011		Increase/(decrease)	
	$	% of Revenues*	$	% of Revenues	$	%
Revenues:						
Wholesale revenues	3,832.9	99.8%	3,709.2	100.0%	123.7	3.3%
Retail revenues	8.0	0.2%	-	-	8.0	100.0%
Total revenues	3,840.9	100.0%	3,709.2	100.0%	131.7	3.6%
Gross profit:						
Wholesale gross profit	465.9	12.2%	447.3	12.1%	18.6	4.2%
Retail gross profit	3.2	40.0%	-	-	3.2	100.0%
Total gross profit	469.1	12.2%	447.3	12.1%	21.8	4.9%
Operating expenses:						
Distribution operations expenses	98.1	2.6%	95.2	2.6%	2.9	3.0%
Selling, general and administrative expenses	138.1	3.6%	135.8	3.7%	2.3	1.7%
Retailer success and development expenses	117.6	3.1%	111.5	3.0%	6.1	5.5%
Retail operating expenses	3.3	41.3%	-	-	3.3	100.0%
Gain on sale of paint assets, net of acquisition and disposition costs	(7.0)	(0.2%)	-	-	(7.0)	(100.0%)
Total operating expenses	350.1	9.1%	342.5	9.3%	7.6	2.2%
Operating income	119.0	3.1%	104.8	2.8%	14.2	13.5%
Interest expense	(23.9)	(0.6%)	(36.4)	(1.0%)	12.5	34.3%
Loss on early extinguishment of debt	(19.9)	(0.5%)	(0.1)	-	(19.8)	(100.0%)
Other	6.6	0.1%	9.4	0.3%	(2.8)	(29.8%)
Net income	81.8	2.1%	77.7	2.1%	4.1	5.3%

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

Consolidated revenues for the year ended December 29, 2012 totaled $3.8 billion, an increase of $131.7 million, or 3.6%, as compared to the prior year. Total wholesale revenues were $3.8 billion for fiscal 2012, an increase of $123.7 million, or 3.3%, as compared to the prior year. (Excluding the elimination of wholesale revenues to WHI of $2.2 million, the increase in wholesale revenues would have been $125.9 million or 3.4%.) A reconciliation of consolidated revenues follows (in millions):

	Amount	% Change vs. 2011
2011 Revenues	$ 3,709.2	
Wholesale Merchandise Revenues change based on new and cancelled domestic stores:		
Revenues increase from new stores added since January 2011	73.0	2.0%
Net decrease from stores cancelled since January 2011	(50.6)	(1.4%)
Increase in wholesale merchandise revenues to comparable domestic stores	91.4	2.5%
Increase in international merchandise revenues	9.0	0.2%
Increase in retail revenues	8.0	0.2%
Other revenue changes	0.9	0.1%
2012 Revenues	$ 3,840.9	3.6%

New stores are defined as stores that were activated from January 2011 through December 2012. In 2012, the Company had an increase in wholesale merchandise revenues from new domestic stores of $73.0 million. This increase was partially offset by a decrease in wholesale merchandise revenues due to domestic store cancellations of $50.6 million. As a result, the Company realized a net increase in wholesale merchandise revenues of $22.4 million related to the impact of both new stores affiliated with the Company and from stores that cancelled their membership in 2011 and 2012.

Wholesale merchandise revenues to comparable domestic stores increased $91.4 million. The categories with the largest revenues increases were electrical, paint supplies, lawn and garden and cleaning supplies. International merchandise revenues increased $9.0 million primarily due to higher revenues to retailers in the Caribbean market.

Retail revenues of $8.0 million represent sales made by ARH retail stores after the acquisition date.

Gross profit for the year ended December 29, 2012 was $469.1 million, an increase of $21.8 million from 2011, and the gross margin percentage was 12.2% of revenues, up from 12.1% in the prior year. The improvement in gross margin percentage was driven entirely by a higher merchandise gross profit in the current year of $10.3 million resulting from a more favorable mix and lower LIFO expense as well as higher retail service gross profit in the current year of $8.6 million primarily as a result of higher income from delivery and traffic services, vendor services, international royalties and fees and bankcard services. Warehouse sales represented 78.0% of wholesale merchandise revenue in 2012 compared to 77.8% in 2011, while direct ship sales were 22.0%, down from 22.2% in 2011.

Operating expenses increased $7.6 million, or 2.2%, to $350.1 million during 2012 as compared to 2011. The increase in operating expenses reflects higher employee benefit and salary expenses of approximately $14.1 million in 2012 compared to the prior year, as well as $3.3 million of retail operating expenses incurred after the acquisition of WHI. These increases were partially offset by the $7.0 million from the gain on sale of paint assets, net of acquisition and disposition costs.

Interest expense decreased $12.5 million due to the refinancing of the Company's credit facility and the redemption of the Company's senior secured notes during the second quarter of 2012.

The loss on the early extinguishment of debt of $19.9 million resulted from the refinancing of the Company's credit facility and the redemption of the Company's senior secured notes during 2012. The $19.9 million loss consisted of a $13.1 million premium payment on the buyback of the notes and the non-cash write-off of $6.8 million in unamortized deferred financing costs and bond discount costs related to the previous credit facility and senior secured notes.

Other income and expense declined $2.8 million from the prior year primarily due to higher gains realized in 2011 as compared to 2012 on the sale of investment securities held by the Company's New Age Insurance, Ltd. subsidiary.

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 to finance the Company's working capital requirements, debt service, patronage distributions, capital expenditures, share redemptions from retailer cancellations and growth initiatives for at least the next 12 months.

The Company's borrowing requirements have historically arisen from, and are expected to continue to arise from, working capital needs, debt service, capital improvements, patronage distributions and other general corporate purposes. In the past, the Company has met its operational cash needs using cash flows from operating activities and funds from its revolving credit 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.

On July 29, 2013, the Company amended its secured credit facility with a group of banks. The amendment extended the maturity date to July 27, 2018 and lowered the interest rate credit spread by 25 basis points. The amended credit facility consists of a $187.5 million amortizing term loan and a $400.0 million revolving credit facility. The facility is expandable to $737.5 million via a $150.0 million accordion that is exercisable without the consent of existing lenders provided that the Company is not in default of the credit agreement and further provided that none of the existing lenders are required to provide any portion of the increased facility. Borrowings under this amended facility bear interest at a rate of either the prime rate plus an applicable spread of 50 basis points to 150 basis points or 150 to 250 basis points over the London Interbank Offered Rate ("LIBOR") depending on the Company's leverage ratio as defined under the agreement. The facility was priced at LIBOR plus 175 basis points at December 28, 2013. This facility requires maintenance of certain financial covenants including a maximum allowable average leverage ratio, a minimum fixed charge coverage ratio and a minimum asset coverage ratio. As of December 28, 2013, the Company was in compliance with its covenants and a total of $187.5 million was outstanding under the credit facility.

The amended term loan requires the Company to make principal repayments of $2.5 million per quarter through September 2014 and $5.0 million per quarter thereafter through March 2017, with no required principal repayments in the final year. Any remaining principal balance will be repaid at the maturity of the amended agreement on July 27, 2018.

The revolving credit facility includes a $175.0 million sublimit for the issuance of standby and commercial letters of credit. As of December 28, 2013, a total of $21.7 million in letters of credit were outstanding. The revolving credit facility also requires the Company to pay fees based on the unused portion of the line of credit at a rate of 15 to 35 basis points per annum depending on the Company's leverage ratio.

The credit facility allows the Company to make revolving loans and other extensions of credit to AHI in an aggregate principal amount not to exceed $75.0 million at any time. As of December 28, 2013, there were no loans or other extensions of credit provided to AHI.

In order to reduce the risk of interest rate volatility, the Company entered into an interest rate swap derivative agreement in June 2012, which expires on March 13, 2017. This swap agreement fixes the LIBOR rate on the full balance of the term loan at 1.13%, resulting in an effective rate of 2.88% after adding the 1.75% margin based on the current pricing tier per the credit agreement. The notional amount of the derivative agreement will decrease to match the principal balance remaining as principal payments are made throughout the term of the loan agreement. The swap arrangement has been designated as a cash flow hedge and has been evaluated to be highly effective. As a result, the after-tax change in the fair value of the swap is recorded in Accumulated other comprehensive income (loss) as a gain or loss on derivative financial instruments. See Note 11 for more information.

As part of the WHI acquisition, the Company assumed a $60.0 million asset-based revolving credit facility with an outstanding balance of $35.0 million on December 16, 2012 (the "ARH Facility"). The ARH Facility matures on December 16, 2017 and is expandable to $85.0 million under certain conditions. In addition, the Company has the right to issue letters of credit up to a maximum of $7.5 million. At the Company's discretion, borrowings under this facility bear interest at a rate of either the prime rate plus an applicable spread of 75 basis points to 100 basis points or LIBOR plus an applicable spread of 175 basis points to 200 basis points, depending on the Company's availability under the ARH Facility and measured on a quarterly basis.

The ARH Facility is collateralized by substantially all of ARH's personal property and intangible assets. Borrowings under the facility are subject to a borrowing base calculation consisting of certain advance rates applied to eligible collateral balances (primarily consisting of certain receivables and inventories). This agreement requires maintenance of certain financial covenants including a minimum fixed charge coverage ratio. As of December 28, 2013, ARH was in compliance with its covenants, there were no loans outstanding under the ARH Facility and there were outstanding letters of credit of $2.0 million.

Total debt, the majority of which is comprised of $187.5 million principal remaining on the term loan was $202.0 million as of December 28, 2013, compared to $290.2 million at December 29, 2012.

Cash Flows

The Company had $17.9 million and $13.1 million of cash and cash equivalents at December 28, 2013 and December 29, 2012, respectively. Drivers of the increase in cash and cash equivalents during the year ended December 28, 2013 included operating cash inflows of $168.0 million. Offsetting the increase in cash and cash equivalents were the payments of $78.6 million under the revolving lines of credit, the payments for additions to property and equipment of $45.0 million, the payment of the cash portion of patronage distributions of $27.1 million, and the principal payments on long-term debt of $16.3 million.

Following is a summary of the Company's cash flows from operating, investing and financing activities for the fiscal years 2013 and 2012, respectively (in millions):

	2013	2012
Cash provided by operating activities before changes in assets and liabilities	$ 160.9	$ 139.1
Net changes in assets and liabilities	7.1	37.6
Net cash provided by operating activities	168.0	176.7
Net cash used in investing activities	(41.4)	(62.6)
Net cash used in financing activities	(121.8)	(116.8)
Net change in cash and cash equivalents	$ 4.8	$ (2.7)

The Company's operating activities generated $168.0 million of cash in 2013 compared to $176.7 million in 2012. Excluding the impact of net changes in assets and liabilities, cash provided by operating activities grew from $139.1 million in 2012 to $160.9 million in 2013. This increase was primarily the result of higher net income in 2013.

The net change in assets and liabilities was down from a $37.6 million increase in cash in 2012 to a $7.1 million increase of cash in 2013. In 2013, receivables increased $53.6 million due to increased dating made available to retailers on certain products. Inventories decreased $52.2 million in 2013 as a result of improved supply chain efficiencies. In 2012, inventories decreased $24.9 million which was largely the result of the sale of the paint manufacturing facilities and inventory to Valspar. Also, in 2012 receivables increased $7.8 million. This increase was primarily due to the purchase of WHI.

Net cash used for investing activities was $41.4 million in 2013 compared to $62.6 million for 2012. Investing activities in 2013 primarily consisted of the $45.0 million in capital expenditures offset by $2.9 million of cash generated as a result of the collection of notes receivable. Investing activities in 2012 primarily consisted of the $52.0 million net cash used to purchase WHI and

$46.4 million in capital expenditures offset by $34.8 million cash generated by the sale of the paint manufacturing facilities and $1.8 million of cash generated as a result of the collection of notes receivable.

Net cash used in financing activities was $121.8 million in 2013 compared to $116.8 million in 2012. During 2013, the Company decreased total debt by a net of $94.9 million and made patronage distributions of $27.1 million. During 2012, the Company decreased total debt by a net of $67.2 million, made patronage distributions of $27.7 million, redeemed $17.4 million of patronage refund certificates and paid $5.2 million in deferred financing costs.

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 14 – 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 28, 2013 are as follows (in millions):

	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Long-term debt (1)	$ 202.0	$ 23.4	$ 47.3	$ 131.3	$ -
Interest payments on long-term debt (2)	21.1	5.9	9.4	5.8	-
Patronage refund certificates payable	28.4	-	6.6	15.9	5.9
Operating leases (3)	320.8	49.3	80.1	54.4	137.0
Purchase commitments (4)	48.7	26.4	20.5	1.8	-
Total	$ 621.0	$ 105.0	$ 163.9	$ 209.2	$ 142.9

(1) Reflects principal payments.
(2) Reflects interest that would be paid if LIBOR rates and interest rate spreads remain unchanged from the December 28, 2013 rates and assumes a consistent outstanding revolving line of credit balance until the expiration of the facility in 2018.
(3) Total operating lease payments include $5.4 million of minimum lease payments for store leases that the Company has assigned to member retailers.
(4) 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. The Company'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 revenues 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, revenues 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 that should be 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. At year-end, the accrual reflects actual purchases made throughout the year.

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, in which case the costs would be netted. 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 accounts and notes receivable 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 revenues 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 28, 2013 and December 29, 2012 was $20.7 million and $21.1 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.

Impact of New Accounting Standards

New Accounting Pronouncements - Issued

In February 2013, the FASB issued Accounting Standards Update ("ASU") No. 2013-02, "Comprehensive Income (Topic 220), Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income," ("ASU 2013-02"). ASU 2013-02 requires the Company to report, in one place, information about reclassifications out of accumulated other comprehensive income (AOCI). The Company is also required to present reclassifications by component when reporting changes in AOCI balances. For significant items reclassified out of AOCI to net income in their entirety in the period, the Company must report the effect of the reclassifications on the respective line items in the statement when net income is presented. ASU 2013-02 is effective for the Company for fiscal years and interim periods beginning after December 15, 2013. The Company does not expect that ASU 2013-02 will have a material impact on the Company's consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-11, "Income Taxes (Topic 740), Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists," ("ASU 2013-11"). ASU 2013-11 requires the Company to present in the financial statements an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statement as a liability and should not be combined with deferred tax assets. ASU 2013-11 is effective for the Company for fiscal years and interim periods beginning after December 15, 2014 with early adoption permitted. The Company does expect that ASU 2013-11 will have an impact on 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 report. The Company undertakes no obligation to publicly release any revision to these forward-looking statements to reflect events or circumstances after the date of this report.

FIVE YEAR SUMMARY OF EARNINGS AND DISTRIBUTIONS

	Years Ended				
	December 28, 2013 (52 Weeks)	December 29, 2012 (52 Weeks)	December 31, 2011 (52 Weeks)	January 1, 2011 (52 Weeks)	January 2, 2010 (52 Weeks)
Revenues	$ 4,154.2	$ 3,840.9	$ 3,709.2	$ 3,530.7	$ 3,457.2
Cost of revenues	3,577.3	3,371.8	3,261.9	3,086.4	3,009.6
Gross profit	576.9	469.1	447.3	444.3	447.6
Total operating and other expenses, net	472.4	387.3	369.6	369.2	351.9
Net income	$ 104.5	$ 81.8	$ 77.7	$ 75.1	$ 95.7
Distribution of net income:					
Patronage distributions to third party retailers	$ 98.2	$ 75.5	$ 74.5	$ 69.9	$ 89.0
Accumulated earnings	6.3	6.3	3.2	5.2	6.7
Net income attributable to Ace Hardware Corporation	$ 104.5	$ 81.8	$ 77.7	$ 75.1	$ 95.7

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 accountants. 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 18, 2014

/s/ John Venhuizen
John Venhuizen
President and Chief Executive Officer

/s/ William M. Guzik
William M. Guzik
Executive Vice President,
Chief Financial Officer and Chief Risk Officer

MEMBERSHIP INFORMATION

Membership Application, Agreements and Stock Subscription

Membership Application and Agreements. All domestic member retailers have membership agreements with us that entitle them to purchase merchandise and services from us. Membership agreements entered into prior to January 1, 2004, granted retailers a license to use some of our trademarks. After January 1, 2004, new retailers are granted a license to use some of our trademarks under a separate Ace brand agreement. Generally, retailers whose membership agreements are dated August 1993 or later are subject to "general member standards," "Ace brand standards," "member operational requirements" and other important requirements.

Only prospects who submit membership applications to us for designated retail outlets that we choose to accept may become Ace retailers and purchase our stock. If you apply to become an Ace retailer, you must complete and submit for each store location a membership application that contains extensive information about yourself and your proposed location, as well as the actual membership agreement, a stock subscription agreement for the purchase of our stock and a number of other agreements and instruments that we require. These include the Ace brand agreement if you propose to operate your store using the Ace name.

You must also pay a $5,000 membership application processing fee. If we accept your application, we sign your stock subscription agreement and your membership agreement and, if applicable, your Ace brand agreement.

Ace Officers Decide Membership. Our officers make all membership decisions. We employ various field sales personnel who contact and solicit existing and prospective member retailers and promote our business and programs; however, these individuals are not allowed to accept new members. We may pay commissions or other incentives to our personnel in connection with the acceptance of new members or the opening of new stores.

Stock Subscription Amount and Terms of Payment. To become a member, you are required to subscribe for $5,000 of our stock per member store. For a first store location, the subscription is for one share of Class A voting stock at a price of $1,000 per share plus 40 shares of Class C non-voting stock at a price of $100 per share. The subscription for shares for each additional store location owned or controlled by the same retailer consists entirely of 50 shares of Class C nonvoting stock at a price of $100 per share. Billing for such shares in full will occur 30 days after the store's activation date, and the certificates for these shares will be issued at that time. You must promptly pay in full for your share purchases.

Use of Proceeds. We use the proceeds that we receive from sales of our stock mainly for general working capital purposes, including the purchase of merchandise for resale and capital expenditures. We reserve the right to use such proceeds for any other proper corporate purpose, as well.

Termination of Membership upon Transfer of Shares. Unless we expressly consent to the continuation of your membership, it will automatically terminate if you attempt to transfer any of your shares of Ace stock (whether purchased or received as patronage distributions) to someone else. Your membership will also terminate if we repurchase your shares.

Retailer Assessments and Charges

In addition to the stock subscription amount and the membership application processing fee described above, we assess additional fees for both mandatory and optional services and programs. Our service and program offerings, and their respective fees, are listed below. All programs and fees are subject to change upon notice. Some of the services or programs listed below may not be available to our Individually Branded retailer members, or we may charge such retailers different fees than those shown below.

Type of Fee (1)	Amount	Due Date	Remarks
Late Payment (2)	.77% of the past due bi-weekly billing statement balance.	10 days after billing	Payable on all overdue amounts.
Low Volume Service Charge (3)	$100 per bi-weekly billing period if annual volume purchased is less than $200,000.	10 days after billing	Payable if you fail to make the $200,000 minimum annual purchases. (See further explanation in Note (3) Below.)

Type of Fee (1)	Amount	Due Date	Remarks
Minimum Freight Charge	$115	10 days after billing	If the net freight bill for a delivery to your store is less than $115, the minimum of $115 will be charged.
Fuel Surcharge	When the U.S. national average price for diesel fuel exceeds $2.05 per gallon, a 0.50% fuel charge applies. The surcharge is adjusted (i.e., increased or decreased) weekly, 0.50% for every five-cent change (increase or decrease) in fuel price.	10 days after billing	The fuel surcharge percentage is applied to the net freight charge.
Core Retail Services (4)	$168 per month for all parent stores and $37 per month for each branch store.	10 days after billing	This service is mandatory and will be billed to your billing statement monthly.
Business Insurance (5)	Will vary depending upon coverage purchased. Estimated annual cost of required coverage: $2,500 - $20,000.	11-month installment plan with 2 months' premium paid in month 1 and balance equally billed monthly over the next 10 months.	Business insurance is required and may be purchased from our affiliate Ace Insurance Agency, Inc., or from unaffiliated third parties.
Ace Bank Card Program	$35 annual fee per store. Additional point-of-service processing fees apply per credit card transaction; such fees vary by card processor (VISA, MasterCard, etc.) and by number and type of transactions processed, and may also vary based on each retailer's total credit card transactional dollar volume processed.	10 days after billing	This program is optional.
Customer Check Verification Service (Telecheck)	1% of face value of your customer's check.	10 days after billing (if billed through Ace).	This is optional. This service is available from Ace or from third parties (e.g., VISA, MasterCard, etc.).

Type of Fee (1)	Amount	Due Date	Remarks
Annual Brand Assessment (6)	Store's first year: $5,000 flat fee per store. Unless the new store opens in Q4, in which case the store is charged nothing in year 1, and $8,000 the following year. Subsequent Years: 2% of prior year purchases subject to: Annual minimum: $3,000 per store. Annual maximum: $10,000 per store.	10 days after billing	This is mandatory for all Ace branded retailers. Billing via 26 bi-weekly statements (each for 1/26 of annual amount).
Ace Rewards® Program	$850 initial fee; $75 per month, per store thereafter. $0.28 per direct mail piece. Each store is required to participate in three Ace Rewards specific direct mail promotions	10 days after billing	This program is mandatory for all Platinum Performance retailers, technology permitting. Additional direct mail and email promotions (beyond the required three) are available at the store's option.
Ace Gift Card Program	$50 initial sign kit fee plus $0.50 per blank (unactivated) card stock. Additional point-of-service processing fees apply per credit card transaction; such fees vary by card processor (VISA, MasterCard, etc.) and by number of transactions processed. Cost will also vary depending upon type of card displays and accessories purchased.	10 days after billing	This program is mandatory for all Platinum Performance retailers, technology permitting.
Regional Advertising (7)	Will vary depending on regional advertising programs.	10 days after billing	Program is market-specific.
Computers	Will vary depending on computer equipment.	Varies	We require that all merchandise orders be submitted to us through an electronic ordering process. You may purchase or lease (using your choice of leasing companies) or finance a computer system.

Type of Fee (1)	Amount	Due Date	Remarks
Broadcast Media Services	Free downloads from ACENET or Ace Brand Place for copies of Ace radio and non-sale event TV ads that you may download or request from us and then customize for your store. You pay for all air-time fees charged by radio/TV stations you contract with; these fees range from $1,000 to over $10,000 depending upon the media services you choose.	Varies, depending upon the radio/TV station you contract with.	This service is optional. Ace or our media buying agency places radio and/or TV buys that you choose.
Group Preprint Program (7)	Price varies by page count and group participation. For example, group pricing for an 8 tab is $43.00 per thousand copies, while individual store orders are $70.00 per thousand copies.	10 days after billing	This program is optional. This is our advertising preprint program.
Monthly Sign Kit Program	$150 per month for full kit; $40 for mini-kit.	10 days after billing	This program is a recommended component of our Group Preprint Program (see above). If you choose to participate in our optional Group Preprint Program, unless you notify us otherwise we will automatically enroll your store in our Monthly Sign Kit Program, which includes all point-of-purchase signage supporting Ace's consumer marketing plan. There are 13 total sign kits in a year, one of which is a branding kit.
New Movers Program	$0.21 per piece.	10 days after billing	This program is optional and you can join or opt out at any time. Your store is automatically enrolled in the "$10 off any purchase" offer when submitting the Preprint Agreement Form unless "no" is checked on the form. There is a 3 month lag time to join or opt out of the program.

Type of Fee (1)	**Amount**	**Due Date**	**Remarks**
Customer Insights Program (Mystery Shop, Customer Engagement, Employee Engagement)	For the enrollment/change, $46 per shop (in-store shops); $15 per shop (phone shops); and $46 per shop (competitor shops). For the monthly bundle, $59 per month billed as $46 Mystery Shop, and a $13 customer engagement survey fee each month after customer surveys are returned.	10 days after billing	This program is optional.
Customer Comment Cards	$38 per pack of 50 stock (blank) cards. $5 per holder.	10 days after billing	The purchase of Customer Comment Cards is optional. The cards are available to retailers through Ace Brand Place, an online ordering site for retailers.
Visual Merchandising Services	Price varies depending on the size of the store. All projects are set to bid to ensure lowest possible cost based on location and timeframes.	10 days after billing	Services may be provided by us and/or by unaffiliated third parties.
Store Planning Services	$5,500 flat fee for basic services package.	Completion of project or 180 days from start of fixture plan (26 equal installments for existing retailers upon request)	Store planning services are mandatory and are provided by us.
Ace Rental Place	Will vary depending upon the rental equipment offered and any optional signage you select.	10 days after billing	This is optional.
The Supply Place-Certification (B2B)	Will vary depending upon marketing material and signage purchased to promote business to business. The initial implementation fee is $50.	10 days after billing	Known as B2B. Materials are intended to support "The Supply Place" brand and are limited to certified participants.
The Supply Place-eCommerce	A one-time initial set up charge of $1,875; $100 monthly charge for the first store; and a $75 monthly charge for each additional store.	10 days after billing	You must complete certification to participate in Thesupplyplace.com and meet minimum POS system requirements.

Type of Fee (1)	Amount	Due Date	Remarks
Retail Loss Prevention (8)	Will vary depending upon equipment or services utilized. Estimated cost range per service is $30 - $3,500. Costs do not include expenses for meeting rooms, travel, lodging, meals or tax where applicable.	As incurred or as agreed	These services and products are optional.
National Catalogues	$29 per month for one set of catalogs per year (18 total). Additional sets are billed at a rate of $16 per month, per set.	10 days after billing	This is optional.
Ace Catalogue on DVD	One DVD is included with the $125 ACENET monthly service fee. Additional DVDs cost $15 per DVD.	10 days after billing	This is optional.
Retail Financial Report (9)	$50 per copy to stores that do not participate in the survey.	As incurred	Participation in the survey is mandatory under certain new store incentive agreements.
Matching Funds	Member can contribute up to $2,400 annually for group advertising.	Quarterly assessment on Ace statement.	This is optional.
Costs and Attorney's Fees	Will vary under circumstances.	As incurred	Payable upon your failure to comply with the Membership Agreement, Brand Agreement and/or other agreements you enter into with us.
Indemnification	Will vary under circumstances.	As incurred	You may have to reimburse us if we are held liable for claims arising from your store's operations.
Training Programs (Pre-Opening and Continuing)	The cost will vary depending upon the type of training, duration, and location of sessions. Price does not include expenses for meeting rooms, travel, lodging, meals, or tax where applicable.	Upon receipt of bill	Training programs are mandatory under certain new store incentive agreements. Other training programs are optional.
Charitable Donations	Will vary depending upon donations you may decide to make, if any, subject to a minimum total contribution of $20 if you choose to make a contribution.	May be made at any time by check. Alternately, can be billed to your bi-weekly billing statement (due 10 days after billing).	All donations are voluntary. We collect them on behalf of our affiliate, Ace Hardware Foundation, and on behalf of an unaffiliated charity, Children's Miracle Network.

Notes:

(1) Except as to fees designated as optional or voluntary, all fees are imposed by and, unless otherwise noted, payable to us. All fees are nonrefundable. Fees that we impose are subject to change upon notice to you.

(2) Late payment fees apply on a national basis at the rate stated (i.e., .77%), except in Texas and Georgia, where the applicable bi-weekly percentage rates are .384% and .692%, respectively. Service charges are assessed on all past due balances according to the following guidelines: i) electronic payments must be initiated by 2 p.m. CST on Tuesday following the due date to avoid a past due service charge; and ii) manual checks must be posted in the bank lockbox by the bank cut off time on Wednesday following the due date to avoid a past due service charge. Past due balances as of the end of day Wednesday will be assessed the past due service charge at the rate of .77% (with the same exceptions of .384% and .692% in Texas and Georgia, respectively). Certain charges are exempt from past due service charges where mandated by the state.

(3) You must pay a low volume service charge if your purchases from us during a calendar year are less than our minimum purchase levels. The charge currently applies on a bi-weekly basis if your annual purchases from us are less than $200,000. If your purchases are less than $200,000 in any given year, a $100 low volume service charge is billed to each of your bi-weekly billing statements during the immediately following year. New stores must be active for a full calendar year before this charge is applicable. The minimum purchase threshold, as well as the amount and manner of calculating the low volume service charge, can be changed by our Board of Directors. Failure to meet our minimum purchase levels constitutes cause for termination of the membership agreement.

(4) Core Retail Services simplifies the billing process by bundling several important programs or services into one monthly charge. These include:

- ACENET: Our primary communications portal. ACENET provides a set of back office and catalog applications such as product search, ordering, defective and returned goods processing, training, Ace statement process, and numerous other applications.

- Safety Data Sheets (SDS): Communicates the hazards of hazardous chemicals. Access is available 24/7 with unlimited single requests included.

- Training Core Charge: This core fee helps to fund the Ace LearningPlace and the creation of educational content, as well as other selective no-additional-charge strategic training. Single stores and parent stores, those holding Class A voting stock, are assessed $16.00 per month; branch stores are assessed $11.00 per month.

- NRHA Membership: Because Ace is a member of the North American Retail Hardware Association ("NRHA"), Ace retailers have access to online training and resources. From this site, retailers can access member newsletters, project brochures, NRHA studies and a variety of associate training tools including the Basic and Advanced Courses in Hardware Retailing.

- Retail Pricing: An assortment of pricing-related services designed to improve gross margin dollars and enhance price image. These include pricing services such as Tailored Pricing and Tailored Hotsheets, and the ongoing pricing research needed for establishing and maintaining suggested Ace retail prices.

(5) We must be named as a loss payee party on your store's contents-insurance coverage. Your store must also have automotive and general liability insurance, each with no less than a $1 million combined single limit, naming us as an additional insured. Your store's general liability insurance must also have a limit of no less than $2 million in the aggregate. Your store must also carry statutory workers compensation insurance and furnish evidence of insurance that is acceptable to us. Your store's insurance must be written with a carrier with an AM Best Key Rating of at least an A- and must provide us with at least 30 days' notice of cancellation. You must provide evidence of such insurance to Ace's Corporate Risk Management Department.

(6) The amount of the brand assessment for a new store in its first year of membership is a flat fee of $5,000, provided the new store is activated by Ace in the first three (3) calendar year quarters. In this case the brand assessment will be billed on the store's bi-weekly statement issued on or after the date that is sixty (60) days following the date of the new store's activation. However, if a new store is activated in the fourth (4th) calendar quarter, the amount of the brand assessment will be equal to the flat fee of $5,000, plus a brand assessment charge of $3,000, for a total assessment of $8,000, which will be billed in twenty six (26) equal installments on the store's bi-weekly statement starting in February of the calendar year following activation through January of the next following calendar year. After a store's first year billing cycle, the amount of the annual brand assessment will be billed in

twenty-six (26) equal installments on its bi-weekly statement from February to January of the next following calendar year. The annual brand assessment is subject to change by our Board of Directors.

(7) Participation in a regional advertising group is voluntary and each store decides whether or not to participate. Retailers from time to time form regional advertising groups that work together and contribute monies to fund regional advertising programs including preprints, regional television and radio commercials, billboards, newspaper ads, sponsorship of local events and local mailings. We currently support retailers' regional advertising efforts by offering Matching Funds of up to $2,400 per store per year for regional programs. We retain the right to form, change, dissolve or merge groups of regional or local members for the purpose of advertising from time to time. Other than offering the Matching Funds program, which may be modified or discontinued at any time, our role in regional and local advertising is to help the retailers develop optional annual advertising strategies. Ace bills the participating stores and assists in the implementation of the advertising campaign.

(8) Retail Loss Prevention is a part of the Property/Loss Prevention Department. Participation in the programs or services or purchase of products offered is optional, most of which are offered by unaffiliated third party vendors. Prices will vary depending upon the equipment desired or level of service requested. For example, prices for package background screening range from $30 - $43 for a single search. In-store loss prevention products start at $50 and increase with product type, quality and quantity. Some of these services and products will be billed by Ace directly to your store statement. In-store consulting, auditing, training, and investigations are available for fees beginning at $500, with fees increasing for additional services, if any, that you request. These services, the in-store consulting, auditing, training, and investigations, are provided by unaffiliated third party vendors and are billed directly to you by the vendor, with the exception of services through the Professional Retailer Services ("PRS") program. Services performed as a part of the PRS program will be billed directly to your store's statement.

(9) The Retail Financial Report is prepared yearly for Ace by an independent third-party vendor. Results profiled in the Retail Financial Report are based on income statement, balance sheet and operating data provided by participating stores.

Patronage Distributions

We operate as a retailer-owned cooperative. As a cooperative, we derive substantially all of our revenues from transactions with our member retailers who are entitled to purchase merchandise and services from us. On an annual basis, we currently distribute substantially all of our net earnings (other than non-patronage income as described below) to our member retailers in the form of patronage distributions consisting of cash, capital stock and Patronage Refund Certificates. The amount of patronage distributions each member receives annually is based upon the volume of the patronage-based merchandise, if any, he or she purchases from us in the previous year.

Membership Interests. Under our cooperative structure, to become a member of Ace, a retailer must subscribe to purchase one share of Class A common stock. Only our Class A common stock has voting rights, and each of our members may hold only one share of Class A common stock. New members and members opening new stores are also required to subscribe for shares of Class C common stock, and additional shares of Class C common stock historically have been issued annually as part of the Company's patronage distribution. As is typical for a cooperative, Ace's common stock represents only the members' participation and membership interests in Ace and do not entitle holders to participate, as stockholders, in the earnings of Ace or realize Ace's value as an enterprise to the extent that it exceeds the aggregate stated par value of our outstanding common stock.

Favorable Corporate Tax Treatment. Generally, under Subchapter T of the Internal Revenue Code, we can deduct from our income for federal income tax purposes the entire amount of the patronage we distribute each year so long as we pay (or allocate against any indebtedness owed to us) at least 20% of the patronage in cash. A similar deduction also is generally available for state income taxes. The cash payments and stated dollar amounts of Class C common stock and Patronage Refund Certificates comprising the patronage distributions we make to each member retailer, including amounts applied to a member's variance allocation account balance, must be taken into a member's gross income for federal income tax purposes. Members may then generally deduct as a business expense the portion of the patronage distribution applied to their variance allocation accounts.

Form of Patronage Distributions. Historically, patronage has been distributed in three currencies—cash, shares of Class C stock and, if the retailer has met the Company's stock requirements, interest-bearing five-year Patronage Refund Certificates. Patronage distributions are made annually according to a specific plan that is adopted by our Board of Directors. This plan can be changed from time to time by the Board as it deems appropriate.

Effective with patronage distributions related to fiscal 2010 that were made in fiscal 2011, the first 40% of the distribution is made in cash for all member retailers. The cash portion of any patronage distribution payable to a past due or terminated retailer is generally applied against the retailer's indebtedness or other obligations to us, if any. The remainder is distributed in shares of Class C

common stock until the retailer meets the stock requirement. The stock requirement is equal to 20% of the most recent year purchases from the Company's retail support centers (warehouses), including without limitation, bulletin, store-traffic-opportunity-program ("STOP") and private label liquid paint products plus 4% of the most recent year purchases shipped directly from the vendor to the retailer without any physical "handling" by the Company (i.e., dropship and less-than-truckload-plus ("LTL Plus") purchases) (See "Patronage Distributions Determinations"). Once the stock requirement and variance allocation account balances have been satisfied, the remainder of the distribution is made in the form of a Patronage Refund Certificate. In addition, for any retailer that has an outstanding loan due to us that is eligible to be satisfied from patronage distributions, any current amounts due (including principal and interest) are applied against the non-cash portion of the patronage distribution before Class C common stock or Patronage Refund Certificates are issued.

Patronage Distribution Determinations. The total patronage income available for distribution to members is determined after various expenses, including interest expense, and is based on net earnings on patronage business that we do with member retailers. Patronage distributions are allocated separately on each of our three basic categories of sales: handled sales (which include warehouse sales and bulletin sales), direct shipment sales and private label paint sales. The Company also maintains a fourth category of patronage-eligible sales (i.e., under the LTL Plus and STOP programs), for which the products' pricing incorporates the value of an 'upfront' dividend. Accordingly, this fourth category of sales generally operates at a break-even. However, were a net loss to occur with respect to this category (or any of the others), such loss would be offset against the profits of the other patronage pools in accordance with the Company's By-laws. Distribution percentage allocations are made with reference to our net earnings from each of the respective patronage pools.

The total patronage distributions distributed to members is based on net earnings on patronage business that we do with member retailers, calculated in accordance with GAAP. Our computation of patronage distributions excludes all of our income and expenses from activities that are not directly related to patronage transactions. The excluded items primarily consist of (1) profits or losses generated from non-shareholder retailers, and (2) profits or losses realized from our Ace Insurance Agency, Inc., New Age Insurance Ltd., Ace Hardware International Holdings, Ltd, and Ace Retail Holdings LLC subsidiaries.

Patronage distributions are usually paid to member retailers within four months after the close of Ace's fiscal year; however, the Internal Revenue Code permits distribution of patronage distributions as late as eight and one half months after the close of Ace's fiscal year, and Ace may elect to distribute the annual patronage distribution at such later time.

DESCRIPTION OF CAPITAL STOCK

Dividend Rights

Our Certificate of Incorporation and By-laws prohibit us from declaring dividends on any shares of any class of our stock. However, we may distribute shares of Class C Stock to you as a part of your annual patronage distribution based on your purchases.

Voting Rights

Our Class A Stock is voting stock. Class C Stock is non-voting, except that holders can vote upon any increase or decrease in the number of authorized shares of that class, any change in the par value of those shares, or anything that would change the power, preferences or special rights of that class so as to adversely affect its shares. Any class of stock that has the right to vote has one vote per share. Cumulative voting of shares for the election of directors or on other matters is not allowed.

Liquidation Rights

If Ace voluntarily or involuntarily liquidates, our net assets after paying or providing for our liabilities (including Patronage Refund Certificates) will be distributed among the shareholders of all classes of our issued and outstanding stock. In that case, holders of Class C Stock would first receive the total amounts that we would have had to pay to repurchase all outstanding shares of that class at the price previously set by our Board of Directors. (Were our net assets not sufficient to pay that amount, then each outstanding share of Class C Stock would share in the distribution of our net assets in the proportion which its purchase or redemption price would bear to the total available for payment.) Next, our net assets would be distributed equally to each Class A stockholder up to the par value of $1,000 per Class A share. Any remaining net assets would be distributed among the shareholders of all classes of stock proportionally in accordance with the amounts already allocated to them.

Preemptive Rights

Stockholders have no preemptive or similar rights to purchase shares of our stock or any securities that we might offer.

Redemption Provisions

Shares of Class A Stock are not redeemable. Shares of Class C Stock that have been issued as patronage distributions may be redeemed by the Company at any time. The redemption price for Class C Stock cannot be less than its $100 par value per share. Were we to redeem stock as discussed above, we would mail notices to each stockholder at least 30 days before the redemption date. If fewer than all of the outstanding Class C shares were being redeemed, then the number of shares and the method of redemption, whether by lot or prorata or some other way, would be determined by our Board of Directors.

Limitations on Ownership of Stock

Our members own all of our outstanding shares of capital stock. Membership in Ace is limited to approved retailers in hardware and related products who have membership agreements with us. These are the only ones eligible to own or purchase shares of any class of our stock.

No member is allowed to own more than one share of our Class A voting stock, no matter how many store locations that member owns or controls. This ensures that each Class A stockholder in our cooperative has equal voting power. We treat a member that is a corporation, partnership or similar entity as being controlled by someone else if at least 50% of the capital stock (or 50% of the profit shares) of that member is owned or controlled by another person or entity.

Other Restrictions and Rights

There is no market for the sale or trading of our stock, and the redemption prices last established by our Board of Directors have not been adjusted since 1974 when Ace first became a cooperative.

(a) As security for your indebtedness to Ace, we retain a first lien upon all your shares of Ace stock and all amounts that you pay us under your Stock Subscription Agreement before your shares are issued. Your interest in your Ace stock and the amounts paid under your Stock Subscription Agreement are always offset by the amount of any indebtedness that you owe us. We will not transfer any of your shares or any funds in your stock subscription account unless you are free from all indebtedness to us. When we repurchase shares from a terminated member as described in section (h) below, the cash portion we would normally pay toward those shares is first applied toward any indebtedness that the terminated member owed to us. The portion of the purchase price of those shares that we would normally pay with an installment note would then be applied toward any indebtedness that still remained.

(b) You are not allowed to transfer your shares of our stock or to sell, assign or pledge them, or to post them as collateral or give lien rights in them to anyone other than Ace without our prior consent. If we refuse to consent to a transfer or assignment of your stock to another hardware retailer, then we must purchase that stock back from you as described in section (h) below. You are not entitled to make a transfer or assignment to anyone who is ineligible to become a member of Ace. In other words, approved transfers can only be made to other retailers who either have Membership Agreements with us or whom we are willing to accept as members. Were you to propose to transfer the ownership of your store location to another Ace retailer, or to someone whom we are willing to accept as a member, you would have the option of either (i) selling or transferring to that person the same number of shares that we would have been required to offer him or her as a member for that store location, or (ii) selling those shares back to us. However, there are certain types of transfers of your business where you do not have the option of selling those shares back to us. These situations involve (x) any transfer which is not complete, unconditional and irrevocable; (y) any transfer to an entity in which you retain an ownership interest; or (z) any transfer to your spouse.

(c) If your membership terminates for your store location, we must repurchase your shares of Ace stock. Our repurchase obligation is subject to our first lien and our right to set off your indebtedness to us as described in section (a) above. If your stock has not yet been paid for and your shares have not yet been issued, we would instead refund the amounts that you paid under your Stock Subscription Agreement, again subject to our first lien and offset rights described in section (a) above. Your membership can be terminated by a formal notice of termination, and it can also be terminated automatically under our By-laws in each of the following three situations without a formal notice:

(i) If your store closes down or ceases business, unless your store is moved with our consent to another location, or unless your store is being acquired by another Ace retailer or by someone whom we are willing to accept as a member for operation under the same membership at another location;

(ii) If an individual holder of our shares or a member of a partnership that is a holder of our shares dies, except where the store location having the Ace membership continues, with our consent, to be operated by the deceased person's estate,

heirs or partnership successors. Changes in the legal form of ownership of the member store from an individual proprietorship or partnership to a corporation or from a partnership to an individual proprietorship are not considered significant in these cases;

(iii) If a court or other official body rules that a member is insolvent, or the member assigns the business to be operated for the benefit of creditors, or a voluntary or involuntary bankruptcy or similar petition is filed under the U.S. Bankruptcy Code regarding the member or the store or business unit for which our shares of stock are held.

(d) Under Delaware corporate law, we are not allowed to repurchase any of our shares if the value of our net assets is less than the aggregate par value of the outstanding shares of our capital stock or would be reduced below that amount by virtue of the repurchase.

(e) We do not need to consent to a transfer of shares of Ace stock that occurs when the shares are held jointly with others and the ownership of the shares automatically passes under law to the survivor(s), nor are we obligated to repurchase the shares in that case, unless the store location either (i) closes down, or (ii) stops being operated as a member of Ace.

(f) If you hold your Ace membership in the form of a corporation (the "member corporation"), you must give us written notice of any proposal where the holders of 50% or more of the voting stock of the member corporation propose to sell or transfer all of their shares of capital stock (both voting and non-voting) of that member corporation. If there is a member corporation but another corporation (the "controlling company") holds 80% or more of the voting stock of the member corporation, then you must also give us written notice if the holders of 50% or more of the voting stock of the controlling company propose to sell or transfer all of their shares of capital stock (both voting and non-voting) in the controlling company. In these cases, when the sale or transfer occurs, the corporation whose shares were sold or transferred can either keep all the shares of Ace stock that it owns for the member corporation or sell all of those shares of Ace stock back to us. If it chooses to sell all of the shares of Ace stock back to us, it must give us notice within 15 days after the effective date of the sale or transfer and then the memberships for all of the store locations represented by that stock are considered terminated by the member's voluntary action. Once terminated in this way, any store location that wishes to continue being a member must submit a new application for our acceptance. However, there are certain types of transfers of their own company stock by the shareholders of member corporations that do not result in an obligation by Ace to buy back the shares. These situations involve (i) any transfer which is not complete, unconditional and irrevocable; (ii) any transfer to an entity in which the person making the transfer retains an ownership interest; or (iii) any transfer to the spouse of the person making the transfer.

(g) The price that we pay when we repurchase shares of Ace stock is as follows:

(i) For Class A Stock, the $1,000 par value of the shares;

(ii) For Class C Stock, the per share price last set by our Board of Directors, currently $100 per share. This price may not be less than the $100 par value of each of these shares.

As described above, any indebtedness owed us is set off against such proceeds.

(h) When we repurchase our stock from a terminated member, we pay the repurchase amount in the following manner:

(i) we pay cash for the share of Class A stock and shares of Class C stock that the terminating member subscribed for in connection with entering into a Membership Agreement and for which shares the terminating member has already paid cash to us; and

(ii) we issue a non-negotiable, 4-year installment note with an interest rate of 6% per annum for a principal amount equal to the amount of the purchase price to be paid by us for (a) shares of Class C stock which exceeds the amount the terminating member paid for such shares in cash, and (b) any shares of Class C stock issued to the terminating member as part of a patronage distribution.

(i) If the repurchase price of a terminating member's capital stock as described above is not enough to satisfy all of such terminating member's indebtedness to Ace, we will apply the face value of the terminating member's patronage certificates against such remaining indebtedness as permitted by our By-laws. The terminating member will receive cash for any remaining amount of any patronage certificate used for this purpose.

(j) We do not have any conversion rights, sinking fund provisions, or liability to further calls or assessments for any shares of our stock.

FEDERAL INCOME TAXES

The following summaries are based on the Internal Revenue Code of 1986, as amended (the "Code"), legislative history, administrative pronouncements, judicial decisions and final, proposed and temporary Treasury Regulations, changes to any of which may affect the tax consequences that are described below. Any such changes may apply retroactively. You should consult with your own tax advisor with regard to the application of the United States federal income tax laws to your particular situation, as well as any tax consequences to you arising under the laws of any state, local or foreign taxing jurisdiction.

Status of Class A and Class C Shares

If your membership were to terminate for all of your retailer store locations and we were to repurchase your shares of Ace stock, that repurchase would include your one share of Class A voting stock. Any such repurchase of such share of Class A Stock would be at its $1,000 par value, the amount you paid for it. You would not realize taxable income from our repurchase of that share.

If we redeem or repurchase your shares of Class C Stock, you could realize taxable income under the Code if the price we paid were to exceed the $100 par value. This could occur if our Board of Directors were to set a higher purchase price for Class C shares at some future date. In this event, unless you still owned our stock for other store locations that remained members, the taxable income you realized at the time of our redemption or repurchase of your Class C shares might qualify for capital gains treatment.

If you were to continue to own shares of Ace stock for other store locations after we redeemed or repurchased your shares for one or more of your locations, the amount we paid you for the redeemed or repurchased shares might be treated as a distribution under the Code and taxed to you as ordinary income. In that case, the income tax basis of your remaining Ace shares would be increased by an amount equal to your basis in the redeemed or repurchased shares.

"Unstated interest" that is taxable income to you under Section 483 of the Code could occur if your membership is terminated and you receive a four-year installment note from us in partial payment for your stock. (See "Description of Capital Stock—Other Restrictions and Rights.") This would most likely happen if the interest rate payable on the note you received (currently 6%) were less than the "applicable federal rate" in effect as of the date of such note.

Tax Treatment of Patronage Distributions

The shares of Class C non-voting stock that we use to pay patronage distributions are "qualified written notices of allocation" within the meaning of Sections 1381 through 1388 of the Code. These Sections of the Code deal with the income tax treatment of cooperatives and their patrons. The dollar amount stated on a qualified written notice of allocation must be taken into the gross income of the person to whom the notice is issued, even though this dollar amount may not actually be paid to the person in the same year that it is taxed.

We receive a deduction from our gross income for federal income tax purposes for the patronage distributions we pay to patrons (that is, to our eligible and qualifying retailers) in the form of qualified written notices of allocation if we pay (or apply against any indebtedness that a patron owes us) not less than 20% of each patron's total patronage distribution in cash and the patron has consented to including the written notice of allocation at its stated dollar amount in his or her gross income for the taxable year in which he or she receives it. We must also make our patronage distributions to patrons within eight and one-half months after the end of the taxable year.

If you become a "member" by owning one share of Class A voting stock, you are deemed under the Company's By-laws to have consented to include in your gross income the amounts specified in the written notices of allocation that we distribute to you. Pursuant to the Stock Subscription Agreement, retailers who have subscribed but not yet fully paid for shares of our stock are also deemed to have consented to include in their gross income the dollar amounts of the written notices of allocation distributed to them.

We may be required to backup withhold for federal income tax purposes with respect to your patronage distribution if (i) you have not provided us with a taxpayer identification number, (ii) we are notified by the IRS that your taxpayer identification number is incorrect, or (iii) we are notified by the IRS to subject your patronage distribution to backup withholding. In all instances where we are required to backup withhold, the amount subject to backup withholding is limited to the amount of the patronage distribution treated as paid in cash.

The portion of the patronage distribution that the Company pays you in cash may not be sufficient, depending upon your income tax bracket, to pay all of your income tax on your patronage distribution.

Prior to January 2, 2011, we had members with stores located in foreign countries. The Code requires different tax treatment (i.e. tax withholding) for patronage distributions we made to eligible retailers whose places of business are located in foreign countries. As noted elsewhere in this Annual Report, we restructured our international operations effective with the 2011 fiscal year and, accordingly, the Company no longer has members whose place of business are located outside the United States.

RISKS OF MEMBERSHIP

There are a number of risks that one should consider carefully before making a decision to open an Ace store. Some of the more important of those risks are described below. There may be other features, risks and benefits particularly relevant to you that are not summarized here.

Risks Associated With Retail Businesses Generally

Success is highly dependent on your individual skills as an independent business person, including your ability to relate to, deal with and "sell to" retail consumers, and generally your ability to lead and manage your store(s). Your success is also dependent on the level of effort you and your colleagues put forth.

Success is also dependent on numerous other variables including merchandise selection and pricing, customer service, consumer preferences, store location and appearance, competition, store operations generally, labor and other costs, lease terms and costs, interest rates, etc. Some but not all of these variables are within your control.

The retail environment is intensely competitive with many purveyors offering consumers a vast range of different products. In addition, internet-based shopping portals are taking an ever-growing share of consumer wallets, placing additional pressures on traditional brick-and-mortar retailers.

Risks Associated With the Retail Hardware Business

The retail hardware business is highly fragmented and intensely competitive. Our retailers' competitors include many large companies that have substantially greater market presence, name recognition and financial, marketing and other resources than we do. They also include independent retail hardware stores, some of which are affiliated with other large retailer-based hardware cooperatives but others of which are not. These stores often have a strong local following. (See "Ace's Business – Competition.")

Sales of hardware and home improvement goods historically depend to some extent on consumers' discretionary spending. An economic downturn in your local area, or in general, could reduce your customers' willingness or ability to purchase the products you sell. This could cause your business and financial results to suffer.

It is relatively easy for other competitors to enter your market. Increased competition could also occur if existing competitors expand their operations in your market, or adopt innovative pricing strategies, store formats or retail sales methods. Any of these developments could adversely affect your market share, sales and profitability.

Newly opened hardware stores can generally expect to experience negative cash flow and pre-tax losses during their early years as business develops and grows.

Risks Specifically Related to the Ace Retail Hardware Business

While many new stores have opened each year recently, and most have done so successfully, Ace's U.S. store count has actually declined in four of the past six years (2011, 2010, 2009 and 2008).

We believe that our trademarks and other proprietary rights are important to our success and our retailers' competitive position. Our failure or inability to adequately protect these rights could adversely affect the value of our brands and, in turn, the value of your store's Ace branding.

The Ace brand can be adversely affected by negative publicity about product quality or by operating issues at Ace or at one or more Ace-branded stores. Virtually all Ace-branded stores (with the exception of the 85 store chain, WHI) are owned by our members, not by Ace. Moreover, third parties could file lawsuits against Ace asserting claims for injuries or damages allegedly caused by products sold by us or by one of our retailers, or other claims. Any one or more of these developments could have an adverse effect on the Ace brand and image and, in turn, on your business results.

Risks Particularly Associated With Your Prospective Store

Although we may have provided you with preliminary information (e.g., retail sales forecasts, site analyses, demographic data, target penetration surveys and similar information) regarding one or more potential sites for your store and the market in which it is or will be located, you assume all responsibility for evaluating and investigating the commercial viability of your store, including its location, the market in which it is located, and your site's lease or purchase terms.

The proforma financial statement and other financial projections (collectively "Projections") that we prepared or assisted you to prepare for your store are estimates only, and are not guarantees of your store's future performance. It is your responsibility to determine whether these Projections are reasonable. Your store's actual financial results are likely to differ from those indicated in the Projections and may do so substantially.

The design and layout of your store can be expected to have a significant effect on its success or failure. While Ace can assist you with store design and layout, you assume responsibility for all aspects of your store's design and layout.

The assortment and prices of products you offer for sale in your store can be expected to have a significant effect on its success or failure. While Ace can assist you with product assortment and pricing, you assume responsibility for all aspects of your store's product assortment and pricing.

We cannot predict the amount of funds that you will need in connection with the construction or conversion remodeling of your store or the ongoing operation of your business. You assume full responsibility for determining the amount and source of funds required to open and operate your store.

You will enjoy financial benefits if your store succeeds. However, if your store fails, you might lose your entire investment in the business. You may also owe others in excess of the amount you invested, due to obligations you made to your landlord, your bank(s) and your suppliers, including Ace. Moreover, we repurchase merchandise from our retailers only in very limited circumstances and never in bulk.

Risks Associated With Ace as Wholesaler and Primary Supplier

You depend on Ace to anticipate and respond in a timely manner to changing consumer demand and preferences regarding hardware, paint and related home-improvement products. These products must appeal to a broad range of consumers whose preferences cannot be predicted with certainty and are subject to change. Additionally, Ace typically makes commitments to purchase products from our suppliers several months in advance of the proposed delivery. If we misjudge the market and fail to purchase the right products in the right quantities, you may not be able to obtain from us the types or quantities of merchandise best suited to your store location. This could cause your sales to decline and your financial results to suffer.

If our suppliers do not provide us with sufficient quantities of products, we may not be able to offer you competitively priced merchandise in the quantities or assortment that you desire. Although Ace purchases merchandise from over 4,700 outside suppliers and no such supplier represents more than 3% of our total purchases, our dependence on our principal suppliers involves risk. Ace does not have long-term agreements with our suppliers and cannot guarantee that we will be able to maintain our relationships with them. If there is a disruption in our supply sources, we may not be able to obtain the merchandise that you desire for your customers.

We import a significant portion of our inventory from manufacturers outside the United States, particularly in Asia. Importing involves risks including potential disruptions resulting from economic and political problems in countries from which merchandise is imported, and duties, tariffs and quotas on imported merchandise. Ace's ability to manage the importing of goods from overseas, their production, timing of deliveries and U.S. Customs-related compliance is an important component of our merchandising strategy. If we fail to manage our import activities well, you may not be able to purchase from us the products that your customers want to buy from you.

Ace needs to maintain substantial buying power in order to provide you with quality products at a competitive price so you can do the same for your customers.

(a) This requires Ace to continue to have a large number of retailers who purchase in large quantities from Ace. If a significant number of our retailers were to leave our cooperative for any reason, or were to remain as members but significantly reduce their purchases from us, Ace's ability to purchase in high volume would be negatively affected. This

reduction in our buying volume could reduce our leverage with our suppliers, resulting in higher supplier prices to Ace and, in turn, higher prices for the merchandise you purchase from us.

(b) This also requires Ace to have a highly developed and efficient warehouse and distribution network—supply chain—which, in turn, requires Ace's continued investment in facilities, technology, trucking and other equipment. Although we expect that our ongoing operations will enable us to make such investments, there is no guarantee that we will be able to do so.

We rely upon management information systems in operating and monitoring all major aspects of our business, including communication with our retailers, merchandising planning and replenishment, supplier purchases, sales to retailers, warehousing, distribution, inventory control, and various corporate-level financial and other functions. Any disruption in the operation of these management information systems, or our failure or inability to continue to upgrade, integrate and expend capital on them, could have a material adverse effect on the Company's ability to sell merchandise and provide cost-effective services to you, and, in turn, on your ability to order merchandise, operate your POS system at retail and/or manage and track your inventory levels.

Risks Associated With Being a Member of the Ace Hardware Cooperative

Although we distribute "patronage distributions" or "patronage rebates" to our stockholders based on the volume of business done with them, we are prohibited from declaring dividends on shares of Ace stock. Your ability to transfer these shares is limited and there is no trading market for them. If you have a store location that is a member of our cooperative and it closes down or if your Ace membership is terminated, you can sell your shares only to the new Ace retailer we approve as a member for your particular store location. If you do not sell your shares in this way, we must repurchase them. We do not expressly set aside any funds to purchase these shares, and repurchases can be made only as permitted under Delaware corporate law. Therefore, except for the voting rights which Class A stock has, our stock has financial value to you only if your membership terminates or if Ace is liquidated.

If you become an Ace member, you must report the total amount of your patronage distributions from us as gross income on your federal income tax return. Therefore, your taxable income will include not only the cash portion of your distribution, but also the stated dollar amount of any shares of Class C Stock and Patronage Refund Certificates or the fair market value of any other property included in your patronage distributions. A minimum of 20% of your total annual patronage distributions must be paid in cash, unless this cash portion has been applied against your indebtedness to us. Depending on your income tax bracket, this cash portion may not be sufficient to pay all of your income tax liability on your patronage distributions. (See "Membership Information-Patronage Distributions" and "Federal Income Taxes—Tax Treatment of Patronage Distributions.")

Our Board of Directors has the authority to establish reasonable reserves, thereby reducing or even eliminating the amount of our net earnings available for distribution as patronage distributions. Our Board of Directors also has the authority to change the patronage distribution plan and, if they were to do so, the cash portion of your patronage distribution could be adversely affected.

Ace Hardware Corporation

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