



**RECREATIONAL EQUIPMENT, INC.**

Consolidated Financial Statements

December 28, 2019 and December 29, 2018

(With Independent Auditors' Report Thereon)

## RECREATIONAL EQUIPMENT, INC.

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KPMG LLP  
Suite 2900  
1918 Eighth Avenue  
Seattle, WA 98101

## Independent Auditors' Report

The Board of Directors  
Recreational Equipment, Inc.:

We have audited the accompanying consolidated financial statements of Recreational Equipment, Inc. and its subsidiaries, which comprise the consolidated balance sheets as of December 28, 2019 and December 29, 2018, and the related consolidated statements of comprehensive income, members' equity, and cash flows for the periods ended December 28, 2019 and December 29, 2018, 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 consolidated financial statements in accordance 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Recreational Equipment, Inc. and its subsidiaries as of December 28, 2019 and December 29, 2018, and the results of their operations and their cash flows for the periods ended December 28, 2019 and December 29, 2018, in accordance with U.S. generally accepted accounting principles.



*Change in Accounting Principle*

As discussed in Note 1 to the consolidated financial statements, in 2019 the Company adopted Accounting Standard Update, 2014-09, *Revenue from Contracts with Customers*, and all related amendments, which established Accounting Standard Codification Topic 606, *Revenue – Revenue from Contracts with Customers*. Our opinion is not modified with respect to this matter.

KPMG LLP

Seattle, Washington

March 6, 2020

**RECREATIONAL EQUIPMENT, INC.**

Consolidated Balance Sheets

December 28, 2019, and December 29, 2018

(In thousands)

<b>Assets</b>	<b>2019</b>	<b>2018</b>
Current assets:		
Cash and cash equivalents	\$ 189,810	270,861
Short-term investments	279,242	292,574
Accounts receivable, less allowance for doubtful accounts of \$224 and \$437, respectively	34,782	33,098
Inventories	535,184	529,484
Prepaid expenses and other	55,179	23,234
Income taxes receivable	3,192	—
Total current assets	1,097,389	1,149,251
Property and equipment, net of accumulated depreciation of \$935,926 and \$898,254, respectively	742,892	608,771
Goodwill, net of accumulated amortization of \$5,551 and \$4,026, respectively	6,509	4,007
Deferred income taxes, net	28,291	28,359
Other	43,850	32,460
Total assets	\$ 1,918,931	1,822,848
<b>Liabilities and Members' Equity</b>		
Current liabilities:		
Accounts payable	\$ 274,752	257,647
Customer-related obligations	221,027	223,236
Patronage dividends payable	155,808	149,287
Accrued payroll and benefits	127,873	117,070
Business taxes and other accrued liabilities	46,086	41,112
Income taxes payable	—	1,388
Total current liabilities	825,546	789,740
Deferred rent and other long-term liabilities	82,621	79,044
Commitments and contingencies (note 9)		
Members' equity:		
Memberships	312,591	290,622
Accumulated other comprehensive income (loss)	381	(712)
Retained earnings	697,792	664,154
Total members' equity	1,010,764	954,064
Total liabilities and members' equity	\$ 1,918,931	1,822,848

See accompanying notes to consolidated financial statements.

**RECREATIONAL EQUIPMENT, INC.**

Consolidated Statements of Comprehensive Income

Periods ended December 28, 2019 and December 29, 2018

(In thousands)

	<b>December 30, 2018 – December 28, 2019</b>	<b>December 31, 2017 – December 29, 2018</b>
Net sales	\$ 3,122,994	2,781,909
Cost of sales	<u>1,715,246</u>	<u>1,567,202</u>
Gross profit	<u>1,407,748</u>	<u>1,214,707</u>
Operating expenses:		
Payroll-related expenses	630,531	561,851
Occupancy, general and administrative	<u>619,877</u>	<u>466,405</u>
Operating expenses	<u>1,250,408</u>	<u>1,028,256</u>
Operating income	157,340	186,451
Other income, net	<u>3,656</u>	<u>1,328</u>
Income before patronage dividends and income taxes	160,996	187,779
Patronage dividends, net	<u>134,153</u>	<u>129,635</u>
Income before income taxes	26,843	58,144
Provision for income taxes	<u>5,799</u>	<u>11,046</u>
Net income	<u>21,044</u>	<u>47,098</u>
Other comprehensive income (loss):		
Unrealized gain (loss) on available-for-sale securities, net of tax of (\$338) and (\$10), respectively	<u>1,093</u>	<u>(345)</u>
Comprehensive income	<u><u>\$ 22,137</u></u>	<u><u>46,753</u></u>

See accompanying notes to consolidated financial statements.

**RECREATIONAL EQUIPMENT, INC.**

Consolidated Statements of Members' Equity

Periods ended December 28, 2019 and December 29, 2018

(In thousands)

	<u>Memberships</u>	<u>Retained earnings</u>	<u>Accumulated other comprehensive income (loss)</u>	<u>Total members' equity</u>
Balance at December 30, 2017	\$ 270,543	617,056	(367)	887,232
Unrealized loss on available-for-sale securities, net of tax	—	—	(345)	(345)
Memberships issued	20,079	—	—	20,079
Net income	—	47,098	—	47,098
Balance at December 29, 2018	290,622	664,154	(712)	954,064
Cumulative effect of adopted accounting standards	—	12,594	—	12,594
Unrealized gain on available-for-sale securities, net of tax	—	—	1,093	1,093
Memberships issued	21,969	—	—	21,969
Net income	—	21,044	—	21,044
Balance at December 28, 2019	\$ <u>312,591</u>	<u>697,792</u>	<u>381</u>	<u>1,010,764</u>

See accompanying notes to consolidated financial statements.

**RECREATIONAL EQUIPMENT, INC.**

Consolidated Statements of Cash Flows

Periods ended December 28, 2019 and December 29, 2018

(In thousands)

	<b>December 30, 2018 – December 28, 2019</b>	<b>December 31, 2017 – December 29, 2018</b>
	<u>          </u>	<u>          </u>
Operating activities:		
Net income	\$ 21,044	47,098
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of goodwill	106,107	104,922
Amortization of investment premium/discount	(1,081)	(782)
Change in provision for sales returns	2,057	3,404
Deferred income taxes, net	(4,469)	(4,069)
Deferred rent	1,058	683
Gain/loss on sale and disposal of equipment	591	(1,189)
Changes in operating assets and liabilities:		
Accounts receivable	(1,485)	(4,921)
Inventories	(39,667)	(32,473)
Prepays and other assets	(9,704)	7,376
Accounts payable and other accrued expenses	40,359	42,644
Net cash provided by operating activities	<u>114,810</u>	<u>162,693</u>
Investing activities:		
Acquisition of business, net of cash acquired	(4,250)	(89)
Purchases of short-term investments	(785,487)	(1,075,471)
Proceeds from sale of short-term investments	801,331	1,075,940
Purchases of property and equipment	(229,532)	(143,746)
Proceeds from sale of property and equipment	108	3,443
Net cash used in investing activities	<u>(217,830)</u>	<u>(139,923)</u>
Financing activity:		
Proceeds from sale of memberships	21,969	20,079
Net cash provided by financing activity	<u>21,969</u>	<u>20,079</u>
Net increase (decrease) in cash and cash equivalents	(81,051)	42,849
Cash and cash equivalents at beginning of year	<u>270,861</u>	<u>228,012</u>
Cash and cash equivalents at end of year	<u>\$ 189,810</u>	<u>270,861</u>
Supplemental disclosure of cash flow information:		
Cash paid for:		
Income taxes	\$ 12,780	4,294
Noncash investing activity:		
Property and equipment additions in accounts payable	\$ 20,032	12,472

See accompanying notes to consolidated financial statements.



## RECREATIONAL EQUIPMENT, INC.

Notes to Consolidated Financial Statements

December 28, 2019 and December 29, 2018

### (1) Basis of Presentation and Summary of Significant Accounting Policies

#### (a) Business Overview

Recreational Equipment, Inc. and its subsidiaries (collectively, REI or the Company) operate as a specialty outdoor retail cooperative. REI is dedicated to inspiring, educating, and outfitting its members and the community for a lifetime of outdoor adventure and stewardship. REI was founded in 1938 by a group of Pacific Northwest mountaineers seeking quality equipment and is committed to promoting environmental stewardship and creating access to inspirational places throughout the country. REI sells goods and services through more than 160 retail stores located throughout the United States, online through rei.com, and through calls to the REI support center.

#### (b) Principles of Consolidation

The consolidated financial statements present the results of operations, financial position, and cash flows of the Company in U.S. dollars, in accordance with U.S. generally accepted accounting principles (GAAP). The consolidated financial statements include the accounts of Recreational Equipment, Inc. and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated upon consolidation.

#### (c) Fiscal Year

REI reports results on a 52/53-week fiscal year ending on the Saturday closest to December 31. Reported results relate to the 52-week fiscal years ended December 28, 2019 and December 29, 2018.

#### (d) Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses and disclosure of contingent assets and liabilities. Uncertainties regarding such estimates and assumptions are inherent and, as a result, actual results could differ. Such estimates include, but are not limited to, the following: useful lives and recoverability of fixed assets, inventory obsolescence, income taxes, sales returns reserves, unredeemed gift cards, unredeemed patronage dividends, and goodwill.

#### (e) Cash and Cash Equivalents

Cash equivalents are highly liquid short-term investments with original maturities of three months or less. Cash and cash equivalents include payments due from financial institutions for third-party credit card and debit card deposits, which are typically received within two to four business days. The Company maintains a portion of its cash and cash equivalent balances with financial institutions that exceed federally insured limits. The Company has not experienced any losses related to these balances and management believes its credit risk to be minimal.

#### (f) Short-Term Investments

The Company invests cash in accordance with its investment policy. The Company's short-term investments are classified as available-for-sale securities and consist primarily of corporate bonds, tax-exempt municipal bonds, commercial paper, and AAA-rated asset-backed securities. The Company is exposed to credit risk in the event of default by issuers and counterparties of the short-term investments. The Company's available-for-sale securities consist primarily of investments that regularly

## RECREATIONAL EQUIPMENT, INC.

Notes to Consolidated Financial Statements

December 28, 2019 and December 29, 2018

trade in active markets; as such, the Company has classified the entire available-for-sale portfolio as a current asset on the consolidated balance sheets. The Company's investments are stated at fair value, with any unrealized gains and losses, net of deferred income taxes, reported as a component of accumulated other comprehensive income (loss). Realized gains and losses on these securities are included in other income, net in the consolidated statements of comprehensive income. The cost of securities sold is determined using the specific identification method. The Company periodically evaluates unrealized losses in its investment securities for other-than-temporary impairment, using both qualitative and quantitative criteria. In the event a security is deemed to be other-than-temporarily impaired, the Company records a charge against net income. No such charges were recorded for the periods ended December 28, 2019 or December 29, 2018.

The cost and fair value of the Company's available-for-sale securities that are carried at fair value at December 28, 2019, by contractual maturity, are as follows (in thousands):

	<u>Cost</u>	<u>Fair value</u>
Due in one year or less	\$ 141,809	141,899
Due in more than one year	<u>136,940</u>	<u>137,343</u>
Total	<u>\$ 278,749</u>	<u>279,242</u>

### **(g) Accounts Receivable**

Accounts receivable are primarily due from vendors and landlords. The Company estimates its allowance for doubtful accounts based on length of time past due and ability to collect the receivable.

### **(h) Inventories**

Inventories are carried at the lower of cost or net realizable value, defined as the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation, on an average cost basis. The Company records a write-down of inventories, which are obsolete or slow-moving, based upon historical experience.

### **(i) Property and Equipment**

Property and equipment are recorded at historical cost less accumulated depreciation and impairments. Depreciation is computed primarily by using the straight-line method based on the assets' estimated useful lives, which are 10 to 30 years for buildings and improvements, and two to 10 years for software, equipment, furniture, and fixtures. Renewals and betterments that add to the productive capacity or extend the useful life of the asset are capitalized. Capitalized software includes the costs of developing or obtaining internal-use software, including external direct costs of materials and services and internal payroll costs related to each software project.

Leasehold improvements made at the inception of the lease are amortized over the shorter of the initial lease term or the asset life. Leasehold improvements made during the lease term are amortized over the shorter of the asset life or the remaining lease term.

Maintenance and repairs are charged to expense as incurred.

## RECREATIONAL EQUIPMENT, INC.

Notes to Consolidated Financial Statements  
December 28, 2019 and December 29, 2018

### **(j) Goodwill**

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized.

The Company has elected the private company alternative to amortize goodwill. For goodwill acquired during 2019 and prior, an amortization period of 7 years has been applied. The Company has elected to follow the authoritative guidance available to private companies to assess goodwill impairment at the entity-wide level. The Company will assess goodwill for impairment whenever events or changes in circumstances indicate that the carrying amount of goodwill may not be fully recoverable. There was no impairment recognized for the periods ended December 28, 2019 and December 29, 2018.

### **(k) Long-Lived Assets**

When facts or circumstances indicate that the carrying values of long-lived assets, including buildings, equipment, and internal-use software may not be recoverable, an evaluation for impairment is performed. An asset is considered impaired when estimated undiscounted future cash flows are less than the carrying amount of the asset. In the event that the carrying amount of such asset is not deemed recoverable, the asset is adjusted to its estimated fair value. Fair value is generally determined based upon a discounted future cash flow model. Property and equipment assets are grouped at the lowest level in which there are identifiable cash flows when assessing impairment. Cash flows for retail assets are identified at the individual store level. There was no impairment recognized for the periods ended December 28, 2019 and December 29, 2018.

### **(l) Customer-Related Obligations**

Sales returns reserves, deferred revenue for unredeemed gift cards, and the rewards earned by cardholders as part of the REI co-branded member reward program are reflected within customer-related obligations.

### **(m) Patronage Dividends**

The Company declares a patronage dividend to members based on the level of qualifying member purchases during each calendar year. As required by the Company's bylaws, the dividend is limited to the distribution of operating income (as defined). The Company records the patronage dividends payable liability based upon its estimate of dividends that will be redeemed by co-op members prior to the dividend expiration date. The Company has historical experience demonstrating that less than 100% of members redeem their entire patronage dividend award within the time period these dividends are available to them. At December 28, 2019, the balance of patronage dividends payable was \$155.8 million, net of estimated dividends of \$47.1 million that will not be redeemed, and at December 29, 2018, the balance of patronage dividends payable was \$149.3 million, net of estimated dividends of \$44.4 million that will not be redeemed.

### **(n) Sabbatical Leave**

The Company provides paid leave to employees with service of 15 or more years. The Company records the compensation cost associated with sabbatical leaves over the requisite service periods.

## RECREATIONAL EQUIPMENT, INC.

Notes to Consolidated Financial Statements  
December 28, 2019 and December 29, 2018

### **(o) Rent**

The Company recognizes minimum rent expense, net of landlord reimbursements, on a straight-line basis over the lease term from the time the Company controls the leased property. For leases that contain predetermined, fixed escalations of the minimum rent, the Company recognizes the rent expense on a straight-line basis and records the difference between the rent expense and the rent payable as a deferred credit.

As part of entering into certain retail store leases, the lessor may provide the Company with a tenant improvement allowance. Typically, such allowances are in the form of cash and represent reimbursements to the Company for tenant improvements made to the leased space. These improvements are capitalized as fixed assets, and the allowances are classified as a component of deferred rent. This incentive is considered a reduction of rent expense by the Company over the term of the lease on a straight-line basis.

### **(p) Memberships**

The Company is a cooperative made up of members. Each eligible member is entitled to vote in the election of the Company's board of directors. To be considered eligible to vote, a member must have purchased at least \$10 worth of merchandise, paid a shipping charge of at least \$10, or become a new member in the previous calendar year. Since January 1, 2008, the one-time fee for a nonrefundable, nontransferable membership has been \$20. As of December 28, 2019, there were 7.0 million voting eligible members.

### **(q) Net Sales**

In 2019, the Company adopted Accounting Standard Update(ASU) No. 2014-09, *Revenue from Contracts with Customers*, and all related amendments, using the modified retrospective transition method, which requires that we recognize revenue differently pre- and post-adoption. See "Significant accounting policies – Recent Accounting Pronouncements Adopted" below for more information.

The Company recognizes revenue from product sales when products are purchased by customers at the Company's stores or when products are shipped for online sales. Revenue is recorded net of sales taxes and estimated allowances for returns. The allowance for sales returns is based on historical information and reduces both sales and cost of sales. The Company records, on a gross basis, a refund liability and an asset for recovery, which are included in customer-related obligations and other current assets, respectively, in the consolidated balance sheets. Shipping revenue is included in net sales and the related costs of shipping are included in cost of sales.

Substantially all of the Company's sales are single performance obligation arrangements for which the transaction price is equivalent to the stated price of the product or service, net of any stated discounts applicable at a point in time. The Company is the principal for the majority of its transactions and recognizes revenue on a gross basis. The Company is the principal when it has control of the merchandise or service before it is transferred to the customer.

## RECREATIONAL EQUIPMENT, INC.

Notes to Consolidated Financial Statements

December 28, 2019 and December 29, 2018

The Company offers no-fee, non-expiring gift cards to its customers. At the time gift cards are sold, no revenue is recognized; rather, the Company records an accrued liability to customers. The liability is relieved and revenue is recognized equal to the amount redeemed at the time gift cards are redeemed for merchandise. The Company records revenue from unredeemed gift cards (breakage) in net sales in proportion over the time period gift cards are actually redeemed. Historical redemption data is used to determine actual redemption patterns.

The Company records profit-sharing income under our credit card program agreement to net sales.

### **(r) Cost of Sales**

Cost of sales includes the cost to purchase and transport merchandise to the Company. The Company receives rebates, allowances, and cooperative advertising funds from vendors. Amounts received related to the reimbursement of costs incurred, such as advertising, are recognized as a reduction in the related expense when the vendor receives a specific incremental, identifiable benefit. Other consideration received from vendors in the form of cash and credits are recorded as a reduction of cost of sales as the related merchandise is sold.

### **(s) Occupancy, General, and Administrative Expenses**

Occupancy, general, and administrative expenses consist primarily of depreciation, advertising, rent, bankcard fees, and other miscellaneous expenses.

### **(t) Advertising Costs**

Advertising production costs for internet, photo, video, direct mail, and other media are expensed the first time the advertisement is delivered. Other advertising costs are expensed as incurred. Advertising expense for 2019 and 2018 was \$88.6 million and \$77.5 million, respectively, and is included in occupancy, general, and administrative expenses.

### **(u) Income Taxes**

The Company operates as a cooperative subject to taxes on all income not distributed to members. The Company computes income taxes using the asset and liability method, under which deferred income taxes are provided for the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the tax basis. The deferred tax assets and liabilities are calculated using the enacted tax rates that are expected to be in effect when the differences are expected to reverse. The Company establishes a valuation allowance for deferred tax assets if it is more likely than not that these items will expire before the Company is able to realize the benefit or future deductibility is uncertain.

**RECREATIONAL EQUIPMENT, INC.**

Notes to Consolidated Financial Statements

December 28, 2019 and December 29, 2018

**(v) Recent Accounting Pronouncements Adopted**

The Company adopted ASU No. 2014-09, *Revenue from Contracts with Customers*, and all related amendments, which established Accounting Standard Codification Topic 606, *Revenue – Revenue from Contracts with Customers*. The core principle of Topic 606 is for companies to recognize revenue in a manner that depicts the transfer of promised goods or services to customers in amounts that reflect the consideration, or payment, to which the company expects to be entitled in exchange for those goods or services. The Company adopted ASU No. 2014-09 in 2019, using the modified retrospective approach through a cumulative effect adjustment to retained earnings of \$12.6 million. Additionally, the 2019 consolidated financial statements have been impacted as follows:

Estimated costs of returns will be recorded as a current asset rather than included within Inventories.

Gift card breakage is recorded in sales, rather than occupancy, general and administrative expenses. It is estimated based on expected customer redemption patterns, rather than when redemption is considered remote.

Certain co-branded credit card income is recorded in sales, rather than occupancy, general and administrative expenses. The timing and method of recognition is not impacted by adoption of this ASU.

Excluding the effect of the opening balance sheet adjustment noted above, the impact of the adoption of ASU No. 2014-09 on our consolidated balance sheet as of December 28, 2019 is as follows (in thousands):

	<u>As reported</u>	<u>ASU No. 2014-09 impact</u>	<u>Excluding ASU No. 2014-09 impact</u>
Inventories	\$ 535,184	(37,117)	572,301
Prepaid expenses and other	55,179	37,117	18,062

The impact of the adoption of ASU No. 2014-09 on our consolidated statements of comprehensive income for fiscal year 2019 is as follows (in thousands):

	<u>As reported</u>	<u>ASU No. 2014-09 impact</u>	<u>Excluding ASU No. 2014-09 impact</u>
Net sales	\$ 3,122,994	94,539	3,028,455
Gross Profit	1,407,748	94,539	1,313,209
Occupancy, general and administrative	619,877	94,539	525,338

## RECREATIONAL EQUIPMENT, INC.

Notes to Consolidated Financial Statements  
December 28, 2019 and December 29, 2018

### **(w) Recent Accounting Pronouncements Not Yet Adopted**

In February 2016, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2016-02, *Leases (Topic 842)*, which was subsequently amended in July 2018 by ASU No. 2018-10, *Codification Improvements to Topic 842, Leases*. This ASU requires lessees to recognize leases on balance sheet and disclose key information about leasing arrangements. The new standard establishes a right-of-use (ROU) model that requires a lessee to record an ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. For nonpublic entities, the new standard is effective for interim and annual periods beginning after December 15, 2020, with early adoption permitted. The Company plans to adopt this ASU in 2020 and plans to utilize the transition option, which does not require application of the guidance to comparative periods in the year of adoption. The Company is currently evaluating the impact of this guidance and expects the adoption will result in a material increase in the assets and liabilities on the consolidated balance sheets. The standard will have no impact on the covenants under the Company’s line of credit agreement.

### **(2) Fair Value**

The Company applies fair value accounting for all financial assets and liabilities that are recognized at fair value in the financial statements. The Company defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities, which are required to be recorded at fair value, the Company considers the principal or most advantageous market in which the Company would transact and the market-based risk measurements or assumptions that market participants would use in pricing the asset or liability, such as risks inherent in valuation techniques, transfer restrictions, and credit risk. Fair value is estimated by applying the following hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement.

The hierarchy is broken down into three levels based on the reliability of inputs as follows:

Level 1 – Quoted prices in active markets for identical assets or liabilities

Level 2 – Other inputs that are directly or indirectly observable in the marketplace

Level 3 – Inputs that are generally unobservable and typically reflect management’s estimate of assumptions that market participants would use in pricing the asset or liability.

As of December 28, 2019, and December 29, 2018, there were no financial instruments within Level 3 of the hierarchy. Nonfinancial assets, including property and equipment and goodwill, are reported at carrying value and are not required to be measured at fair value on a recurring basis. However, on a periodic basis, or whenever events or changes in circumstances indicate their carrying value may not be recoverable, the Company assesses long-lived assets for impairment. Nonrecurring assessments use significant unobservable inputs and, therefore, fall under Level 3 of the fair value hierarchy.

**RECREATIONAL EQUIPMENT, INC.**

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December 28, 2019 and December 29, 2018

In accordance with the fair value accounting requirements, companies may choose to measure eligible financial instruments and certain other items at fair value. The Company has not elected the fair value option for any eligible financial instruments. The carrying amount of the Company's accounts receivable and accounts payable on the consolidated balance sheets approximate fair value due to their short-term nature.

Assets and liabilities measured at fair value consist of the following as of December 28, 2019 (in thousands):

	<u>Cost basis</u>	<u>Unrealized gains</u>	<u>Fair value</u>	<u>Cash and cash equivalents</u>	<u>Short-term investments</u>
Cash	\$ 42,235	—	42,235	42,235	—
Level 1:					
Money market	<u>147,575</u>	<u>—</u>	<u>147,575</u>	<u>147,575</u>	<u>—</u>
Subtotal	<u>189,810</u>	<u>—</u>	<u>189,810</u>	<u>189,810</u>	<u>—</u>
Level 2:					
Asset-backed securities	37,697	62	37,759	—	37,759
Commercial paper	82,133	—	82,133	—	82,133
Corporate bonds	107,526	296	107,822	—	107,822
Municipal bonds	48,498	135	48,633	—	48,633
Other	<u>2,895</u>	<u>—</u>	<u>2,895</u>	<u>—</u>	<u>2,895</u>
Subtotal	<u>278,749</u>	<u>493</u>	<u>279,242</u>	<u>—</u>	<u>279,242</u>
Total	\$ <u>468,559</u>	<u>493</u>	<u>469,052</u>	<u>189,810</u>	<u>279,242</u>

Assets and liabilities measured at fair value consist of the following as of December 29, 2018 (in thousands):

	<u>Cost basis</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Cash and cash equivalents</u>	<u>Short-term investments</u>
Cash	\$ 38,356	—	38,356	38,356	—
Level 1:					
Money market	<u>232,505</u>	<u>—</u>	<u>232,505</u>	<u>232,505</u>	<u>—</u>
Subtotal	<u>270,861</u>	<u>—</u>	<u>270,861</u>	<u>270,861</u>	<u>—</u>
Level 2:					
Asset-backed securities	34,885	(142)	34,743	—	34,743
Commercial paper	74,340	—	74,340	—	74,340
Corporate bonds	108,111	(686)	107,425	—	107,425
Municipal bonds	<u>76,176</u>	<u>(110)</u>	<u>76,066</u>	<u>—</u>	<u>76,066</u>
Subtotal	<u>293,512</u>	<u>(938)</u>	<u>292,574</u>	<u>—</u>	<u>292,574</u>
Total	\$ <u>564,373</u>	<u>(938)</u>	<u>563,435</u>	<u>270,861</u>	<u>292,574</u>



**RECREATIONAL EQUIPMENT, INC.**

Notes to Consolidated Financial Statements

December 28, 2019 and December 29, 2018

**(3) Property and Equipment**

Property and equipment consist of the following as of December 28, 2019 and December 29, 2018 (in thousands):

	<u>2019</u>	<u>2018</u>
Land, buildings, and improvements	\$ 433,916	428,496
Equipment, furniture, and fixtures	415,619	400,454
Software	338,698	303,392
Leasehold improvements	280,823	266,278
Construction-in-progress	209,762	108,405
	<u>1,678,818</u>	<u>1,507,025</u>
Less accumulated depreciation	<u>935,926</u>	<u>898,254</u>
Total	<u>\$ 742,892</u>	<u>608,771</u>

The Company's depreciation expense was \$103.9 million for 2019 and \$103.8 million for 2018.

As of December 28, 2019, the Company had classified as held for sale \$10.5 million of net assets owned and committed for sale. The sale of property is associated with the relocation of the REI corporate headquarters and is expected to close in 2020.

**(4) Goodwill**

In 2019, the Company completed a business acquisition for \$5.0 million. Revenue and total assets of the acquired company are not material to the Company's overall net sales and total assets. Operating results of the acquired business subsequent to February 14, 2019 are included in the Company's 2019 operating results. The Company estimated the allocation of the purchase price to the assets acquired and liabilities assumed, of which \$4.5 million was allocated to goodwill, to be amortized over the useful life of seven years. For the periods ended December 28, 2019 and December 29, 2018, goodwill amortization expense was \$2.0 million and \$1.1 million, respectively. There were no acquisitions in 2018.

Goodwill activity is as follows for the periods ended December 28, 2019 and December 29, 2018 (in thousands):

	<u>2019</u>	<u>2018</u>
Goodwill, beginning balance	\$ 4,007	5,154
Goodwill acquired during the period	4,477	—
Goodwill amortization during the period	<u>(1,975)</u>	<u>(1,147)</u>
	<u>\$ 6,509</u>	<u>4,007</u>

**RECREATIONAL EQUIPMENT, INC.**

Notes to Consolidated Financial Statements

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**(5) Line of Credit**

In 2017, the Company entered into a line of credit agreement. Under the facility, the Company is permitted to borrow a maximum of \$100 million. The agreement expires September 5, 2022. No amounts were outstanding at December 28, 2019 or December 29, 2018. At December 28, 2019, approximately \$2.6 million of the amount available under the line of credit was reserved for outstanding letters of credit. The Company was in compliance with all covenants imposed by the line of credit agreement as of December 28, 2019 and December 29, 2018.

**(6) Income Taxes**

The provision for income taxes is as follows for the periods ended December 28, 2019 and December 29, 2018 (in thousands):

	<b>2019</b>	<b>2018</b>
Current:		
Federal	\$ 2,950	10,276
State	2,781	4,832
	5,731	15,108
Deferred	68	(4,062)
Total provision for income taxes	\$ 5,799	11,046

A reconciliation from the U.S. statutory rate to the effective tax rate is as follows for the periods ended December 28, 2019 and December 29, 2018 (in thousands):

	<b>2019</b>		<b>2018</b>	
	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>
Tax at federal statutory rate	\$ 5,637	21.0 %	12,210	21.0 %
State income taxes, net of federal tax benefit	1,252	4.7	4,122	7.1
Tax credits	(3,383)	(12.6)	(1,729)	(3.0)
Other	2,293	8.5	(3,557)	(6.1)
	\$ 5,799	21.6 %	11,046	19.0 %

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Notes to Consolidated Financial Statements

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Significant components of the Company's deferred income taxes as of December 28, 2019 and December 29, 2018 (in thousands) are as follows:

	<b>2019</b>	<b>2018</b>
Deferred tax assets:		
Patronage dividends	\$ 9,723	10,001
Inventory basis differences	8,434	5,277
Gift cards	3,998	7,623
Deferred rent	12,829	12,531
Deferred income	1,206	1,448
Nonqualified retirement plan accrual	4,079	3,161
Employee benefits and compensation	7,304	7,000
Other	3,477	3,498
Total deferred tax assets	51,050	50,539
Deferred tax liabilities:		
Fixed asset depreciation and basis differences	(22,759)	(22,180)
Total net deferred tax assets	\$ 28,291	28,359

The 2017 Tax Act was signed into law on December 22, 2017. The 2017 Tax Act significantly revised the U.S. corporate income tax by, among other things, lowering the statutory corporate tax rate from 35% to 21%, eliminating certain deductions, imposing a mandatory one-time tax on accumulated earnings of foreign subsidiaries, introducing new tax regimes, and changing how foreign earnings are subject to U.S. tax. The 2017 Tax Act also enhanced and extended through 2026 the option to claim accelerated depreciation deductions on qualified property. The Company's blended future expected tax rate is 26%, comprised of the 21% federal rate and an expected 5% state rate.

Significant judgment is required in evaluating the Company's tax positions and determining the Company's provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate determination is uncertain. The Company establishes reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes will be due. These reserves are established when Company management believes that certain positions might be challenged despite the Company's belief that their tax return positions are fully supportable. These reserves are adjusted in light of changing facts and circumstances, such as the outcome of tax audits. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate. The Company recognizes interest and penalties accrued related to unrecognized tax benefits in tax expense and tax liabilities. As of December 28, 2019, the liability for uncertain tax positions includes an immaterial amount related to interest and penalties. Tax years 2015 through 2019 remain open to examination by the major taxing jurisdictions to which the Company is subject. Management does not anticipate any potential settlement or examination to result in a material change to the Company's financial position.

## RECREATIONAL EQUIPMENT, INC.

Notes to Consolidated Financial Statements

December 28, 2019 and December 29, 2018

### (7) Employee Benefits Plan

The Company has a defined contribution retirement and profit-sharing plan covering employees meeting certain eligibility requirements (generally, one year of employment and 1,000 hours of service). Company contributions are based on a percentage of eligible participant compensation ranging from 5% to 15%, depending on the Company's profitability. The retirement and profit-sharing plan Company contributions were approximately \$29.9 million and \$26.3 million for 2019 and 2018, respectively.

The Company also has a nonqualified deferred compensation plan, which provides a voluntary pay deferral option enabling eligible participants to contribute a portion of their respective annual base salary and bonus plan payments. Compensation is charged to expense in the period earned. In order to fund the nonqualified deferred compensation plan's future obligations, the Company has purchased investments held in irrevocable trusts commonly referred to as "Rabbi Trusts." As the Company is the owner of the investments and in order to reflect the Company's policy to pay benefits equal to the accumulations, the assets and liabilities are reflected in the consolidated balance sheets. At December 28, 2019 and December 29, 2018, assets and liabilities recorded in connection with deferred compensation plan benefits totaled \$19.0 million and \$15.4 million, respectively.

The nonqualified deferred compensation plan also provides the Company's highly compensated employees with a contribution equal to that which would have been allocated to them under the qualified retirement plan were it not for the limitations imposed by Internal Revenue Code Section 401(a)(17) and Section 415 and one-time eligibility limitations due to hire date. The Company's contributions to the nonqualified deferred compensation plan are based on a percentage of eligible participant compensation ranging from 5% to 15%, depending on the Company's profitability. Total Company contributions were \$0.3 million and \$0.2 million for 2019 and 2018, respectively.

### (8) Leases

The Company leases 138 retail store locations and office spaces. All leases are classified as operating leases and expire within the next 20 years but contain various renewal options. Certain leases contain provisions for contingent rent expense based on a percentage of sales revenue. Rent expense under operating leases, net of tenant improvement allowances, was approximately \$74.2 million and \$70.9 million for 2019 and 2018, respectively, and does not include common area charges, real estate taxes, and other executory costs.

Future minimum lease payments under noncancelable operating leases as of December 28, 2019 are as follows (in thousands):

2020	\$	80,038
2021		75,574
2022		66,302
2023		58,627
2024		52,873
Thereafter		<u>196,894</u>
	\$	<u>530,308</u>

## **RECREATIONAL EQUIPMENT, INC.**

Notes to Consolidated Financial Statements

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### **(9) Commitments and Contingencies**

The Company is subject from time to time to various claims and lawsuits arising in the ordinary course of business, including lawsuits alleging infringement of technology patents, violations of state and/or federal wage and hour and other employment laws, and other consumer-based claims. Some of these lawsuits purport or may be determined to be class or collective actions and seek substantial damages or injunctive relief, or both, and some may remain unresolved for several years. In management's opinion, the recorded reserves in the Company's consolidated financial statements are adequate in light of the probable and estimable liabilities. As of the date of this report, management does not believe any currently identified claim, proceeding, or litigation, either alone or in the aggregate with other claims, will have a material impact on the Company's results of operations, financial position, or cash flows. Because these matters are subject to inherent uncertainties, management's view of them may change in the future.

### **(10) Subsequent Events**

The Company evaluated subsequent events through March 6, 2020, the date the consolidated financial statements were available to be issued. There were no material subsequent events or transactions that required recognition or disclosure in these consolidated financial statements.