KPMG

RECREATIONAL EQUIPMENT, INC.

Consolidated Financial Statements

January 2, 2021 and December 28, 2019

(With Independent Auditors' Report Thereon)

RECREATIONAL EQUIPMENT, INC.

Table of Contents

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 January 2, 2021 and December 28, 2019, and the related consolidated statements of comprehensive income, members' equity, and cash flows for the years ended January 2, 2021 and December 28, 2019, 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 January 2, 2021 and December 28, 2019, and the results of their operations and their cash flows for the years ended January 2, 2021 and December 28, 2019, in accordance with U.S. generally accepted accounting principles.

Change in Accounting Principle

As discussed in Note 1 to the consolidated financial statements, during the year ended January 2, 2021 the Company adopted Accounting Standards Update, 2016-02, Leases, and all related amendments, which established Accounting Standard Codification Topic 842, Leases. Our opinion is not modified with respect to this matter.

KPMG LLP

Seattle, Washington
March 19, 2021

RECREATIONAL EQUIPMENT, INC.

Consolidated Balance Sheets

January 2, 2021 and December 28, 2019

(In thousands)

Assets		**January 2, 2021**	**December 28, 2019**
Current assets:			
Cash and cash equivalents	$	715,911	189,810
Short-term investments		121,081	279,242
Accounts receivable, less allowance for doubtful accounts of $758 and $224, respectively		39,024	34,782
Inventories		454,554	535,184
Prepaid expenses and other		53,474	55,179
Income taxes receivable		—	3,192
Total current assets		1,384,044	1,097,389
Property and equipment, net of accumulated depreciation of $905,829 and $935,926, respectively		428,493	742,892
Operating lease right-of-use assets		398,774	—
Goodwill, net of accumulated amortization of $1,226 and $5,551, respectively		3,252	6,509
Deferred income taxes, net		53,646	28,291
Other		30,260	43,850
Total assets	$	2,298,469	1,918,931
Liabilities and Members' Equity			
Current liabilities:			
Accounts payable	$	294,287	274,752
Customer-related obligations		218,622	221,027
Co-op member reward		112,358	—
Patronage dividends payable		33,923	155,808
Accrued payroll and benefits		98,724	127,873
Current lease Liabilities		69,784	—
Business taxes and other accrued liabilities		53,556	46,086
Income taxes payable		9,001	—
Total current liabilities		890,255	825,546
Long-term lease liabilities		373,849	—
Deferred rent and other long-term liabilities		38,878	82,621
Total liabilities		1,302,982	908,167
Commitments and contingencies (note 9)			
Members' equity:			
Memberships		330,857	312,591
Accumulated other comprehensive income		873	381
Retained earnings		663,757	697,792
Total members' equity		995,487	1,010,764
Total liabilities and members' equity	$	2,298,469	1,918,931

See accompanying notes to consolidated financial statements.

RECREATIONAL EQUIPMENT, INC.

Consolidated Statements of Comprehensive Income

Periods ended January 2, 2021 and December 28, 2019

(In thousands)

		December 29, 2019 – January 2, 2021	December 30, 2018 – December 28, 2019
Net sales	$	2,754,714	3,122,994
Cost of sales		1,638,934	1,715,246
Gross profit		1,115,780	1,407,748
Operating expenses:			
Payroll-related expenses		632,901	630,531
Occupancy, general and administrative		533,354	619,877
Operating expenses		1,166,255	1,250,408
Operating income (loss)		(50,475)	157,340
Other income (expense), net		(3,401)	3,656
Income (loss) before patronage dividends and income taxes		(53,876)	160,996
Patronage dividends, net		(4,630)	134,153
Income (loss) before income taxes		(49,246)	26,843
Provision (benefit) for income taxes		(15,211)	5,799
Net income (loss)		(34,035)	21,044
Other comprehensive income:			
Unrealized gain on available-for-sale securities, net of tax of ($193) and ($338), respectively		492	1,093
Comprehensive income (loss)	$	(33,543)	22,137

See accompanying notes to consolidated financial statements.

RECREATIONAL EQUIPMENT, INC.

Consolidated Statements of Members' Equity

Periods ended January 2, 2021 and December 28, 2019

(In thousands)

		Memberships	Retained earnings	Accumulated other comprehensive income (loss)	Total members' equity
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		312,591	697,792	381	1,010,764
Unrealized gain on available-for-sale securities, net of tax		—	—	492	492
Memberships issued		18,266	—	—	18,266
Net loss		—	(34,035)	—	(34,035)
Balance at January 2, 2021	$	330,857	663,757	873	995,487

See accompanying notes to consolidated financial statements.

RECREATIONAL EQUIPMENT, INC.

Consolidated Statements of Cash Flows

Periods ended January 2, 2021 and December 28, 2019

(In thousands)

		December 29, 2019 – January 2, 2021	December 30, 2018 – December 28, 2019
Operating activities:			
Net income (loss)	$	(34,035)	21,044
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization of goodwill		98,016	106,107
Amortization of investment premium/discount		40	(1,081)
Change in provision for sales returns		(3,182)	2,057
Deferred income taxes, net		(25,547)	(4,469)
Deferred rent		—	1,058
(Gain)/loss on sale and disposal of property and equipment		(61,753)	591
Changes in operating assets and liabilities:			
Accounts receivable		4,935	(1,485)
Inventories		80,631	(39,667)
Prepaids and other assets		2,968	(9,704)
Accounts payable and other accrued expenses		30,397	40,359
Net cash provided by operating activities		92,470	114,810
Investing activities:			
Acquisition of business, net of cash acquired		(750)	(4,250)
Purchases of short-term investments		(120,083)	(785,487)
Proceeds from sale of short-term investments		278,890	801,331
Purchases of property and equipment		(134,356)	(229,532)
Proceeds from sale of property and equipment		391,664	108
Net cash provided by (used in) investing activities		415,365	(217,830)
Financing activities:			
Proceeds from line of credit		171,900	—
Repayment of line of credit		(171,900)	—
Proceeds from sale of memberships		18,266	21,969
Net cash provided by financing activities		18,266	21,969
Net increase (decrease) in cash and cash equivalents		526,101	(81,051)
Cash and cash equivalents at beginning of period		189,810	270,861
Cash and cash equivalents at end of period	$	715,911	189,810
Supplemental disclosure of cash flow information:			
Cash paid for:			
Income taxes	$	1,640	12,780
Noncash investing activity:			
Property and equipment additions in accounts payable	$	3,574	20,032

See accompanying notes to consolidated financial statements.

(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 connecting every person to the power of the outdoors and engaging them in the fight to protect it. REI sells goods and services through more than 165 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 53-week and 52-week fiscal years ended January 2, 2021 and December 28, 2019, respectively.

(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 and goodwill, inventory obsolescence, income taxes, sales returns reserves, unredeemed gift cards, unredeemed patronage dividends, and unredeemed member rewards.

(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, 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 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 (expense), 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 January 2, 2021 or December 28, 2019.

The cost and fair value of the Company's available-for-sale securities that are carried at fair value at January 2, 2021, by contractual maturity, are as follows (in thousands):

		Cost	Fair value
Due in one year or less	$	42,137	42,366
Due in more than one year		77,765	78,715
Total	$	119,902	121,081

(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 collectability of 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 2 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.

(Continued)

Maintenance and repairs are charged to expense as incurred.

(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 over a period of 7 years. 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 January 2, 2021 and December 28, 2019.

(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. Impairment is reflected within occupancy, general and administrative expenses. Impairment recognized was $14.4 million for the period ended January 2, 2021, and there was no impairment recognized for the period ended December 28, 2019.

(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 did not declare dividends for 2020. 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 January 2, 2021, the balance of patronage dividends payable was $33.9 million, net of estimated dividends of $23.8 million that will not be redeemed, and 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. Net dividend expense for 2020 and 2019 was ($4.6) million and $134.2 million respectively, inclusive of the impact of breakage estimate adjustments.

(n) Co-op Member Reward

The Company issued a 2020 Co-op Member Reward as a special promotional reward to members. It is not a patronage dividend, and the reward is based on 10% of eligible net qualified purchases made during 2020. The rewards have a 10-month expiration window ending December 31, 2021. The Company applied historical redemption patterns to estimate rewards that will be unredeemed (breakage). At January 2, 2021, the balance of co-op member rewards was $112.4 million, net of estimated breakage of $23.7 million.

(o) 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.

(p) Leases

In 2020, the Company early-adopted the new lease standard using the modified retrospective transition method, which requires that the Company recognize leases differently pre- and post-adoption. See “Recent Accounting Pronouncements Adopted” in note 1(w) below for more information.

All leases are categorized as operating leases. Lease agreements cover certain retail locations, office space, warehouse and storage space, and equipment. Operating leases are included in operating lease right-of-use assets and current and long-term operating lease liabilities in our consolidated balance sheets.

Leased assets represent the Company’s right to use an underlying asset for the lease term, and lease liabilities represent the Company’s obligation to make lease payments arising from the lease. Operating lease right-of-use assets and liabilities are recognized at the commencement date based on the present value of lease payments over the lease term. The Company uses the 10-year Treasury interest rate as the discount rate for present value of lease payments when the rate implicit in the contract is not readily determinable. The Company determines and updates the discount rate on a quarterly basis accordingly.

For operating leases with variable payments dependent upon an index or rate that commenced subsequent to adoption of ASU No. 2016-02, the Company applies the active index or rate as of the lease commencement date. Variable lease payments not based on an index or rate are not included in the operating lease liability as they cannot be reasonably estimated and are recognized in the period in which the obligation for those payments is incurred. Leases that have a term of twelve months or less upon commencement date are considered short-term in nature. Accordingly, short-term leases are not included on the consolidated balance sheets and are expensed on a straight-line basis over the lease term, which commences on the date the Company has the right to control the property.

(q) 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 January 2, 2021, there were 6.4 million voting eligible members.

(r) Net Sales

The Company recognizes revenue from product sales when products are purchased or picked up by customers at the Company's stores or when products are shipped to customers. 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.

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.

As discussed in note 1(n), in 2020, the Company issued a Co-op Member Reward to its members. The Company reduced revenue to reflect the deferred revenue associated with the reward, and a corresponding liability was established. The deferral is based on the estimated value for which the reward is expected to be redeemed, net of estimated unredeemed rewards (breakage). When a member reward is redeemed, revenue is recognized for the value of the reward, and the liability is reduced.

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

(s) 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.

(Continued)

(t) Occupancy, General and Administrative Expenses

Occupancy, general and administrative expenses consist primarily of depreciation, rent, advertising, gain or loss on asset disposal, bankcard fees, and other miscellaneous expenses.

(u) 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 2020 and 2019 was $59.5 million and $88.6 million, respectively, and is included in occupancy, general and administrative expenses.

(v) 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.

(w) Recent Accounting Pronouncements Adopted

In February 2016, the FASB issued ASU No. 2016-02, "*Leases (Topic 842)*," which establishes a right-of-use model and requires an entity that is a lessee to recognize the right-of-use assets and liabilities arising from leases on the balance sheets. ASU No. 2016-02 also requires disclosures about the amount, timing, and uncertainty of cash flows arising from leases. Leases will be classified as finance or operating, with classification affecting both the pattern and classification of expense recognition in the statements of earnings. This guidance was subsequently amended by ASU No. 2018-01, "*Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842*;" ASU No. 2018-10, "*Codification Improvements to Topic 842*;" and ASU No. 2018-11, "*Leases (Topic 842): Targeted Improvements*." ASU No. 2016-02 and subsequent updates require a modified retrospective transition, with the cumulative effect of transition, including initial recognition of lease assets and liabilities for existing operating leases, as of (i) the effective date or (ii) the beginning of the earliest comparative period presented. These updates also provide a number of practical expedients for implementation which the Company is applying, as discussed below.

On December 29, 2019 (the "effective date"), the Company adopted ASU No. 2016-02 and subsequent updates, collectively referred to as "Topic 842", using the modified retrospective transition method. In addition, the Company adopted the package of practical expedients in transition, which permits prior conclusions without reassessing lease identification, lease classification, and initial direct costs on leases that commenced prior to the Company's adoption of the new standard. The Company elected the ongoing practical expedient to not recognize operating lease right-of-use assets and operating lease liabilities related to short-term leases. The Company also elected the private company practical expedient to use a risk-free discount rate for its leases comparable to corresponding lease teams. The Company did not elect the use-of-hindsight or land easements practical expedients. For leases beginning subsequent to the effective date, the Company elected to not separate lease and non-lease components for certain classes of assets including real estate and certain equipment. To determine the measurement of the lease liability for operating leases with variable payments based on an index or rate that commenced prior to the adoption of Topic 842, the Company elected to apply the active index or rate at the effective date.

As a result of adopting Topic 842, the Company recognized net operating lease right-of-use assets of $408.5 million and operating lease liabilities of $461.9 million on the adoption date. Existing prepaid rent, accrued rent, and closed store reserves were recorded as an offset to the gross operating lease right-of-use assets. The cumulative effect of the adoption resulted in an immaterial adjustment to the opening balance of retained earnings as of December 29, 2019. The standard did not have a material impact on our results of operations or cash flows.

(x) Recent Accounting Pronouncements Not Yet Adopted

In December 2019, the FASB issued ASU No. 2019-12, "*Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*," as part of its overall simplification initiative to reduce costs and complexity of applying accounting standards while maintaining or improving the usefulness of the information provided to users of financial statements. Amendments include removal of certain exceptions to the general principles of Topic 740, "*Income Taxes*," and simplification in several other areas. ASU No. 2019-12 is effective for annual reporting periods beginning after December 15, 2021. Early adoption is permitted. The Company is evaluating the effect it will have on the consolidated financial statements and related disclosures and does not anticipate a material impact.

In June 2016, the FASB issued ASU No. 2016-13, "*Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*," which introduced an expected credit loss model for the impairment of financial assets measured at amortized cost. The model replaces the probable, incurred loss model for those assets and, instead, broadens the information an entity must consider in developing its expected credit loss estimate for assets measured at amortized cost. ASU No. 2016-13 is effective for annual reporting periods beginning after December 15, 2022. Early adoption is permitted. The Company is evaluating the effect it will have on the consolidated financial statements and related disclosures and does not anticipate a material impact.

(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 January 2, 2021, and December 28, 2019, 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.

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 January 2, 2021 (in thousands):

	Cost basis	Unrealized gains	Fair value	Cash and cash equivalents	Short-term investments
Cash	$ 21,427	—	21,427	21,427	—
Level 1:					
Money market	694,484	—	694,484	694,484	—
Subtotal	715,911	—	715,911	715,911	—
Level 2:					
Asset-backed securities	18,324	177	18,501	—	18,501
Mortgage backed	4,183	118	4,301	—	4,301
Corporate bonds	81,784	723	82,507	—	82,507
Municipal bonds	15,611	161	15,772	—	15,772
Subtotal	119,902	1,179	121,081	—	121,081
Total	$ 835,813	1,179	836,992	715,911	121,081

(Continued)

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

	Cost basis	Unrealized gains	Fair value	Cash and cash equivalents	Short-term investments
Cash	$ 42,235	—	42,235	42,235	—
Level 1:					
Money market	147,575	—	147,575	147,575	—
Subtotal	189,810	—	189,810	189,810	—
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	2,895	—	2,895	—	2,895
Subtotal	278,749	493	279,242	—	279,242
Total	$ 468,559	493	469,052	189,810	279,242

(3) Property and Equipment

Property and equipment consists of the following as of January 2, 2021 and December 28, 2019 (in thousands):

	2020	2019
Land, buildings, and improvements	$ 358,733	433,916
Equipment, furniture, and fixtures	348,650	415,619
Software	324,766	338,698
Leasehold improvements	284,941	280,823
Construction-in-progress	17,232	209,762
	1,334,322	1,678,818
Less accumulated depreciation	905,829	935,926
Total	$ 428,493	742,892

The Company’s depreciation expense was $106.1 million for 2020 and $103.9 million for 2019.

In 2020, the Company sold its two Washington State corporate headquarter locations for a total of $414.6 million and recorded gains of $80.2 million before taxes; the gains on sales are included in occupancy, general and administrative expenses.

(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 January 2, 2021 and December 28, 2019, goodwill amortization expense was $1.0 million and $2.0 million, respectively. There were no acquisitions in 2020.

Goodwill activity is as follows for the periods ended January 2, 2021 and December 28, 2019 (in thousands):

		2020	2019
Goodwill, beginning balance	$	6,509	4,007
Goodwill acquired (disposed of) during the period		(2,257)	4,477
Goodwill amortization during the period		(1,000)	(1,975)
	$	3,252	6,509

(5) Line of Credit

In 2020, the Company completed an amendment to its line of credit agreement. Under the amended credit facility, the Company is permitted to borrow a maximum of $125 million, with the option to increase to $175 million for six months each year. The agreement expires April 7, 2025. No amounts were outstanding on January 2, 2021 or December 28, 2019. On January 2, 2021, approximately $2.5 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 January 2, 2021 and December 28, 2019.

(6) Income Taxes

The provision for income taxes is as follows for the periods ended January 2, 2021 and December 28, 2019 (in thousands):

		2020	2019
Current:			
Federal	$	4,619	2,950
State		5,524	2,781
Deferred:			
Federal		(18,719)	753
State		(6,635)	(685)
Total provision (benefit) for income taxes	$	(15,211)	5,799

A reconciliation from the U.S. statutory rate to the effective tax rate is as follows for the periods ended January 2, 2021 and December 28, 2019 (in thousands):

	2020		2019	
	Amount	**Percent**	**Amount**	**Percent**
Tax at federal statutory rate	$ (10,342)	21.0 %	$ 5,637	21.0 %
State income taxes, net of federal tax benefit	(2,402)	4.9	1,252	4.7
Tax credits	(1,455)	3.0	(3,383)	(12.6)
Other	(1,012)	2.1	2,293	8.5
	$ (15,211)	31.0 %	$ 5,799	21.6 %

Significant components of the Company's deferred income taxes as of January 2, 2021 and December 28, 2019 (in thousands) are as follows:

	2020	2019
Deferred tax assets:		
Co-op member reward	$ 29,213	—
Patronage dividends	4,596	9,723
Inventory basis differences	10,796	8,434
Gift cards	5,624	3,998
Operating lease liabilities	126,394	—
Deferred rent	—	12,829
Deferred income	564	1,206
Nonqualified retirement plan accrual	4,587	4,079
Employee benefits and compensation	8,263	7,304
Other	5,417	3,477
Total deferred tax assets	195,454	51,050
Deferred tax liabilities:		
Operating lease right-of-use assets	(113,614)	—
Fixed asset depreciation and basis differences	(28,194)	(22,759)
Total net deferred tax assets	$ 53,646	28,291

The Company's blended future expected tax rate is 26%, comprised of the enacted 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 January 2, 2021, the liability for uncertain tax positions included an immaterial amount related to interest and penalties. Tax years 2016-2020 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.

(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 $17.1 million and $29.9 million for 2020 and 2019, 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 January 2, 2021 and December 28, 2019, assets and liabilities recorded in connection with deferred compensation plan benefits totaled $20.9 million and $19.0 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 onetime 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 $0.1 million and $0.3 million for 2020 and 2019, respectively.

(8) Leases

The Company leases 146 retail store locations, office spaces, and equipment. All leases are classified as operating leases and expire within the next 20 years but contain various renewal options. Certain lease agreements include rental payments based on an index or rate, and others include rental payments based on a percentage of sales.

(Continued)

All lease costs are included within occupancy, general and administrative under operating expenses. The components of lease cost follow (in thousands):

		2020
Operating lease cost	$	77,289
Variable lease cost		36,290
Sublease income		(806)
	$	112,773

Rent expense under operating leases and accounted for under previous lease guidance, net of tenant improvement allowances, was approximately $74.2 million for 2019, and does not include common area charges, real estate taxes, and other executory costs.

ASU 2016-02 allows private companies to use risk-free interest as the discount rate for the present value of lease payments when the rate implicit in the contract is not readily determinable. The Company determines a risk-free rate on a quarterly basis. Lease terms and discount rates follow:

	2020
Weighted-average remaining lease term (years)	10.7
Weighted-average discount rate	1.8 %

The approximate future minimum lease payments under operating leases as of January 2, 2021 are as follows (in thousands):

2021	$	87,898
2022		66,946
2023		65,574
2024		58,965
2025		52,105
Thereafter		156,245
Total lease payments		487,733
Less imputed interest		(44,100)
Present value of lease liabilities	$	443,633

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

2021	$	80,038
2022		75,574
2023		66,302
2024		58,627
2025		52,873
Thereafter		196,894
	$	530,308

ROU asset amortization and the change in the lease liability are included under depreciation and amortization of goodwill in the consolidated statements of cash flows. Supplemental cash flow information related to leases is as follows (in thousands):

		2020
Cash paid for amounts included in measurement of liabilities:		
Operating cash flows from operating leases	$	67,925
Right-of-use assets obtained in exchange for new operating liabilities		65,083

(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 19, 2021, 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.