RECREATIONAL EQUIPMENT, INC.

Consolidated Financial Statements

January 1, 2022 and January 2, 2021

(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.:

Opinion

We have audited the consolidated financial statements of Recreational Equipment, Inc. and its subsidiaries (the Company), which comprise the consolidated balance sheets as of January 1, 2022 and January 2, 2021, and the related consolidated statements of comprehensive income (loss), members' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Company as of January 1, 2022 and January 2, 2021, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with U.S. generally accepted accounting principles, and for 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.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for one year after the date that the consolidated financial statements are available to be issued.

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

KPMG LLP

Seattle, Washington
March 18, 2022

RECREATIONAL EQUIPMENT, INC.

Consolidated Balance Sheets

January 1, 2022 and January 2, 2021

(In thousands)

Assets		**January 1, 2022**	**January 2, 2021**
Current assets:			
Cash and cash equivalents	$	800,494	715,911
Short-term investments		223,758	121,081
Accounts receivable, less allowance for doubtful accounts of $686 and $758, respectively		50,478	39,024
Inventories		621,678	454,554
Prepaid expenses and other		57,343	53,474
Total current assets		1,753,751	1,384,044
Property and equipment, net of accumulated depreciation of $949,518 and $905,829, respectively		466,687	428,493
Operating lease right-of-use assets		449,792	398,774
Goodwill, net of accumulated amortization of $1,866 and $1,226, respectively		2,612	3,252
Deferred income taxes, net		60,353	53,646
Other		29,702	30,260
Total assets	$	2,762,897	2,298,469
Liabilities and Members' Equity			
Current liabilities:			
Accounts payable	$	357,862	294,287
Customer-related obligations		252,792	218,622
Co-op member reward payable: promotional portion		—	112,358
Co-op member reward payable: dividend portion		193,424	33,923
Accrued payroll and benefits		199,628	98,724
Current lease liabilities		73,578	69,784
Business taxes and other accrued liabilities		51,392	53,556
Income taxes payable		35,245	9,001
Total current liabilities		1,163,921	890,255
Long-term lease liabilities		436,091	373,849
Deferred rent and other long-term liabilities		43,012	38,878
Total liabilities		1,643,024	1,302,982
Commitments and contingencies (note 9)			
Members' equity:			
Memberships		358,323	330,857
Accumulated other comprehensive income		132	873
Retained earnings		761,418	663,757
Total members' equity		1,119,873	995,487
Total liabilities and members' equity	$	2,762,897	2,298,469

See accompanying notes to consolidated financial statements.

RECREATIONAL EQUIPMENT, INC.

Consolidated Statements of Comprehensive Income (Loss)

Periods ended January 1, 2022 and January 2, 2021

(In thousands)

		January 3, 2021 – January 1, 2022	December 29, 2019 – January 2, 2021
Net sales	$	3,739,259	2,754,714
Cost of sales		1,981,654	1,638,934
Gross profit		1,757,605	1,115,780
Operating expenses:			
Payroll-related expenses		798,045	632,901
Occupancy, general and administrative		635,264	533,354
Operating expenses		1,433,309	1,166,255
Operating income (loss)		324,296	(50,475)
Other expense, net		(7,664)	(3,401)
Income (loss) before co-op member rewards: dividend portion and income taxes		316,632	(53,876)
Co-op member rewards: dividend portion, net		186,596	(4,630)
Income (loss) before income taxes		130,036	(49,246)
Provision (benefit) for income taxes		32,375	(15,211)
Net income (loss)		97,661	(34,035)
Other comprehensive income:			
Unrealized gain (loss) on available-for-sale securities, net of tax of $260 and ($193), respectively		(741)	492
Comprehensive income (loss)	$	96,920	(33,543)

See accompanying notes to consolidated financial statements.

RECREATIONAL EQUIPMENT, INC.

Consolidated Statements of Members' Equity

Periods ended January 1, 2022 and January 2, 2021

(In thousands)

		Memberships	Retained earnings	Accumulated other comprehensive income	Total members' equity
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
Unrealized loss on available-for-sale securities, net of tax		—	—	(741)	(741)
Memberships issued		27,466	—	—	27,466
Net income		—	97,661	—	97,661
Balance at January 1, 2022	$	358,323	761,418	132	1,119,873

See accompanying notes to consolidated financial statements.

RECREATIONAL EQUIPMENT, INC.

Consolidated Statements of Cash Flows

Periods ended January 1, 2022 and January 2, 2021

(In thousands)

		January 3, 2021 – January 1, 2022	December 29, 2019 – January 2, 2021
Operating activities:			
Net income (loss)	$	97,661	(34,035)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization of goodwill		86,800	98,016
Amortization of investment premium/discount and other		1,542	40
Change in provision for sales returns		4,385	(3,182)
Deferred income taxes, net		(6,448)	(25,547)
(Gain)/loss on sale and disposal of property and equipment		656	(61,753)
Changes in operating assets and liabilities:			
Accounts receivable		5,790	4,935
Inventories		(167,124)	80,631
Prepaids and other assets		(5,953)	2,968
Accounts payable and other accrued expenses		262,225	30,397
Net cash provided by operating activities		279,534	92,470
Investing activities:			
Acquisition of business, net of cash acquired		—	(750)
Purchases of short-term investments		(366,886)	(120,083)
Proceeds from sale of short-term investments		262,980	278,890
Purchases of property and equipment		(117,245)	(134,356)
Proceeds from sale of property and equipment		48	391,664
Net cash (used in) provided by investing activities		(221,103)	415,365
Financing activities:			
Proceeds from line of credit		—	171,900
Repayment of line of credit		—	(171,900)
Payment of debt issuance costs		(1,314)	—
Proceeds from sale of memberships		27,466	18,266
Net cash provided by financing activities		26,152	18,266
Net increase in cash and cash equivalents		84,583	526,101
Cash and cash equivalents at beginning of period		715,911	189,810
Cash and cash equivalents at end of period	$	800,494	715,911
Supplemental disclosure of cash flow information:			
Cash paid for:			
Income taxes	$	22,031	1,640
Noncash investing activity:			
Property and equipment additions in accounts payable	$	6,652	3,574

See accompanying notes to consolidated financial statements.

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

(a) Business Overview

Recreational Equipment, Inc. (REI or the Company) operates as a specialty outdoor retail cooperative. REI is dedicated to inspiring, educating, and outfitting its growing community of more than 21 million members to live their most fulfilling life outdoors and engaging them in the fight to protect it. REI sells goods and services through more than 170 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 and 53-week fiscal years ended January 1, 2022 and January 2, 2021, 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 return reserves, unredeemed gift cards, and unredeemed Co-op 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. Realized gains and losses on these securities are included in other expense, net in the consolidated statements of comprehensive income (loss). 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 1, 2022 or January 2, 2021.

The cost and fair value of the Company's available-for-sale securities that are carried at fair value at January 1, 2022, by contractual maturity, are as follows (in thousands):

		Cost	Fair value
Due in one year or less	$	88,803	88,966
Due in more than one year		134,776	134,792
Total	$	223,579	223,758

(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 of the initial lease plus any renewals that are reasonably certain at the date the leasehold improvements are made.

Maintenance and repairs are charged to expense as incurred.

(Continued)

(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 1, 2022 and January 2, 2021.

(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. There was no impairment recognized for the period ended January 1, 2022, and there was impairment recognized of $14.4 million for the period ended January 2, 2021.

(l) Customer-Related Obligations

Sales return 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) Co-op Member Reward

The Company declares and issues a Co-op Member Reward: Dividend Portion (dividend) as 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 annual income on a cooperative basis (as defined).

The Company may elect to issue a Co-op Member Reward: Promotional Portion (promotional reward), which is intended to deliver a benefit and experience similar to that of the patronage dividend.

The Co-op Member Reward in any given year may be comprised of only the dividend portion, only the promotional portion, or a combination of the two.

In 2021, the Company issued only a Co-op Member Reward: Dividend Portion (dividend). At January 1, 2022, the balance of Co-op Member Reward Payable: Dividend Portion was $193.4 million, net of estimated dividends of $41.6 million that will not be redeemed, and at January 2, 2021, the balance was $33.9 million, net of estimated dividends of $23.8 million that will not be redeemed (breakage). Net

(Continued)

Co-op Member Reward: Dividend Portion expense for 2021 and 2020 was $186.6 million and ($4.6) million, respectively, inclusive of the impact of breakage estimate adjustments.

In 2020, the Company issued only a Co-op Member Reward: Promotional Portion (promotional reward). The promotional reward issued in 2020 had a 10-month expiration window, and all such rewards expired during the period ended January 1, 2022. At January 1, 2022, there was no remaining balance of Co-op Member Reward Payable: Promotional Portion, and the balance was $112.4 million, net of estimated breakage of $23.7 million for the period ended January 2, 2021.

The Company records the Co-op Member Reward Payable based upon its estimate of rewards that will be redeemed by co-op members prior to the expiration date. The Company has historical experience demonstrating that less than 100% of members redeem their entire rewards within the time period these rewards are available to them.

(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.

(o) Leases

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

(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 2008 and through 2021, the one-time fee for a nonrefundable, nontransferable membership has been $20. As of January 1, 2022, there were 7.8 million voting eligible members.

(q) 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 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 redeemed. Historical redemption data is used to determine actual redemption patterns.

As discussed in note 1(m), in 2020, the Company issued a Co-op Member Reward: Promotional Portion 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 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.

(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.

(Continued)

(s) Occupancy, General and Administrative Expenses

Occupancy, general and administrative expenses consist primarily of advertising, rent, information technology, bankcard fees, depreciation, 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 2021 and 2020 was $74.7 million and $59.5 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.

(v) Recent Accounting Pronouncements Not Yet Adopted

In December 2019, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (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. For nonpublic entities, the new standard 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. For nonpublic entities, 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.

There have been no other new accounting pronouncements issued but not yet adopted that are expected to materially affect our financial condition or results of operations.

(2) Fair Value

The Company applies fair value accounting for certain financial assets and liabilities that are recognized at fair value in the financial statements, including cash equivalents and investments. 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 certain 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 1, 2022, and January 2, 2021, there were no liabilities within Level 1, 2, or 3 and 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.

(Continued)

Assets measured at fair value consist of the following as of January 1, 2022 (in thousands):

	Cost basis	Unrealized gains	Fair value	Cash and cash equivalents	Short-term investments
Cash	$ 39,536	—	39,536	39,536	—
Level 1:					
Money market	760,958	—	760,958	760,958	—
U.S. Treasury securities	11,497	5	11,502	—	11,502
Subtotal	811,991	5	811,996	800,494	11,502
Level 2:					
Asset-backed securities	32,188	(32)	32,156	—	32,156
Mortgage backed	2,847	64	2,911	—	2,911
Corporate bonds	118,425	122	118,547	—	118,547
Municipal bonds	18,150	18	18,168	—	18,168
Commercial paper	36,797	2	36,799	—	36,799
Other	3,675	—	3,675	—	3,675
Subtotal	212,082	174	212,256	—	212,256
Total	$ 1,024,073	179	1,024,252	800,494	223,758

Assets 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

(3) Property and Equipment

Property and equipment consists of the following as of January 1, 2022 and January 2, 2021 (in thousands):

	2021	2020
Land, buildings, and improvements	$ 378,883	358,733
Equipment, furniture, and fixtures	367,555	348,650
Software	310,215	324,766
Leasehold improvements	312,057	284,941
Construction-in-progress	47,495	17,232
	1,416,205	1,334,322
Less accumulated depreciation	949,518	905,829
Total	$ 466,687	428,493

The Company's depreciation expense was $80.6 million for 2021 and $106.1 million for 2020.

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

Goodwill activity is as follows for the periods ended January 1, 2022 and January 2, 2021 (in thousands):

	2021	2020
Goodwill, beginning balance	$ 3,252	6,509
Goodwill acquired (disposed of) during the period	—	(2,257)
Goodwill amortization during the period	(640)	(1,000)
	$ 2,612	3,252

(5) Line of Credit

In 2021, the Company entered into a new line of credit agreement, which replaced the line of credit in place at January 2, 2021. Under the new credit agreement, the Company is permitted to borrow a maximum of $400 million. The agreement expires on September 14, 2026. No amounts were outstanding under either line of credit at January 1, 2022 or January 2, 2021. At January 1, 2022, approximately $3.7 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 agreements as of January 1, 2022 and January 2, 2021.

(Continued)

(6) Income Taxes

The provision for income taxes is as follows for the periods ended January 1, 2022 and January 2, 2021 (in thousands):

		2021	2020
Current:			
Federal	$	26,115	4,619
State		12,967	5,524
Deferred:			
Federal		(4,143)	(18,719)
State		(2,564)	(6,635)
Total provision (benefit) for income taxes	$	32,375	(15,211)

A reconciliation from the U.S. statutory rate to the effective tax rate is as follows for the periods ended January 1, 2022 and January 2, 2021 (in thousands):

		2021			2020	
		Amount	Percent		Amount	Percent
Tax at federal statutory rate	$	27,308	21.0 %	$	(10,342)	21.0 %
State income taxes, net of federal tax benefit		7,380	5.7		(2,402)	4.9
Tax credits		(2,694)	(2.1)		(1,455)	3.0
Other		381	0.3		(1,012)	2.1
	$	32,375	24.9 %	$	(15,211)	31.0 %

Significant components of the Company's deferred income taxes as of January 1, 2022 and January 2, 2021 are as follows (in thousands):

		2021	2020
Deferred tax assets:			
Co-op member reward: Promotional portion	$	—	29,213
Co-op member reward: Dividend portion		19,022	4,596
Inventory basis differences		17,081	10,796
Gift cards		6,485	5,624
Operating lease liabilities		132,514	126,394
Deferred income		181	564
Nonqualified retirement plan accrual		6,222	4,587
Employee benefits and compensation		15,378	8,263
Other		9,191	5,417
Total deferred tax assets		206,074	195,454
Deferred tax liabilities:			
Operating lease right-of-use assets		(116,946)	(113,614)
Fixed asset depreciation and basis differences		(28,775)	(28,194)
Total net deferred tax assets	$	60,353	53,646

The Company's blended future expected tax rate is 26%, comprised of the enacted 21% federal rate and an expected 5% state rate. As of January 1, 2022, and January 2, 2021, the Company had state tax net operating loss (NOL) carryforwards of $1.4 million and zero, respectively, which are available to reduce future taxable income. The Company also had state tax credits of $0.2 million and $0.5 million as of January 1, 2022, and January 2, 2021, respectively. The NOL will begin to expire in 2043, and tax credit carryforwards will begin to expire in 2023.

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 its 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 1, 2022, the liability for uncertain tax positions included an immaterial amount related to interest and penalties. Tax years 2017-2021 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 5% of eligible participant compensation. The retirement and profit-sharing plan Company contributions were approximately $18.1 million and $17.1 million for 2021 and 2020, 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 1, 2022 and January 2, 2021, assets and liabilities recorded in connection with deferred compensation plan benefits totaled $23.9 million and $20.9 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 5% of eligible participant compensation. Total Company contributions were $0.2 million and $0.1 million for 2021 and 2020, respectively.

(8) Leases

The Company leases 155 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.

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

		2021	2020
Operating lease cost	$	79,556	77,289
Variable lease cost		35,575	36,290
Sublease income		(1,028)	(806)
	$	114,103	112,773

ASU 2016-02 allows private companies to use risk-free interest rate 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:

	2021	2020
Weighted-average remaining lease term (years)	8.3	10.7
Weighted-average discount rate	1.8 %	1.8 %

The approximate future minimum lease payments under operating leases as of January 1, 2022 are as follows (in thousands):

2022	$	81,308
2023		83,381
2024		77,075
2025		67,955
2026		65,643
Thereafter		160,289
Total lease payments		535,651
Less imputed interest		(25,982)
Present value of lease liabilities	$	509,669

Right-of-use 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):

		2021	2020
Cash paid for amounts included in measurement of liabilities:			
Operating cash flows from operating leases	$	91,312	67,925
Right-of-use assets obtained in exchange for new operating liabilities		131,311	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. 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 18, 2022, 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.