



ARMY & AIR FORCE  
EXCHANGE SERVICE

# 2016 ANNUAL REPORT





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## MESSAGE FROM DIRECTOR/CEO TOM SHULL



SOLDIER FOR LIFE

In 2016, the Army & Air Force Exchange Service set up new shops at the tip of the spear, gained DoD approval to honor the service of our Nation's Veterans and again delivered strong earnings and dividends to the military community. A compelling customer experience continues to be the foundation of the Exchange's strong performance. 2016 was a great year for the Exchange as total revenue exceeded \$8.3 billion and earnings of \$384 million exceeded plan. From earnings, the Exchange provided \$225 million in dividends to Quality-of-Life programs for service members and their families.

Compared to 2011, the Exchange nearly doubled its earnings from 3.2 percent of sales to 6 percent in 2016. The organization is a model of efficiency within the federal government and leads key competitors in the commercial retail sector such as Target and Wal-Mart in terms of cash flow, a key measure of financial health.

A sustained focus on growth strategies and cost savings has propelled the Exchange's financial performance to the very top of the retail industry. As the business thrives, the benefit we provide our military grows stronger.

January 11, 2017, was an historic day for the Exchange and those we serve as the Under Secretary of Defense for Personnel and Readiness formally concurred with an Exchange proposal to provide a lifelong online military exchange benefit to all of America's honorably discharged Veterans. Veterans Day 2017 will be an equally significant date as the Exchange welcomes home potentially 13 million Veterans. The new Veterans online shopping benefit will allow the Exchange to accelerate growth efforts as it will double the Exchange's online customer base. This significant increase in potential authorized customers should further improve the Exchange's merchandise assortment, pricing and service as the full impact of the Veterans online shopping benefit is realized during the next few years.

With multiple brick-and-mortar retail format operations in 34 countries and all 50 states and territories, a thriving internet business, a mall management operation, and one of the largest private label credit portfolios, the Exchange is one of the most complex and diverse retailers in America. Throughout 2016, the Exchange provided a lifeline for troops serving in far-flung places, going where other retailers could not or would not—including war zones and austere remote locations.

At ShopMyExchange.com, we brought our eCommerce site in-house to improve stability and scalability. Online and in our stores, the Exchange remains focused on driving process efficiencies and improving the customer experience. Our Ship-from-Store initiative (launched in July 2016), for example, now leverages brick-and-mortar Exchanges as mini distribution centers. Ship-from-Store is maximizing inventory productivity while accelerating speed of service as fulfillment occurs from locations closest to the customer.

As the Exchange operates more efficiently, it is aggressively partnering with other DoD entities to improve operations and reduce the burden on the American taxpayer. Our newest distribution center is an excellent example of the cross-functional cooperation and collaboration our leadership team continues to champion. The Gernersheim Distribution Center in Germany is a key partner in what is now a Logistics Center of Excellence, which also includes the Defense Commissary Agency (DeCA) and Defense Logistics Agency (DLA). By working together, the commissary, DLA and Exchange are reducing costs while maintaining a high level of service to the best customers in the world, our Nation's service members and their families.

The Exchange is unlike any other retailer. Our team is "all in" for those who serve. In 2016, we went to the tip of the spear with our troops. In the coming year, we will continue to go where they go. It is our passion for serving those who serve, combined with the level and breadth of service that only the Exchange can provide, that sets us apart and why no other organization or business can do what we do.

Army Strong! Air Force Strong! Exchange Strong! It is an honor to serve those who serve.

*Tom Shull*



# SERVING TROOPS AT THE TIP OF THE SPEAR

No matter where America's military deploys or how large are its missions, Exchange associates go where our Nation's Warfighters go to provide a lifeline to America. Exchange support of deployed service members is a key enabler of the U.S. Armed Forces' readiness and resiliency.

In 2016, the Exchange served American and multinational troops deployed to Southwest Asia and the Middle East, Ukraine, Poland, Australia and Cameroon. In addition to normal store operations, expeditionary support included barber, beauty, alterations, name-brand restaurants, first-run movies and other critical services.

## SOUTHWEST ASIA & THE MIDDLE EAST

2016 marked the 15th year since the 9/11 terrorist attacks that the Exchange supported American Soldiers, Airmen, Sailors, Marines, Coast Guard members and multinational military personnel in Southwest Asia and the Middle East. This past year, the Exchange operated 11 facilities in Afghanistan, seven in Iraq and 10 in Kuwait, plus five in Qatar, three in Jordan, two in the United Arab Emirates and one in Saudi Arabia. The Exchange provided Wi-Fi and telecommunications services, arguably the No. 1 morale booster for troops serving overseas.

## UKRAINE

In April, at the International Peacekeeping and Security Center in Western Ukraine, the Exchange opened a 10-foot-by-10-foot troop-run store stocked with basic necessities for the Joint Multinational Training Group-Ukraine, raising Soldier morale by providing a lifeline to America.

## POLAND

In June, the Exchange served 30,000 U.S., NATO and multinational troops participating in Anakonda 16, the largest military exercise in Europe since 1992. The Exchange deployed three mobile field exchanges (MFEs) and 15 associates to Poland.

In January 2017, three Exchange MFEs and three field barber shops were deployed to three locations in Poland to support 3,500 troops bound for locations throughout Eastern Europe. It marked the first time Western forces were deployed on a continuous basis to NATO's newly expanded eastern flank.



CP TRZEBIEN, POLAND -- EXCHANGE ASSOCIATES SET UP A MOBILE FIELD EXCHANGE IN SUPPORT OF ANAKONDA 16.



RAMSTEIN AB, GERMANY -- ACTOR BEN AFFLECK TAKES A PHOTO WITH AIRMEN BEFORE A SCREENING OF HIS NEW MOVIE.

AZORES  
Lajes Field



"WHEN LIFE GIVES YOU SNOW, THERE'S AN AAFES NEARBY."  
SPEC. ERIK GUERRERO, 3-4 INFANTRY DIVISION, THE FIRST MFE CUSTOMER IN POLAND



NOVO SELO, BULGARIA -- AN EXCHANGE FOOD TRUCK BOOSTS TROOPS' MORALE WITH A PIZZA DELIVERY.



YAVORIV, UKRAINE -- SOLDIERS STOCK UP ON NECESSITIES AT THE TROOP STORE.



## POLAND (continued)

The MFEs are 53-foot-long shipping containers custom-built to operate as small stores. Much stronger than older mobile exchanges, they retain all desirable shipping features, including strong steel structures that can be transported to locations by rail, road or ship. All equipment, including heating and air-conditioning systems, are located inside the MFEs. Forklifts carry the merchandise onto the MFEs loading dock and goods are then moved inside by pallet jack, eliminating the hand-carrying of products commonly associated with older types of mobile exchanges. Every inch of wall space is maximized for the goods desired by those who are deployed.

Internet access enabled by satellite communications or cellular modem allows cash registers to communicate with the Exchange's retail and resupply system, even if they are located halfway around the world.

## SOUTHEAST EUROPE

In 2016, the Exchange operated stores in Bulgaria and Romania for troops supporting Operation Atlantic Resolve, a demonstration of U.S. commitment to peace and security in the region. The Exchange's other facilities included three in Bosnia and three in Kosovo.

## THE PACIFIC

Throughout 2016, the Exchange served more than 12,000 U.S. Soldiers, Airmen, Sailors and Marines in military exercises throughout the Pacific from Camp Casey in Korea to Camp Kengun in Japan.

In February and March, associates supported 3,500 troops rotating in and out at Camp Casey.

Also in February, the Guam/Saipan Exchange supported more than 1,500 service members from the U.S. Air Force, U.S. Navy, and Airmen from Japan, Australia, the Philippines, South Korea and New Zealand for Cope North 16 exercises. The needs of Cope North participants were fulfilled with added food vendors and increased hours of operation.

During the same months, associates operated an MFE, barber and concession food operations for 800 U.S. Marines in the Gwangyang field exercise. From March 7-22, the Exchange served 900 U.S. Soldiers from Hawaii engaged in the Key Resolve military exercise in Korea. Also in March, the Exchange's MFE on a Republic of Korea installation in Pohang supported 850 U.S. Marines during a military exercise.



AL ASAD, IRAQ -- TROOPS WATCHED DISNEY ROGUE ONE: A STAR WARS STORY AT THE SAME TIME THE BLOCKBUSTER WAS RELEASED IN THE U.S.



UNION III, IRAQ -- AN EXCHANGE IN BAGHDAD OFFERS FOOD AND OTHER COMFORTS OF HOME.



BAGRAM, AFGHANISTAN -- EXCHANGE EUROPE COMMANDER COL. GEOFF DE TINGO AND ASSOCIATES IN FRONT OF AN A-10.



GAROUA, CAMEROON -- THE UNIT-RUN IMPREST FUND EXCHANGE OFFERS TROOPS A TASTE OF HOME.





**PACIFIC (continued)**

In April 2016, the Kunsan Air Base Exchange supported more than 1,800 U.S. Air Force, Army, Marine Corps, Navy and South Korea service members during bilateral training exercise Max Thunder 16.

From May through June, the Exchange took care of about 30 Army Mariners in Pacific Reach, a military exercise between Japan and Korea. The Army watercraft, attached to the U.S. Army Garrison at Camp Zama, Japan, conducted operations to Korea, moving Japan Ground Self-Defense Force equipment between the two countries. Operation Pacific Reach is a great example of multiple Exchange facilities lending support to the U.S. Army's mission in the Pacific. It is a collaborative multinational and multi-Exchange effort that makes the overall mission a success.

In August and September, associates from Camp Humphreys and Osan Air Base staffed an MFE to provide Quality-of-Life support to U.S. and Canadian Soldiers participating in the Ulchi Freedom Guardian military exercise in Yong-in, South Korea. On the first day, Soldiers bought more than 1,000 items. Throughout September, the Exchange served 450 U.S. Marines in Ulchi Freedom Guardian.

In October, the Exchange supported the arrival of 7,000 Sailors aboard the USS Ronald Reagan and supporting fleet operations at a Republic of Korea Navy base. Concessionaires included clothing, a GNC store and Korean gifts, while an Exchange telecommunications partner provided Wi-Fi services.

In December, associates from Japan's Camp Zama Exchange served more than 1,600 U.S. troops and 4,600 Japanese military personnel in the annual Yama Sakura exercise at Camp Kengun in Kumamoto City. Yama Sakura is a simulation-driven, joint command exercise co-hosted by the U.S. and Japanese. Living out the Exchange motto, "We go where you go," the associates from Camp Zama traveled more than 700 miles from their homes to serve the troops.

**AUSTRALIA**

The Exchange opened a store Nov. 7 at Robertson Barracks near Darwin, Australia. A joint venture with the Marine Corps, the Exchange served 2,000 Marines. Some 31,000 more Marines are expected to rotate into Australia as major joint and multinational exercises continue.



CAMP MUJUK, KOREA -- MARINES WAIT IN LINE FOR NEW BARBERSHOP AND EXCHANGE.



BARRIGADA, GUAM -- AN AIRMAN IS THE FIRST CUSTOMER AT THE NEW EXPRESS.



THE ROBERTSON BARRACKS EXCHANGE SERVED MARINES IN AUSTRALIA.

**KOREA**

- USAG Yongsan
- Cp Coiner
- Cp Kim
- Sobingo Compound
- USAG Red Cloud/Casey
- Cp Bonifas
- Cp Stanley
- Cp Hovey
- Korea DC
- Osan AB
- Cp Humphreys
- Kunsan AB

**JAPAN**

- Misawa AB
- USAG Daegu
- Cp Carroll
- Cp Walker
- Cp George
- Cp Henry
- Japan DC
- Yokota AB
- Cp Zama

**OKINAWA**

- Kadena AB
- Cp Foster
- Cp Hansen
- Cp Courtney
- Cp Schwab
- MCAS Futenma
- Okinawa DC
- Cp Kinser

**HAWAII**

- Wheeler AAF
- Hawaii DC
- Bellows AFS
- Schofield Barracks
- Ft Shafter
- Hickam AFB
- Maui Exchange
- Pohakuloa Training Area

**GUAM**

- Andersen AFB
- Barrigada Readiness Center

**AUSTRALIA**

- Robertson Barracks

**AMERICAN SAMOA**

- Tafuna



SCHOFIELD BARRACKS, HAWAII -- CAPT. LAKOSKEY, 25TH INFANTRY DIVISION, TURNED TO THE EXCHANGE FOR GEAR SUCH AS FLASHLIGHTS.



## STRATEGIC PRIORITIES

*Throughout 2016, the Exchange continued to improve the customer experience, which helped sustain dividends to support critical Quality-of-Life programs and cemented the Exchange's relevancy in the lives of America's Warfighters and their families.*

### VETERANS ONLINE SHOPPING BENEFIT APPROVED

In January 2017, the Office of the Secretary of Defense approved a policy change to extend military exchange online shopping privileges to all honorably discharged Veterans. This new benefit will launch on Veterans Day 2017 as the Exchange welcomes home potentially 13 million Veterans to their military family.

This new benefit recognizes the honorable service of all Veterans, regardless of their years in the Armed Forces. Upon program maturation within five years, the initiative is projected to produce sales of \$192 million, earnings of \$9.5 million, and \$5 million in additional dividends annually for critical Quality-of-Life programs.

### INTENSIFY NATIONAL BRANDS

Our focus on intensifying customer valued brands generated nearly \$400 million in sales, a 2.7 percent increase compared to 2015. More than 110 additional name-brand concept shops introduced Kensie, Kate Spade, Thalia, Fox Croft, CeCe, Silver Jeans, True Religion, Free People, Jones New York and G.H.Bass.

Disney at the Exchange concept shops remained popular with military shoppers as total Disney sales reached \$25.4 million, a 30 percent increase versus 2015, with Star Wars driving demand. "The Force Awakens" DVD/Blu-ray generated nearly \$835,000 in sales alone.

In Exchange food courts, brand intensification merged with our efforts to introduce more better-for-you options. The Exchange opened 68 name-brand restaurants, including these better-for-you options:

- » 10 Boston Markets from Hawaii to North Carolina.
- » Six Qdoba Mexican Eats from Colorado to New York.
- » Chipotle Mexican Grills at Forts Hood and Bliss.
- » Freshens Fresh Food Studio at Davis-Monthan Air Force Base.

The focus on better-for-you options resonated with Soldiers, Airmen and their families and resulted in total restaurant sales of \$885 million to produce earnings of \$110 million.

### IMPROVE THE ONLINE SHOPPING EXPERIENCE AND ORDER FULFILLMENT

Sales from ShopMyExchange.com were \$236.7 million, 5 percent higher than 2015 as the organization continued to refine and improve the online shopping experience.

A wider selection of name brands such as Magnolia Home, Ethan Allen, Zuo and more increased ShopMyExchange.com's assortment by nearly 18,000 unique products. Customers placed more than 1 million orders in 2016 and browsed through more than 28,000 products online that were also sold in Exchange brick-and-mortar stores.

A new subscription service for repeat ordering of paper towels, diapers and other necessities debuted in 2016.

### REMAINING RELEVANT WITH SISTER AGENCIES

The Exchange launched an online business-to-business (B2B) website that allowed U.S. government agencies and organizations to save 10 percent and pay no sales tax with government purchasing cards. Since debuting in Europe this past June, the Army, Air Force, Navy and Defense Commissary Agency, NATO, Army and Air Force MWR, Landstuhl Army Medical Center, Defense Department schools, AFN radio network, Stars & Stripes newspaper and other groups placed \$2.3 million in orders for everything from office supplies to military tactical gear. A partnership with Office Depot enabled the Exchange to expand its B2B assortment by more than 1,000 items.

### OPTIMIZE THE SUPPLY CHAIN

The Exchange lowered supply-chain costs by \$10.3 million, bringing total cumulative reductions since 2011 to \$110 million.

Greater control of manual packaging and presentation processes reduced order delivery time to the customer to three days in the CONUS and 10 days in OCONUS.





Ninety-eight percent of Exchange online orders are now picked, packed and shipped the same day.

In 2016, more than 800,000 items were shipped from Exchange stores to customers throughout the world due to successful implementation of the Ship-from-Store initiative. The first 15 Ship-from-Store locations focused on fulfilling online orders from the Exchanges closest to each customer, thus reducing delivery times and transportation costs. Thirty-eight more Ship-from-Store locations will be added in 2017.

At the Exchange's West Coast Distribution Center in California and Waco Distribution Center in Texas, modern warehouse management systems for supply chain and retail merchandising solutions were implemented this past year. As a result, quicker picking, packing and shipping the same day in new e-Commerce stations are ensuring online purchases are being shipped to customers faster and more accurately.

As part of the European Infrastructure Consolidation, a reorganization of U.S. forces, the Exchange relocated its distribution center in Germany from Giessen to Germersheim in January 2017 to what consolidation logistics experts called a "Logistics Center of Excellence." The Exchange joined the Defense Logistics Agency and Defense Commissary Agency at the center, which will enhance collaboration among the organizations and save millions of dollars in transportation costs. Because the distribution center is closer to Port of Germersheim, the Exchange expects to avoid \$800,000 a year in transportation costs.

From Giessen, Exchange drivers hauled merchandise 100 miles before reaching their first delivery destinations. The first delivery point from Germersheim is 65 miles. This more central location reduces an estimated 234,000 miles a year.

From the Germersheim Distribution Center, beverages, boxed food, appliances and other merchandise are shipped to Exchanges and Express convenience stores throughout Europe, Southwest Asia and contingency locations. The Exchange private fleet also transports raw goods and materials from Germersheim to the Exchange's bakery and water plant in Gruenstadt, Germany.

## GROW CONCESSIONS

A compelling mix of products, services, entertainment, food and fuel options was offered last year to improve quality of life in military communities. The year 2016 brought more name-brand concessions such as NAPA Auto Parts, Haggar Outlet, Claire's and other well-known businesses to Exchange shopping malls. Exchange concessions in 2016 generated \$1.6 billion in sales and nearly \$190 million in earnings, 4.8 percent higher than 2015.

In 2016, Disney offered 15 first-run movies in Exchange movie theaters in CONUS. Warner Bros., Paramount, Disney, Fox, Sony, Lionsgate, Focus Features and independent studios also offered 24 free advance first-run screenings, while 20th Century Fox provided 23 early screenings on video cassettes for troops in contingency locations.

In December, the Exchange and The Walt Disney Studios premiered "Rogue One: A Star Wars Story" in Afghanistan, Iraq and Jordan, continuing the Exchange's longstanding commitment to bring needed tastes of home to troops far from friends and families during the holidays.

In May, an Exchange dental clinic opened at Fort Stewart. The clinic is the Exchange's third; the first opened at Fort Hood; the second, at Fort Irwin. More than 8,700 patients visited the clinics in 2016 for general dentistry, orthodontics, periodontics, dentures and other services.

The Exchange kept service members fueled up as its Express convenience stores sold 402 million gallons of gasoline and increased margins by 2 percent above 2015. The Exchange's new web-based request-for-proposal system was used by more than 100 potential suppliers, who proposed more than 10,000 pricing points. The initiative resulted in lower fuel prices of 2.03-cents per gallon, a savings of \$9.9 million for the Exchange and its sister Marine Corps and Coast Guard Exchanges.

Fuel tech upgrades improved the monitoring of inventory, sales and delivery at 194 Express convenience stores. A new web-based pricing system now allows the Exchange to react immediately to competitors' price changes to ensure Expresses offer customers the best prices possible.





Exchange bakeries in Germany, Japan and Korea supported U.S. forces stationed overseas by delivering fresh, American name-brand products to 150 Exchanges, Express stores, restaurants, commissaries, military dining facilities, ships, embassies and Department of Defense schools. Worldwide, the facilities baked 2.8 million loaves of bread, 6 million tortillas and 2.8 million packages of buns. The bakery in Gruenstadt, Germany, produced 7 million Krispy Kreme doughnuts for troops and their families throughout Europe.

Exchange water plants in Gruenstadt and Vicenza, Italy, using state-of-the-art processes, produced 5 million gallons of Culligan and Nature's Recipe water for service members and their families in 24 countries. The plants received top inspections for quality. The Exchange served 3.2 million meals in 2016 to children in 78 cafeterias in overseas Army and Air Force Department of Defense schools.

At Fort Bragg, N.C., plans for the Exchange's second community entertainment complex are well underway, and the complex is on schedule to open next year. The center is 94 percent pre-leased with a diverse combination of national, regional and local name-brand retail and dining facilities.

## GROW THE EXPRESS

New concepts, signing and graphics changed the look and feel of the Exchange's Express convenience store experience. More than 300 better-for-you items are featured and include wraps, salads, hummus, yogurt, fresh fruit, milk and hard-boiled eggs.

At Express convenience stores, Exchange BE FIT options have accounted for one out of every five food products sold for two years running, accounting for nearly \$65 million in sales and nearly 19 percent of all food sales with bananas, Smart Water, fresh salads and fruit seeing the greatest demand.

Throughout 2016, the Exchange planned a pilot location to re-image the Express convenience stores. Fort Riley's Big Red One Express opened in February 2017 with an innovative format infused with new items, specialty beverages and hot-to-go foods. A new queuing system at the registers gives customers multiple chances to pick up items on their way out. Angled fixtures and displays naturally lead customers through the store.

## INSPIRE AND DEVELOP FUTURE LEADERS

In 2016, the Exchange invested in the organization's future leaders, promoting 1,046 associates and providing learning opportunities for college interns, Wounded Warriors and Veterans. Managers and associates throughout every level of the Exchange engaged in core business and retail management training. The Exchange's executive and leadership development programs prepared high potential candidates with leadership skills needed to advance to positions of higher responsibility at the senior executive level.

The Exchange placed top priority on hiring military spouses, other dependents and Veterans, who now comprise 37 percent of the organization's total workforce.

## FOCUS CAPEX PROGRAM ON HIGH ROI PROJECTS

The Exchange spent more than \$110 million on capital projects involving stores, restaurants and other facilities worldwide. More than \$52 million in improvements were made at the Fort Gordon, Fort Sill, Fort Jackson and Barksdale AFB shopping centers.

Fort Gordon's \$32 million expansion to 167,000 square feet brought everything under one roof, adding 80,000 square feet to the 20-year-old mall. At Fort Sill, Fort Jackson and Barksdale, the Exchange updated these Shopping Centers into modern, customer-friendly shopping experiences with a strong assortment of national brands.

In August, a new \$15.7 million Express and mega-food complex was completed in the heart of Fort Bragg, while in November, the Exchange opened a new \$6.2 million mini mall for troops relocating to South Korea's expanding Camp Humphreys.

## REDUCE OPERATING EXPENSES

The Exchange turnaround continues to come into focus as the 121-year-old benefit now serves as the model for lean, accountable and more efficient DoD service to the military community. In 2016, total Selling, General & Administrative expenses decreased by nearly \$6 million vs. 2015, bringing total savings secured during the past five years to \$325 million. Between 2011 and 2016, the equivalent of 7,500 full-time positions were eliminated.





# SNAPSHOTS

## FEBRUARY

The Exchange is named one of DiversityBusiness.com's top 25 government agencies for multicultural business opportunities.

## MARCH

The Exchange is recognized by Popeyes Louisiana Kitchen for operational excellence at the restaurant's international conference. The Exchange's Popeyes restaurants at Camp Casey, Schofield Barracks and Lackland AFB are each awarded Bronze Plates for operational excellence and customer service.

The Exchange is named a Best for Vets employer by Military Times for a third straight year.

A renovated Exchange main store reopens at Barksdale AFB.

## APRIL

The Exchange begins serving Soldiers of the Joint Multinational Training Group in the Ukraine. The group included 400 American Soldiers.

The Exchange and Defense Logistics Agency deliver frozen meat to American troops serving in Iraq so they can enjoy barbecues downrange.



Exchange associates at Ramstein AB serve food and water to hundreds of military families evacuated from Turkey's Incirlik AB because of rising unrest.

## MAY

A renovated Exchange shopping mall reopens at Fort Gordon.

An Exchange dental clinic opens at Fort Stewart. The clinic is the Exchange's third; the first opened at Fort Hood; the second, at Fort Irwin.

## JUNE

The Exchange serves more than 31,000 troops participating in the Anakonda 16 military exercise in Poland.



The Exchange helps open a troop-run store in Cameroon to serve American troops training the African country's military in land mine detection.

## JULY

The Exchange celebrates its 121st anniversary.

The Exchange opens its first direct-operated Freshens Fresh Food Studio at Davis-Monthan AFB, the first on a military installation in the continental United States. Freshens operates its own restaurants at Korea's Osan AB and Camp Humphreys.

The Exchange begins shipping online orders from stores to reduce costs and increase speed of delivery. The first Ship-from-Store operations are located at Forts Sam Houston and Belvoir as well as Lackland, MacDill and Nellis AFBs.

## AUGUST

In partnership with Comcast NBCUniversal and U.S. cable, satellite and telecommunications providers, the Exchange provides free live streaming coverage of the 2016 Rio Olympics for troops, including those serving at remote locations and downrange. More than 71,000 service members streamed the Olympics competition.

The Exchange opens the 43,000-square-foot, nearly \$16 million Smoke Bomb Hill Express in the heart of Fort Bragg, complete with a mega food court featuring Boston Market, Arby's, Qdoba, Hunt Brothers Pizza and Subway, among others.

For the ninth straight year, LATINA Style magazine names the Exchange a top company for Latinas to work.

The Exchange opens McAlister's Deli at Scott Air Force Base. It's McAlister's first location on an Army or Air Force installation.

Associates from Camp Humphreys and Osan AB staff a mobile field exchange in Yong-in, South Korea to provide Quality-of-Life support to U.S. and Canadian Soldiers engaged in the Ulchi Freedom Guardian exercise.

## SEPTEMBER



The Exchange opens Chipotle restaurants at Forts Bliss & Hood.

For the fourth straight year, U.S. Veterans Magazine names the Exchange one of its "Best of the Best" for employment of veterans and their spouses.

The Exchange opens a new \$4.3 million Express convenience store in Barrigada, Guam.

## OCTOBER

The Exchange launches more Ship-from-Store online fulfillment centers at Forts Campbell, Bragg and Carson and Travis Air Force Base.

CreditCards.com reports the military exchanges' MILITARY STAR card has the lowest flat interest rate—10.49 percent—among all of America's Top 100 retailers' credit offerings.

## NOVEMBER



The Exchange and Defense Logistics Agency send frozen turkeys from the U.S. to the Baghdad Diplomatic Support Center and Baghdad Embassy Complex Exchanges in time for troops to enjoy traditional Thanksgiving dinners.

The Exchange implements its first overseas Ship-from-Store online fulfillment at Ramstein Air Base.

A \$6.2 million mini mall at U.S. Army Garrison Humphreys opens. The 24,000-square-foot store includes an Express, Starbucks, Taco Bell, Subway, dry cleaners, barbershop and Military Auto Source. The new building serves the moving of troops from Camp Casey and Yongsan Army Garrison to Camp Humphreys.

## DECEMBER

Based on a survey of readers who bought electronics during the past year, Consumer Reports names the Exchange's ShopMyExchange.com as the eighth most popular website for electronics.

Associates from Camp Zama, Japan, serve more than 1,600 U.S. troops and 4,600 Japanese military personnel in the Yama Sakura military exercise at Camp Kengun.

The Exchange opens a \$7.5 million renovated shopping center at Fort Sill and completes a \$5.5 image upgrade at Fort Jackson.

The Exchange and Boingo extend Wi-Fi internet service to six more installations, including the latest at Joint Base Lewis-McChord, Wash. The locations bring the number of installations that include the service to 34.

The Exchange partners with Air Force Services to open a new 3,400-square-foot Military Clothing store in a more convenient, prominent location in the Pentagon's second-floor retail concourse to better serve Soldiers, Sailors, Marines and Airmen.

The Exchange and the Walt Disney Studios premiere "Rogue One: A Star Wars Story" for service members in Afghanistan, Iraq and Jordan.

The Exchange holds a special holiday shopping event at Joint Base San Antonio-Lackland for more than 3,000 basic military training recruits who normally are not allowed outside of their dorms when not training. The Exchange's first Facebook Live video of the shopping day sets a record for Exchange social media channels, reaching 3 million people.

## JANUARY

The Exchange ships its first order out of the new Germersheim Distribution Center in Germany. The Exchange moved its Europe distribution facility from Giessen to Germersheim to join the Defense Commissary Agency and Defense Logistics Agency in creating a "Logistics Center of Excellence" to foster collaboration and reduce transportation costs.

The Exchange opens three mobile field exchanges in Poland to support 3,500 troops entering the country on their way to multiple locations throughout Europe.

The Office of the Secretary of Defense approves a policy change extending online Exchange shopping privileges to all honorably discharged veterans. The Veterans shopping benefit will start on Veterans Day 2017.



## FAMILY SERVING FAMILY

*More than just a store on a military installation, the Exchange is a Department of Defense institution offering a full complement of merchandise and services to support troops and their families, wherever they serve.*

Of the Exchange's 35,000-plus associates, more than 85 percent are personally connected to the military. The organization's workforce includes Veterans, parents, spouses and extended family members of those who are serving or have served.

Family is at the heart of the Exchange's mission and drives its success. The Exchange's relationship with those who wear our Nation's uniform is one of the 121-year-old organization's greatest strengths and uniquely positions it to meet the needs of customers in ways no other retailer possibly can.

Throughout 2016, the Exchange's core value of "Family Serving Family" improved military readiness and resiliency at locations around the world. For instance:

- » When hundreds of military families were evacuated to Germany's Ramstein AB from Turkey because of rising safety concerns, they were fed and cared for by Ramstein associates, who provided Subway sandwiches, Culligan water and other refreshments.
- » To avoid the chance of military families running low on gas during a pipeline leak, the Exchange transported 50,000 barrels of fuel by leasing a barge that traveled from Yorktown, N.Y., to Wilmington, N.C. From there, fuel trucks ran between the barge and the Exchange Express convenience stores throughout the eastern United States for 30 days.
- » The Exchange and the Defense Logistics Agency teamed up to provide frozen meat to service members in Iraq, allowing them the opportunity to enjoy barbecues in the middle of the desert.
- » The Exchange provided 19,000 meals a day below cost to students in 78 Department of Defense school cafeterias in nine overseas countries.
- » At Afghanistan's Bagram Airfield, Exchange associates helped troops after a suicide bomber attack in November.
- » Through Military Clothing Sales stores, the Exchange outfitted 1.5 million military uniforms below cost.
- » At Wright-Patterson AFB, the services team thanked an Airman and his family for their service to the Nation by "hiring" their 8-year-old autistic son as a mechanic at the Firestone car-care center. Under the watchful tutelage of Firestone mechanics, the youngster helped perform routine maintenance on a truck.
- » At Fort Sill, Exchange General Manager Daniel Wise also served as a "distinctive religious group leader" to the installation's Jewish community, which went without a rabbi chaplain for about seven years prior to Wise's arrival. Post commanders credit Wise with breathing fresh life into Fort Sill's Jewish community.
- » At Goodfellow AFB, Texas, Assistant Store Manager Lisa Piper presented 175 gift bags to Airmen training during the Christmas holidays.
- » Associates at Vandenberg AFB provided bottled water, food and other necessities to firefighters battling a nearly 13,000-acre Canyon Fire.





# BOARD OF DIRECTORS



**Lt Gen & Chairman**  
**Gina M. Grosso**  
 Deputy Chief of Staff, Manpower, Personnel & Services



**LTG**  
**Aundre F. Piggee**  
 Deputy Chief of Staff, G-4, HQ DA



**Mr.**  
**Thomas C. Shull**  
 Director/CEO, Army & Air Force Exchange Service



**LTG**  
**Karen E. Dyson**  
 Military Deputy for Budget, HQDA ASA FM



**LTG**  
**Kenneth R. Dahl**  
 Commanding General, Installation Management Command (IMCOM)



**SMA**  
**Daniel A. Dailey**  
 Sergeant Major of the Army



**CMSAF**  
**Kaleth O. Wright**  
 Chief Master Sergeant of the Air Force



**MG**  
**James V. Young Jr.**  
 Commanding General (Troop Program Unit), 75th Training Command



**Maj Gen**  
**James F. Martin**  
 Deputy Assistant Secretary of the Air Force (Budget)



**Maj Gen**  
**Margaret B. Poore**  
 Commander, Air Force Personnel Center (AFPC/CC)



**Mr.**  
**Horace Larry SES**  
 Deputy Director, Air Force Services



**Mr.**  
**Donald G. Salo SES**  
 Deputy Assistant Secretary of the Army (Military Personnel/Quality of Life)

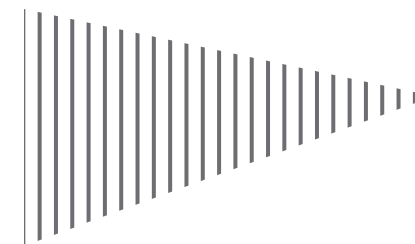


**Col**  
**John N. Tree**  
 Mobilization Assistant to the Commander, Oklahoma City Air Logistics Complex

## FINANCIAL STATEMENTS

Army and Air Force Exchange Service  
 Years Ended January 28, 2017 and January 30, 2016  
 With Report of Independent Auditors

Ernst & Young LLP





Army and Air Force Exchange Service

Financial Statements

Years Ended January 28, 2017 and January 30, 2016

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**Report of Independent Auditors**

The Board of Directors  
Army and Air Force Exchange Service  
Departments of the Army and Air Force

We have audited the accompanying financial statements of Army and Air Force Exchange Service, which comprise the balance sheets as of January 28, 2017 and January 30, 2016, and the related statements of earnings, comprehensive income, changes in net assets, and cash flows for the years then ended, and the related notes to the financial statements.

**Management’s Responsibility for the Financial Statements**

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

**Auditor’s Responsibility**

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

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

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



## Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Army and Air Force Exchange Service at January 28, 2017 and January 30, 2016, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

*Ernst & Young LLP*

May 25, 2017

## Army and Air Force Exchange Service

### Balance Sheets

(Dollars in Thousands, Unless Otherwise Noted)

	January 28, 2017	January 30, 2016
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 61,554	\$ 84,530
Trade and other accounts receivable, less allowance for uncollectible accounts of \$32,245 at January 28, 2017 and \$36,783 at January 30, 2016	3,058,184	3,176,564
Merchandise inventories	1,288,450	1,315,965
Short-term investments	9,937	12,978
Supplies and other current assets	41,193	51,261
Total current assets	4,459,318	4,641,298
Buildings and improvements	3,606,910	3,568,415
Fixtures and equipment	1,214,605	1,206,873
Construction-in-progress	218,411	187,854
	5,039,926	4,963,142
Accumulated depreciation	(3,072,285)	(2,922,779)
	1,967,641	2,040,363
Other assets	5,437	2,530
Long-term investments and supplemental plan assets	18,614	17,629
Total assets	\$ 6,451,010	\$ 6,701,820
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 406,183	\$ 387,986
Commercial paper and current maturities of long-term debt	999,553	732,652
Accrued salaries and other employee benefits	111,330	113,817
Dividends payable	38,116	49,732
Other current liabilities	184,514	209,723
Total current liabilities	1,739,696	1,493,910
Long-term debt	298,761	704,699
Accrued pension and other benefits	1,086,849	1,649,944
Other noncurrent liabilities	77,314	73,326
Total liabilities	3,202,620	3,921,879
Net assets:		
Accumulated other comprehensive loss:		
Pension and postretirement benefit liability	(2,012,149)	(2,411,584)
Derivative instruments	437	(1,147)
Total accumulated other comprehensive loss	(2,011,712)	(2,412,731)
Retained earnings	5,260,102	5,192,672
Total net assets	3,248,390	2,779,941
Total liabilities and net assets	\$ 6,451,010	\$ 6,701,820

See accompanying notes.



Army and Air Force Exchange Service

Statements of Earnings  
(Dollars in Thousands, Unless Otherwise Noted)

	Year Ended	
	January 28, 2017	January 30, 2016
Net sales	\$ 6,462,469	\$ 6,718,486
Finance revenue	256,829	262,682
Concession income	202,179	194,769
Other operating income	31,019	29,849
Total revenue	<u>6,952,496</u>	<u>7,205,786</u>
Cost of sales and operating expenses:		
Cost of goods sold	4,791,553	5,018,196
Selling, general, and administrative:		
Employee compensation and benefits	1,073,974	1,159,045
Depreciation and amortization	261,270	270,907
Other	505,237	491,890
Total selling, general, and administrative expenses	<u>1,840,481</u>	<u>1,921,842</u>
Interest expense	11,354	10,574
Bad debt expense	24,221	21,794
Total expenses	<u>6,667,609</u>	<u>6,972,406</u>
Operating income	284,887	233,380
Other income	7,558	7,176
Net earnings	<u>\$ 292,445</u>	<u>\$ 240,556</u>

See accompanying notes.

Army and Air Force Exchange Service

Statements of Comprehensive Income  
(Dollars in Thousands, Unless Otherwise Noted)

	Year Ended	
	January 28, 2017	January 30, 2016
Net earnings	\$ 292,445	\$ 240,556
Other comprehensive income:		
Reclassification of unrealized gain on derivative instruments to earnings	1,584	14,399
Pension and postretirement benefits adjustments		
Unrealized gain arising during the period	298,394	314,202
Amortization of net loss	101,041	205,168
Other comprehensive income	<u>401,019</u>	<u>533,769</u>
Comprehensive income	<u>\$ 693,464</u>	<u>\$ 774,325</u>

See accompanying notes.



Army and Air Force Exchange Service

Statements of Changes in Net Assets  
(Dollars in Thousands, Unless Otherwise Noted)

Years Ended January 28, 2017 and January 30, 2016

	Retained Earnings	Accumulated Other Comprehensive Loss	Net Assets
Balance at February 1, 2015	\$ 5,189,815	\$ (2,946,500)	\$ 2,243,315
Net earnings	240,556	-	240,556
Pension and postretirement benefits adjustments	-	519,370	519,370
Reclassification of unrealized gain on derivative instruments to earnings	-	14,399	14,399
Dividends to the Central Welfare Funds, Departments of the Army, the Air Force, the Navy and the Marine Corps	(237,699)	-	(237,699)
Balance at January 30, 2016	5,192,672	(2,412,731)	2,779,941
Net earnings	292,445	-	292,445
Pension and postretirement benefits adjustments	-	399,435	399,435
Reclassification of unrealized gain on derivative instruments to earnings	-	1,584	1,584
Dividends to the Central Welfare Funds, Departments of the Army, the Air Force, the Navy and the Marine Corps	(225,015)	-	(225,015)
Balance at January 28, 2017	<u>\$ 5,260,102</u>	<u>\$ (2,011,712)</u>	<u>\$ 3,248,390</u>

See accompanying notes.

Army and Air Force Exchange Service

Statements of Cash Flows  
(Dollars in Thousands, Unless Otherwise Noted)

	Year Ended	
	January 28, 2017	January 30, 2016
<b>Operating activities</b>		
Net earnings	\$ 292,445	\$ 240,556
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	291,359	302,059
Loss on disposal of property and equipment	1,696	2,328
Loss on supplemental pension plan assets	1,412	371
Bad debt expense	24,221	21,794
Changes in operating assets and liabilities:		
Accounts receivable	94,159	100,682
Merchandise inventories	27,515	(22,158)
Supplies and other assets	7,161	12,739
Pension assets and liabilities	(160,179)	(103,584)
Long-term investments and supplemental plan assets	(2,339)	(299)
Accounts payable	18,909	28,178
Change in cash overdraft	476	347
Accrued salaries and other employee benefits	(2,091)	(5,056)
Other liabilities	(24,701)	(31,839)
Net cash provided by operating activities	<u>570,043</u>	<u>546,118</u>
<b>Investing activities</b>		
Purchases of property and equipment	(228,085)	(252,634)
Proceeds from the sale of property and equipment	7,753	6,162
Purchases of investments	(58)	(12,978)
Proceeds from the disposition of investments	3,040	16,994
Net cash used in investing activities	<u>(217,350)</u>	<u>(242,456)</u>
<b>Financing activities</b>		
Net (repayments) proceeds under line-of-credit agreements	(50,000)	150,000
Net repayments under commercial paper agreements	(83,385)	(122,250)
Net repayments from issuance of long-term debt	-	(150,000)
Repayments of long-term debt	(5,652)	(5,380)
Payment of dividends	(236,632)	(199,237)
Net cash used in financing activities	<u>(375,669)</u>	<u>(326,867)</u>
Net decrease in cash and cash equivalents	(22,976)	(23,205)
Cash and cash equivalents at beginning of year	84,530	107,735
Cash and cash equivalents at end of year	<u>\$ 61,554</u>	<u>\$ 84,530</u>

See accompanying notes.



Army and Air Force Exchange Service

Notes to Financial Statements  
(Dollars in Thousands, Unless Otherwise Noted)

January 28, 2017

**1. Description of Business and Summary of Significant Accounting Policies**

**General**

The Army and Air Force Exchange Service (the Exchange or the Company) is a joint non-appropriated fund instrumentality (NAFI) of the United States (U.S.) organized under the Departments of the U.S. Army and the U.S. Air Force. The Exchange provides retail services to soldiers, airmen, and their families through a network of stores principally located in the U.S., Europe, the Pacific Rim, and the Middle East, substantially all of which are located on U.S. government installations. Middle East services operating in Afghanistan and Iraq primarily provide support for Operation Freedom Sentinel (OFS), Operation Resource Support (ORS), and Operation Inherent Resolve (OIR). In addition to providing merchandise and services of necessity and convenience to authorized patrons at competitively low prices, the Exchange's mission is to generate reasonable earnings to supplement appropriated funds for the support of Army and Air Force morale, welfare, and recreation programs. The Exchange maintains custody of and control over its non-appropriated funds. Funds that are not distributed as dividends are reinvested in the Exchange's operations. The Exchange is exempt from direct state taxation and from state regulatory laws. Such laws include licensing and price control statutes.

The Exchange utilizes accounting principles generally accepted in the United States (U.S. GAAP) applicable to "for profit" organizations because of the nature of its commercial-type operations. The Exchange's financial statements include the operations of all exchanges at U.S. Army and Air Force installations throughout the world.

**Fiscal Year**

The Exchange's fiscal year end is the Saturday nearest January 31. References to fiscal year 2016 and fiscal year 2015 herein are to the fiscal years ended January 28, 2017 and January 30, 2016, respectively.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**1. Description of Business and Summary of Significant Accounting Policies (continued)**

Net sales by geographic region are summarized below:

	<b>Year Ended</b>	
	<b>January 28, 2017</b>	<b>January 30, 2016</b>
Continental U.S., including Alaska and Hawaii	<b>\$ 4,648,354</b>	\$ 4,852,867
Pacific Rim	<b>711,433</b>	728,910
Europe, primarily Germany	<b>680,948</b>	730,163
Middle East, including Afghanistan and Iraq	<b>174,905</b>	168,196
Other countries	<b>246,829</b>	238,350
Total net sales	<b><u>\$ 6,462,469</u></b>	<u>\$ 6,718,486</u>

Long-lived assets comprise property and equipment. Long-lived assets, net of accumulated depreciation and amortization, by geographic region are summarized below:

	<b>Year Ended</b>	
	<b>January 28, 2017</b>	<b>January 30, 2016</b>
Continental U.S., including Alaska and Hawaii	<b>\$ 1,593,618</b>	\$ 1,635,199
Pacific Rim	<b>227,626</b>	248,609
Europe, primarily Germany	<b>145,332</b>	155,608
Middle East, including Afghanistan and Iraq	<b>1,065</b>	947
Total long-lived assets, net	<b><u>\$ 1,967,641</u></b>	<u>\$ 2,040,363</u>



Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**1. Description of Business and Summary of Significant Accounting Policies (continued)**

**Appropriated Funds**

In accordance with applicable U.S. Army and Air Force regulations, the Exchange is not required to pay rent for the use of properties owned by the U.S. government or utility costs associated with overseas exchanges. Permanent structures that are constructed by the Exchange and paid for from Exchange funds become the property of the U.S. government; however, the Exchange has the right to occupy and use the structures. The structures cannot be used for other than the Exchange's purposes without prior approval by the Exchange Director/Chief Executive Officer and the relevant department of the U.S. government. As such, the Exchange has included the cost of the structures on its balance sheet and depreciates the cost of the structures on a straight-line basis over their estimated useful lives. Services, such as ocean transportation of merchandise to certain locations on U.S. chartered vessels and performance of administrative and supervisory functions by military personnel have been provided without charge to the Exchange.

Management has estimated the value of transportation costs provided by the U.S. government for Exchange materials shipped to and from overseas Exchange facilities to be approximately \$101,522 and \$107,008 for fiscal years 2016 and 2015, respectively. In addition, Middle East transportation costs of \$26,131 and \$31,833 were paid by the U.S. government for fiscal years 2016 and 2015, respectively.

The Exchange receives reimbursements of certain incremental costs incurred by the Exchange in relation to support provided to contingency operations. Appropriated fund (APF) reimbursements are recorded when an incremental cost that qualifies for reimbursement has been incurred and reimbursement by responsible agency is reasonably assured. Such APF reimbursement receivables are classified as trade and other accounts receivable in the accompanying balance sheets and are recorded as an offset to the related expenses (as described below) in the statement of earnings. In fiscal years 2016 and 2015, the Exchange recorded APF reimbursements of \$18,358 and \$19,406, respectively. These amounts include expenses related to inventory markdowns and shortages, personnel costs, in-theater transportation and other expenses.

**Dividends**

The Exchange is required, under various agreements, to distribute a portion of each year's net earnings in the form of dividend payments to the Central Welfare Funds, Departments of the Army, the Air Force, the Navy, and the Marine Corps.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**1. Description of Business and Summary of Significant Accounting Policies (continued)**

**Use of Estimates**

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the accompanying financial statements and accompanying notes. Key estimates made by Company management include the level of allowance needed for potentially uncollectible accounts receivable and discount rates, long-term rate of return on assets, health care trend assumptions, and mortality assumptions used to determine obligations associated with pension plans and postretirement benefit plans.

In pension accounting, the most significant actuarial assumptions are the discount rate, the long-term rate of return on plan assets, and mortality. In determining the long-term rate of return on plan assets, the Company considers the nature of the plans' investments, an expectation of the plans' investment strategies and the expected rate of return. Pension assets include investments in limited partnerships, real estate properties, private equity, timber, agriculture and debt, which do not have readily available market values. In these instances, management reviews and takes responsibility for assessing, concluding on, and recording the fair market values for investments provided by the general partner, investment manager or appraiser, as appropriate. Management believes estimated fair values have been reported in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, but may differ materially from the values that would have been used had a ready market for these investments existed. See Note 6 for further information about benefit plans.

**Cash and Cash Equivalents**

Cash equivalents represent cash on hand in stores, deposits in banks, and third-party credit card receivables. Cash and cash equivalents are carried at cost, which approximates fair value.

**Investments in Debt Securities**

Investments in debt securities have original maturities of greater than 90 days. These investments are typically held to maturity and are classified as such because the Company has the intent and ability to hold them to maturity. Held-to-maturity securities are carried at amortized cost.



Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**1. Description of Business and Summary of Significant Accounting Policies (continued)**

**Accounts Receivable, Finance Revenue, and Provisions for Credit Losses**

As of January 28, 2017 and January 30, 2016, approximately \$2,412,248 and \$2,452,602, respectively, of the accounts receivable balance represents amounts due to the Exchange under its in-house credit program, the MILITARY STAR<sup>®</sup> Card. The MILITARY STAR<sup>®</sup> Card program extends credit to eligible Exchange customers for the purchase of retail goods at Exchange stores worldwide.

Minimum payments are calculated based on 2.777% of the unpaid balance as of the customer's last purchase. These payments are applied in accordance with the Credit CARD Act of 2009. Payments are recorded against outstanding receivable balance and debited to cash accounts.

Concentrations of credit risk, with respect to customer receivables, are limited due to the large number of customers comprising the Company's credit card base and their dispersion throughout the world. The Company believes the carrying amount of existing customer receivables is the best estimate of fair value due to the short-term nature of those receivables.

The Company's trade and accounts receivable balance also includes \$152,944 and \$158,062 of receivables from the Marine Exchange (MCX) for Marine MILITARY STAR<sup>®</sup> Card outstanding balances and related processing fees as of January 28, 2017 and January 30, 2016, respectively.

Finance revenue is calculated based upon the customer account balance outstanding during the period after consideration of the applicable grace period, typically 30 days following the billing date. The finance rate charged is a variable interest rate calculated at a variable amount above the U.S. Prime Rate reported in *The Wall Street Journal*. The standard APR for fiscal year 2016 was 10.49%. The standard APR was increased to 10.74% on December 15, 2016. Beginning at 90 days past due, the delinquency rate of 18.74% applies. Finance charges are recorded unless an account balance has been outstanding for more than 150 days. Customer receivables past due 90 days or more and still accruing interest were approximately \$55,539 and \$52,027 as of January 28, 2017 and January 30, 2016, respectively.

Accounts past due for 30 days or more are considered delinquent. Accounts delinquent for 150 days are submitted to the collection department. The Exchange utilizes various means to collect past-due accounts, as well as accounts written off, including some methods not available to other retail organizations. The Exchange has agreements with other U.S. government entities

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**1. Description of Business and Summary of Significant Accounting Policies (continued)**

that allow the Exchange to garnish wages of service personnel, as well as claim the debtors' future payments from such U.S. government entities, including U.S. Treasury income tax refunds. Personal contact, external collection agencies, and letters to service personnel superiors are also used to pursue delinquent accounts. The outstanding receivables related to accounts previously written off (previously submitted to the collection department) were \$302,258 and \$326,248 at January 28, 2017 and January 30, 2016, respectively. These accounts are at least 150 days past due and are generally outstanding for one to five years.

The Exchange's credit card portfolio consists of smaller-balance, homogeneous loans. Due to the homogeneous nature of the credit card portfolios, a provision for credit loss is recorded related to the Exchange's current credit card portfolio based on a percentage of total projected charge-offs that are considered uncollectible. Additionally, with respect to accounts previously written off, the Exchange records and evaluates collectability of a net receivable using a portfolio approach pooled by year based on estimated probable recoveries.

The Exchange periodically evaluates the adequacy of the provision using such factors as prior account loss experience, changes in the volume of the account portfolio, changes in the estimates of anticipated recoveries on delinquent or written off balances, and changes in credit policy. These factors were considered in establishing the Exchange's allowance for doubtful accounts, and the net receivable related to accounts previously written off, as of January 28, 2017 and January 30, 2016. It is reasonably possible that the amounts the Exchange will ultimately recover on delinquent balances could differ materially in the near term from the amounts assumed in arriving at the allowance for doubtful accounts and net receivable related to accounts previously written off. Collections on accounts previously written off and submitted to U.S. government entities totaled approximately \$165,492 and \$179,559 in fiscal years 2016 and 2015, respectively. Bad debt expense of \$24,221 recorded in fiscal year 2016 is primarily related to the Exchange's current credit card portfolio. This is compared to \$21,794 in bad debt expense recorded in fiscal year 2015. The Exchange uses a portfolio approach pooled by year to record the net receivable related to accounts previously written off, whereby finance income is no longer accrued and cash collections are applied to outstanding principal until 100% of the portfolio has been collected. Subsequent cash collections in excess of amounts previously written off are recorded as finance revenue. Finance revenue recognized in fiscal year 2016 related to accounts previously written off totaled approximately \$14,063 compared to approximately \$16,007 in fiscal year 2015.



Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**1. Description of Business and Summary of Significant Accounting Policies (continued)**

The following table sets forth the age of the Exchange's credit card receivables that have not yet been submitted to U.S. government entities for collection.

	January 28, 2017		January 30, 2016	
	Amount	Percentage of Receivables	Amount	Percentage of Receivables
	<i>(In Millions)</i>			
Current	\$ 2,070	80.7%	\$ 2,132	81.7%
1–29 days past due	265	10.3	263	10.1
30–59 days past due	111	4.3	103	3.9
60–89 days past due	63	2.5	60	2.3
90+ days past due	56	2.2	53	2.0
Period-end gross credit card receivables	<u>\$ 2,565</u>	<u>100.0%</u>	<u>\$ 2,611</u>	<u>100.0%</u>

The following table sets forth the provision for possible credit loss related to the Exchange's current credit card portfolio and does not include the net receivable related to accounts submitted to U.S. government entities for collection. In addition, this table does not include the provision for bad debt for other trade accounts receivable that are unrelated to the Exchange's credit card portfolio.

	2016	2015
	<i>(In Millions)</i>	
Allowance at beginning of period	\$ 34	\$ 37
Provision for bad debt	24	21
Write-offs (net of recoveries)	(29)	(24)
Allowance at end of period	<u>\$ 29</u>	<u>\$ 34</u>

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**1. Description of Business and Summary of Significant Accounting Policies (continued)**

The following table sets forth the credit scores of the Exchange's credit card portfolio that have not yet been submitted to US government entities for collection as reported by FICO (formerly known as "Fair Isaac Corporation").

	January 28, 2017	January 30, 2016
	<i>(In Millions)</i>	
Nondelinquent accounts (Current and 1–29 days past due):		
FICO score of 700 or above	\$ 722	\$ 719
FICO score of 600 to 699	1,224	1,258
FICO score below 600	389	418
Total nondelinquent accounts	<u>2,335</u>	<u>2,395</u>
Delinquent accounts (30+ days past due)	230	216
Period-end gross credit card receivables	<u>\$ 2,565</u>	<u>\$ 2,611</u>

**Merchandise Inventories**

The Exchange's inventories are valued at the lower of cost or market, as determined primarily by the retail inventory method of accounting (RIM), except for distribution center inventories, which are based on the first-in, first-out inventory method. Certain warehousing and distribution costs are included in the cost of inventory. \$10,715 and \$12,375 of these costs were included in merchandise inventory at January 28, 2017, and January 30, 2016, respectively. For discussions of risk related to inventory in the Middle East, refer to Note 9.

Inherent in the RIM calculation are certain significant management judgments and estimates, including, among others, merchandise markons, markups, markdowns and shrinkage, which significantly impact the ending inventory valuation at cost, as well as resulting gross margins. The methodologies utilized by the Exchange in the application of the RIM calculation are consistent for all periods presented. Such methodologies include the development of the cost-to-retail ratios, the groupings of homogenous classes of merchandise, the development of shrinkage and obsolescence reserves, and the accounting for price changes.



Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**1. Description of Business and Summary of Significant Accounting Policies (continued)**

**Buildings and Improvements**

Buildings and improvements primarily represent permanent structures constructed and paid for by the Exchange and owned by the U.S. government. These assets are recorded by the Exchange at cost with depreciation provided using the straight-line method over the estimated useful lives of the assets. The useful lives are governed, to a large extent, by the deployment of Army and Air Force personnel and, to some extent, by the requirements of the Departments of the Army and the Air Force with respect to space occupied by the Exchange. Buildings are generally depreciated over 30 years, and improvements are depreciated from 7 to 15 years. The Exchange loses its rights to buildings and improvements in the event of base closures and accelerates depreciation of its assets when such closures are probable. As part of the Exchange's mission, "We Go Where You Go," there are facilities built to serve the military community regardless of its ability to generate a profit. With all construction projects, these service (Quality of Life) projects must go through the Board and Finance Committee for review and approval prior to construction. Projected returns of less than 7% internal rate of return are considered service projects and are segregated during the asset impairment review process (discussed below). Although these facilities are segregated from the fixed asset portfolio, the Exchange closely monitors operations to ensure the highest level of efficiencies can be maintained while maximizing profits.

The carrying value of long-lived assets, including property and equipment and definite-lived intangible assets, is evaluated annually or whenever events or changes in circumstances indicate that a potential impairment has occurred relative to a given asset or assets. Factors that could result in an impairment review include, but are not limited to, a current-period cash flow loss combined with a history of cash flow losses or a projection that demonstrates continuing losses associated with the use of a long-lived asset, significant changes in the manner of use of the assets, or significant changes in business strategies. An impairment loss is recognized when the estimated undiscounted cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. When an impairment loss is recognized, the carrying amount of the asset is reduced to its estimated fair value as determined based on quoted market prices or through the use of other valuation techniques. The Company has not recorded any long-lived asset impairment charges during fiscal years 2016 or 2015.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**1. Description of Business and Summary of Significant Accounting Policies (continued)**

**Fixtures and Equipment**

Fixtures and equipment are carried at cost with depreciation provided using the straight-line method over the estimated useful lives of the assets. Depreciable lives used are as follows:

	<u>Depreciable Life</u>
Asset type:	
Motor vehicles	5 to 10 years
Equipment	2 to 15 years
Software	3 to 10 years

**Base Realignment**

Congress has not authorized a Base Realignment and Closure (BRAC) since 2005. In the event of closure of certain military bases around the world or a reduction in military forces, a decrease in sales at Exchange stores and a related decrease in the use of MILITARY STAR<sup>®</sup> Card due to the reduction of the customer base would likely occur.

**Self-Insurance**

The Exchange acts as self-insurer for property, automobile, public liability, workers' compensation, comprehensive casualty losses, ocean marine, and other casualty losses. However, the Exchange has commercial property insurance covering the buildings, contents, and inventories at certain locations. The provision for certain self-insurance losses is based on calculations performed by the Exchange's independent actuarial consultants using loss development factors to estimate ultimate loss. The Company's self-insurance reserves were \$80,167 and \$76,016 as of January 28, 2017 and January 30, 2016, respectively. Workers' compensation reserves were discounted at a weighted-average rate of 3.85% and 3.94% as of January 28, 2017 and January 30, 2016, respectively. Property and liability reserves were discounted at a rate of 2.28% and 2.30% as of January 28, 2017 and January 30, 2016, respectively. General liability reserves were discounted at a weighted-average rate of 2.31% and 2.20% as of January 28, 2017 and January 30, 2016, respectively.



Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**1. Description of Business and Summary of Significant Accounting Policies (continued)**

**Separation Pay and Vacation Leave Accruals**

Separation pay and vacation leave for local national employees in foreign countries are accrued as earned based upon the labor laws of host countries and upon agreements between the U.S. and foreign governments. In order to estimate this liability, the Company and its actuaries make certain assumptions, including the amounts considered recoverable from foreign governments under existing agreement terms. Actual results may vary from these assumptions. Additionally, the liability for vacation leave earned by U.S. citizens is accrued as earned.

**Advertising Costs**

Advertising costs are expensed when the advertisement first occurs. Advertising expense was \$45,103 and \$46,816 for the years ended January 28, 2017 and January 30, 2016, respectively, and is included in selling, general, and administrative expenses. The Exchange's cooperative advertising allowances are generally accounted for as a reduction in the purchase price of inventory.

**Revenue Recognition**

Revenue from retail sales is recognized at the time of sale. Revenue from sales made under a layaway program is recognized upon delivery of the merchandise to the customer. With respect to sales returns, a significant portion of the Company's products are consumables or perishables and are not subject to return by customers. Additionally, sales returns of products subject to the Company's return policy represent an insignificant portion of overall sales. Finance revenue includes finance charges and administrative fees on credit sales. Concession income includes fees charged to concessionaires based on a percentage of their sales and is recognized at the time of sale. Other operating income includes fees received from sources such as Western Union, delivery services, gift card breakage and indirect retail income.

**Income Taxes**

The Exchange is a non-appropriated fund instrumentality of the U.S. and, as such, is not subject to the payment of income taxes.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**1. Description of Business and Summary of Significant Accounting Policies (continued)**

**401(k)**

The Company has a 401(k) voluntary savings and investment plan open to regular full- and part-time employees who meet certain minimum requirements. Effective fiscal 2013, new hire associates are automatically enrolled in the 401(k) savings plan after a 30 day waiting period during which they may opt out. The employees can make voluntary contributions to the plan not to exceed the lesser of 99% of eligible participant compensation or the applicable 401(k) maximum deferral contribution limit for the year.

**Foreign Currency Hedging**

As part of an overall risk management strategy, the Company uses foreign currency exchange contracts to hedge exposures to changes in foreign currency rates on the Company's payroll and foreign vendor obligations denominated in foreign currencies. These derivative instruments are accounted for in accordance with ASC 815, *Derivatives and Hedging*. ASC 815 requires that all derivative financial instruments be recognized in the financial statements and measured at fair value. Derivatives that are not hedges must be adjusted to fair value through earnings. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in net assets until the hedged item is recognized in earnings. Hedged items are reclassified from accumulated other comprehensive income (loss) and into earnings using the specific identification method. The Company's policy is that it does not speculate in hedging activities. The maximum length of time over which the Company is hedging its exposure to the variability of future cash flows for forecasted transactions is one year.

**Benefit plans**

Expenses related to the Company's benefit plans are determined based on a number of actuarial assumptions, which are reviewed and determined on an annual basis. These assumptions include discount rates, health care cost trend rates, compensation increase rate, benefits earned, mortality rates, number of participants, certain demographics and other factors. Actual results that differ from assumptions are accumulated and amortized to expense over future periods and, therefore generally affect recognized expense in future periods. The projected benefit obligation is recognized on the balance sheets. Actuarial gains and losses are recognized as components of accumulated other comprehensive loss in net assets until amortized as a component of net periodic benefit cost.

**1. Description of Business and Summary of Significant Accounting Policies (continued)**

**Fair Value Measurements**

The Exchange records financial instruments at fair value in accordance with ASC 820, *Fair Value Measurements and Disclosures*. Under ASC 820, fair value is considered to be the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The fair value definition under ASC 820 focuses on an exit price, which is the price that would be received to sell an asset or paid to transfer a liability versus an entry price, which would be the price paid to acquire an asset or received to assume a liability. See Note 2 for further information regarding fair value measurements.

Financial instruments that potentially subject the Exchange to concentrations of credit risk consist principally of investments held by a noncontributory supplement deferred compensation plan (Supplemental Plan) and derivative financial instruments. The Company uses high credit quality counterparties when executing derivative transactions.

**Recent Accounting Pronouncements**

In May 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. This standard removes the requirement to categorize within the fair value hierarchy certain investments for which fair value is not readily available but measured using the net asset value per share. This standard was adopted by the Company beginning January 31, 2016, and prior period amounts have been retrospectively adjusted for consistency in presentation. The Company's adoption of this standard only affects the presentation of fair values of postretirement plan assets in Note 6 and does not impact our balance sheets or statements of earnings.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, issued as a new Topic, ASC Topic 606. This ASU is a comprehensive new revenue recognition model that requires a company to recognize revenue when it transfers promised goods or service to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. For non-public companies, this ASU is effective for reporting periods after December 15, 2018. The Company is currently assessing the impact of the adoption of ASU 2014-09 and has not determined the effect of the standard on the Company's ongoing financial reporting.

**1. Description of Business and Summary of Significant Accounting Policies (continued)**

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. This standard requires all leases that have a term of over 12 months to be recognized on the balance sheet with the liability for lease payments and the corresponding right-of-use asset initially measured at the present value of amounts expected to be paid over the term. Recognition of the costs of these leases on the income statement will be dependent upon their classification as either an operating or a financing lease. Costs of an operating lease will continue to be recognized as a single operating expense on a straight-line basis over the lease term. Costs for a financing lease will be disaggregated and recognized as both an operating expense (for the amortization of the right-of-use asset) and interest expense (for interest on the lease liability). For non-public companies, this ASU is effective for reporting periods after December 15, 2019. The Company is currently assessing the impact of the adoption of ASU 2014-09 and has not determined the effect of the standard on the Company's ongoing financial reporting.

**Subsequent Events**

The Exchange has evaluated subsequent events through May 25, 2017, the date at which the financial statements were available to be issued, and determined that no additional disclosures to those presented were necessary.

**2. Fair Value Measurements**

ASC 820, established a framework for measuring fair value. The inputs used to measure fair value are prioritized based on a three-level hierarchy as follows:

Level 1 – Quoted prices in active markets for identical assets or liabilities. The Exchange uses the unadjusted quoted prices in active markets for identical assets or liabilities to which the Exchange has access. An active market for the asset or liability is one in which transactions for the asset or liability occur with sufficient frequency and volume to provide ongoing pricing information.

Level 2 – Observable inputs other than quoted prices in Level 1. The Exchange determines the value of the investment holdings by evaluating its pro rata share of investments where it does not own the underlying securities but rather a proportional share of the fund, such as mutual fund and common collective trusts. Significant inputs, other than quoted market prices included in Level 1 that are observable, impact either directly or indirectly, the asset or liability. Level 2 inputs include, but are not limited to, quoted prices for similar assets or



Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**2. Fair Value Measurements (continued)**

liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted market prices that are observable for the asset or liability, such as interest rate curves and yield curves observable at commonly quoted intervals, volatilities, credit risk, and default rates.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Inputs are unobservable for the assets or liabilities. The Exchange invests only with managers that provide financial statements that are independently audited at least once a year. The statements are accompanied by a report from the auditing firm, which discloses the accounting basis as well as an opinion regarding the reliability of the financial statements. In addition to the audited statements, the fund managers have provided the type of investments as well as the methods used to value and appraise all investments in the fund's portfolio. The Company's benefit plan Level 3 assets and liabilities are measured at fair value on a recurring basis.

Cash and cash equivalents, accounts payable, and accrued liabilities are reflected in the accompanying balance sheet at cost, which approximates fair value due to the short-term nature of these instruments. Trade and other accounts receivable are reflected in the accompanying balance sheet at cost less a provision for credit losses, which approximates market value due either to the short-term nature of the instruments or the variable market rate of interest that is charged on outstanding credit card balances. The fair value of the Company's debt is disclosed in Note 4.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**2. Fair Value Measurements (continued)**

The following table sets forth by level, within the fair value hierarchy, the Company's assets and liabilities, except for pension and post retirement assets and debt which are disclosed later, that are measured at fair value as of January 28, 2017 and January 30, 2016:

	Fair Value as of January 28, 2017			
	Total	Level 1	Level 2	Level 3
Assets:				
Collective investment funds <sup>(1)</sup>	\$ –	\$ –	\$ –	\$ –
Due from broker	9	9	–	–
Short-term investments	9,937	9,937	–	–
Assets at fair value	9,946	9,946	–	–
Investments measured at net asset value:				
Collective investment funds <sup>(1)</sup>	18,518			
Total assets	\$ 28,464			
Liabilities:				
Foreign currency derivatives <sup>(2)</sup>	\$ (437)	\$ (437)	\$ –	\$ –
Total liabilities	\$ (437)	\$ (437)	\$ –	\$ –
	Fair Value as of January 30, 2016			
	Total	Level 1	Level 2	Level 3
Assets:				
Due from broker	\$ 10	\$ 10	\$ –	\$ –
Short-term investments	12,978	12,978	–	–
Assets at fair value	12,988	12,988	–	–
Investments measured at net asset value:				
Collective investment funds <sup>(1)</sup>	17,088			
Total assets	\$ 30,076			
Liabilities:				
Foreign currency derivatives <sup>(2)</sup>	\$ 1,147	\$ 1,147	\$ –	\$ –
Total liabilities	\$ 1,147	\$ 1,147	\$ –	\$ –

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**2. Fair Value Measurements (continued)**

- <sup>(1)</sup> Holdings consist of a Black Rock equity fund (approximately 50% in fiscal year 2016 and 40% in fiscal year 2015), which is passive in nature and employs a strategy to closely follow the S&P 500 index, and a BlackRock U.S. Debt Index fund (approximately 50% in fiscal year 2016 and 60% in fiscal year 2015), which employs a strategy that seeks to match the performance of the Barclays Capital Aggregate Bond Index by investing in a diversified sample of the bonds that make up the index.
- <sup>(2)</sup> Derivatives are included on the accompanying balance sheets in 2016 and 2015, in accounts payable and accrued salaries and other employee benefits.

The Company holds investments related to the Supplemental Plan totaling \$18,527 and \$17,098 at January 28, 2017 and January 30, 2016, respectively, which are included in long-term investments and Supplemental Plan assets on the accompanying balance sheets. Supplemental Plan assets are classified as trading securities since gains and losses from these investments are intended to offset the cost of the Supplemental Plan. Earnings on trading securities were \$1,412 and \$371 in fiscal years 2016 and 2015, respectively. The cost of securities sold is determined primarily on a specific identification method. (Refer to Note 6 for further discussion of the Supplemental Plan, and refer to Note 4 for further discussion of the Company's derivative positions.)

**3. Indebtedness**

**Committed Lines of Credit**

The Exchange maintains two committed lines of credit aggregating to \$2,000,000. The first is an unsecured revolving line of credit that is facilitated by a 13-bank syndicate led by Wells Fargo Bank, N.A. aggregating to \$1,500,000 that was entered into on June 24, 2014, and expires on June 24, 2019. As of January 28, 2017, there is \$0 outstanding under Wells Fargo. There were no borrowings under the Wells Fargo Bank, N.A. syndication in 2016.

In addition, the Exchange has a committed line of credit for \$500,000 with Installation Management Command G-9 (IMCOM G-9). This agreement was renewed on March 2, 2016, for a five-year term; however, borrowings against the line of credit cannot exceed term of agreement. Renewal reviews will take place 24 months prior to expiration in order to have the renewal of future agreements in place prior to the one year expiration timeframe. During fiscal year 2016, daily borrowings were generally due within 30 to 260 days. As of January 28, 2017, there is

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**3. Indebtedness (continued)**

\$250,000 outstanding under IMCOM G-9 line of credit; during fiscal year 2016, borrowings under the IMCOM G-9 line of credit had interest rates ranging from 0.50% to 0.85% and 0.10% to 0.85% during fiscal year 2015.

**Commercial Paper**

In June 2013, the Exchange implemented a Commercial Paper (CP) program. Currently, the four dealers are BTMU, Wells Fargo, Williams Capital and SunTrust Bank. As of January 28, 2017 and January 30, 2016, the outstanding commercial paper obligations, inclusive of original issue discount, were \$643,615 and \$727,000, respectively. The CP program is an open-ended agreement; however, outstanding balances as of January 28, 2017, have maturity dates that range from 1 to 265 days. Borrowings under the commercial paper program had interest rates ranging from 0.33% to 0.69% during fiscal year 2016, and 0.09% to 0.47% during fiscal year 2015.

**Senior Notes**

In December 2011, the Exchange completed a private placement debt offering of \$200,000 in senior notes due and paid on February 28, 2017. In October 2009, the Exchange completed a private placement debt offering of \$90,000 in senior notes (the 2024 senior notes), which comprise a 15-year amortizing principal. As of January 28, 2017, these senior notes have a total remaining outstanding obligation of \$54,699.

**Term Loans**

The Exchange has two term loan agreements in an aggregate amount of \$150,000 as of January 28, 2017, with Branch Banking & Trust and Fifth Third Bank. These term loan agreements mature December 31, 2017, and bear interest of at LIBOR plus 0.50%.

The average interest rate for all indebtedness, including lines of credit (both committed and uncommitted), commercial paper, senior notes and term loans was 1.08% for the year ended January 28, 2017.



Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**3. Indebtedness (continued)**

Debt obligations as of January 28, 2017 and January 30, 2016, consisted of the following:

	<u>2016</u>	<u>2015</u>
Outstanding debt principal balances:		
IMCOM G-9 committed line of credit	\$ 250,000	\$ 300,000
2.50% senior notes due 2017	200,000	200,000
4.95% senior notes due 2024	54,699	60,351
Term Loan – Branch Banking & Trust	100,000	100,000
Term Loan – Fifth Third Bank	50,000	50,000
Commercial Paper – Wells Fargo	153,615	235,000
Commercial Paper – Bank of Tokyo Mitsubishi	231,000	188,000
Commercial Paper – Williams Capital	106,000	149,000
Commercial Paper – SunTrust Bank	153,000	155,000
Total debt obligations	<u>1,298,314</u>	1,437,351
Current maturities	<u>(999,553)</u>	<u>(732,652)</u>
Total long-term debt obligations	<u>\$ 298,761</u>	<u>\$ 704,699</u>

The Exchange believes that the carrying values of amounts outstanding under its line of credit, commercial paper, and term loan agreements approximate fair value given the term of the debt and floating interest rates. As of January 28, 2017, the estimated fair values for the 2017 senior notes and 2024 senior notes are \$204,374 and \$60,404, respectively. Fair value is calculated using a discounted cash flow analysis with estimated interest rates offered for notes with similar terms and maturities.

Cash paid for interest for fiscal years 2016 and 2015, was approximately \$11,354 and \$10,495, respectively. The Exchange has complied with all financial and nonfinancial covenants per loan agreements as of January 28, 2017, and expects to comply through the period ending February 3, 2018.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**3. Indebtedness (continued)**

Principal maturities of debt obligations as of January 28, 2017, are as follows:

2017	\$ 999,553
2018	6,239
2019	6,555
2020	6,887
2021	257,236
Thereafter	21,844
	<u>\$ 1,298,314</u>

Historically the Company has regularly extended or replaced its line of credit facilities with similar short-term borrowings and on similar terms and conditions. The Company believes it has the ability and intent to renew its existing facilities coming due in 2017 or replace such facilities on substantially the same or better terms and conditions.

**4. Derivative Financial Instruments**

Forward and option collar foreign exchange contracts are used primarily to hedge the risk of the Company's Euro-denominated payroll and foreign vendor obligations against adverse changes in foreign currency exchange rates. Under the foreign exchange contracts, the Company agrees to pay an amount equal to a specified exchange rate multiplied by a Euro notional principal amount, and to receive in return an amount equal to a specified monthly pegged exchange rate multiplied by the same Euro notional principal amount. No other cash payments are made under the contracts, and the contracts cannot be terminated. Under the option collar contracts (effectively the simultaneous purchase of a call option and sale of a put option for the same notional amount and maturity, with the put being the floor strike rate and the call being the ceiling strike rate) the user maintains full protection against adverse movements, but gains due to favorable exchange rate moves are limited to the strike price of the sold option.

The Company has designated the forward and option collar foreign exchange contracts as cash flow hedges of its exposure to changes in its functional currency-equivalent cash flows on the associated payroll and foreign vendor obligations. Accordingly, the changes in the fair value of the Company's forward and option collar foreign exchange contracts are recorded in the Company's balance sheet as an asset or liability and in net assets (as a component of accumulated

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**4. Derivative Financial Instruments (continued)**

other comprehensive loss). As the notional amounts and terms of each forward and option collar foreign exchange contract match those of its liability counterpart at maturity, any ineffectiveness is immaterial in the foreign exchange contracts.

Upon expiration of the hedge contracts, the amount of the hedged item that affects earnings is reclassified from accumulated other comprehensive loss.

As of January 28, 2017, the Company had various foreign exchange contracts (forwards and option collars) outstanding related to approximately \$64,322 (€62,000) of its forecasted payroll and inventory purchase liabilities. As of January 28, 2017, the notional value of the outstanding forward contracts was \$12,077 (€11,500). The notional value of outstanding option collar contracts was \$52,245 (€50,500). The net gain of \$437 is included in accrued salaries, separation pay and other benefits and accounts payable on the accompanying balance sheet and is included as a component of accumulated other comprehensive loss. The balance of \$437 in accumulated other comprehensive loss is expected to be reclassified into earnings within the next 12 months. The effects of outstanding derivatives are revalued periodically. The Company has recognized approximately \$155 in losses on foreign currency hedge transactions settled during fiscal year 2016, compared to \$18,463 in losses during fiscal year 2015.

Unrealized gains and losses on foreign exchange hedges that are included in accumulated other comprehensive loss are recognized into earnings as the related payroll expenses are paid or the related inventory is sold through.

	<b>Derivative Instruments</b>	
	<b>Balance Sheet Location</b>	<b>Fair Value</b>
		<b>January 28, 2017</b>
<b>Derivatives designated as hedging instruments</b>		
Foreign currency exchange contracts	Accounts payable	\$ (328) \$ (287)
	Accrued salaries, separation pay, and other employee benefits	(109) (860)
Total derivatives designated as hedging instruments		<u>\$ (437) \$ (1,147)</u>

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**4. Derivative Financial Instruments (continued)**

Reclassifications from accumulated other comprehensive loss are recognized in selling, general, and administrative other expense in the statement of earnings.

**5. Lease and Rental Obligations**

The Company's operating lease and rental commitments primarily include real estate and information technology leases. The Company recorded rent expense of \$4,461 and \$4,187 for the fiscal years ended January 28, 2017 and January 30, 2016, respectively. The following is a schedule, by year, of the future minimum rental payments required under all leases as of January 28, 2017:

2017	\$ 252
2018	142
2019	140
2020	140
2021	121
Thereafter	3,125
	<u>\$ 3,920</u>

**6. Benefit Plans**

The Exchange has a defined benefit pension plan, the Retirement Annuity Plan (the Basic Plan), covering regular full-time civilian employees of the Company who are citizens or residents of the U.S. In addition, a noncontributory supplemental deferred compensation plan (the Supplemental Plan) provides for selected benefits to employees in the Executive Management Program. The Exchange's policy is to annually fund actuarially determined postretirement expense unless the respective plan is fully funded or unless an asset-liability model has shown the respective plan will likely become fully funded even in the absence of future contributions. The benefits are based on years of service and the employees' highest three-year average compensation. Assets of the plans consist primarily of marketable debt and equity securities.

In addition to the Exchange's benefit plans discussed above, certain medical and dental (health care) and life insurance benefits are also provided to retired employees through the Postretirement Medical/Dental and Life Insurance (Postretirement) plans for employees of the Exchange. All regular full-time U.S. civilian employees who are paid on the U.S. dollar payroll may become



Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**6. Benefit Plans (continued)**

eligible for these benefits if they satisfy eligibility requirements during their working lives. The Exchange's policy is to annually fund actuarially determined postretirement expense unless the respective plan is fully funded or unless an asset-liability model has shown the respective plan will likely become fully funded, even in the absence of future contributions.

The Exchange also provides certain life insurance and other disability benefits for active employees. Benefits are paid from a Voluntary Employee Beneficiary Association (VEBA) trust maintained by the Exchange and to which the Exchange contributes each year. As of January 28, 2017, the Exchange recorded a liability of approximately \$21,813, which represents an estimated liability of \$31,502 less trust assets of \$9,689. As of January 30, 2016, the Exchange recorded a liability of approximately \$24,861, which represents an estimated liability of \$32,400 less trust assets of \$7,539.

In addition, the Company provides a noncontributory defined benefit pension plan to its employees in the United Kingdom (UK Plan). With the UK Plan, the Exchange also provides postemployment benefits (e.g., separation pay) through its Local National benefit plans to employees in Germany, Japan, Okinawa, Azores, Italy, and Turkey (collectively, referred to as Foreign Plans).

The Exchange measures the cost of its pension plans and other postretirement benefit plans in accordance with ASC 715, *Compensation – Retirement Benefits*. In addition, assets of the Supplemental Plan do not qualify as plan assets as defined in ASC 715 and, as a result, are accounted for in accordance with ASC 320, *Investments-Debt and Equity Securities*.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**6. Benefit Plans (continued)**

The following table provides a reconciliation of the changes in the plans' benefit obligations and fair value of assets for the years ended January 28, 2017 and January 30, 2016. Amounts are stated in millions.

	Pension Benefits				Other Benefits			
	The Basic Plan		Supplemental Plan		Postretirement		Foreign Plans	
	2016	2015	2016	2015	2016	2015	2016	2015
<b>Change in projected benefit obligations (PBO)</b>								
PBO at prior measurement date	\$ 4,429	\$ 5,075	\$ 19	\$ 24	\$ 2,423	\$ 2,659	\$ 70	\$ 84
Service cost	89	103	1	2	23	30	2	3
Interest cost	205	198	1	1	111	104	2	2
Plan participants' contributions	3	4	–	–	–	–	–	–
Actuarial loss (gain)	71	(676)	2	(7)	(68)	(258)	10	(9)
Foreign exchange impact	–	–	–	–	–	–	(5)	(3)
Benefits paid	(253)	(255)	(1)	(1)	(98)	(105)	(3)	(3)
Administrative expenses paid	(20)	(20)	–	–	(8)	(7)	–	–
Other	–	–	–	–	–	–	(3)	(4)
PBO at current measurement date	<u>\$ 4,524</u>	<u>\$ 4,429</u>	<u>\$ 22</u>	<u>\$ 19</u>	<u>\$ 2,383</u>	<u>\$ 2,423</u>	<u>\$ 73</u>	<u>\$ 70</u>
<b>Change in plan assets</b>								
Fair value of assets at prior measurement date	\$ 3,699	\$ 3,866	\$ –	\$ –	\$ 1,512	\$ 1,623	\$ 42	\$ 47
Actual return on assets	505	(146)	–	–	218	(60)	7	(2)
Employer contributions	250	250	–	–	41	62	2	3
Plan participants' contributions	3	4	–	–	–	–	–	–
Benefits paid	(253)	(255)	–	–	(98)	(105)	(2)	(3)
Administrative expenses paid/foreign exchange impact	(20)	(20)	–	–	(8)	(8)	(5)	(3)
Fair value of assets at current measurement date	<u>\$ 4,184</u>	<u>\$ 3,699</u>	<u>\$ –</u>	<u>\$ –</u>	<u>\$ 1,665</u>	<u>\$ 1,512</u>	<u>\$ 44</u>	<u>\$ 42</u>
Funded status at fiscal year end	<u>\$ (340)</u>	<u>\$ (730)</u>	<u>\$ (22)</u>	<u>\$ (19)</u>	<u>\$ (718)</u>	<u>\$ (911)</u>	<u>\$ (29)</u>	<u>\$ (28)</u>

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

6. Benefit Plans (continued)

Supplemental Plan assets do not qualify as plan assets.

The following table reflects amounts recognized in the balance sheets as of January 28, 2017 and January 30, 2016. Amounts are stated in millions.

	Pension Benefits				Other Benefits			
	The Basic Plan		Supplemental Plan		Postretirement		Foreign Plans	
	2016	2015	2016	2015	2016	2015	2016	2015
<b>Amounts recognized in the balance sheets</b>								
Other current liabilities	\$ -	\$ -	\$ 1	\$ 1	\$ 35	\$ 54	\$ 2	\$ 2
Accrued pension and other benefits liability	340	730	22	18	683	857	27	26
Accumulated other comprehensive loss	(1,250)	(1,439)	(7)	(5)	(736)	(951)	(18)	(16)

A summary of the components of net periodic benefit cost (income) for the benefit plans is as follows for the years ended January 28, 2017 and January 30, 2016. Amounts are stated in millions.

	Pension Benefits				Other Benefits			
	The Basic Plan		Supplemental Plan		Postretirement		Foreign Plans	
	2016	2015	2016	2015	2016	2015	2016	2015
<b>Net periodic cost</b>								
Service cost	\$ 89	\$ 103	\$ 1	\$ 2	\$ 23	\$ 30	\$ 2	\$ 2
Interest cost	204	198	1	1	111	104	2	3
Expected return on assets	(299)	(303)	-	-	(117)	(122)	(3)	(3)
Prior service cost amortization	-	-	-	-	-	-	-	-
Other adjustments	-	-	-	-	-	-	(1)	1
Net loss amortization	60	129	-	1	45	73	1	2
Net periodic benefit cost	\$ 54	\$ 127	\$ 2	\$ 4	\$ 62	\$ 85	\$ 1	\$ 4

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

6. Benefit Plans (continued)

Information for benefit plans with an accumulated benefit obligation in excess of plan assets is as follows. Amounts are stated in millions.

	Pension Benefits				Other Benefits			
	The Basic Plan		Supplemental Plan		Postretirement		Foreign Plans	
	2016	2015	2016	2015	2016	2015	2016	2015
Projected benefit obligation	\$ 4,524	\$ 4,429	\$ 22	\$ 19	\$ 2,383	\$ 2,423	\$ 73	\$ 70
Accumulated benefit obligation	4,255	4,179	8	8	2,383	2,423	66	65
Fair value of plan assets	4,184	3,699	-	-	1,665	1,512	44	42

Amounts included in accumulated other comprehensive loss for all plans at January 28, 2017, consist of net actuarial gains of \$2,012,149. Amortization of this amount expected to be recognized in fiscal year 2017 is \$109,878.

Actuarial Assumptions

Actuarial weighted-average assumptions used in determining plan obligations are as follows:

	Pension Benefits		Pension Benefits		Other Benefits	
	The Basic Plan		Supplemental Plan		Postretirement	
	2016	2015	2016	2015	2016	2015
Assumptions used to determine expense:						
Discount rate	4.83%	3.99%	4.83%	3.99%	4.94%	4.09%
Long-term rate of return on assets	7.75	8.25	-	-	7.95	8.50
Compensation increase rate	4.03	4.73	8.92	9.80	-	-
Assumptions used at disclosure:						
Discount rate	4.48	4.83	4.48	4.83	4.54	4.94
Compensation increase rate	3.91	4.73	9.28	9.80	-	-



Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

6. Benefit Plans (continued)

Assumed Health Care Cost Trend Rates at the End of January

	2016	2015		
Health care cost trend rate assumed for next year	6.50%	7.00%		
Rate to which the cost trend rate is assumed to decline (ultimate trend rate)	4.50%	4.50%		
Year that the rate reaches the ultimate trend rate	2025	2026		
	Other Benefits		Other Benefits	
	UK Plan		Local National Plan	
	2016	2015	2016	2015
Assumptions used to determine expense:				
Discount rate	3.60%	3.00%	1.10%	0.96%
Long-term rate of return on assets	6.50	6.00	—	—
Compensation increase rate	2.40	2.80	2.37	2.26
Assumptions used at disclosure:				
Discount rate	2.70	3.60	1.20	1.18
Compensation increase rate	2.90	2.40	2.37	2.35

Actuarial assumptions are based on management's best estimates and judgment. The Exchange reassesses its benefit plan assumptions on a regular basis. The expected rate of return for the plan assets represents the average rate of return to be earned on the plan assets over the period that the benefits included in the benefit obligation are to be paid. In developing the expected rate of return, the Exchange considers the impact of long-term compound annualized returns on the plan assets.

Pension Plan Assets

The Exchange's investment objectives for the benefit plans are designed to generate asset returns that will enable the plans to meet their future benefit obligations. The precise amount for which these obligations will be settled depends on future events, including interest rates, salary increases and the life expectancy of the plans' members. The obligations are estimated using actuarial assumptions, based on the current economic environment.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

6. Benefit Plans (continued)

The benefit plans seek to achieve total returns sufficient to meet expected future obligations, as well as returns greater than their policy benchmark reflecting the target weights of the asset classes used in their targeted strategic asset allocation. The plans' targeted strategic allocation to each asset class was determined through an asset-liability modeling study.

The following table sets forth the target allocations of plan assets:

	Pension Benefits		Other Benefits		Other Benefits	
	The Basic Plan		Postretirement Plan		UK Plan	
	2016	2015	2016	2015	2016	2015
Domestic equity securities	12%	12%	13%	13%	26%	26%
International equity securities	11	11	11	11	35	35
Emerging market equity securities	3	3	4	4	4	4
Low-Vol Global Equity	9	9	10	10	—	—
Investment-grade fixed income	16	16	12	12	35	35
High-yield fixed income	10	10	10	10	—	—
Treasury inflation protected securities (TIPS)	5	5	5	5	—	—
Real estate – private	5	5	5	5	—	—
Real estate – public	2	2	2	2	—	—
Private equity	9	9	10	10	—	—
Commodities	5	5	5	5	—	—
Alternative debt	5	5	5	5	—	—
MLPs	5	5	5	5	—	—
Timber/Farmland	3	3	3	3	—	—
Total	100%	100%	100%	100%	100%	100%

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**6. Benefit Plans (continued)**

The Exchange's benefit plan actual asset allocations at January 28, 2017 and January 30, 2016, by asset class category are as follows:

	Pension Benefits		Other Benefits		Other Benefits	
			Postretirement			
	The Basic Plan 2016	2015	2016	2015	UK Plan 2016	2015
Domestic equity securities	13%	12%	15%	14%	20%	21%
International equity securities	10	10	12	12	40	38
Emerging market equity securities	3	3	5	4	6	5
Low-Vol Global Equity	9	9	11	11	—	—
Investment-grade fixed income	16	18	13	16	34	36
High-yield fixed income	10	10	10	10	—	—
TIPS	5	5	5	5	—	—
Real estate – private	8	9	6	6	—	—
Real estate – public	2	2	2	2	—	—
Private equity	10	9	10	10	—	—
Commodities	7	7	4	4	—	—
MLPs	4	3	4	3	—	—
Alternative debt	3	3	3	3	—	—
Total	100%	100%	100%	100%	100%	100%

The fair value hierarchy discussed in Note 2 is not only applicable to assets and liabilities that are included in the Company's consolidated balance sheets but is also applied to certain other assets that indirectly impact the consolidated financial statements. The Company uses the fair value hierarchy to measure the fair value of assets held by pension and postretirement benefit plans.

Equity securities are diversified across various industries and comprise common and preferred stocks of U.S. and international companies and equity positions in privately held companies controlled through limited partnerships. Common and preferred stocks are based on market quotations and are classified as Level 1 in the fair value hierarchy. The fair values of the

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

**6. Benefit Plans (continued)**

investments in the collective investment funds represent the net asset values of the shares or units of such funds as determined by the issuer. Limited partnerships are valued based on net asset value as determined by the general partners and represent the plans' proportionate share of the estimated fair value of the underlying net assets limited partnership. The limited partnerships are valued based on purchase price when recently acquired; valuation models such as discounted cash flows or market multiples; financial measures, such as free cash flow or earnings before interest, taxes, depreciation and amortization (EBITDA); or market comparisons for similar assets and are classified as Level 3 investments. Foreign obligations are foreign equities traded on U.S. exchanges as American Depository Receipts (ADRs), are valued based on market quotations, and are classified as Level 1 investments.

Debt securities comprise corporate bonds, government securities, and asset-backed or collective investment funds and limited partnerships with underlying debt securities. U.S. government obligations are valued at the closing price reported on the active market on which the individual securities are traded. U.S. government obligations are valued as Level 1 investments. U.S. government agency securities are usually traded in active markets; however, they may not trade with sufficient frequency to rely on a single price of the same security. As such, broker quotes may be used based on similar assets in active markets with these assets classified as level 2. Corporate bonds are usually traded in active markets; however, they may not trade with sufficient frequency to rely on a single price of the same security. As such, broker quotes may be used based on similar assets in active markets. Asset-backed securities are publicly traded securities with coupon payments based on the performance of the underlying assets and are usually traded in active markets; however, they may not trade with sufficient frequency to rely on a single price of the same security. As such, broker quotes may be used based on similar assets in active markets. Corporate bonds and asset-backed securities are classified as Level 2 investments.

Real estate and commodities comprise investments whose underlying value is based on real estate or commodities. Publicly traded securities are equity shares in Real Estate Investment Trusts (REITs) or Master Limited Partnerships (MLPs) and are valued based on market quotations. Collective investment funds with underlying investments in exchange-traded positions are classified as Level 2 investments. The net asset value of collective investment funds and limited partnerships with underlying investments in real estate are based on the selling price of the property, income the property is expected to generate and the market values of any commodities currently on the land.



Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

6. Benefit Plans (continued)

Other investments consist primarily of investment contracts and are valued at the quoted price as determined by the issuer. Contracts are classified as Level 2 investments.

The following table sets forth by level, within the fair value hierarchy, the Company's benefit plan assets and liabilities that are measured at fair value as of January 28, 2017:

	Benefit Plans			
	Total	Level 1	Level 2	Level 3
<b>Assets</b>				
Temporary investments <sup>(a)</sup>	\$ 3,601	\$ 3,601	\$ –	\$ –
Equity securities:				
Common and preferred stock <sup>(b)</sup>	782,096	782,096	–	–
Foreign obligations <sup>(c)</sup>	18,163	18,163	–	–
Debt securities:				
Common and preferred stock <sup>(b)</sup>	–	–	–	–
Corporate bonds <sup>(d)</sup>	610,088	–	610,088	–
U.S. government obligations <sup>(e)</sup>	309,199	309,199	–	–
Asset-backed securities <sup>(f)</sup>	1,581	–	1,581	–
Real estate and commodities:				
Common and preferred stock	343,454	343,454	–	–
Other investments	6,656	–	6,656	–
Total investments at fair value	2,074,838	\$ 1,456,513	\$ 618,325	\$ –
Investments measured at net asset value:				
Collective investment funds:				
Equity securities <sup>(g)</sup>	1,571,329			
Debt securities <sup>(h)</sup>	777,259			
Real estate and commodities <sup>(i)</sup>	710,936			
Short term investment funds <sup>(j)</sup>	96,768			
Limited partnerships:				
Equity securities <sup>(k)</sup>	438,165			
Debt securities <sup>(k)</sup>	168,473			
Real estate and commodities <sup>(k)</sup>	51,615			
Total investments measured at net asset value	3,814,545			
Plan assets not measured at fair value or net asset value <sup>(l)</sup>	4,030			
Total assets	\$ 5,893,413			

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
(Dollars in Thousands, Unless Otherwise Noted)

6. Benefit Plans (continued)

	Benefit Plans			
	Total	Level 1	Level 2	Level 3
<b>Assets</b>				
Temporary investments <sup>(a)</sup>	\$ 35,334	\$ 35,334	\$ –	\$ –
Equity securities:				
Common and preferred stock <sup>(b)</sup>	678,126	678,126	–	–
Foreign obligations <sup>(c)</sup>	19,021	19,021	–	–
Debt securities:				
Corporate bonds <sup>(d)</sup>	542,243	–	542,243	–
U.S. government obligations <sup>(e)</sup>	288,537	288,537	–	–
Asset-backed securities <sup>(f)</sup>	1,896	–	1,896	–
Real estate and commodities:				
Common and preferred stock <sup>(b)</sup>	206,388	206,388	–	–
Other investments	7,346	–	7,346	–
Total investments at fair value	1,778,891	\$ 1,227,406	\$ 551,485	\$ –
Investments measured at net asset value:				
Collective investment funds:				
Equity securities <sup>(g)</sup>	1,245,700			
Debt securities <sup>(h)</sup>	704,041			
Real estate and commodities <sup>(i)</sup>	287,970			
Short term investment funds <sup>(j)</sup>	184,961			
Limited partnerships:				
Equity securities <sup>(k)</sup>	459,614			
Debt securities <sup>(k)</sup>	159,068			
Real estate and commodities <sup>(k)</sup>	443,918			
Total investments measured at net asset value	3,485,272			
Plan assets not measured at fair value or net asset value <sup>(l)</sup>	(10,192)			
Total assets	\$ 5,253,971			

<sup>(a)</sup> Primarily consist of cash held in foreign currencies.

<sup>(b)</sup> 2016: Holdings are diversified as a percentage of total equity as follows: Domestic Markets (46%) and Developed International Markets (54%). Domestic Markets are diversified by Large Cap (55%), Small Cap (19%), and Public Real Estate – REITS (27%). There are no significant concentrations of holdings by the Exchange.

2015: Holdings are diversified as a percentage of total equity as follows: Domestic Markets (47%) and Developed International Markets (53%). Domestic Markets are diversified by Large Cap (54%), Small Cap (17%), and Public Real Estate – REITS (29%). There are no significant concentrations of holdings by the Exchange.

## Army and Air Force Exchange Service

### Notes to Financial Statements (continued) (Dollars in Thousands, Unless Otherwise Noted)

#### 6. Benefit Plans (continued)

<sup>(c)</sup> 2016: Holdings include International 70% and Domestic 30% securities in the form of American Depository Receipts which represent underlying securities, traded on non-U.S. exchanges.

2015: Holdings include International 88% and Domestic 12% securities in the form of American Depository Receipts which represent underlying securities, traded on non-U.S. exchanges.

<sup>(d)</sup> 2016: Includes 60% and 58% of investments in corporate high-yield debt with S&P rating of B- and below as of January 28, 2017 and January 30, 2016, respectively. The remaining investments are in investment-grade corporate bonds.

<sup>(e)</sup> Fixed-income treasury securities backed by the full faith and credit of the U.S. government. There are no significant foreign currency risks within this segment.

<sup>(f)</sup> Holdings consist primarily of publicly traded fixed-income securities whose payments are based on the performance of an underlying asset. The underlying assets are allocated as follows: collateralized mortgage obligations 0.0% and 1.4% and other assets 100.0% and 98.6%, including student loans as of January 28, 2017 and January 30, 2016, respectively.

<sup>(g)</sup> 2016: 74% of holdings consist of BlackRock index funds, which are passive in nature and employ a strategy of investing in securities that provide beta (market) exposure to a specific index including the S&P 500 and MSCI EAFE. The remaining 26% consists of international, small cap, and low volatility investments in the form of mutual funds. The collective investment funds consist of Domestic (46%) and International (54%). Investments have a required notice of three days for any sales or liquidation. The fund's management may impose restrictions on cash redemptions in the fund outside the normal course of business. Distributions may be made in cash or in kind or partly in cash or partly in kind at the sole discretion of the fund's trustee. There are no restrictions on withdrawals.

2015: 72% of holdings consist of BlackRock index funds, which are passive in nature and employ a strategy of investing in securities that provide beta (market) exposure to a specific index including the S&P 500 and MSCI EAFE. The remaining 28% consists of international, small cap, and low volatility investments in the form of mutual funds. The collective investment funds consist of Domestic (38%) and International (62%). Investments have a required notice of three days for any sales or liquidation. The fund's management may impose restrictions on cash redemptions in the fund outside the normal course of business. Distributions may be made in cash or in kind or partly in cash or partly in kind at the sole discretion of the fund's trustee. There are no restrictions on withdrawals.

<sup>(h)</sup> 2016: Holdings consist of two core fixed income index funds (approximately 75%), which both employ a strategy that seeks to match the performance of the Barclays Long Credit Index, and a Loomis Sayles high yield fund (25%), which employs a strategy that seeks to match the performance of the CS High Yield Index. Issuances and

## Army and Air Force Exchange Service

### Notes to Financial Statements (continued) (Dollars in Thousands, Unless Otherwise Noted)

#### 6. Benefit Plans (continued)

redemptions are made on each business day. Distributions may be made in cash or in kind or partly in cash or partly in kind at the sole discretion of the fund's trustee. The BlackRock funds have a required notice of three days for any sales or liquidation.

2015: Holdings consist of two core fixed income index funds (approximately 75%), which both employ a strategy that seeks to match the performance of the Barclays Long Credit Index, and a Loomis Sayles high yield fund (25%), which employs a strategy that seeks to match the performance of the CS High Yield Index. Issuances and redemptions are made on each business day. Distributions may be made in cash or in kind or partly in cash or partly in kind at the sole discretion of the fund's trustee. The BlackRock funds have a required notice of three days for any sales or liquidation.

<sup>(i)</sup> 2016: Investments include both commodities and real estate, which provide diversified returns relative to stocks and bonds. The underlying commodity investments are actively traded futures, which have full pricing transparency and daily liquidity and are reported at net asset value. Real estate holdings include direct real estate investments in properties that are valued by appraisal and reported as Level 3. The investments are diversified by core 64% and value-added or opportunistic 11% investments. Commodity investments include farmland and timber, which represent 25% of the allocation. There is quarterly redemption available for the real estate investments with a 60-day notice.

2015: Investments include both commodities and real estate, which provide diversified returns relative to stocks and bonds. The underlying commodity investments are actively traded futures, which have full pricing transparency and daily liquidity and are reported as Level 2 investments. Real estate holdings include direct real estate investments in properties that are valued by appraisal and reported as Level 3. The investments are diversified by core 63% and value-added or opportunistic 10% investments. Commodity investments include farmland and timber, which represent 26% of the allocation. There is quarterly redemption available for the real estate investments with a 60-day notice.

<sup>(j)</sup> The State Street Bank and Trust Company Short Term Investment Fund employs a strategy to provide safety of principal, daily liquidity, and a competitive yield by investing in high-quality money market instruments. Issuances and redemptions are made on each business day. The fund's management may impose restrictions on cash redemptions in the fund outside the normal course of business. Distributions may be made in cash or in kind or partly in cash or partly in kind at the discretion of the fund's trustee.

<sup>(k)</sup> Includes limited partnerships that invest primarily in U.S. buyout opportunities as well as opportunistic debt of a range of privately held companies. The fund does not have to redeem its limited partnership investment at its net asset value. Instead, the fund receives distributions as the underlying assets of the fund are liquidated. It is estimated that the underlying assets of these funds will be gradually liquidated over the next 1 to 10 years.

<sup>(l)</sup> Holdings consist of net amounts due to or from brokers for the sale of securities as of the balance sheet date.



Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
*(Dollars in Thousands, Unless Otherwise Noted)*

**6. Benefit Plans (continued)**

**Employer Contributions**

The Exchange expects to contribute approximately \$34,105 to the other Postretirement benefit plans in fiscal 2017.

**Estimated Future Benefit Payments**

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

Fiscal Years	Basic Plan	Supplemental Plan	Postretirement	Foreign Plans
2017	\$ 250,398	\$ 448	\$ 113,335	\$ 4,729
2018	253,449	453	118,278	4,632
2019	256,523	459	123,569	4,942
2020	259,886	466	127,940	4,685
2021	263,406	472	131,612	4,726
2022–2026	1,365,214	2,567	695,638	25,262

**7. Dividends**

The Exchange is required, under various agreements, to distribute a portion of each year's net earnings before performance bonuses in the form of dividend payments to the Central Welfare Funds, Departments of the Army, the Air Force, the Navy, and the Marine Corps. If earnings exceed the financial plan (AFP), the Exchange will retain the first 15% of the excess earnings and the remainder will be distributed in the form of dividend payments.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)  
*(Dollars in Thousands, Unless Otherwise Noted)*

**7. Dividends (continued)**

Under the current dividend policy, non-cash pension and employee benefit plan expenses are excluded from net earnings subject to dividends. Any other exclusion, such as employee bonuses, used in the calculation of net earnings subject to dividends must be approved by the Board of Directors.

The Exchange's policy is to annually fund actuarially determined postretirement expense unless the plan is fully funded or unless an asset-liability model has shown the plan will likely become fully funded, even in the absence of future contributions. Therefore, each year, pension expense generally reduces the net earnings subject to dividends to the extent cash contributions have actually been made.

**8. Commitments and Contingencies**

The Company is a defendant in various lawsuits and claims. In the opinion of management, the amounts, if any, which might ultimately be paid in connection with settlement of the litigation would not have a material effect on the financial condition, results of operations, or cash flows of the Company.

**9. Middle East, Including U.S. Missions in Afghanistan and Iraq**

The Company's presence in Iraq, Qatar, Afghanistan, and Kuwait was supported by 46 stores as of January 28, 2017, and 42 stores as of January 30, 2016. Approximately \$174,038 (2.7%) and \$162,244 (2.4%) of the Company's net revenues in the fiscal years 2016 and 2015, respectively, were derived from sales to U.S. troops stationed in the Middle East, including Operation Freedom's Sentinel (OFS), Operations Resources Support (ORS), and Operation Inherent Resolve (OIR). The increase in revenue for fiscal year 2016 was primarily due to U.S. troops being redeployed. The Company's inventory balance in this region, at cost, was \$20,469 at January 28, 2017, and \$23,819 at January 30, 2016. It is difficult to estimate the potential inventory that may be forfeited if the United States must quickly exit a country. Any related loss on inventory would adversely affect the Company's results, however, such losses are eligible for reimbursement appropriations that are reasonably assured of collection.

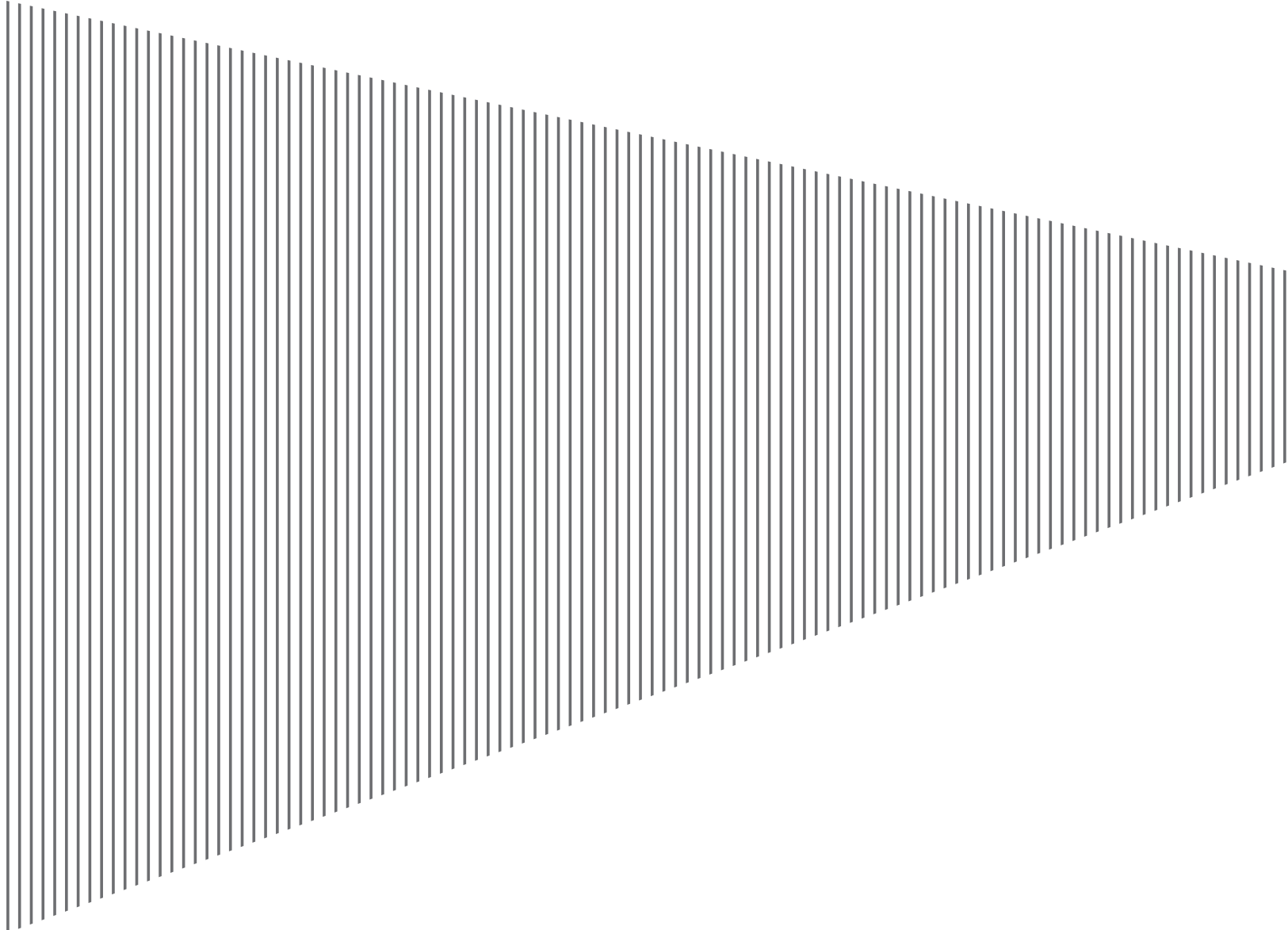
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U.S. Air Force Brig. Gen. Richard Moore, 86th Airlift Wing commander, flies a C-130J Super Hercules at Germany's Ramstein Air Base past France's Mont Saint-Michel to commemorate the 73rd anniversary of D-Day. His flight also highlighted the United States' steadfast commitment to European allies and partners. (U.S. Air Force photo by Senior Airman Devin Boyer)





# 2016 BY THE NUMBERS

1,000

WOUNDED WARRIORS  
HIRED SINCE 2010

1.1M

COMBAT UNIFORMS  
OUTFITTED

7 PLANTS

PROVIDING BAKED GOODS/  
WATER OVERSEAS

3.2M

SCHOOL LUNCHES  
SERVED

85%

ASSOCIATES CONNECTED  
TO MILITARY

4,558

ASSOCIATES DEPLOYED TO  
COMBAT ZONES SINCE 9/11

107M

FOOD CUSTOMERS SERVED

\$8.3B

REVENUE FY 2016

\$384M

EARNINGS FY 2016

\$225M

IN DIVIDENDS