The Army & Air Force Exchange Service

Annual Report 2010

You save . . . we give back

www.shopmyexchange.com

Contents

shopmyexchange.com

Commander's Column

Building lifelong emotional connections

Since taking command of the Exchange in April 2010, I have been extremely impressed with how our associates care for America's warfighters and their families.

Part of that excellent service comes from the fact that so many have a history of personal and family military service. Because of this connection, our associates have an even deeper passion for—and commitment to—our vision and mission.

That enduring mission remains: provide quality goods and services at competitively low prices and pass along dividends to support Air Force Services and Army Morale, Welfare and Recreation programs.

We operate more than 3,100 facilities in 30-plus countries, all 50 states, five U.S. territories and on the Internet, building relationships with our valued shoppers one transaction at a time.

In this annual report, you'll read about the many ways that we are serving our 12.4 million eligible shoppers and establishing lifelong emotional connections with our military communities around the world.

Consider these remarkable accomplishments:

- Achieved earnings of $390.9 million.
- Recorded total sales of $9.9 billion.
- Provided dividends of $261.1 million to MWR programs for all branches of the armed forces.
- Continued the largest capital improvement project in the Exchange's 116-year history, opening five energy-efficient shopping centers and 18 specialty stores and renovating 11 others—part of a $1.5 billion investment during the next five years.
- Began rebranding the Army & Air Force Exchange Service to create a tangible, timeless and emotional connection with our military shoppers, build on our corporate strengths and make our stores the first choice for all shopping needs.
- Opened Freedom Crossing at Fort Bliss, the first open-air shopping village on any military installation in the world.
- Began providing an exciting way for budget-conscious shoppers to compare wireless, Internet, cable television and phone services for discounted packages that fit on-the-go military lifestyles.
- Began installing a $33 million, state-of-the-art warehouse management system to get the right products to the right people at the right places at the right times.
- Continued providing expeditionary and mission support capabilities to our troops at home, in Afghanistan and Iraq, and other overseas locations. No other retailer comes close to matching us, period.
- Provided more than 18 million products and great deals on our website, www.shop**my**exchange.com, now more user-friendly, dynamic and colorful than ever.
- Reached more than 41,000 shoppers on Facebook and thousands more via Twitter, YouTube and the "Salute to Your Service" blog.

I am happy to say that we accomplished these success stories and many others despite a troubled economy in which financial markets stood in disarray, consumer confidence hit all-time lows and many merchants struggled to

See 'Releasing the power...," Page 7

The Army & Air Force Exchange Service is a Department of Defense military command with a retail mission: provide quality merchandise and services at competitive prices in order to generate earnings that provide dividends for Morale, Welfare and Recreation programs for our troops. This drives all of our business decisions and actions, the guiding philosophy that we communicate with pride as mirrored in:

- **Great prices. Our customers rely on us for ways to save on life's essentials.**
- **Great brands. Our customers like treating themselves and others to little luxuries at those great prices.**
- **Easy and convenient shopping tailored to their unique, on-the-go lifestyles.**
- **Being where our customers are—anywhere around the world.**

The 'Exchange'

AAFES becomes 'the Exchange' with new logo, look, same great prices

With the cutting of a ribbon at Tinker AFB, Okla., on Sept. 17, 2010, we began a new Exchange experience by unveiling one of the most profound changes in the Army & Air Force Exchange Service's storied 116-year history.

Our new corporate logo—a red-and-blue "X" with the word "Exchange" underneath—and complete store redesign debuted at Tinker AFB, Okla.

To keep pace with the ever-changing retail environment, the Army & Air Force Exchange Service—now branded as the "Exchange"—is undergoing this master branding initiative to provide a uniform global shopping experience and create a tangible, timeless and emotional connection with our customers. We aim to tap into their sense of community and help bring service members and their families "back home" by turning our facilities into exciting destinations.

EXCHANGE™

ARMY & AIR FORCE EXCHANGE SERVICE

We want to create a tangible, timeless and emotional connection with our customers, to bring service members and their families "back home" by making each installation's shopping experience a destination.

World-class experience

Redefining the Exchange brand encompasses everything about the way we do business, from our store layouts to our new logo to the way our associates provide expert customer service. The rebranding will change our shopping bags, associate attire and name tags, cash register receipts, sales flyers, store graphics and our website, www.shop**my**exchange.com.

With the launch of the new retail concept at Tinker AFB, military shoppers immediately began enjoying a world-class experience. They were welcomed to a store boasting fresh new colors, textures, graphics, and a cutting-edge layout divided into three major merchandise worlds—Home, Life and Style.

In addition, the customer service section now sits at the front of the store, where shoppers can get expert service as soon as they walk through our doors.

The rebranded design at Tinker AFB has garnered major awards from three of the retail industry's most prestigious organizations. The Retail Design Institute recognized the Exchange and our consultant, Chute Gerdeman, with its Legion of Honor as the top large store format store design. *Chain Store Age* recognized the Exchange as first-place winner in its "Store of the Year Awards."

In addition, the Association for Retail Environments recognized the Exchange for excellence in retail design, originality in use of space and materials, and quality in executing the total concept.

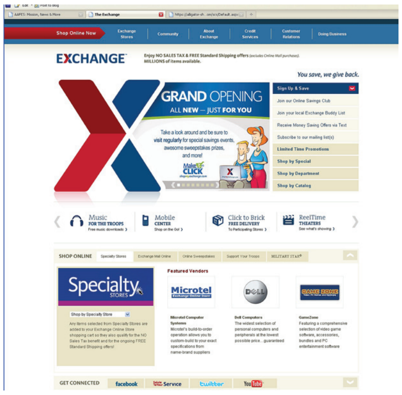
Double-digit sales increases

So far, the branding effort is paying big dividends with a double-digit percent sales increase at Tinker.

We will continue this year rebranding and redesigning other stores. The project and all of our capital improvements are part of our strategic vision of building for the future and ensuring facilities have a lifelong emotional connection with customers in many more ways than one.

World’s largest Exchange gets major facelift

*Shop**my**exchange.com, the user-friendly “store” open 24/7, from around the world*



To the Exchange, a professionally designed website is like having a sales associate who works 24 hours a day, seven days a week, telling shoppers about our products, competitive prices and service to our warfighters.

Our talented designers began this past fall leveraging their 80+ years of experience to reshape our corporate website, www.shop**my**exchange.com, into an ideal shopping destination.

The web designers, led by Jon Leines and Bryan Johnson, infused the site with usability improvements; clean, neat lines; an uncluttered look with attractive graphics, stylish menus and less words; easy-to-locate information about the Exchange; speedier log-in; integrated social media and interactive Exchange history timeline; and video trailers, celebrity interviews and movie guides in our ReelTime Theaters area.

Their work culminated March 26, 2011, when we debuted the revamped site.

Dell, Office Depot, Harley Davidson and more

Thousands of first-time and repeat visitors now find a much easier path to the “shopping sites,” the Exchange Online Mall and Exchange Online Store, which we operate for all the military exchanges. We also are planning to redesign those sites.

Now, online shoppers can find more than 18 million products, including many sold in our traditional stores and offerings from more than 100 partners, including Dell Computers, Office Depot, Harley Davidson, among other household names—all offering military discounts.

Visitors will certainly see our new logo, the red-and-blue “X” with the phrase, “You save . . . we give back,” displayed prominently throughout the site, thus cementing our new brand in their minds. Eye-popping graphics attract them to Super DAILY $pecials, Weekly $avings, other promotions, banners, e-newsletters, buddy lists, sweepstakes, social media and mobile apps.

Doing whatever is needed to give our customers an enjoyable online experience is critically important because about 35 percent of our 12.4 million eligible shoppers live 40 or more miles from our traditional stores.

Soldiers at Camp Casey, Korea, learn about the Exchange’s new website.

Visually appealing, memorable

For the past three years, the Exchange’s online sales totaled $528.6 million, nearly $165 million for 2010 alone—and we anticipate that revenue will climb 11-15 percent as our customers and new visitors discover that www.shop**my**exchange.com is even easier to use.

We are very proud of our new website, and we hope our customers will enjoy it, too. As in the words of our designers, we are gratified to create something memorable for our shoppers.

“We have created a visually appealing website that conveys our new brand in an outstanding way and easily brings updated information to our communities,” Johnson said. “Thus, the Exchange will be able to better serve them.”

Make it CLICK
shopmyexchange.com

“About 35 percent of our 12.4 million eligible shoppers live 40 or more miles from our traditional stores, making www.shopmyexchange.com their closest shopping destination.”

FREEDOM CROSSING AT FORT BLISS

LIFESTYLE VILLAGE

EL PASO, TEXAS

Freedom Crossing

21st century shopping for modern fighting force where Wild West gunslingers once roamed

FORT BLISS, Texas – Just in time for the 2010 holiday shopping season, we threw open the doors of “Freedom Crossing at Fort Bliss” to 5,000 valued shoppers, celebrities, dignitaries and military officials for three days of celebrations.

The festive “Celebrate What’s New” in November was the largest opening in the Exchange’s 116-year history. After five years of planning and constructing, the $100 million Freedom Crossing, a 492,000-square-foot, open-air shopping center, debuted to serve 127,000 Soldiers, plus their family members, who are expected on the installation by late 2012, a 60 percent increase from its 2008 population. Already bigger than the State of Rhode Island, Fort Bliss is undergoing the largest transformation of a military installation since World War II under the Defense Department’s troop realignment initiatives.

Unchartered waters

Freedom Crossing is the first open-air retail development on a military installation in the world, venturing into unchartered waters in which national, regional and local retailers can operate privately within a shopping complex.

Chief Operating Officer Michael Howard said service members, their families and military retirees will enjoy the convenient, safe, innovative and environmentally-friendly retail destination. The relaxed, inviting atmosphere offers a 217,000-square-foot Exchange main store, the size of nearly four football fields and more than double the facility it replaced. Shoppers enjoy a 10-screen, 1,700-seat movie theater; large indoor food and vendor marketplace; and outdoor retail space with privately owned shops.

“Good for business and good for the community, Freedom Crossing continues to enhance the lifestyle of Army personnel, military families, National Guardsmen, Reservists and retirees in the El Paso area,” Howard said.

Arby’s to Apple

In addition, new restaurants never before seen on a military installation, including Arby’s, Sarku Japan, Buffalo Wild Wings and Smashburger, among others, are pacifying hungry shoppers. Victoria’s Secret, Coach, Apple, Martha Stewart, Nintendo, Hewlett Packard, Izod, Under Armour and Nike “concept shops” in the main store give consumers the full range of popular products and services.

The largest Firestone auto-repair shop in the U.S. also is located at Fort Bliss.

Outdoor water fountains, comfortable benches, children’s rain forest/themed play area, hearth, shaded dining patios, and

Freedom Facts

- First open-air shopping village on any military installation in the world.
- Serves 127,000 active military, retirees and family members.
- Nearly 500,000 square feet of retail shopping space.
- Anchors:

  Exchange — 217,000 square feet

  Commissary — 111,200 square feet
- More than 175,000 square feet of open air/specialty retail, entertainment and restaurant tenants.
- Movie theater — 10 screens, nearly 33,000 square feet, 1,700 seats.
- Number of Exchange associates — 880.
- Seven mobile food trucks serve troops anywhere on the vast installation.

www.freedomcrossingatfortbliss.com

Soldiers enjoy some downtime, while, below, glimmering shots of water dance under the West Texas stars at Freedom Crossing Lifestyle Center. Shoppers, also pictured below, relax in front of the outdoor fireplace.

lawn for community events turn the quaint 52 acres into a social gathering place for military families.

Freedom Crossing resulted from a unique public and private partnership between the Exchange, ServiceStar Development Company of Denver, Colo., post commanders, the Army's Family Morale, Welfare and Recreation Command, Army Installation Management Command and Defense Commissary Agency.

Built without taxpayer dollars

The Exchange built Freedom Crossing totally from revenues without using any taxpayer dollars. While we return about 60 percent of our earnings as "dividends" to MWR programs, we invest the rest in new and renovated facilities.

During the past five years, we've completed nearly 130 major construction projects valued at $1.1 billion, every cent put toward larger, better and more environmentally sustainable stores.

Continuing capital investments

In the next five years, we'll continue emphasizing capital investment, earmarking $1.5 billion for even more new and renovated facilities. This investment in the future will ensure we have the infrastructure in place as military transformation initiatives affect troops and their families.

"Throughout our history, the Exchange has gone where our warfighters go," said Exchange Commander Maj. Gen. Bruce Casella. "Freedom Crossing represents a commitment that has continued for 116 years to improving the quality of life for our troops, families, civilians and retirees, regardless of where they are deployed or where they live.

"We at the Exchange take that commitment very, very seriously."

"The opening of Freedom Crossing was by far the most significant quality of life event on Fort Bliss in the past decade. This is the best Exchange-private partnership I have seen in my 30-year career."

—Maj. Gen. Dana J.H. Pittard, commander, Fort Bliss

Chief Operating Officer Michael Howard

2010: great accomplishments, huge challenges, enhanced shopping experiences

Like many people have told us, today's military Exchanges don't resemble the ones their parents and grandparents visited regularly. America's troops just a generation or two ago would hardly recognize our retail facilities around the world as we enjoy our 116th year of serving Soldiers, Airmen, National Guard members, Reservists, retirees, and their families.

The year 2010 was one of great accomplishments across our global organization. We finished the year with more than 41,000 Facebook "friends" and laid the groundwork for this year's rollout of our sophisticated warehouse management system that will ensure we get the right products to the right people at the right time.

We opened the first open-air shopping complex on a military installation anywhere in the world, while streamlining our supply chain and cutting operating costs even further.

New products, new concepts

Truly, the year 2010 was one of enhancing the shopping experience for "the best customers in the world."

Our Sales Directorate introduced new premium brands and expanded our store-in-store concept shops. Topping the list of concept shops was Michael Kors luxury handbags and Izod ladies' and men's apparel.

We unveiled our second Victoria's Secret Pink concept shop at the Freedom Crossing lifestyle center at Fort Bliss, Texas. Other notable concept shops were Ellen Tracey, Ralph Lauren and Nautica.

Meanwhile, our Hardlines team partnered with Ashley Furniture to enhance the shopping experience, thanks to dozens of new Ashley concept shops. Customers have commented on the noticeable savings at their Exchanges and the extended assortment at our website, www.shop**my**exchange.com.

Additionally, Martha Stewart linens and houseware concept shops continue to prove successful with sales topping $8 million, a 51 percent increase from the previous year. We added to the excitement by rolling out 13 concept shops last year with six to nine additional shops planned for this year.

In 2010, we provided the ultimate "geek" experience in our PowerZone consumer electronics departments with the most up-to-date computers, smartphones, iPads and all the attachments.

Beauty, glam and geeks

We also continued expanding our "Beauty Bar" concept for discriminating shoppers who want to look their best. Featuring makeup artists and skin-care consultants, Beauty Bars include innovative brands of prestige cosmetics to meet the needs of women ages 18-28 and women with darker skin tones.

In addition, several new brands of skin care and makeup were introduced and include popular, trendy brands like Smashbox, Too Faced, Carol's Daughter and Strivectin, just to name a few.

To capitalize on a new and growing trend in the fragrance and beauty category of one-ounce or smaller sizes, we opened 10 Glam on the Go concept shops in 2010 and plan to expand these offerings even more this year.

In the PowerZone, 11 new Apple concept stores delivered the ultimate "geek" experience to our shoppers. Along with the industry launch of iPad, the Exchange brought the newest technology directly to customers at the same time as our competitors.

Due to the overwhelming success of the iPad tablet, customers will see other manufacturers, such as Samsung and Motorola, launch their versions in 2011. Brand-loyal customers responded positively to the launch of 12 new Bose concept shops and product offers exclusively for the military from Sony, Fuji and Kodak.

We also provide the popular products at the most competitive prices so our shoppers can keep more money in their pockets. But we take this even further: our budget-conscious shoppers saved between 20 and 50 percent when they reached for our private-label Exchange Select family of 600-plus safe, high-quality and affordable products in categories ranging from health and beauty care to laundry detergents.

We also put more money back in their pockets through our proprietary, quality clothing labels, such as Passports for women, R&R Casual for men and PBX for the family.

Collaborating to cut costs

While we were offering shoppers competitive prices and quality merchandise, we collaborated across the organization in sourcing, procurement and logistics, and with suppliers, vendors, our sister military exchanges, the Defense Commissary Agency

continued on next page

Commander Maj. Gen. Bruce Casella

Releasing the power of the Exchange to serve America's warfighters and families

continued from Page 1

I am confident that this great organization is poised to continue our long-standing tradition of excellence as we work together to maintain a strong and viable Exchange for patrons, beneficiaries, partners, associates and the military communities we serve.

maintain viability. The Exchange remained fundamentally sound and strategically positioned to weather the storm.

Partnering to cut costs

With an eye toward efficiency in 2010, we partnered with our sister military exchanges, the Defense Commissary Agency and other military organizations to pool resources and cut operating costs through bulk purchases and other initiatives. We kept even tighter controls on personnel and supply-chain costs.

Given our successful track record and tight control on expenses, the Exchange continues to receive interest from investors and banks because of our strong credit rating and solid performance during the market downturn. From both Standard and Poor's and Moody's, the Army & Air Force Exchange Service received the highest ratings possible, which means our business is excellent with minimal financial risk.

Meeting the needs of 'valued shoppers'

Despite these challenges, our "military command with a retail mission" continued in 2010 and well into this year meeting the needs of active duty troops, National Guard members, Reservists, their families, and military retirees around the world.

In addition to operating modern, sleek main stores with name-brand and our quality exclusive-brand merchandise, we collaborate with local small businesses and community entrepreneurs to offer our customers specialty products and services, such as barber shops, dry cleaning, alterations and many others.

Overseas, the Exchange operates bakeries and plants that furnish Wonder Bread, Home Pride Bread and Culligan Water, to name a few, to Exchanges, commissaries, troop dining facilities, military hospitals, and MWR food and beverage activities. What's more, we provide nearly 4 million nutritious meals per day to students in grades K-12 in 88 Defense Department schools around the world on a break-even basis.

This enormous footprint means that wherever our valued shoppers call home, the Exchange is there.

Continuing the tradition

Releasing the power of the Exchange is not a simple task, requiring teamwork throughout the organization in a way that rewards excellent customer service, innovation and results.

I am confident that this great organization is poised to continue our long-standing tradition of excellence as we work together to maintain a strong and viable Exchange for patrons, beneficiaries, partners, associates and the military communities we serve.

Bruce A Casella

Maj. Gen. Bruce A. Casella
Commander, Army & Air Force Exchange Service

COO Michael Howard

Clearly defined strategies guide Exchange well into 21st century

and other organizations to enhance the efficiency and reduce operating costs by more than $24 million.

As we proceed through the Exchange's second century of operation, only through a clearly defined strategic plan does the Exchange benefit and our mission flourish.

Our 2010 operating plan focused on "Releasing the Power of the Exchange" to become an even greater force multiplier. Today, we are leveraging the synergies we share with patrons, stakeholders, partners and associates to strengthen the Exchange benefit for all.

The Exchange seeks every day to fulfill its mission of serving Soldiers, Airmen and their families regardless of where they are deployed or living.

No other retailer deploys with the troops like the Exchange; no one takes care of military families like the Exchange; and no other group of employees lives, breathes and sleeps the military culture more than our nearly 44,000 associates around the world.

We've been here for 116 years, and this nearly $10 billion a year major American retailer plans to stay around for another century or more fulfilling its mission to our brave warfighters and their families.

Social Media & Mobile Marketing

We are reaching out to our customers with the most up-to-date methods, and social networking is right at the top. Consider what we're doing:

Facebook is social media's leader, so the Exchange is taking full advantage of the website's popularity by maintaining a public forum where our customers—aka "fans"—can communicate instantaneously with our customer relationship experts.

On our Facebook page, they can see what events are happening at their installations and join in discussions about how we can improve their shopping experience.

To excite fans, we offer coupons, exclusive offers and contests. In one contest, parents and grandparents could upload pictures of their young ones in the "Cutest Kiddo," which quadrupled the number of our Facebook fans.

Via Twitter, we monitor and respond in real-time to customer concerns and "tweet" links to other valuable information.

Our YouTube videos tell shoppers about the great sales and promotions, merchandise and services at *their* Exchanges and online.

The Salute to Your Service blog allows us to converse with customers, and vice versa.

What's more, more than 15,000 customers find out about our great deals and sales promotions via messages they want send to their cell phones.

Throughout our 116 years, we've created exciting shopping destinations and good deals for the world's best customers. As we are well into our second century of operation, we are reaching those shoppers in ways that our managers and associates of just a generation ago couldn't have imagined.

In 2010, Jessica Provan, Ingrid Fanini, Leah Miller and Maricella Esparza, left to right, saw the number of Exchange "friends" on Facebook skyrocket from 1,882 fans to 41,179 by Christmas.

1,882 "fans" in January 2010
to
41,179 "fans" in December 2010

1,057 followers in January 2010
to
1,458 followers in December 2010

Blog with us.
www.salutetoyourservice.com

27,134 visits in January 2010
to
81,546 visits in December 2010

74,773 views in January 2010
to
152,238 views in December 2010

Mobile marketing

More than 15,000 customers find out about our great deals and promotions via their cell phones.

Keeping our troops connected

Bringing them the latest devices, accessories, Internet, TV and phone services

The Exchange is now a one-stop shop featuring the latest smartphones and home Internet, TV and phone services for today's on-the-go military families.

Successful launches of Exchange Mobile Center for wireless communications and Connect@Home for off-base home Internet, TV and telephone services provide shoppers with easy access to the hottest devices, best plans and expert assistance.

Perfect for on-the-go families

Our customers live very mobile and connected lifestyles, and typically want the latest and greatest in new technology and devices. To meet their needs, the Exchange began opening Exchange Mobile Center kiosks this past fall in our PowerZone consumer electronics departments and in selected mall locations in the continental U.S.

These kiosks quickly became attractive destination points with top-selling smartphones, accessories and service plans from major carriers like AT&T, T-Mobile, and Verizon, along with an expanding array of prepaid services at extremely competitive prices.

Patrons who prefer to buy online or don't live near an Exchange with a kiosk can enjoy the same great deals and an expanded selection by visiting the Exchange Mobile Center at www.shop**my**exchange.com.

What's more, our Connect@Home service debuted in July 2010 to give military families living off-base in the continental U.S. the ability to make smarter, budget-minded choices about their home Internet, TV and telephone service with just a few clicks of the computer mouse.

By calling 1-877-836-5202 or going to www.shop**my**exchange.com and simply typing in their current or prospective address, shoppers can call up side-by-side comparisons of features and prices from AT&T, Charter, Comcast, Cox, Dish Network, Quest, Time Warner, Verizon and other providers, depending on locale.

They can even choose whether to buy a single service or get all offerings bundled into a nice, neat package, and then select a start-up.

Connect@Home is perfect for Soldiers, Airmen and their families, who average moving every two years and often face a confusing array of Internet, TV and phone choices at their new locations.

From Europe to the Pacific . . . and back

Across the continental United States, overseas in Europe and the Pacific, and in contingency locations, the focus during 2010 was about providing patrons with expanded service and more choices. We made important strides in Japan and Korea by adding a second mobile service provider and worked with service providers to enhance Internet and TV services.

"We've seen the future of a connected world and we want to help our customers be a part of it, wherever they go," said Mark Morell, vice president of our Advanced Telecommunications Division.

America's warfighters are technologically savvy: 82 percent of them carry smartphones, well above the technology industry's norm of 49 percent. Androids, iPhones and BlackBerrys are reshaping their mobile experiences . . . and we intend to give our shoppers what they want.

The Exchange story by the numbers

$9.9 billion — Amount of sales generated by the Exchange's global operations.

$261.1 million — Estimated total dividends contributed by the Exchange from its revenues in 2010 to the Army's Morale, Welfare and Recreation programs and Air Force Services. Dividends also go to other branches of the armed services.

98 percent — The amount of the Exchange budget that comes from its own revenue and other sources, not including tax money appropriated by Congress.

24 percent — The average amount customers save buying the most popular products at the Exchange compared to competitors, according to the Market Basket Survey.

3,100+ — Number of Exchange main stores and other retail facilities around the world.

30 — The number of countries in which the Exchange has a footprint.

1,143 and 966 — Number of brand-name and Exchange signature-brand restaurants, respectively, operated around the world.

80 and **167** — Number of Exchange facilities and name-brand restaurants, respectively in Afghanistan, Iraq and other contingency locations.

72 — Number of Exchange phone centers in contingency locations for troop members to call home.

43,991 — Number of associates around the world, with **25 percent** being military spouses and other family members.

4,700 — Number of associates who have deployed, sometimes more than once, to Afghanistan, Iraq, Kuwait and other countries since 9/11.

18 million-plus — Number of products available on the Exchange's website, www.shopmyexchange.com.

4 million — Number of nutritious meals served to children at 88 Department of Defense Schools during the 2009-2010 school year by the Exchange on a break-even basis.

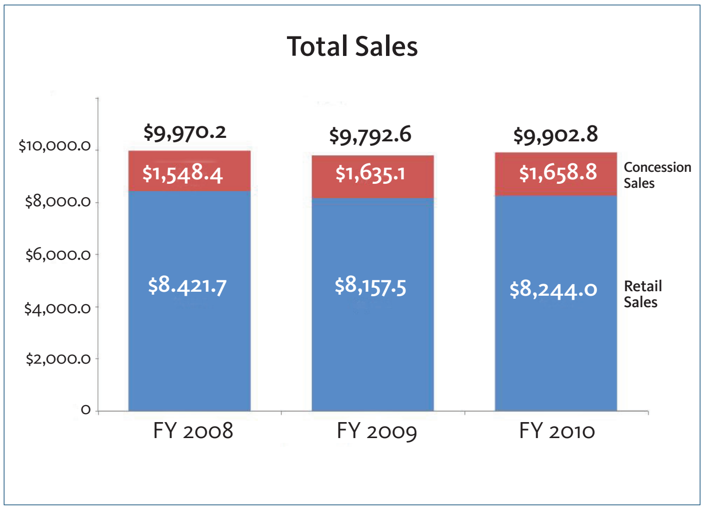
Our valued stakeholders

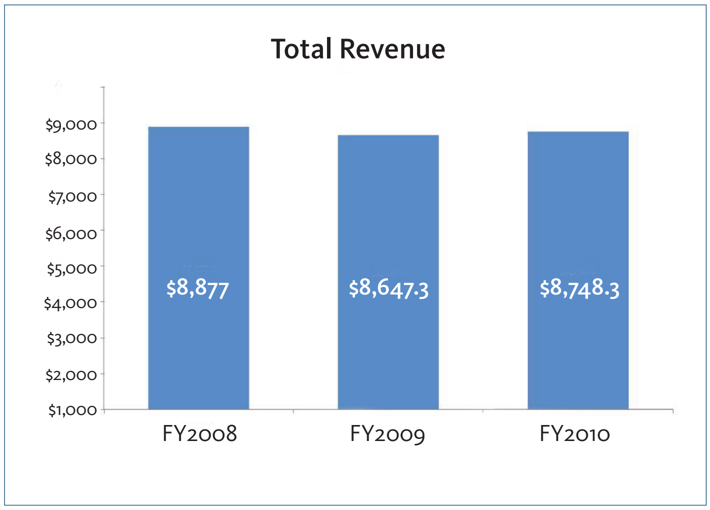
12.4 million eligible shoppers—active duty troops, National Guard members, Reservists, military retirees, and their families

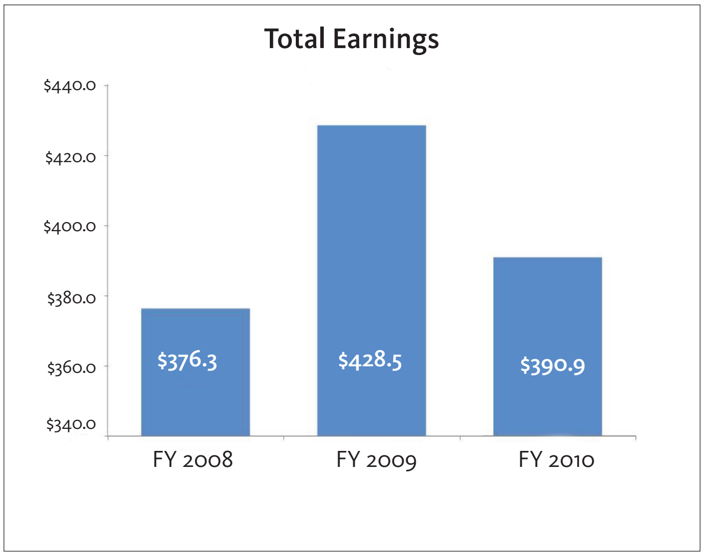
The Exchange was number **5** on *Forbes* magazine's top 10 niche businesses for being a "century-old retailer" that serves "active and retired Army and Air Force personnel with discounts and (inexpensive) shipping . . . Bigger than A&P, Limited Brands and Nordstrom."

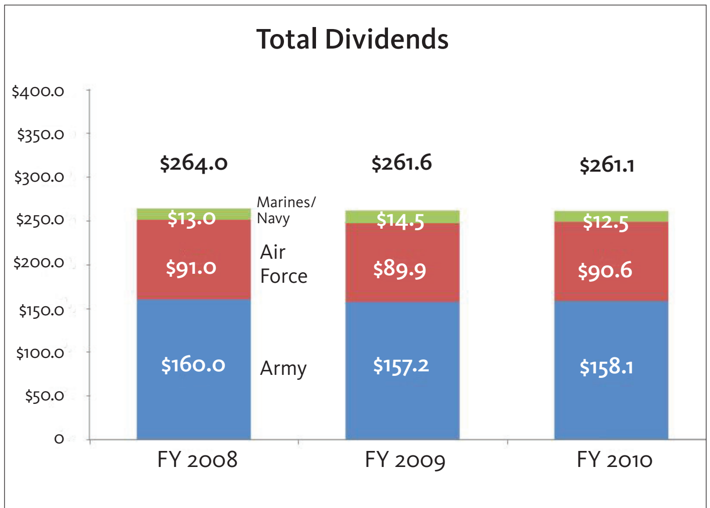
Our "We Match Prices!" is our best way to satisfy customers in the unlikely event they find a lower price on the same item. If our price difference is **less than $10,** we offer an immediate price adjustment on the spot. If the difference is **more than $10,** customers can show an ad to a sales associate or manager and the price will be adjusted accordingly.

Nearly 2 million people carry the Exchange's MILITARY STAR® cards, the top in-house retail credit card in the U.S. In 2010, revenue from the cards topped **$215 million.**







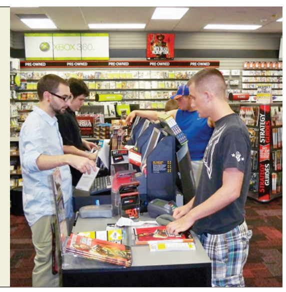


all figures in charts in millions

Exchange revenue sources

86.6 percent
Main stores, specialty stores, Military Clothing and Direct Marketing
(Direct Marketing includes the Exchange's website, www.shopmyexchange.com, and catalogs)

2.3 percent
Concessions, such as GameStop, Firestone and spas, among others



7.3 percent
Food and Theaters

0.3 percent
Vending & Services
(Services include barber shops, beauty shops and similar enterprises)

SNAPSHOTS

Katrina couldn't keep this Exchange closed

Five years after Hurricane Katrina wiped out the Exchange at Keesler AFB, Miss., eager shoppers began lining up before dawn in April 2010 to become the first patrons at a new 171,000-square-foot, earth-friendly, state-of-the-art store.

The new Exchange in Biloxi along the Gulf Coast features an enclosed mall with 20-foot ceilings and skylights; alterations; barber, beauty and flower shops; nail salon; optical services; military clothing store; GNC, GameStop and other third-party vendors; and Manchu Wok, Anthony's Pizza, Taco Bell, Baskin-Robbins and Charley's Steakery, among others. "It is wonderful to have our store back," said Susan Wright, an Exchange associate. "It's like we, as a family, are home, finally."

Exchange story debuts in Times Square

The Exchange hit the Big Apple in September with a video, above, appearing on the famous NBC screen in Times Square to tell millions of passersby how associates have served America's warfighters for 115 years. Sharp, one of the Exchange's electronics vendors, offered the free airtime. The 30-second video, which ran one time every hour, was produced by the Exchange's award-winning multimedia division.

Exchange beats competitors on electronics survey

The Exchange beat out some of the country's best-known retailers in a survey of electronics-savvy shoppers. The December 2010 *Consumer Reports*' "Best New Electronic" issue ranked our PowerZone electronics departments fifth out of 17 walk-in stores in overall customer satisfaction, beating out Best Buy, Wal-Mart, Target and major American retailers.

Associates deploy to Haiti after killer quake

Living up to the Exchange's motto "We go where you go," nearly a dozen associates deployed in March 2010 to earthquake ravaged Haiti to serve American troops helping with recovery efforts. Led by Teo Smith, an Exchange retail program specialist, associates from throughout the United States, Puerto Rico and Honduras set up two mobile exchanges for the troops. Meanwhile, associates at Homestead AFB and Patrick AFB in Florida ratcheted up shoppette operating hours to 24/7 at the U.S. Southern Command to assist troops waiting for deployment to Haiti or returning from the country.

Americans send $1 million gift, phone cards to deployed Soldiers, Airmen

The American public continues to remember troops serving far from home, sending nearly $1 million of Exchange gift and phone cards. In 2010, civilians from all walks of life went online to the Exchange's website, www.shop**my**exchange.com, to send $125,000 worth of gift cards to military families around the world. What's more, the Exchange's "Help Our Troops Call Home" accounted for nearly $660,000 in online sales to non-authorized Exchange shoppers in 2010—and $9.1 million since the program's inception in 2003. At $22, the Military Exchange Global Prepaid Phone Card delivers more than two hours of calling time between Iraq or Afghanistan to the United States. Since the program's inception in the early 2000s, the American public's support has amounted to 60 million minutes of conversation between the front lines and home fronts. The phone and gift cards can be sent to individual service members or "any service member" through the American Red Cross, Air Force Aid Society, Fisher House Foundation, Navy-Marine Corps Relief Society, Soldier & Family Assistance Center, and USO.

Exchange rewards those who 'made the grade'

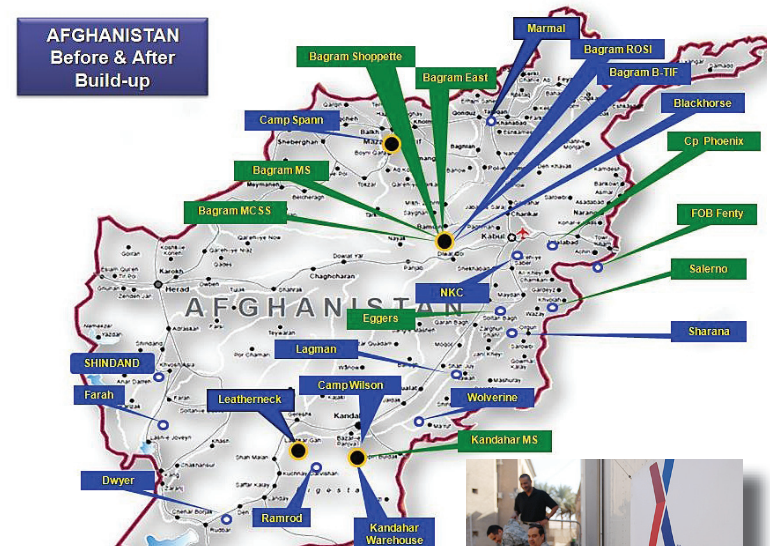
Now in its 10th year, the Exchange's "You Made the Grade" program continued recognizing students around the world who achieved a "B" average or better on their schoolwork. The benefits-filled books the Exchange presented to them include coupons for meals in our many restaurants, video rentals and discounts on DVDs in our PowerZones. Several students around the world receive U.S. Savings Bonds worth up to $5,000. As in the words of Exchange Deputy Commander Brig. Gen. Francis Hendricks, "It's simple: learning pays."

The War Front

For many years at the Exchange, our motto, "We go where you go," has served as our call to action to deploy voluntarily wherever troops are located, whether on battlefields, at military exercises, at forest fires, in the aftermath of hurricanes and earthquakes, or on humanitarian missions to isolated villages.

While we strive to serve all military consumers, our special responsibility is to serve those on the front lines, including our warfighters in Afghanistan, Iraq and throughout the Middle East. Sustained expeditionary and mission support demonstrates that at the Exchange, we mean it when we say "We go where you go"—something none of our competitors in the retail industry can say.

Since 2001, nearly 4,700 Exchange associates have deployed voluntarily to Afghanistan, Iraq, throughout Southwest Asia and the Middle East, and in Bosnia and Kosovo—sometimes more than once—to serve America's fighting heroes. For six to 12 months, they leave the comforts and safety of their homes behind to live in the same conditions as the troops to operate our stores.



Our Bosnia and Kosovo stores support the NATO peacekeeping mission that began in the mid-1990s.

Drawing down in Iraq

At any given time, about 300 associates are deployed throughout the region, working with a vast cadre of third-country and local nationals to provide merchandise, food and special services that bring a touch of home to those troops stationed so far away.

In 2010, the number of Exchanges stood at 80 in Afghanistan, Cyprus, Iraq, Kuwait, Kyrgyzstan, Qatar, Oman, Saudi Arabia, United Arab Emirates, Bosnia and Kosovo.

When the war effort shifted from Iraq to Afghanistan in 2009 and 2010, the Exchange shifted to reflect fewer troops in one country to a groundswell of fighters in the second country.

Since October 2010 in Iraq, we've closed nearly 300 non-essential facilities and services, although 28 retail stores, 86 restaurants, 182 services and 84 short-term concessions remain. The services include barber/beauty shops, alterations, AT&T phone centers and Internet service.

Upswing in Afghanistan

Meanwhile, we've ratcheted up services in Afghanistan, where our most recent facility, at Tarin Kowt serves more than 6,800 multi-national troops. When the 1,500-square-foot store opened, sales reached $7,400 within the first hour, even without credit-card connectivity.

The troops' enthusiastic response reaffirms that the Exchange is a force multiplier in austere—and dangerous—locations.

In Afghanistan, we expect six stores to open in 2011, bringing the total to 32. We also operate 15 restaurants, 53 concessions, 67 short-term concessions, 30 unit-run tactical field exchanges and eight troop-run imprest fund stores.

Opening restaurants, concessions

We've received 33 requests from military leaders to open concessions and name-brand restaurants. As a result, we've opened Green Beans coffee shops at Camps Sabalu-Harrison and Wolverine, Pizza Huts at Bagram AB and Camp Phoenix, and Popeyes at Camp Walton. We continue to operate our traditional Exchanges at Bagram AB and Kandahar AB.

Nimble, flexible

Working with commanders on the ground, our innovative ways deliver the Exchange benefit, minimize costs and improve customer service. Our organization is nimble and flexible, adapting our dynamic footprint to meet the military's changing needs.

We definitely go where our troops go.

Sustained expeditionary and mission support demonstrates that at the Exchange, we truly do "go where you go"—something none of our competitors in the retail industry can say. At left, troops celebrate the opening of an Exchange store at Camp Wisdom, Afghanistan.

The Exchange's Green Initiatives

Reducing energy, water consumption and waste generation is a win-win situation for all, making partnerships between the Exchange and military installations crucial.

The Exchange's Major Recognition

- **2011: The Secretary of Defense Environmental Award**
- **2010: U.S. Department of Energy's Federal Energy Management Award**
- **2010: Secretary of the Army's Sustainability Team Award**

Randolph AFB in San Antonio, Texas, was the Exchange's first "green" store when it opened in 2010.

Our award-winning sustainability measures touch literally every one of our nearly 44,000 associates and 12.4 million valued shoppers in some way, from simple steps like turning off the lights to intricate projects like building earth-friendly main stores.

Recycling bins, energy-efficient lighting, water-reducing fixtures, Energy Star® vending machines, sustainable new and renovated stores, and shelves lined with Energy Star® appliances are popping up in our stores around the world.

Recycling millions of pounds

In 2010, we also recycled more than 16 million pounds of trash. That's 7,200 tons, nearly 60 percent more than the previous year, generating $670,000 in income that helped our bottom line and annual dividends to the Army's Morale, Welfare and Recreation programs and Air Force services.

Our successful Trash-4-Cash program helped reduce bulk paper, plastic, aluminum cans and other waste. In our restrooms in the continental United States, automated towel dispensers reduced trash by 88,000 pounds.

What's more, we diverted more than 2 million pounds of used vegetable oil from the waste stream and reutilized it as animal feed and biodiesel fuel.

Providing environmentally-friendly products

In our stores, environmentally-conscious shoppers can choose from a variety of Energy Star® washers, refrigerators and other products for their homes.

Making our buildings "greener"

We started off on the right foot by opening our first "green" Exchanges at Randolph AFB, Texas, and Fort Polk, La., both built to Leadership in Energy and Environmental Design (LEED) Silver standards. They were among the first Defense Department facilities to register with the U.S. Green Building Council and were part of the LEED for Retail pilot program.

The facilities include roofs that reflect 78 percent of light and ultraviolet rays; low-flow technology for water efficiency; stormwater capture and treatment; energy-efficient equipment; and air-conditioning systems 20 percent more efficient than conventional ones.

We've championed the use of light-emitting diode (LED) technology in all Army gas-station canopies.

Reducing energy, water consumption and waste generation is a win-win situation for all, making partnerships between the Exchange and installations crucial.

TOP TEN Green Initiatives

The Exchange is to be environmentally friendly in all areas of activities, while still offering the best shopping experience to customers.

EXCHANGE EARTH FRIENDLY

1. In 2010, the Exchange recycled and diverted more than 6,000 tons of trash from landfills.

2. The Exchange increased recycling volume by more than 3,650 tons or 396 percent.

3. The Exchange implemented a cooperate-wide recycling program at 152 stores in the continental U.S.

4. Since 2007, the Exchange has reduced annual water usage by 15.3 percent.

5. The Exchange sells used cooking oil and grease from 290 restaurants. This program recycles more than 2 million pounds of cooking oil.

6. The Exchange uses bio-diesel fuel when available and economically feasible.

7. The Exchange offers a vast selection of Energy Star products.

8. Since 2007, the Exchange has reduced energy usage by 5.5 percent.

9. In 2009, the Exchange rolled out a 5¢ reusable bag credit that saved customers nearly $24,000.

10. The Exchange actively supports programs centered on green initiatives.

FINANCIAL STATEMENTS

Army and Air Force Exchange Service
Years Ended January 29, 2011 and January 30, 2010

Ernst & Young LLP

Army and Air Force Exchange Service

Financial Statements

Years Ended January 29, 2011 and January 30, 2010

Contents

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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 balance sheets of Army and Air Force Exchange Service (the Exchange or the Company) as of January 29, 2011 and January 30, 2010, and the related statements of earnings, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. 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. We were not engaged to perform an audit of the Exchange's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Exchange's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our 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 29, 2011 and January 30, 2010, 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 16, 2011

Army and Air Force Exchange Service

Balance Sheets

(Dollars in thousands, unless otherwise noted)

	January 29, 2011	January 30, 2010
Assets		
Current assets:		
Cash and cash equivalents	**$ 100,778**	$ 135,683
Trade and other accounts receivable, less allowance for uncollectible accounts (at January 29, 2011 – $42,561, at January 30, 2010 – $40,980)	**3,531,405**	3,325,334
Merchandise inventories	**1,520,344**	1,524,112
Short-term investments	**22,548**	21,127
Supplies and other current assets	**38,093**	41,729
Total current assets	**5,213,168**	5,047,985
Buildings and improvements	**3,102,074**	2,878,578
Fixtures and equipment	**1,404,923**	1,236,232
Construction-in-progress	**179,457**	317,036
	4,686,454	4,431,846
Accumulated depreciation	**(2,372,230)**	(2,173,032)
	2,314,224	2,258,814
Other assets	**603**	642
Prepaid pension assets	**402,563**	121,832
Long-term investments and supplemental plan assets	**23,864**	21,741
Total assets	**$ 7,954,422**	$ 7,451,014
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 621,424**	$ 625,763
Notes payable to banks	**1,600,415**	1,459,202
Accrued salaries, separation pay and other employee benefits	**119,562**	155,936
Dividends payable	**28,892**	61,531
Other current liabilities	**216,159**	196,959
Total current liabilities	**2,586,452**	2,499,391
Notes payable to banks – long term	**730,364**	734,779
Accrued pension and other benefits	**568,489**	679,177
Other noncurrent liabilities	**59,117**	56,761
Total liabilities	**3,944,422**	3,970,108
Net assets:		
Accumulated other comprehensive loss:		
Pension liability	**(1,131,048)**	(1,525,186)
Derivative instruments	**461**	(4,732)
Total accumulated other comprehensive loss	**(1,130,587)**	(1,529,918)
Retained earnings	**5,140,587**	5,010,824
Total net assets	**4,010,000**	3,480,906
Total liabilities and net assets	**$ 7,954,422**	$ 7,451,014

See accompanying notes.

Army and Air Force Exchange Service

Statements of Earnings

(Dollars in thousands, unless otherwise noted)

	Year Ended January 29, 2011	Year Ended January 30, 2010
Net sales	**$ 8,244,004**	$ 8,157,519
Finance revenue	**253,553**	230,309
Concession income	**213,763**	222,086
Other operating income	**36,935**	37,423
Total revenue	**8,748,255**	8,647,337
Cost of sales and operating expenses:		
Cost of goods sold	**6,308,863**	6,205,938
Selling, general and administrative:		
Employee compensation and benefits	**1,151,106**	1,139,552
Depreciation and amortization	**316,647**	270,266
Other	**532,125**	586,352
Total selling, general and administrative	**1,999,878**	1,996,170
Interest expense	**50,843**	46,558
Bad debt expense	**9,608**	6,084
	8,369,192	8,254,750
Operating income	**379,063**	392,587
Other income	**11,826**	35,887
Net earnings	**$ 390,889**	$ 428,474

See accompanying notes.

Army and Air Force Exchange Service

Statements of Changes in Net Assets

(Dollars in thousands, unless otherwise noted)

	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Net Assets
Balance at January 31, 2009	$ 4,843,949	$ (1,497,999)	$ 3,345,950
Net earnings	428,474	–	428,474
Change in funded status of pension and other postretirement benefit liabilities	–	(39,572)	(39,572)
Net change in fair value of derivative instruments	–	7,653	7,653
Comprehensive income			396,555
Dividends to the Central Welfare Funds, Departments of the Army, the Air Force, the Navy, and the Marine Corps	(261,599)	–	(261,599)
Balance at January 30, 2010	5,010,824	(1,529,918)	3,480,906
Net earnings	**390,889**	**–**	**390,889**
Change in funded status of pension and other postretirement benefit liabilities	**–**	**394,138**	**394,138**
Net change in fair value of derivative instruments	**–**	**5,193**	**5,193**
Comprehensive income			**790,220**
Dividends to the Central Welfare Funds, Departments of the Army, the Air Force, the Navy, and the Marine Corps	**(261,126)**	**–**	**(261,126)**
Balance at January 29, 2011	**$ 5,140,587**	**$ (1,130,587)**	**$ 4,010,000**

See accompanying notes.

Army and Air Force Exchange Service

Statements of Cash Flows

(Dollars in thousands, unless otherwise noted)

	Year Ended January 29, 2011	Year Ended January 30, 2010
Operating activities		
Net earnings	**$ 390,889**	$ 428,474
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	**333,233**	284,262
Loss on disposal of property and equipment	**8,235**	6,088
Gain on supplemental pension plan assets	**(2,620)**	(28,342)
Bad debt expense	**9,608**	6,084
Changes in operating assets and liabilities:		
Accounts receivable	**(215,679)**	(344,898)
Merchandise inventories	**3,768**	45,328
Supplies and other current assets	**3,636**	(8,180)
Other assets	**38**	1,068
Prepaid pension assets	**(42,711)**	(62,001)
Long-term investments and supplemental plan assets	**710**	(259)
Accounts payable	**(11,417)**	(13,916)
Accrued salaries, separation pay and other employee benefits	**(35,076)**	14,041
Other current liabilities	**19,883**	17,699
Accrued pension and other benefits	**45,115**	75,015
Other noncurrent liabilities	**2,357**	16
Net cash provided by operating activities	**509,969**	420,479
Investing activities		
Purchases of property and equipment	**(400,426)**	(477,010)
Proceeds from the sale of property and equipment	**3,548**	15,625
Purchases of investments	**(30,570)**	(29,427)
Proceeds from the disposition of investments	**28,570**	27,935
Net cash used in investing activities	**(398,878)**	(462,877)
Financing activities		
Proceeds under line-of-credit agreements	**1,596,000**	1,455,000
Repayments under line-of-credit agreements	**(1,455,000)**	(1,949,000)
Proceeds from issuance of long-term debt	–	740,000
Repayments of long-term debt	**(4,202)**	(1,019)
Change in cash overdraft	**10,972**	2,437
Payment of dividends	**(293,766)**	(259,149)
Net cash used in financing activities	**(145,996)**	(11,731)
Net decrease in cash and cash equivalents	**(34,905)**	(54,129)
Cash and cash equivalents at beginning of year	**135,683**	189,812
Cash and cash equivalents at end of year	**$ 100,778**	$ 135,683

See accompanying notes.

(Dollars in thousands, unless otherwise noted)

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 non-appropriated fund instrumentality (NAFI) of the United States (U.S.) and is organized as a joint major command 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, primarily Iraq and Afghanistan in support of Operation Enduring Freedom and Operation New Dawn (OEF/OND), substantially all of which are located on U.S. government installations. In addition to providing merchandise and services of necessity and convenience to authorized patrons at uniformly 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, whose application would result in interference with the performance by the Exchange of its assigned Federal functions. Such laws include licensing and price control statutes. The Exchange summarizes its revenues on the basis of its customers' locations.

Net sales by geographic region are summarized below:

	Year Ended January 29, 2011	Year Ended January 30, 2010
Continental U.S.	**$ 5,303,101**	$ 5,138,985
Pacific Rim, including Alaska and Hawaii	**1,197,400**	1,128,614
Germany	**800,273**	808,106
OEF/OND	**683,216**	804,669
Other countries	**260,014**	277,145
Total net sales	**$ 8,244,004**	$ 8,157,519

(Dollars in thousands, unless otherwise noted)

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

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

	Year Ended January 29, 2011	Year Ended January 30, 2010
Continental U.S.	**$ 1,670,979**	$ 1,574,780
Pacific Rim, including Alaska and Hawaii	**369,427**	381,589
Europe, primarily Germany	**266,885**	294,730
OEF/OND	**6,933**	7,715
Total long-lived assets	**$ 2,314,224**	$ 2,258,814

The Exchange utilizes accounting principles generally accepted in the United States 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 Army and Air Force bases throughout the world.

Appropriated Funds

In accordance with applicable 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 Commander 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.

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

Management has estimated the value of transportation costs provided by the U.S. Government for Exchange materials shipped to and from overseas the Exchange facilities to be approximately $143,540 and $133,344 for fiscal years 2010 and 2009, respectively. In addition, OEF/OND transportation costs of $140,319 and $147,805 were paid by the U.S. Government for fiscal years 2010 and 2009, respectively.

The Exchange also receives reimbursements of certain incremental costs incurred by the Exchange in relation to OEF/OND from Department of the Army and Department of the Air Force appropriated funds. In prior years through fiscal 2009, such appropriated fund (APF) reimbursements were recorded when received. During fiscal 2010, a review of appropriated fund reimbursements was conducted by the Department of the Army to assess the processing, billing, collection and monitoring practices of the Exchange in relation to all Overseas Contingency Operations, including OEF/OND. As a result of this Department of the Army review, several clarifications and improvements were made or agreed to in relation to the APF reimbursement process between the Department of the Army, which serves as the executive agent for APF reimbursements, and the Exchange.

In connection with these clarifications and improvements, during fiscal 2010, the Exchange received $81,796 in APF reimbursements, primarily for incremental costs related to OEF/OND during the Exchange's 2004 and 2005 fiscal years. Such reimbursements were recorded as an offset to fiscal 2010 Other selling, general and administrative expenses on the Statements of Earnings. Also in connection with these clarifications and improvements, Department of the Army personnel verified that in early fiscal 2011 the Exchange would be receiving $6,314 in APF reimbursements for incremental costs related to OEF/OND during the Exchange's 2007 fiscal year. Based upon this verification and the clarifications and improvements made or agreed to between the Department of the Army and the Exchange, and in consideration of the pattern and consistency of APF reimbursements of OEF/OND incremental costs in recent fiscal years, in fiscal 2010 the Exchange began accruing for expected APF reimbursements. In fiscal 2010 and going forward, APF reimbursements are recorded when an incremental cost that qualifies for reimbursement has been incurred and reimbursement by the Department of the Army or the Department of the Air Force is reasonably assured. Accordingly, as of January 29, 2011, $28,419 in incremental costs qualifying for reimbursement had been incurred for which reimbursement by the Department of the Army or the Department of the Air Force is reasonably assured, including the $6,314 in incremental costs incurred in fiscal 2007. Such APF reimbursements receivable are classified as Trade and other accounts receivable in the Balance Sheets.

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

In fiscal 2010, the Exchange recorded a total of $159,119 in APF reimbursements in relation to OEF/OND. As indicated above, $81,796 of this amount related to fiscal years 2004 and 2005 and $6,314 of this amount related to fiscal year 2007. Additionally, $71,008 of this amount related to APF reimbursements recognized in fiscal 2010, of which $13,318 related to incremental costs incurred in fiscal 2009 and reimbursed to the Exchange in fiscal 2010.

In fiscal 2010, of the total $159,119 in APF reimbursements recorded by the Exchange in relation to OEF/OND, approximately $6,125 was recognized for inventory markdowns and shortages, $17,984 was recognized for personnel costs, $41,185 was recognized for in-theater transportation, and $93,824, primarily related to APF reimbursements of incremental costs incurred in previous fiscal years, was recognized for other expenses. In fiscal 2009, the Exchange received and recorded $79,814 in APF reimbursements related to OEF/OND. Of this amount, $15,466 was recognized for inventory markdowns and shortages, $22,423 was recognized for personnel costs, $37,955 was recognized for in-theater transportation, and $3,970 for was recognized for other expenses

Base Realignment

On May 13, 2005, the Department of Defense (DoD) announced the 2005 Base Realignment and Closure (BRAC) listing that impacts the existence of various military installations and personnel around the world. The goal of this global base realignment is to strategically position the military to accomplish future objectives. The list was formally approved by Congress and became law on November 9, 2005. Under this law, the DoD is required to complete these actions by September 15, 2011. The net book value recorded for property at the BRAC locations was $2,199 as of January 29, 2011, compared to $8,329 as of January 30, 2010, and is being depreciated over the estimated remaining lives of the assets based on the expected dates of the closures.

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 the MILITARY STAR® Card credit due to the reduction of the customer base would likely occur.

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

Fiscal Year

The Exchange's fiscal year-end is the Saturday nearest January 31. References to fiscal 2010 and fiscal 2009 herein are to the fiscal years ended January 29, 2011 and January 30, 2010, respectively.

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.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Pension assets include alternative investments in limited partnerships, real estate properties, private equity, timber, agriculture, and alternative 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 alternative 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* (ASC 820), but may differ significantly from the values that would have been used had a ready market for these investments existed; such differences could be material.

Translation of Foreign Currencies

The Exchange maintains foreign currencies only to the extent necessary to pay local current liabilities. Current liabilities are recorded daily and translated to U.S. dollars at "pegged" rates. Payments of current liabilities are recorded based on the "pegged" rate. At year-end, the current liabilities are translated from the pegged rates to the end-of-period market rates. The majority of

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

such resulting gain or loss is recorded as foreign currency gain or loss with the remainder to the expense or asset account that gave rise to the current liability. The Company recognized a net loss on foreign currency of approximately $16,577 and $5,213 for the years ended January 29, 2011 and January 30, 2010, respectively. In addition, the noncurrent liability for local national separation pay has been adjusted to end-of-period market rates.

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. All book overdraft balances have been reclassified to accounts payable.

Investments in Debt Securities

Investments in debt securities have original maturities 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.

Accounts Receivable

Customer accounts receivable are classified as current assets and include some amounts that are due after one year. 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 value of existing customer receivables is the best estimate of fair value.

The Company's accounts receivable balance includes $182,624 and $174,270 of receivables from the Marine Exchange (MCX) for Marine MILITARY STAR® Card outstanding balances and related processing fees as of January 29, 2011 and January 30, 2010, respectively.

As of January 29, 2011 and January 30, 2010, approximately $2,760,138 and $2,623,645 respectively, of the accounts receivable balance represents amounts due to the Exchange under its in-house credit program, the MILITARY STAR® Card. MILITARY STAR® Card 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.

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

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 average finance rate charged for fiscal 2010 and 2009 was 9.99%, however, effective September 1, 2010, the rate increased to 10.24%. Finance charges are recorded unless an account balance has been outstanding for more than 150 days. The recorded investment in customer receivables past due 90 days or more and still accruing interest is approximately $45,169 and $51,263 as of January 29, 2011 and January 30, 2010, respectively. In fiscal 2010, the Company implemented new policies and procedures to comply with new federal credit card legislation. The legislation required the elimination of a minimum annual percentage rate (APR), which caused the Company to modify the variable rate formula. Additional provisions of the legislation include late payment warning, minimum payment warning, consideration of ability to repay, elimination of floor rates, limits on raising interest rates and or fees on outstanding balances, and advance notice of rate increases or other significant changes.

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 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.

A provision for possible 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, the Exchange records a net receivable related to accounts previously written off based upon estimated ultimate 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. 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.

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

Collections on delinquent balances submitted to U.S. Government entities totaled approximately $127,136 and $131,769 in fiscal years 2010 and 2009, respectively. Bad debt expense of $9,608 was recorded in 2010 compared to $6,084 in fiscal 2009. The allowance for bad debt as of January 29, 2011, was calculated based on historical collection experience. Management will continue to refine its reserve estimates as new customer information and trends develop.

Merchandise Inventories

The Exchange 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, distribution, and procurement expenses are included in the cost that can be inventoried. For the years ended January 29, 2011 and January 30, 2010, $10,359 and $11,440 of these expenses were allocated to merchandise inventory, respectively.

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 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.

Buildings and Improvements

Buildings and improvements primarily represent permanent structures constructed by the Exchange and owned by the U.S. Government. These assets are recorded 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.

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

In accordance with accounting standards governing the impairment or disposal of long-lived assets, the carrying value of long-lived assets, including property and equipment and definite-lived intangible assets, is evaluated 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 2009 or 2010.

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:

Asset Type	Depreciable Life
Motor vehicles	5 to 10 years
Equipment	2 to 10 years
Software	3 to 7 years

At January 29, 2011, property and equipment included approximately $1,416,453 of fully depreciated assets that remain in use.

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

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 has established self-insurance reserves of $66,562 and $72,499 as of January 29, 2011 and January 30, 2010, respectively. Workers' compensation reserves have been discounted at a weighted average rate of 4.95% for January 29, 2011. General liability reserves are discounted at a weighted average rate of 3.16%. The reserves for both workers' compensation and property and liability were discounted based on a rate of 4.75% and 3.50%, respectively for January 30, 2010.

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 (see Note 7). Additionally, the liability for vacation leave earned by U.S. citizens is accrued as earned.

Advertising Costs

Advertising costs are expensed in the period in which the advertising first occurs. The Exchange's cooperative advertising allowances are generally accounted for as a reduction in the purchase price of inventory.

Advertising expense was $64,861 and $70,729 for the years ended January 29, 2011 and January 30, 2010, respectively, and is included in selling, general, and administrative expenses.

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

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. 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 and ATM 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.

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. 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.

Reclassifications

Certain reclassifications have been made to the accompanying fiscal 2009 financial statements to conform to the fiscal 2010 presentation.

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). 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

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

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.

Fair Value Measurements

The Exchange values financial instruments in accordance with ASC 820. 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 3 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 the Supplemental Plan and derivative financial instruments. The Company uses high credit quality counterparties when executing derivative transactions.

Recent Accounting Pronouncements

In January 2010, the FASB issued Accounting Standards Update (ASU) 2010-06, *Improving Disclosures about Fair Value Measurements*. The update amends existing accounting rules regarding fair value measurements and disclosures to add new requirements for disclosures related to transfers into and out of investment Levels 1 and 2, and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 investment measurements. It also clarifies existing fair value disclosures about the level of disaggregation, as well as inputs and valuation techniques used to measure fair value. The update is effective for the first reporting period beginning after December 15, 2009, except for the requirement to provide the Level 3 activity of purchases, sales, issuances, and settlements on a gross basis, which will be effective for fiscal years beginning after December 15, 2010. As this update only relates to financial statement disclosures, the Exchange does not expect it will have an impact on its results of operations, cash flows, or financial positions.

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

Subsequent Events

The Exchange has evaluated subsequent events through May 16, 2011, the issuance date of the financial statements, and determined that no additional disclosures to those presented are necessary.

2. Investments in Debt Securities

As of January 29, 2011, the Company held investments carried at $8,300 and $2,000 (which mature March 2012 and March 2011, respectively), in support of non-German, Local National separation pay. Investments are classified as "held-to-maturity" in accordance with ASC 320-10, *Investments – Debt and Equity Securities*, and are classified on the accompanying balance sheets in long-term/short-term investments and supplemental plan assets.

As of January 30, 2010, the Company held a €15,000 (approximately $21,127) German government security to support the liability for German Local National separation pay, which was classified as and included in short-term investments on the accompanying balance sheet. In December 2010, this bond matured and a new bond, valued at €15,000 (approximately $20,270), was purchased. The new bond is due to mature on December 16, 2011, is valued at $20,548 as of January 29, 2011, and is classified as a short-term investment on the accompanying balance sheet.

3. Fair Value Measurements

As prescribed by ASC 820, the fair value of financial assets and liabilities is based on the following fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value into three levels:

> **Level 1 inputs** – Unadjusted quoted prices in active markets for identical assets or liabilities to which the Company has access. An active market for the asset or liability is one in which transactions for the asset or liability occurs with sufficient frequency and volume to provide ongoing pricing information.

(Dollars in thousands, unless otherwise noted)

3. Fair Value Measurements (continued)

Level 2 inputs – Significant inputs other than quoted market prices included in Level 1 that are observable, either directly or indirectly, for the asset or liability. Level 2 inputs include, but are not limited to, quoted prices for similar assets or 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 inputs – Unobservable inputs for the asset or liability.

The following table sets forth by level, within the fair value hierarchy, the Company's assets and liabilities that are measured at fair value as of January 29, 2011 and January 30, 2010:

	Fair Value as of January 29, 2011			
	Total	**Level 1**	**Level 2**	**Level 3**
Assets[1]:				
Cash and cash equivalents	**$ 18**	**$ 18**	**$ –**	**$ –**
Equity securities[3]	**14,947**	**–**	**14,947**	**–**
Collective investment funds	**392**	**–**	**392**	**–**
Foreign currency derivatives	**461**	**–**	**461**	**–**
Total assets	**$ 15,818**	**$ 18**	**$ 15,800**	**$ –**

	Fair Value as of January 30, 2010			
	Total	**Level 1**	**Level 2**	**Level 3**
Assets[1]:				
Cash and cash equivalents	$ 40	$ 40	$ –	$ –
Equity securities[3]:				
Collective investment funds	13,012	–	13,012	–
Total assets	$ 13,052	$ 40	$ 13,012	$ –
Liabilities[2]:				
Foreign currency derivative liabilities	$ (4,732)	$ –	$ (4,732)	$ –
Total liabilities	$ (4,732)	$ –	$ (4,732)	$ –

[1] Supplemental Plan assets are included in Long-term investments and Supplemental Plan assets on the balance sheet.

[2] Derivative liabilities are included on the balance sheet in Accounts payable and Accrued salaries, separation pay, and other employee benefits.

[3] Investments held by the Supplemental Plan are consistent with those held by the Basic Plan. See Note 7 for further description of these assets.

(Dollars in thousands, unless otherwise noted)

3. Fair Value Measurements (continued)

The Company holds investments related to the Supplemental Plan totaling $15,357 and $13,052 at January 29, 2011 and January 30, 2010, respectively. 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. Net income on trading securities was $2,620 and $28,342 in fiscal 2010 and 2009, respectively. The cost of securities sold is determined primarily on a specific identification method. (Refer to Note 7 for further discussion of the Supplemental Plan, and refer to Note 5 for further discussion of the Company's derivative positions.)

Cash and cash equivalents, trade and other accounts receivable, accounts payable, and accrued liabilities are reflected in the balance sheet at cost, which approximates fair value due to the short-term nature of these instruments. The fair value of the Company's debt is disclosed in Note 4. The table below sets forth a summary of changes in the fair value of the Company's Level 3 assets for the year ended January 30, 2010. The Company had no Level 3 assets for the year ended January 29, 2011, other than those discussed in Note 7.

	Year Ended January 30, 2010		
	Equity Securities	**Debt Securities**	**Real Estate/ Commodities**
Balance, beginning of year	$ 11,721	$ 14,374	$ 43,098
Realized gains (losses)	(29)	–	749
Unrealized gains (losses)	767	(2,843)	(4,987)
Aggregation transfers[1]	(12,413)	(11,531)	(38,328)
Net purchases, sales, issuances and settlements	(46)	–	(532)
Balance, end of year	$ –	$ –	$ –

[1] Refer to Note 7 for discussion of aggregation transfers.

(Dollars in thousands, unless otherwise noted)

3. Fair Value Measurements (continued)

The allocation of Supplemental Plan assets at January 29, 2011 and January 30, 2010, by asset category, is as follows:

	2010	**2009**
Domestic equity securities	**97%**	97%
Investment-grade fixed income	**3**	3
Total	**100%**	100%

4. Indebtedness

Syndicated Lines of Credit

As of January 29, 2011, the Exchange has an unsecured, revolving line of credit that is facilitated by a 12-bank syndicate led by Wells Fargo/Wachovia aggregating to $750,000. This agreement expires in December 2011. There was $250,000 outstanding under this line of credit at January 29, 2011. The Exchange also has an unsecured, multiyear revolving credit line facilitated by a 15-bank syndicate led by JPMorgan Chase aggregating to $755,000. This agreement expires in October 2012. At January 29, 2011, no funds were outstanding on this line of credit.

Uncommitted Lines of Credit

As of January 29, 2011, the Exchange maintains two uncommitted lines of credit aggregating to approximately $1,550,000, one with JPMorgan Chase, and the other with Army Family and Morale, Welfare and Recreation Command (Army FMWRC), a separate NAFI. Borrowings under these lines of credit were $1,346,000 at January 29, 2011, compared to $1,205,000 at January 30, 2010. While both of these lines are open ended, the outstanding balances under these lines have various maturity dates, with the latest being May 2011.

Borrowings under all lines of credit, both committed and uncommitted, bear interest rates ranging from 0.40% to 1.45%. The average interest rate under these lines of credit was 1.29% for the year ended January 29, 2011.

(Dollars in thousands, unless otherwise noted)

4. Indebtedness (continued)

Senior Notes

In June 2009, the Exchange completed a $650,000 offering of debt in a private placement. This offering provided the Exchange with $650,000 in fixed-rate, committed senior notes (the Series A, B, and C senior notes), which were issued in three tranches.

In October 2009, the Exchange completed another private placement debt offering of $90,000 in senior notes (the 2024 senior notes), which comprise a 15-year amortizing principal. As of January 29, 2011, these senior notes have a total remaining obligation of $84,779.

Debt obligations as of January 29, 2011 and January 30, 2010, consisted of the following:

	2010	2009
Outstanding debt principal balances:		
Wachovia revolving line of credit, expiring 2011	**$ 250,000**	$ 100,000
JPMorgan Chase revolving line of credit, expiring 2012	–	150,000
JPMorgan Chase uncommitted line of credit	**996,000**	1,005,000
Army FMWRC uncommitted line of credit	**350,000**	200,000
5.24% Series A senior notes due 2012	**150,000**	150,000
5.47% Series B senior notes due 2013	**150,000**	150,000
5.74% Series C senior notes due 2014	**350,000**	350,000
4.95% senior notes due 2024	**84,779**	88,981
Total debt obligations	**2,330,779**	2,193,981
Current maturities	**(1,600,415)**	(1,459,202)
Total long-term debt obligations	**$ 730,364**	$ 734,779

Based on the short-term nature of the Company's line of credit borrowings, the Exchange believes that the carrying values of amounts outstanding under the line of credit agreements approximate fair value given the term of the debt and floating interest rates. The estimated aggregate fair value for the senior notes (A–C) is $702,604 as of January 29, 2011, and the estimated fair value of the 2024 senior notes is $89,215. Fair value is calculated using a discounted cash flow analysis with estimated interest rates offered for notes with similar terms and maturities.

4. Indebtedness (continued)

Cash paid for interest for fiscal years 2010 and 2009 was approximately $50,843 and $45,954, respectively. The Exchange has complied with all financial and non-financial covenants per loan agreements as of January 29, 2011.

Principal maturities of debt obligations as of January 29, 2011, are as follows (in thousands):

2011	$ 1,600,415
2012	154,639
2013	154,874
2014	355,120
2015	5,380
Thereafter	60,351
	$ 2,330,779

5. 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 put and call 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 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.

(Dollars in thousands, unless otherwise noted)

5. Derivative Financial Instruments (continued)

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 29, 2011, the Company had various foreign exchange contracts (forwards and option collars) outstanding related to approximately $108,774 (€82,000) of its forecasted payroll and inventory purchase liabilities. As of January 29, 2011, the notional value of the outstanding forward contracts (€19,000) was $25,796 with a corresponding gain of $55. The notional value of outstanding option collar contracts (€63,000) was $82,978, with a corresponding gain of $406. The net gain of $461 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 $461 in accumulated other comprehensive loss is expected to be reclassified into earnings within the next 12 months. In addition, the Company has recognized approximately $13,661 in losses on foreign currency hedge transactions during fiscal 2010, compared to $9 in losses during fiscal 2009.

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 purchased.

	Derivative Assets (Liabilities)		
		Fair Value	
	Balance Sheet Location	January 29, 2011	January 30, 2010
Derivatives designated as hedging instruments			
Foreign currency exchange contracts	Accounts payable	$ 346	$ (3,549)
	Accrued salaries, separation pay and other employee benefits	115	(1,183)
Total derivatives designated as hedging instruments		$ 461	$ (4,732)

Reclassifications from accumulated other comprehensive loss are recognized in Selling, general and administrative other expense in the Statements of Earnings.

(Dollars in thousands, unless otherwise noted)

6. 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 $21,944 and $21,142 for the fiscal years ended January 29, 2011 and January 30, 2010, respectively. The following is a schedule, by year, of the future minimum rental payments required under all leases as of January 29, 2011:

2011	$ 16,042
2012	8,343
2013	5,671
2014	939
2015	936
Thereafter	393
Total	$ 32,324

7. 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 pension plan, certain medical and dental (health care) and life insurance benefits are also provided to retired employees through the Postretirement Medical/Dental (PRM) and Life Insurance (Other 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 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.

7. Benefit Plans (continued)

The Exchange also provides certain life insurance, disability, and other related postemployment benefits for active employees. Benefits are paid from a VEBA trust maintained by the Exchange and to which the Company contributes each year. Prior to fiscal 2009, trust assets were deemed sufficient to cover estimated medical, dental, and postemployment liabilities. However, in fiscal 2009, the Exchange determined that estimated liabilities exceeded trust asset amounts and recorded a net liability at January 30, 2010 of approximately $16,169. In fiscal 2010, the Company recorded a net liability of $22,895.

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

The Exchange measures the cost of its pension plans and other benefit plans in accordance with ASC 715, *Compensation – Retirement Benefits* (formerly Statement of Financial Accounting Standards (SFAS) No. 87, *Employers' Accounting for Pensions*, and SFAS No. 106, *Employers' Accounting for Post-retirement Benefits Other than Pensions*, as amended by SFAS No. 158). 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* (formerly SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*).

Aggregation

In December 1997, the Exchange approved a proposal to: (1) transfer accumulated plan benefit obligations related to participants in the Supplemental Plan, to the extent such benefits are limited under Internal Revenue Code 415 (IRC Section 415) to the Basic Plan and fund such obligations using the Basic Plan assets, (2) retain sufficient assets in the Supplemental Plan to make benefit payments in excess of IRC Section 415 limits, and (3) transfer residual assets from the Supplemental Plan to the Postretirement Medical/Dental and Life Insurance Plan for Employees of the Army and Air Force Exchange Service (Postretirement Plan), collectively referred to as "aggregation". This proposal was approved by the Internal Revenue Service (IRS) on July 23, 1998.

7. Benefit Plans (continued)

The proposal included an amendment to allow the Supplemental Plan to utilize its assets to pay postretirement medical benefits in addition to the pension benefits provided by the Supplemental Plan related to eligible employees' incomes in excess of IRC Section 415 limits. In addition, the Basic Plan will pay benefits to the participants who were previously provided for under the Supplemental Plan up to the IRC Section 415 limits. The Exchange obtained a private letter ruling from the IRS on August 8, 2000, that concluded the qualification of the Plan is not affected by the proposed change. The Exchange notified the Assistant Undersecretary of Defense, the Honorable Charles Abell, in May 2001 of the Exchange's intention to proceed with the aggregation. On May 31, 2001, the Assistant Undersecretary of Defense notified the Exchange that aggregation could not be implemented until such time that the DoD Office of General Counsel could review the documents provided.

Effective July 1, 2009, the aggregation plan was approved by the DoD and was commenced by the Exchange, whereby the Exchange transferred approximately $364 million in projected benefit obligations of the Supplemental Plan to the Basic Plan. Additionally, the Exchange transferred approximately $245 million in assets of the Supplemental Plan to the Postretirement Plan. The transfer of assets created an actuarial prepayment equivalent to the value of the assets transferred to the Postretirement Plan. Accordingly, the Company intends to amortize this prepayment as a credit towards its annual funding policy over nine years. As of July 1, 2009, $12 million in assets and accumulated plan benefit obligations remained in the Supplemental Plan.

7. Benefit Plans (continued)

The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of assets for the years ended January 29, 2011 and January 30, 2010. Amounts are stated in millions.

	Pension Benefits				Other Benefits			
	The Basic Plan		Supplemental Plan		Postretirement		Foreign Plans	
	2010	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**
Change in projected benefit obligations (PBO)								
PBO at prior measurement date	**$ 3,119**	$ 2,442	**$ 7**	$ 352	**$ 1,798**	$ 1,578	**$ 108**	$ 86
Service cost	**72**	66	**1**	1	**22**	20	**4**	4
Interest cost	**185**	174	**–**	10	**102**	106	**4**	4
Plan participants' contributions	**4**	4	**–**	–	**–**	–	**–**	–
Change in measurement date	**–**	–	**–**	–	**–**	–	**–**	–
Aggregation	**–**	364	**–**	(364)	**–**	–	**–**	–
Actuarial gain (loss)	**34**	270	**1**	29	**6**	171	**(4)**	11
Foreign exchange impact	**–**	–	**–**	–	**–**	–	**1**	5
Benefits paid	**(210)**	(186)	**–**	(21)	**(84)**	(72)	**(3)**	(2)
Administrative expenses paid	**(18)**	(15)	**–**	–	**(7)**	(5)	**–**	–
PBO at current measurement date	**$ 3,186**	$ 3,119	**$ 9**	$ 7	**$ 1,837**	$ 1,798	**$ 110**	$ 108

	Pension Benefits				Other Benefits			
	The Basic Plan		Supplemental Plan		Postretirement		Foreign Plans	
	2010	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**
Change in plan assets								
Fair value of assets at prior measurement date	**$ 3,241**	$ 2,836	**$ 13**	$ 250	**$ 1,174**	$ 787	**$ 27**	$ 20
Actual return on assets	**572**	602	**2**	29	**220**	205	**3**	5
Employer contributions	**–**	–	**–**	–	**21**	14	**2**	1
Plan participants' contributions	**4**	4	**–**	–	**–**	–	**–**	–
Aggregation	**–**	–	**–**	(245)	**–**	245	**–**	–
Benefits paid	**(210)**	(186)	**–**	(21)	**(84)**	(72)	**(2)**	(2)
Administrative expenses paid/foreign exchange impact	**(18)**	(15)	**–**	–	**(7)**	(5)	**–**	3
Fair value of assets at current measurement date	**$ 3,589**	$ 3,241	**$ 15**	$ 13	**$ 1,324**	$ 1,174	**$ 30**	$ 27
Funded status at fiscal year-end	**$ 403**	$ 122	**$ (9)**	$ (7)	**$ (513)**	$ (624)	**$ (80)**	$ (81)

7. Benefit Plans (continued)

The following table reflects amounts recognized in the balance sheets as of January 29, 2011 and January 30, 2010. Amounts are stated in millions.

	Pension Benefits				Other Benefits			
	The Basic Plan		Supplemental Plan		Postretirement		Foreign Plans	
	2010	2009	2010	2009	2010	2009	2010	2009
Amounts recognized in the balance sheets								
Prepaid pension asset	**$ 403**	$ 122	**$ –**	$ –	**$ –**	$ –	**$ –**	$ –
Other current liabilities	**–**	–	**–**	–	**43**	40	**8**	6
Accrued pension and other benefits liability	**–**	–	**9**	7	**470**	584	**72**	75
Accumulated other comprehensive (loss) income	**(426)**	(664)	**(9)**	(10)	**(675)**	(822)	**(21)**	(28)

A summary of the components of net periodic benefit cost (income) for the benefit plans is as follows for the years ended January 29, 2011 and January 30, 2010:

	Pension Benefits				Other Benefits			
	The Basic Plan		Supplemental Plan		Postretirement		Foreign Plans	
	2010	2009	2010	2009	2010	2009	2010	2009
Net periodic cost								
Service cost	**$ 72**	$ 66	**$ 1**	$ 1	**$ 22**	$ 20	**$ 4**	$ 4
Interest cost	**185**	174	**–**	10	**102**	106	**4**	4
Expected return on assets	**(299)**	(302)	**–**	–	**(109)**	(100)	**(2)**	(2)
Prior service cost amortization	**–**	–		–	**(4)**	(4)	**–**	–
Net loss amortization	**–**	–	**2**	–	**48**	40	**2**	1
Net periodic benefit (income) cost	**$ (42)**	$ (62)	**$ 3**	$ 11	**$ 59**	$ 62	**$ 8**	$ 7

Information for benefit plans with an accumulated benefit obligation in excess of plan assets (dollars in millions):

	Pension Benefits		Other Benefits		Pension Benefits	
	Supplemental Plan		Postretirement		Foreign Plans	
	2010	2009	2010	2009	2010	2009
Projected benefit obligation	**$ 9**	$ 7	**$ 1,837**	$ 1,798	**$ 110**	$ 108
Accumulated benefit obligation	**9**	7	**1,837**	1,798	**92**	87
Fair value of plan assets	**–**	–	**1,324**	1,174	**30**	27

(Dollars in thousands, unless otherwise noted)

7. Benefit Plans (continued)

Amounts included in accumulated other comprehensive income (loss) for all plans at January 29, 2011, consist of net actuarial losses of $1,130,030 and a net prior service credit of $8,418. Amortization of these amounts expected to be recognized in fiscal year 2011 is $54,407 for net actuarial losses and $4,063 for prior service cost.

Actuarial Assumptions

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

	Pension Benefits The Basic Plan		Pension Benefits Supplemental Plan		Other Benefits Postretirement	
	2010	**2009**	**2010**	**2009**	**2010**	**2009**
Assumptions used to determine expense:						
Discount rate	**6.00%**	6.75%	**6.00%**	6.75%	**6.00%**	6.75%
Long-term rate of return on assets	**8.25%**	8.25%	**–**	–	**8.75%**	8.75%
Compensation increase rate	**5.50%**	5.50%	**5.50%**	5.50%	**5.50%**	5.50%
Assumptions used at disclosure:						
Discount rate	**6.00%**	6.00%	**6.00%**	6.00%	**6.00%**	6.00%
Compensation increase rate	**5.50%**	5.50%	**5.50%**	5.50%	**5.50%**	5.50%

	Other Benefits UK Plan		Other Benefits Local National Plan	
	2010	**2009**	**2010**	**2009**
Assumptions used to determine expense:				
Discount rate	**5.70%**	7.00%	**3.26%**	4.12%
Long-term rate of return on assets	**6.90%**	6.90%	**–**	–
Compensation increase rate	**4.50%**	4.50%	**2.58%**	2.69%
Assumptions used at disclosure:				
Discount rate	**5.70%**	5.65%	**3.04%**	3.26%
Compensation increase rate	**4.50%**	4.50%	**2.52%**	2.58%

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 pension plans 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.

(Dollars in thousands, unless otherwise noted)

7. Benefit Plans (continued)

Pension Plan Assets

The Exchange's investment objectives for the pension 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.

The pension 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 The Basic Plan		Other Benefits Postretirement Plan		Other Benefits UK Plan	
	2010	**2009**	**2010**	**2009**	**2010**	**2009**
Domestic equity securities	**17%**	17%	**22%**	22%	**26%**	26%
International equity securities	**12**	12	**16**	16	**35**	35
Emerging market equity securities	**5**	5	**5**	5	**4**	4
Investment-grade fixed income	**21**	21	**12**	12	**35**	35
High-yield fixed income	**10**	10	**10**	10	**–**	–
TIPS	**5**	5	**5**	5	**–**	–
Real estate – private	**8**	8	**8**	8	**–**	–
Real estate – public	**2**	2	**2**	2	**–**	–
Private equity	**10**	10	**10**	10	**–**	–
Commodities	**5**	5	**5**	5	**–**	–
Alternative debt	**5**	5	**5**	5	**–**	–
Total	**100%**	100%	**100%**	100%	**100%**	100%

(Dollars in thousands, unless otherwise noted)

7. Benefit Plans (continued)

The Exchange's pension plans asset allocations at January 29, 2011 and January 30, 2010, by asset class category are as follows:

	Pension Benefits		Other Benefits		Other Benefits	
	The Basic Plan		Postretirement Plan		UK Plan	
	2010	**2009**	**2010**	**2009**	**2010**	**2009**
Domestic equity securities	**22%**	28%	**26%**	28%	**26%**	26%
International equity securities	**13**	12	**18**	18	**36**	35
Emerging market equity securities	**5**	6	**6**	6	**4**	4
Investment-grade fixed income	**20**	19	**13**	15	**34**	35
High-yield fixed income	**5**	6	**5**	6	**–**	–
TIPS	**8**	8	**5**	6	**–**	–
Real estate – private	**8**	4	**8**	4	**–**	–
Real estate – public	**2**	2	**2**	2	**–**	–
Private equity	**7**	6	**7**	6	**–**	–
Commodities	**5**	5	**6**	6	**–**	–
Alternative debt	**5**	4	**4**	3	**–**	–
Total	**100%**	100%	**100%**	100%	**100%**	100%

Equity securities are diversified across various industries and are comprised of common and preferred stocks of U.S. and international companies and equity positions in privately held companies controlled through limited partnerships. Publicly traded corporate equity securities are valued at the last reported sale price on the last business day of the year of the plans. The estimated fair value of the investments in the collective investment funds represents the underlying net asset value of the shares or units of such funds as determined by the issuer. Limited partnerships are valued at the plan's proportionate share of the estimated fair value of the underlying net assets as determined by the general partners. The limited partnerships are classified as Level 3 investments.

Debt securities are comprised of corporate bonds, government securities, and asset-backed or collective investment funds and limited partnerships with underlying debt securities. Corporate bonds primarily consist of investment-grade rated bonds and notes, of which no significant concentration exists in any one rating category or industry. Government securities include inflation-indexed U.S. Treasury notes and U.S. Government bonds. Asset-backed securities are publicly traded securities with coupon payments based on the performance of the underlying assets. Corporate bonds, government securities, and asset-backed securities are valued at the last

7. Benefit Plans (continued)

reported sale price. The estimated fair value of the investments in the collective investment funds represents the underlying net asset value of the shares or units of such funds as determined by the issuer. Limited partnerships are valued at the plan's proportionate share of the estimated fair value of the underlying net assets as determined by the general partners. The limited partnerships are classified as Level 3 investments.

Real estate and commodities are comprised of investments whose underlying value is based on real estate or commodities. Publicly traded securities are equity shares in Real Estate Investment Trusts (REITs) and valued at the last reported sale price. Collective investment funds with underlying investments in exchange-traded positions are classified as Level 2 investments. Collective investment funds and limited partnerships with underlying investments in real estate are classified as Level 3 investments. The estimated fair value of the underlying real estate is 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.

Other investments consist primarily of investment contracts and are valued at the quoted price as determined by the issuer. Contracts classified as Level 2 assets are guaranteed an issuer with high creditworthiness. Contracts classified as Level 3 have valuations based on underlying assets with unobservable inputs.

(Dollars in thousands, unless otherwise noted)

7. Benefit Plans (continued)

The following table sets forth by level, within the fair value hierarchy, the Company's plan assets and liabilities that are measured at fair value as of January 29, 2011:

	Benefit Plans			
	Total	Level 1 Quoted Prices in Active Markets	Level 2 Significant Observable Inputs	Level 3 Significant Unobservable Inputs
Cash	$ 15,741	$ 15,741	$ –	$ –
Equity securities:				
Common and preferred stock	1,197,627	1,197,627	–	–
Collective investment funds	764,786	–	764,786	–
Limited partnerships	336,565	–	–	336,565
Debt securities:				
Government bonds	421,888	421,888	–	–
Corporate debt	382,122	382,122	–	–
Asset-backed securities	30,713	30,713	–	–
Collective investment funds	669,427	–	669,427	–
Limited partnerships	214,772	–	–	214,772
Real estate and commodities:				
Common and preferred stock	106,543	106,543	–	–
Collective investment funds	563,357	–	136,448	426,909
Limited partnerships	101,733	–	–	101,733
Due to/from broker for sale of securities – net	116,587	116,587	–	
Other	20,751	–	14,677	74
Total	$ 4,942,612	$ 2,271,221	$ 1,585,338	$ 1,080,053

(Dollars in thousands, unless otherwise noted)

7. Benefit Plans (continued)

The following table sets forth by level, within the fair value hierarchy, the Company's plan assets and liabilities that are measured at fair value as of January 30, 2010:

	Benefit Plans			
	Total	**Level 1 Quoted Prices in Active Markets**	**Level 2 Significant Observable Inputs**	**Level 3 Significant Unobservable Inputs**
Cash	$ 22,402	$ 22,402	$ –	$ –
Equity securities:				
Common and preferred stock	1,304,857	1,304,857	–	–
Collective investment funds	762,863	–	762,863	–
Limited partnerships	254,953	–	–	254,953
Debt securities:				
Government bonds	368,070	368,070	–	–
Corporate debt	325,724	325,724	–	–
Asset-backed securities	135,265	135,265	–	–
Collective investment funds	385,754	–	385,754	–
Limited partnerships	207,946	–	9,274	198,672
Real estate and commodities:				
Common and preferred stock	78,536	78,536	–	–
Collective investment funds	460,686	–	69,428	391,258
Limited partnerships	104,827	–	–	104,827
Other	29,424	–	29,234	190
Total	$ 4,441,307	$ 2,234,854	$ 1,256,553	$ 949,900

(Dollars in thousands, unless otherwise noted)

7. Benefit Plans (continued)

Level 3 Gains and Losses

The tables below sets forth a summary of changes in the fair value of the Plan's Level 3 assets for the year ended January 29, 2011 and January 30, 2010:

	Year Ended January 29, 2011		
	Equity Securities	Debt Securities	Real Estate/ Commodities
Balance, beginning of year	**$ 254,953**	**$ 198,672**	**$ 496,275**
Realized gains (losses)	**3,931**	**6,215**	**18,860**
Unrealized gains (losses) relating to instruments still held at the reporting date	**30,261**	**20,179**	**29,635**
Net purchases, sales, issuances and settlements	**47,420**	**(10,294)**	**(16,055)**
Balance, end of year	**$ 336,565**	**$ 214,772**	**$ 528,715**

	Year Ended January 30, 2010		
	Equity Securities	Debt Securities	Real Estate/ Commodities
Balance, beginning of year	$ 231,670	$ 121,700	$ 566,764
Realized gains (losses)	(3,571)	4,357	20,538
Unrealized gains (losses) relating to instruments still held at the reporting date	(7,426)	45,171	(123,117)
Net purchases, sales, issuances and settlements	21,867	15,913	(6,238)
Aggregation transfers	12,413	11,531	38,328
Balance, end of year	$ 254,953	$ 198,672	$ 496,275

Employer Contributions

The Exchange expects to contribute approximately $43,359 to the Other Postretirement benefit plans in fiscal 2011.

(Dollars in thousands, unless otherwise noted)

7. Benefit Plans (continued)

Estimated Future Benefit Payments

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

Fiscal Years	Basic Plan	Supplemental Plan	Postretirement	Foreign Plans
2011	$ 203,201	$ 471	$ 95,851	$ 9,164
2012	205,761	486	102,913	8,001
2013	210,061	495	109,599	7,867
2014	215,798	509	115,636	8,067
2015	222,281	526	120,921	7,428
2016–2020	1,190,784	2,831	667,579	37,487

Assumed Health Care Cost Trend Rates at January 30:

	2010	2009
Health care cost trend rate assumed for next year	**8.00%**	8.00%
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	**2016**	2014

8. Dividends

The Exchange is required, under various agreements, to distribute a portion of each year's net earnings before 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 dividends were paid on the pension income and realized and unrealized gains and losses recorded in accordance with ASC 715 and ASC 320, the Exchange would be paying dividends to the Central Welfare Funds, Departments of the Army, the Air Force, the Navy, and the Marine Corps on noncash amounts, which would impact cash reserves used in the normal operation of

8. Dividends (continued)

the business. Accordingly, under the current dividend policy, these items are excluded from net earnings subject to dividends. Any other exclusion 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.

9. 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.

10. Operation Enduring Freedom/Operation New Dawn (OEF/OND)

On March 19, 2003, the United States declared war against Iraq. As a result, the Company increased its presence in Iraq, Qatar, Afghanistan and Kuwait from 12 stores as of February 1, 2003, to 124 stores as of January 30, 2010. However, Operation New Dawn (OND), implemented by the President of the United States in 2010, resulted in U.S. Troop withdrawal from Iraq. Consequently, there have been 33 AAFES store closures in Iraq during fiscal 2010 and the Company's inventory balance in OEF/OND decreased from $86,038 at January 30, 2010, to $53,374 at January 29, 2011. Current conditions in Iraq and Afghanistan continue to be uncertain. Any continued or significant disruption or retreat from the locale directed by the United States military could have an adverse impact on the results of operations. As a result, it is difficult to estimate the potential inventory that may be forfeited if the United States must quickly exit either country. Any related loss on inventory could adversely affect the Company's results of operations. Approximately $683,216 (8.3%) and $804,670 (9.9%) of the Company's net revenues in the fiscal years ended January 29, 2011 and January 30, 2010, respectively, were derived from sales to U.S. Troops stationed in OEF/OND regions.

10. Operation Enduring Freedom/Operation New Dawn (OEF/OND) (continued)

As a result of the lack of depository banks in the region, cash sales are deposited with United States Military Finance offices in the Middle East and are then reimbursed to the Company within 90 days. Receivables from Military Finance offices were $2,837 and $8,269 as of January 29, 2011 and January 30, 2010, respectively.

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