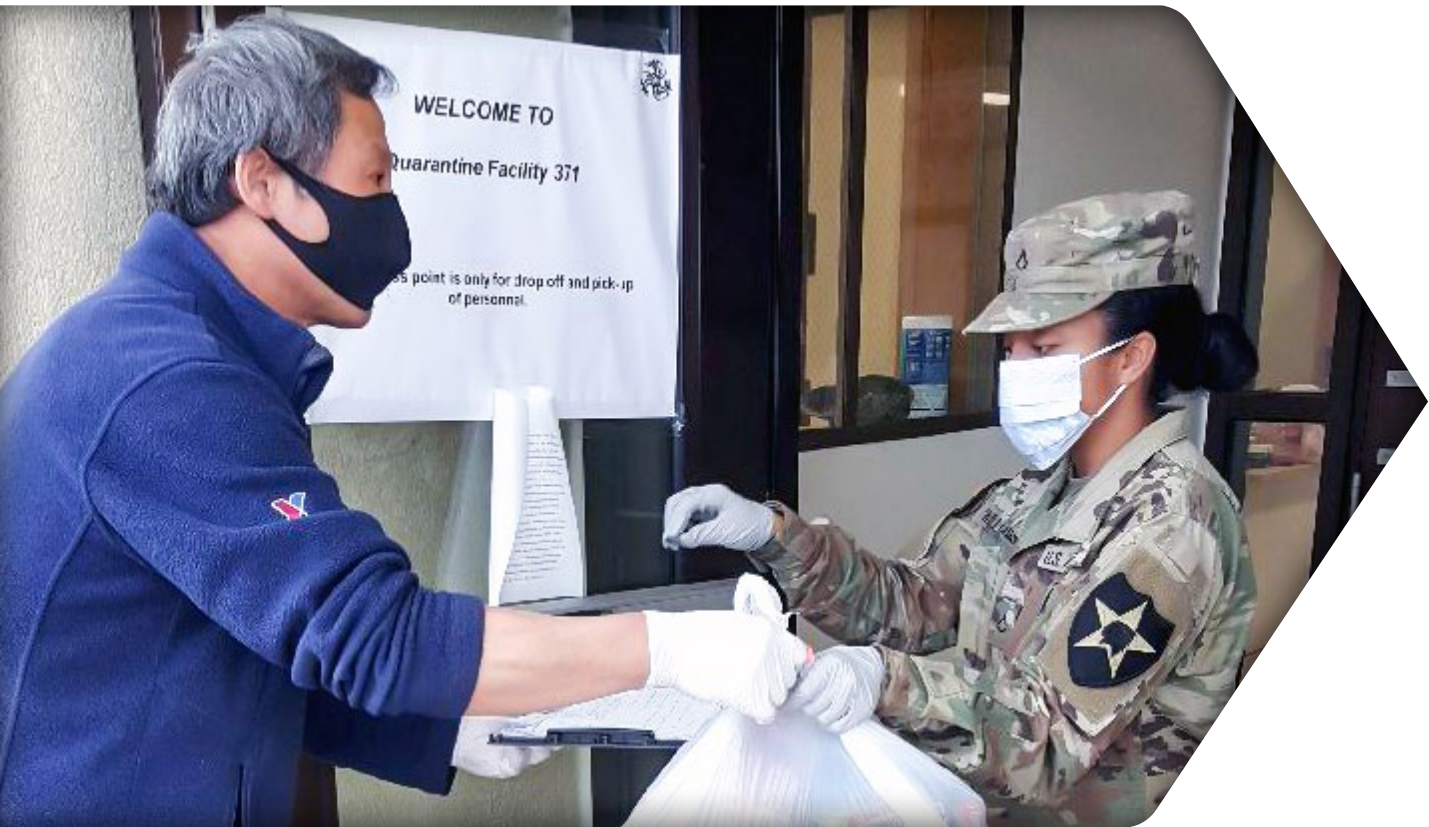




ARMY & AIR FORCE
EXCHANGE SERVICE



**PROTECTING THE FORCE
PRESERVING THE BENEFIT**

2020 MISSION REPORT

STRENGTHENING THE BENEFIT IN UNPRECEDENTED TIMES

As the COVID-19 pandemic upended the retail industry, the Army & Air Force Exchange Service leaned forward in 2020 to provide mission-essential support while preserving the benefit for Warfighters past, present and future.

Early in the pandemic, the Exchange resolved to keep associates working when military communities needed them most. As worldwide job losses soared, the Exchange continued to honor this commitment, ending 2020 without a single layoff or furlough.

Like its private-sector counterparts, the Exchange saw a significant reduction in daily foot traffic. While this negatively impacted brick-and-mortar retail, concession and restaurant sales, e-commerce sales through ShopMyExchange.com increased by 47%.

The Exchange responded quickly to the in-store sales drop, making responsible decisions to improve liquidity. Besides reducing expenses, the Exchange dramatically rebalanced inventory purchases to reflect changes in pandemic needs, delayed capital projects, and worked with suppliers and creditors to improve merchandise flow and liquidity. Through these measures, the Exchange ended 2020 with an even stronger balance sheet than before the pandemic began. This strength will provide operational flexibility to reinvest in the post-pandemic recovery.

The Exchange recorded \$7.5 billion in revenue in 2020 with \$218 million in dividend-eligible earnings. This enabled the Exchange to contribute \$153 million in dividends to support critical Quality-of-Life programs that promote military readiness and resiliency including Child, Youth and School Services, Armed Forces recreation Centers and more. In the past 10 years, the Exchange distributed more than \$2.1 billion to these programs.

Providing a safe, sanitized and secure environment was the Exchange's top priority in 2020. Before the CDC recommended face coverings or the Department of Defense mandated their wear, the Exchange distributed personal protective equipment to all frontline and distribution center associates. PXs and BXs worldwide required physical distancing, regularly disinfected frequently touched surfaces, and placed clear acrylic barriers at cash registers and customer service desks. To reduce crowds during the holiday shopping season, the Exchange spread out its holiday sales over a 12-week period, an industry-leading approach that proved successful.

Despite an unprecedented 2020, the Exchange's long-term financial outlook is strong, and the organization remains cash flow positive. The Exchange is well-positioned for a post-pandemic rebound, with plans to intensify online shopping, increase capital efficiencies and further emphasize collaboration with the commissary and sister exchanges.

In the words of then-Joint Base San Antonio Commander Brig. Gen Laura Lenderman, "Our community knows it can count on its Exchange to maintain mission-essential support, even in times of widespread disruption and uncertainty."

It is the Exchange's mission to ensure all Soldiers, Airmen, Guardians and military communities have the same peace of mind, knowing the Exchange will always provide care and comfort—no matter the circumstances.



Tom Shull
Director/Chief Executive Officer

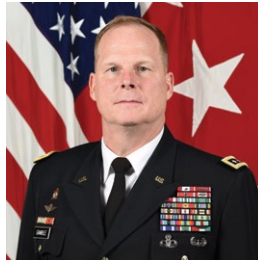


2020 BOARD OF DIRECTORS

Per Army Regulation 215-8/Air Force Instruction 24-211 (I), the Secretary of the Army and the Secretary of the Air Force have oversight responsibility of the Army & Air Force Exchange Service Board of Directors and exchange operations.



**Lt Gen
Brian T. Kelly**
Chairman
Deputy Chief of Staff, Manpower,
Personnel & Services (HQ USAF/A1)



**LTG
Duane A. Gamble**
Vice Chairman
Deputy Chief of Staff, G-4, HQDA
(DALO-ZA)



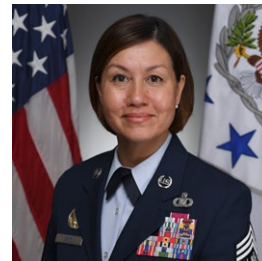
**Mr.
Tom C. Shull, SES**
Director/CEO, Army & Air Force
Exchange Service



**LTG
Thomas A. Horlander**
Military Deputy for Budget, HQDA
(ASA FM)



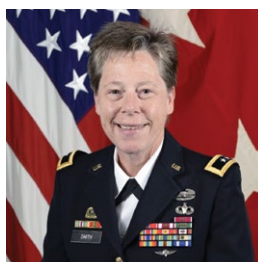
**LTG
Jason T. Evans**
Deputy Chief of Staff, G-9, HQDA
(DAIN-ZA)



**CMSAF
JoAnne S. Bass**
Chief Master Sergeant of the Air
Force (AF/CCC)



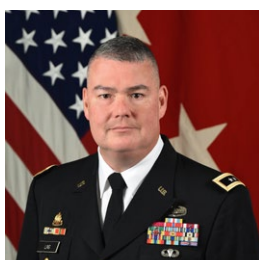
**SMA
Michael A. Grinston**
Sergeant Major of the Army (DACS/
SM)



**MG
Tammy S. Smith**
Special Assistant, Assistant
Secretary of the Army (Manpower &
Reserve Affairs) & Director, Quality
of Life



**Maj Gen
James D. Peccia**
Deputy Assistant Secretary of the Air
Force, Budget (SAF/FMB)



**MG
David W. Ling**
Commanding General, 79th Theater
Sustainment (AFRC-RCA-CG)



**Ms.
Kimberly K. Toney, SES**
Executive Director, Air Force
Personnel Center (AFPC/CA)



**Brig Gen
John N. Tree**
Mobilization Assistant to the Air
Force Chief of Staff (HQ USAF/CC)



**Mr.
Horace "H.L." Larry, SES**
Director, Air Force Services (HQ AF/A1S)

MILITARY COMMUNITY SUPPORT



Camp Taji, Iraq



Mission Support

- 691,000 military uniforms outfitted at cost in 2020
- More than 300 facilities in austere locations in Southwest Asia and Eastern Europe
- Mobile field exchanges for military exercises and disaster support

Overseas Support

- 7 plants (bakeries and water)
- 5.9 million baked goods produced
- 1.8 million meals served in Department of Defense Education Activity schools

Retail

- 4,920 stores with operations in more than 30 countries, 50 states and four U.S. territories
- 121 main PXs/BXs stocked with national brands
- 605 convenience stores (Expresses, gas stations, troop stores, specialty stores, Class Six locations)
- 167 Military Clothing stores
- Online shopping, including privileges for honorably discharged Veterans

Restaurants

- 1,700 restaurants with BE FIT options
- 45 restaurants opened in 2020
- 74 million meals served

Services

- 3,618 mall stores and kiosks, including wellness services such as dentistry and optometry
- 16 of 75 movie theaters operational during the pandemic
- 183,000 subscribers directly supported through Exchange-contracted internet services
- 36 self-serve micro markets opened in 2020

Veteran and Spouse Employment

- 85% of associates are connected to the military
- 45% of associates are Veterans, spouses or dependents
- 9,624 Veterans and 37,888 military spouses have joined the Exchange workforce since 2013
- 1,719 Wounded Warriors hired since 2010

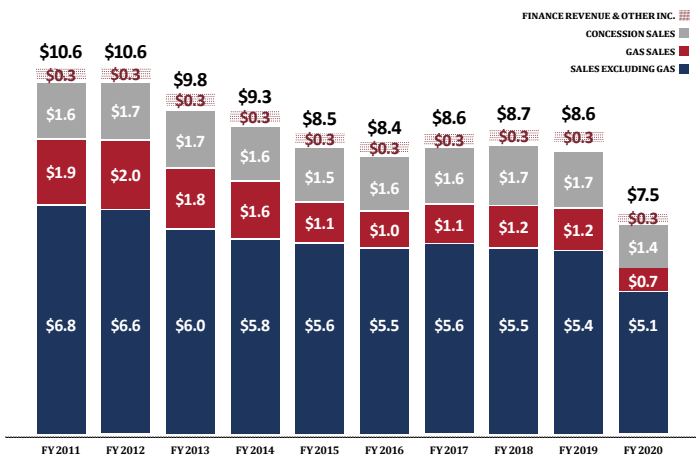
Worldwide Logistics

- 3rd largest shipper in the Defense Transportation System
- 11 distribution centers
- 45 million cases shipped
- 11th largest private retail fleet
- 13.8 million miles driven

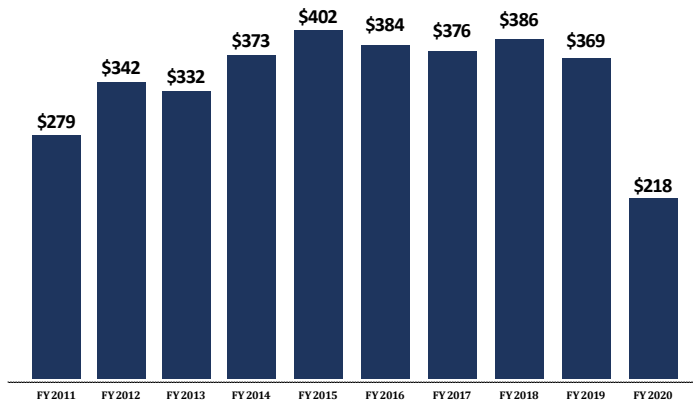
MILITARY STAR®

- Total benefit: \$429 million
- Lowest flat-rate retail APR (10.24%)
- 0% interest Military Clothing line
- 1 in 5 transactions on **MILITARY STAR®**

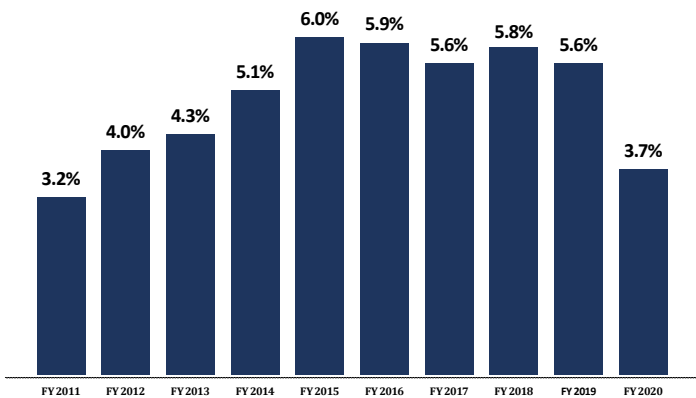
FINANCIAL HIGHLIGHTS



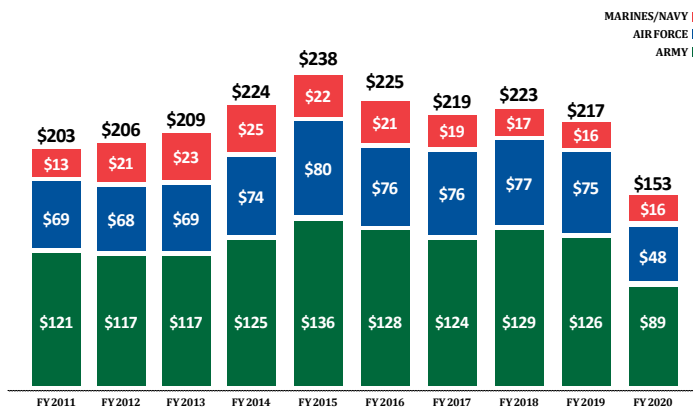
TOTAL REVENUE (\$ BILLIONS)



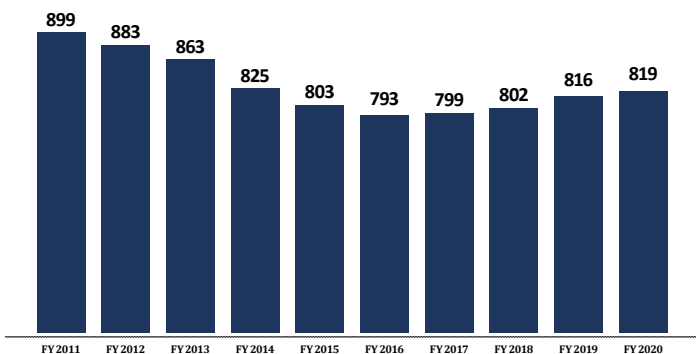
EARNINGS SUBJECT TO DIVIDENDS (\$ MILLIONS)



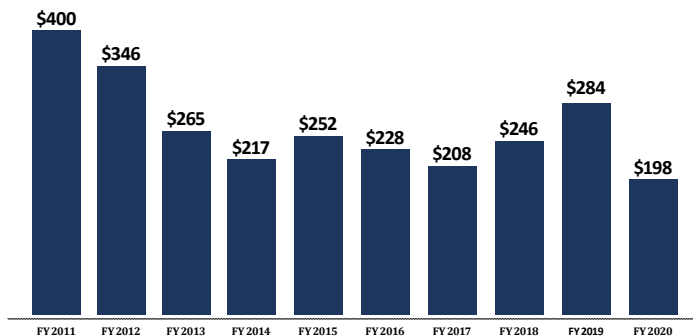
EARNINGS PERCENT OF SALES



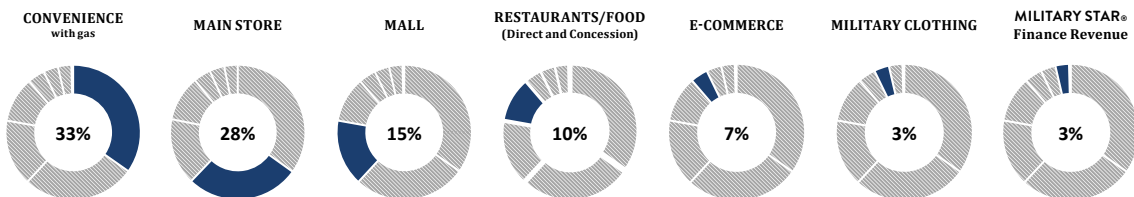
ARMY, AIR FORCE, MARINES/NAVY DIVIDENDS (\$ MILLIONS)



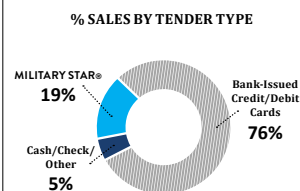
ACTIVE DUTY ARMY & AIR FORCE (THOUSANDS)



CAPITAL EXPENDITURES (\$ MILLIONS)



TOTAL 2020 REVENUE COMPOSITION



RESILIENCY DOWNRANGE: Serving at the Tip of the Spear

For more than 125 years, the Exchange has been a lifeline to America for Warfighters serving in austere locations.

Through small storefronts, imprest fund activities and stores on wheels known as mobile field exchanges, the Exchange offers deployed troops a taste of home, including drinks, snacks, hygiene products and more.

During Exercise DEFENDER-Europe 20, the largest U.S. exercise in Europe in more than 25 years, the Exchange served more than 17,000 troops. In total, the Exchange supported 23 exercises across Europe, Southwest Asia and Africa.

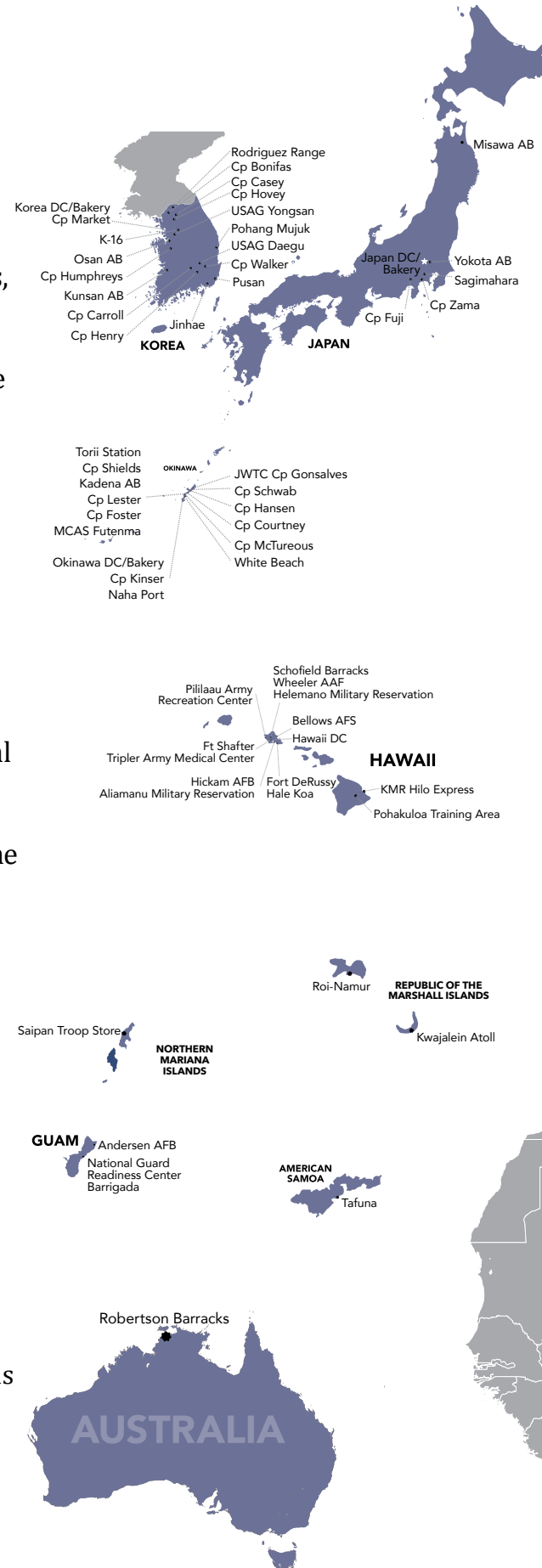
In partnership with The Walt Disney Studios, the Exchange also continued its longstanding efforts to offer special first-run movie screenings to Warfighters serving in Southwest Asia. On Dec. 25, about 600 service members at Al Dhafra Air Base, United Arab Emirates, and Camp Buehring, Kuwait, were treated to a free screening of "Soul," a rare opportunity for those serving in the region to see a new film as it made its initial rollout in the U.S.

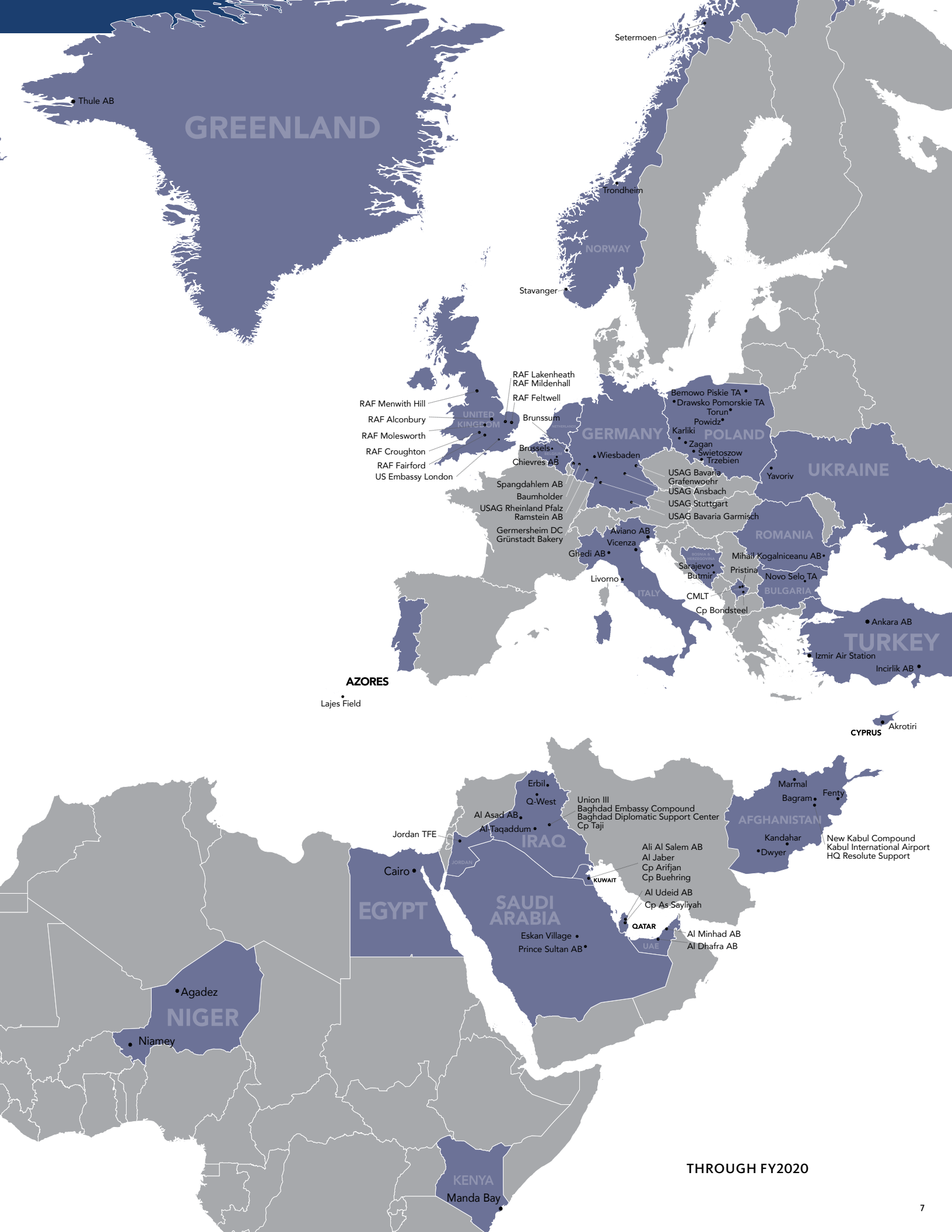
The Exchange further demonstrated its downrange agility at the onset of the COVID-19 pandemic, quickly adjusting operations as needed to ensure deployed troops could still get a taste of home as lockdown restrictions and quarantine protocols were implemented worldwide.

In the Pacific, the Exchange supported four major exercises, with more than 5,400 members of U.S. and international forces served during Exercises Cope North and Valiant Shield in Guam and Exercises Fuji Viper and Yama Sakura in Japan. The Exchange also supported installation-level training rotations for more than 17,000 service members in Korea and more than 3,200 troops in Northern Australia.

By the Numbers:

- More than 30 countries with Exchange-supported operations
- 27 exercises supported across Europe, Southwest Asia, Africa and the Pacific





COVID-19: Safe, Sanitized and Secure

2020 will forever be remembered as the year of COVID-19.

Masks. Physical distancing. Stay-at-home orders. It seemed life as the world knew it was turned on its head overnight. As uncertainty reigned, Warfighters and their families counted on their Exchange to deliver safe, sanitized and secure service at brick-and-mortar PXs and BXs and online at ShopMyExchange.com.

In the early months of the pandemic, scores of civilian retailers closed their doors as states issued stay-at-home orders. But the Exchange remained open. Every day, Exchange associates put on their face masks, stepped out of their homes and bravely continued to serve those who serve—just as they had done for the previous 125 years.

As with all facets of daily life, adjustments were made to maximize health and safety. Most of these measures are still in place today: requiring associates and shoppers to wear face masks; keeping clear acrylic shields at cash registers and customer service desks; reminding shoppers to keep 6 feet of distance through signage and floor decals; emphasizing takeout service at Exchange restaurants; and consistently sanitizing frequently used surfaces such as PIN pads.

When troops deployed to the pandemic's front lines, the Exchange went with them. In April, a mobile field exchange (MFE)—a store on wheels offering snacks, beverages and hygiene items—activated to serve troops deploying on COVID-19 missions from U.S. Army North's Joint Base San Antonio-Fort Sam Houston headquarters. The following day, an additional MFE deployed to the Army field hospital at the Javits Center in New York City, serving Warfighters and medical personnel conducting COVID-19 relief operations within days of the hospital's opening.

"It's very cool that the Exchange is here [at the NYC Army field hospital] and can provide this type of support for the troops. I actually had placed an order for military rank with the Fort Hamilton general manager the day before and was able to pick it up today when the MFE opened."

*Pfc. Maxwell Premmana
Army National Guard
442nd Military Police Company*

Clockwise from left, high-traffic areas such as the PowerZone were sanitized often; Nellis Air Force Base command thanked associates; shopping carts were routinely cleaned; a Kadena manager prepared one of 600 orders to be delivered to quarantined USS Blue Ridge crew members; and Soldiers practiced physical distancing at the Fort Leonard Wood Military Clothing store.



Soldiers assigned to Company C., 2nd Battalion, 12th Infantry Regiment, 2nd Infantry Brigade Combat Team, 4th Infantry Division, screened patrons for COVID-19 symptoms upon entry into the Fort Carson main PX. Hand sanitizers and wash stations were placed at the entrance to help stop the spread of COVID-19. (U.S. Army photo by Staff Sgt. Inez Hammon)



COVID-19: Safe, Sanitized and Secure

As the year progressed, many Exchange team members took on new responsibilities, like implementing the Exchange's new curbside pickup program. Exchanges also provided critical support to quarantined troops returning from overseas, establishing personal shopper programs; assembling care packages; launching unmanned, contactless micro markets in installation quarantine areas; and deploying MFEs to serve quarantined Warfighters.

In addition to supporting Warfighters' readiness and resiliency, the Exchange ensured military families' needs were met. As military children in Europe and the Pacific transitioned to virtual classes, the Exchange offered grab-and-go lunches at safe, physically distanced pickup locations, serving more than 1 million grab-and-go meals by the year's end.

Providing this mission-essential support was no simple task. Exchange leaders from across the globe worked together in real time to ensure PXs and BXs continued to receive merchandise even as global supply chains were strained. Region leaders and managers stayed nested with installation commands, ensuring military communities' needs were met and local command guidance was followed at all Exchange facilities.

As the fight against COVID-19 marches on into 2021, the Exchange remains ready as ever to provide essential Quality-of-Life support to Warfighters and their families.

Customer Support By the Numbers:

- 299K buy online, pick up in store orders
- 20,240 curbside pickups
- 7,657 personal shopper orders for quarantined troops
- 2.3 million ship from store fulfillments, up 94% from 2019

"I cannot overstate the importance of the measures you have taken to protect your employees as well as those you serve. Your tremendous work and selfless efforts allow this fight to be sustained and directly safeguard the members of our community and our fighting force."

*Army Maj. Gen. Lonnie Hibbard
Commanding General for the U.S. Army Center for
Initial Military Training and U.S. Army Training and
Doctrine Command*

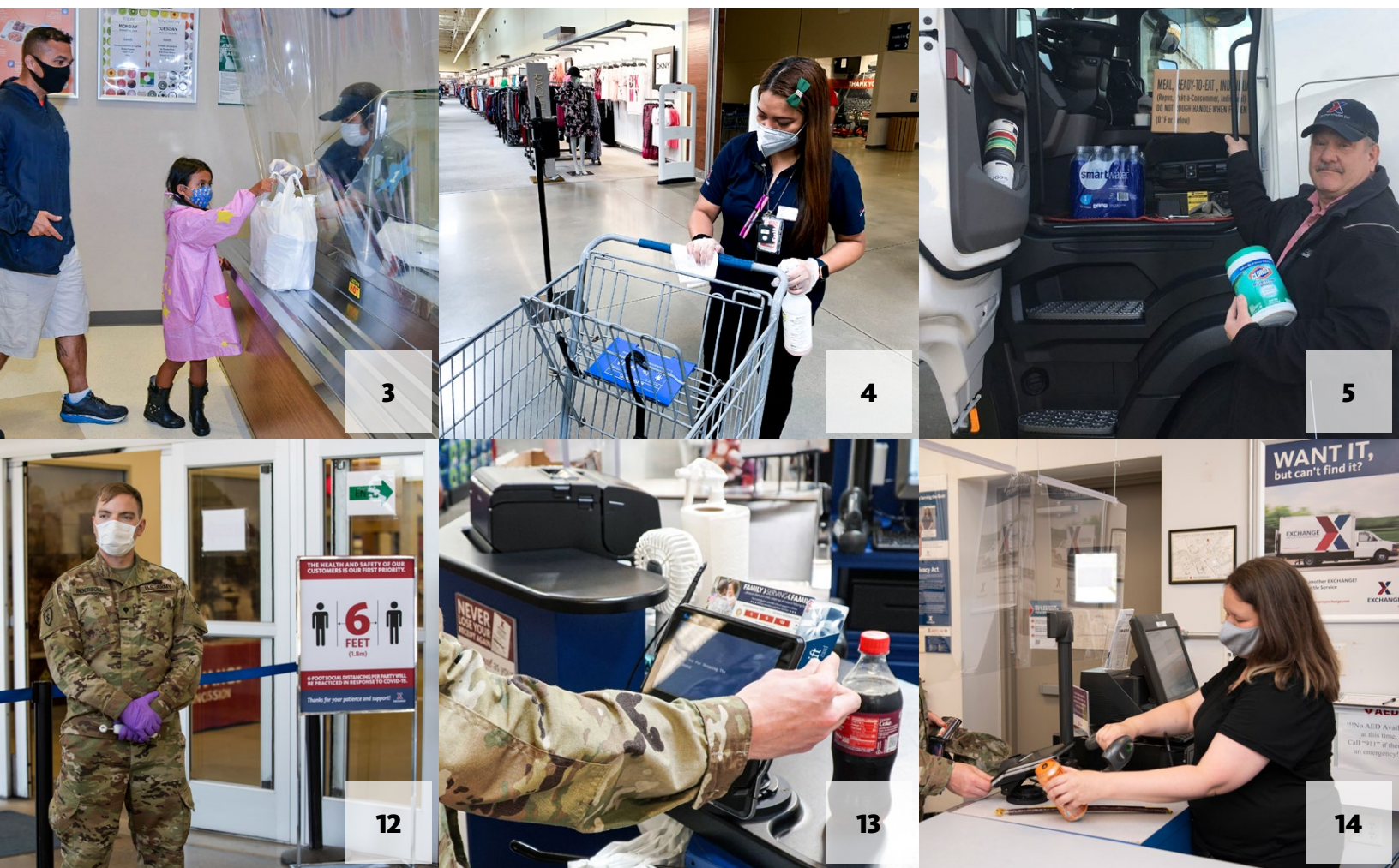
Clockwise from left, an associate delivered a personal shopper program order to a Camp Humphreys quarantine site; hand sanitizer and disinfectant kept shoppers safe; personal shopper program orders were transported to quarantined Soldiers at Fort Bliss; Exchange School Meal Program associates provided hand sanitizer to students in Okinawa; and shoppers at the Royal Air Force Fairford Express masked up to stop the spread of COVID-19 (U.S. Air Force photo by Senior Airman Jennifer Zima)



When military students in Europe and the Pacific began attending classes virtually, the Exchange's School Meal Program pivoted, distributing grab-and-go lunches from designated pickup sites like this one in Okinawa. More than 1 million grab-and-go meals were served to military children abroad in 2020.



COVID TIMELINE: As the Pandemic Evolved, the Exchange Adapted to Maintain a Safe, Sanitized and Secure Environment



- 1. FEB. 11** The World Health Organization gives the novel coronavirus a name: COVID-19.
- 2. FEB. 24** The Exchange activates its Disaster Support Group.
- 3. EARLY MARCH** The Exchange launches a grab-and-go school meal program for military children overseas.
- 4. MARCH** Associates receive training on COVID-19 prevention, sanitation and personal protective equipment.
- 5. MARCH** COVID-19 prevention tips are sent digitally to approximately 160 truck drivers' tablets in CONUS.
- 6. MARCH 4** Exchanges worldwide receive guidance for maintaining a safe, sanitized and secure environment.
- 7. MARCH 11** WHO declares COVID-19 a pandemic.
- 8. MARCH 13** COVID-19 is declared a national emergency. Exchanges pause all food and beverage sampling.
- 9. MARCH 18** The Fort Bliss Exchange launches a personal shopper program for quarantined troops, the first of 45 Exchanges to do so. Associates' healthcare benefits are expanded through Sept. 30.
- 10. MARCH 19** California is the first of 43 states to issue COVID-19 restrictions.



6



9



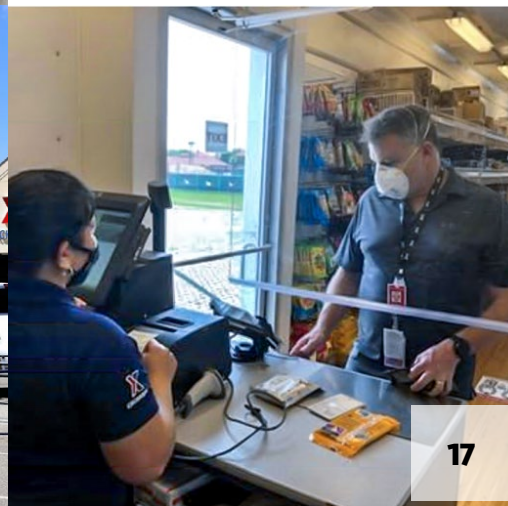
11



15



16



17

- 11. MARCH 20** A COVID-19 page launches on the Exchange's online community Hub. The Exchange opens its first self-serve micro market for quarantined troops at Fort Hood.
- 12. MARCH 24** The DoD authorizes commanders to grant limited Exchange privileges to on-duty federal emergency, medical and mission-critical personnel during the national emergency.
- 13. MARCH 25** PXs, BXs and other Exchange facilities encourage shoppers to pay for purchases using a credit, debit or gift card instead of cash.
- 14. MARCH 27** Exchanges roll out clear acrylic barriers at cash registers, customer service desks and other customer interaction points.
- 15. LATE MARCH** Before the CDC recommends face coverings or the DoD mandates their wear, the Exchange distributes reusable face masks to associates.
- 16. APRIL 2** The Exchange launches curbside pickup at six locations, expanding the service to more than 100 PXs and BXs by the year's end.
- 17. APRIL 6** A mobile field exchange is deployed to Joint Base San Antonio-Fort Sam Houston to support U.S. Army North's relief operations. Associates gain more flexibility in managing their 401(k) accounts in accordance with the Coronavirus Aid, Relief, and Economic Security Act of 2020.

COVID TIMELINE: As the Pandemic Evolved, the Exchange Adapted to Maintain a Safe, Sanitized and Secure Environment



18



19



20



25



26



27

- 18. APRIL 7** An MFE deploys to the Army field hospital at the Javits Center in Manhattan, the first MFE in New York City since Superstorm Sandy in 2012.
- 19. APRIL 9** PXs and BXs receive signing to remind shoppers to stay 6 feet apart.
- 20. APRIL 10** Eligible U.S. associates receive Team Awards up to \$400 for exceeding 2019 earnings goals. The award is paid several months early.
- 21. APRIL 15** An MFE deploys to Fort Benning to support recent basic training graduates.
- 22. MAY** Exchange barbers provided safe, sanitized and secure haircuts—a critical service for Warfighters.
- 23. MAY 22** Kadena Air Base Exchange and Okinawa Distribution Center personnel deliver nearly 600 orders and hundreds of pizzas to more than 525 Sailors quarantined aboard the USS Blue Ridge.
- 24. JULY 13** Associates are authorized to make midyear changes to their Flexible Spending Accounts through July 24.
- 25. JULY 14** An MFE opens to serve quarantined troops at Fort Drum.



21



22



23



28



29



31

- 26. AUGUST** The Exchange ships \$1.6 million in face masks, gloves, floor decals and hand sanitizer dispensers to 190 Department of Defense Education Activity schools.
- 27. SEPT. 1** The Exchange partners with Disney for Operation Fun, a four-month series of family-friendly online activities including three free online movie screenings—a first for the Exchange.
- 28. SEPT. 4** 12 Weeks of Black Friday Savings launches, moving forward the traditional holiday shopping season to help shoppers avoid holiday crowds.
- 29. NOVEMBER** Associates rate job satisfaction at 79 out of 100 in the Exchange’s annual associate survey—7 points above the retail industry average.
- 30. NOV. 15** The number of confirmed COVID-19 cases in the United States passes 11 million, adding 1 million new cases in a single week.
- 31. DECEMBER** Associates receive a onetime Hero Bonus. Extraordinary associates also received individual awards.
- 32. DEC. 14** The United States administers the first COVID-19 vaccine doses.

STAYING ENGAGED:

Connecting With Military Communities

The Exchange, ever resourceful in finding ways to improve the quality of life of Warfighters and their families, leveraged its virtual channels to inform and entertain the military community throughout 2020.

From the pandemic's onset, the Exchange used its Facebook, Twitter and Instagram pages—as well as store-specific social media channels—to bring shoppers the latest on efforts to ensure a safe, sanitized and secure shopping environment. Demand for information drove significant organic growth across Exchange social media channels in 2020, increasing reach by 49% and engagement by 47% compared to 2019.

In March, the Exchange added a dedicated COVID-19 page to its online community Hub, offering shoppers a one-stop resource on how PXs and BXs were supporting military shoppers during the pandemic, as well as answers to frequently asked questions, news releases, near-real-time updates on local Exchange operating hours, links to local Exchange Facebook pages and more.

In April, the Exchange launched “Chief Chat,” a Facebook Live series hosted by the Exchange's senior enlisted advisor. During the chats, the military community could interact in real time with special celebrity guests, including Hollywood stars, platinum-selling musical artists, military leaders such as Chief Master Sgt. of the Air Force JoAnne Bass and Sgt. Maj. of the Army Michael Grinston and more. The effort was a success, with 94 episodes drawing 1.1 million views and driving 54,000 engagements in 2020.

Throughout the year, the Exchange developed new ways of comforting and supporting military communities using its digital channels. In September, the Exchange launched Operation Fun, a four-month virtual campaign that brought the magic of Disney—including free online movie screenings—into military families' homes through the XKids community Hub.

The COVID-19 pandemic profoundly changed how the world communicates. In 2020, the Exchange was able to swiftly adapt and bring Soldiers, Airmen, Guardians and their families a much-needed taste of normalcy—another example of the organization's longstanding agility in fulfilling its mission to serve those who serve.

EXCHANGE™ CHIEF CHAT

SENIOR ENLISTED ADVISOR
INTERACTS DIRECTLY WITH
THE MILITARY COMMUNITY



Chief Master Sgt. Luis Reyes
Past Host



Chief Master Sgt. Kevin Osby
Current Host



"AAFES has been there to support our Soldiers and our families, and I really appreciate it."

-Exchange Board Member and Sgt. Maj. of the Army Michael Grinston

July 9



"Whenever you're overseas somewhere and you want a connection to home, that's AAFES."

-Exchange Board Member and Chief Master Sgt. of the Air Force JoAnne Bass

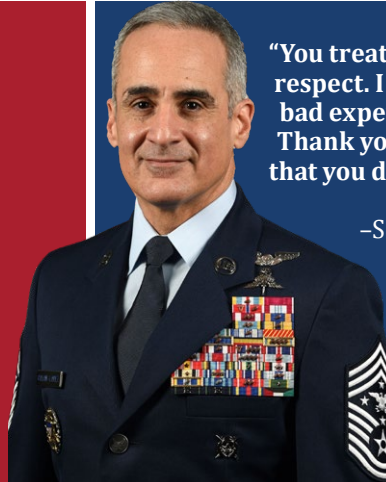
Oct. 22



"What keeps [Guardians, Airmen or Soldiers] around is our way of life and the experience that we deliver to them and their loved ones, and you guys are such an important part of that."

-Chief Master Sgt. of the Space Force Roger A. Towberman

Jan. 13



"You treat the troops with respect. I have never had a bad experience with AAFES. Thank you for everything that you do."

-Senior Enlisted Advisor to the Chairman of the Joint Chiefs of Staff Ramón Colón-López

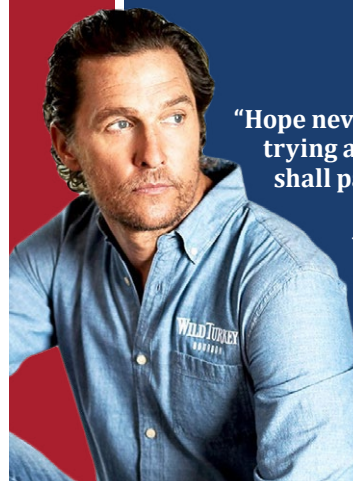
July 14



"Somebody wouldn't think somebody would be putting themselves at risk by going & working at an Exchange store, but in this day and age, that's exactly what's happening."

-Mark Wahlberg, actor and entrepreneur

April 22



"Hope never goes out of style. As trying as things can get, this too shall pass."

-Matthew McConaughey, Academy Award-winning actor, producer and writer

Dec. 2

WELCOMING HOME VETERANS:

Expanding the Exchange Benefit

2020 marked the first year of a lifelong, in-store Exchange shopping benefit for 4.1 million service-connected disabled Veterans, Purple Heart recipients, former prisoners of war and primary family caregivers for Veterans enrolled in the Department of Veterans Affairs Program of Comprehensive Assistance for Family Caregivers.

Welcoming home Veterans with tax-free shopping and military-exclusive pricing is familiar territory for the Exchange: On Veterans Day 2017, the retailer extended a lifelong online shopping benefit to 15 million honorably discharged Veterans. Through the end of 2020, Veterans have placed about 750,000 tax-free online orders at ShopMyExchange.com.

In 2020, letting Veterans know about their Exchange benefit was a core priority. While the COVID-19 pandemic curtailed in-person outreach, the Exchange persevered, connecting with Veterans at virtual conferences held by the Air Force Association, Association of the United States Army and National Defense Transportation Association. During these online events, Veterans learned how to start shopping and make the most of their new benefit.

Additionally, the Exchange celebrated its eighth year as a Commemorative Partner with the United States of America Vietnam War Commemoration, planning events and activities that recognize Vietnam Veterans and their families.

Whether an honorably discharged Veteran shopping online or a Purple Heart recipient visiting their local PX or BX, Veterans make military communities stronger: Every time they exercise their hard-earned Exchange benefit, they strengthen Quality-of-Life programs critical to the readiness and resiliency of those who serve today and ensure the Exchange benefit remains strong for the Warfighters of tomorrow.

Clockwise from left, Offutt Air Force Base BX associates showed their appreciation for our Nation's Veterans during the In Recognition Of event; a Veteran received his challenge coin at the Wiesbaden PX; and a Veteran was thanked for his service at the Osan Air Base BX.



As part of a joint military resale event, exchanges and commissaries saluted our Nation's Veterans with special In Recognition Of tributes, including challenge coin giveaways, like this one at the Fort Buchanan PX.



SERVICE-SPECIFIC SUPPORT:

Making Military Communities Stronger

The Exchange's commitment to delivering Service-specific support drove robust initiatives in 2020 tailored to the respective needs of Soldiers, Airmen, Guardians and their families.

In August, U.S. Army Installation Management Command (IMCOM) and the Exchange debuted the Digital Garrison mobile app, putting real-time, installation-specific information and tax-free shopping in the hands of Soldiers and their families.

IMCOM launched a program to improve the quality of life of Soldiers at Forts Polk, Wainwright, Irwin and Hood. The Exchange supported this effort through a slate of projects at the four posts targeted by the program:

- **Fort Polk:** Completing a \$600,000 Express upgrade; putting in new carpet at the main store; and installing new Army spirit wall murals at the main store and mall entrances
- **Fort Wainwright:** Renovating the food court Subway; introducing a new assortment of insignia and tactical gear at the Last Frontier Express; and expanding the selection at the Military Clothing store
- **Fort Irwin:** Renovating the Reel Time Theater in preparation for the theater's 2021 grand reopening
- **Fort Hood:** Completing an image upgrade and expansion at the Kouma Express to include a new Slim Chickens restaurant and, at the main store, opening a rebranded and expanded PowerZone

2020 also marked the first anniversary of the U.S. Space Force, the Department of Defense's newest independent service branch. The Exchange ramped up its support of Guardians and their families, rolling out Space Force-branded merchandise at Buckley, Peterson and Vandenberg Air Force Bases.

The Exchange also continued its longstanding support of Air Force Patriot Express and military contracted airline flight passengers in 2020, catering nearly 172,700 meals to Warfighters, U.S. civilians and their families flying out of Yokota, Osan and Kadena Air Bases and the greater Indo-Pacific theater.

As the unique needs of Soldiers, Airmen, Guardians and their families continue to evolve, the Exchange remains steadfast in its mission to improve their quality of life wherever they live, work and play.

"Digital Garrison provides information at the ready to improve the quality of life for Soldiers and their families. Staying connected as a community is key to strengthening readiness and resiliency."

*Lt. Gen. Douglas Gabram
Commanding General, U.S. Army Installation
Management Command*

Clockwise from left, the Fort Polk Exchange's renovated Express with a Hunt Brothers Pizza quick-serve restaurant improved quality of life for Soldiers (Photo courtesy of the Fort Polk Public Affairs Office); catering meals were delivered via an Exchange trailer to an Air Force airliner at Yokota Air Base; the Fort Hood Exchange's new Slim Chickens brought more dining options to the community (Fort Hood Sentinel photo by Blair Dupre); and General Manager Cindy Cantu displayed Space Force merchandise at Buckley Air Force Base.



Digital Garrison, a free app launched in 2020 by the U.S. Army and the Exchange, puts information about Quality-of-Life services at each installation at the fingertips of Soldiers and their families. Above, an associate greeted a Soldier at the Joint Base Lewis-McChord Exchange’s Digital Garrison display.



SERVING THOSE WHO SERVE, TOGETHER:

Collaborative Efforts Prove Essential in 2020

The Exchange remained fully engaged with its partners in 2020 to strengthen military communities.

The Exchange, Navy Exchange Command (NEXCOM), Marine Corps Exchange (MCX), Coast Guard Exchange (CGX) and Defense Commissary Agency (DeCA) continued to share purchasing insights and strategies through a joint buying alliance initiated in 2019, saving \$45.2 million in 2020. The partnership also proved critical during the COVID-19 pandemic: When demand skyrocketed for items like cleaning and hygiene products, exchanges and commissaries shared sources and leads to keep shelves stocked even as global supplies were strained.

Other 2020 partnerships included:

- Continuing to expand the **MILITARY STAR®** card, with MCX gas pumps accepting the card starting in April.
- Starting the rollout of **MILITARY STAR®** card acceptance at MCX lodges.
- Renegotiating Exchange fuel contracts to ensure sister Exchanges receive the same terms and conditions on fuel purchases, enabling MCX to save as much as \$6 million annually and CGX to save as much as \$300,000 per year.
- Honoring the selfless service of Veterans with a series of In Recognition Of events hosted by Exchanges and commissaries, including Facebook Live interviews with military heroes, online Veterans Day concerts, the social media-based Test Your Strength Plank Challenge and challenge coin giveaways.
- Allowing Exchange shoppers to donate to Army Emergency Relief and the Air Force Assistance Fund year-round, empowering Warfighters and military families to make a difference in the lives of those in need every time they shop their local Exchange. In 2020, Exchange shoppers donated \$2.4 million to the relief organizations—a 980% increase over 2019.

Clockwise from left, Exchange Europe/Southwest Asia Region Senior Enlisted Advisor Sgt. Maj. Julia Henry handed out challenge coins to Air Force Veterans at the Kaiserslautern Military Community Center Exchange; the Exchange last year began inviting shoppers to help service members in need year-round by making a donation to Army Emergency Relief and the Air Force Assistance Fund at the register.



Air Force Col. Scott Maskery, Exchange Pacific Region commander, presented a challenge coin to a Veteran during a combined Veterans Day and 245th Marine Corps birthday celebration at the Camp Foster Military Clothing store.



IT'S AN HONOR TO SERVE THOSE WHO SERVE



BEYOND THE PANDEMIC:

Advancements in Logistics and Military Uniform Service

In February 2020, the Dan Daniel Distribution Center (DDDC) in Virginia finished rolling out the new JDA warehouse management system, priming the Exchange to fulfill a surge in online shopping.

The system uses cutting-edge technology to allow DCs to pick, pack and ship merchandise to PXs, BXs and e-commerce shoppers with speed and precision, making the Exchange well-prepared to handle unprecedented demand during the pandemic. As the pandemic raged, the DDDC processed 75% more e-commerce units in 2020 vs. 2019.

In July, the Exchange began rolling out the Army Green Service Uniform (AGSU) at Military Clothing stores. The new uniform harks back to the iconic look of World War II-era “pinks and greens.”

While the uniform itself evokes the past, its rollout represented new territory for the Exchange and the Army: In a first, the AGSU’s initial run was procured directly by the Exchange using Army funds. At the request of the Army, the Exchange leveraged its unique procurement capabilities to bring the AGSU to market up to two years sooner than previous uniforms.

Another milestone followed Sept. 1, when the Exchange Credit Program and **MILITARY STAR®** card announced the first enhancements to its Military Clothing Plan—a zero-interest credit line for qualifying Military Clothing purchases—in more than 40 years. In addition to doubling the plan’s credit limit from \$500 to \$1,000, the program extended the plan’s payment duration from eight to 12 months, giving Warfighters more flexibility to pay for required uniforms.

As the year drew to a close, the Exchange completed the first phase of a project eight years in the making: relocating the Korea Distribution Center from Camp Market to a new, 255,806-square-foot facility at Camp Humphreys. The move is expected to save the Exchange an estimated \$2.25 million in transportation and operational costs over five years.

Clockwise from left, an Exchange logistics associate transported merchandise through the Dan Daniel Distribution Center (DDDC); a Fort Sill Military Clothing store associate outfitted a Soldier with the AGSU; and DDDC associates checked in new merchandise using the warehouse management system.



The new Army Green Service Uniform was displayed at the Fort Knox Military Clothing store. In a first for the Exchange and Army, the Exchange procured the uniform directly. (U.S. Army photo by Eric Pilgrim)



DISASTER SUPPORT: Mission-Essential Help When It's Needed Most

The 2020 Atlantic hurricane season was the most active in 15 years, generating a record 30 named storms, 13 of which developed into hurricanes.

Using lessons learned from years of providing natural disaster relief to military communities, the Exchange stood ready to provide mission-essential support at locations prone to severe weather in 2020, prepositioning merchandise months in advance of the storm season to ensure Warfighters and their families could still access the essentials.

- **Hurricane Isaias (August):** Emergency supplies, including 43 pallets of water, 18 generators, nearly 400 gas cans, 120 extension cords and more, were shipped to Exchanges in Florida and the Carolinas.
- **Typhoons Bavi, Maysak and Haishen (August):** While 2020's mild typhoon season prompted installation delays and closures, area Exchanges worked closely with command teams to quickly reopen Exchange stores to support troops and families in the Indo-Pacific theater.
- **Tropical Storm Marco and Hurricane Laura (August):** Emergency inventory was deployed to Exchanges and distribution centers across Florida, Louisiana, Mississippi, Texas and the Carolinas, including 23 pallets of water, more than 1,250 batteries, 270 first aid kits and bandages, 80 weather radios, and other essential supplies.
- **Hurricane Sally (September):** Exchanges in Alabama, Florida and Mississippi were stocked with emergency supplies such as generators, water, batteries and hygiene items, while the Services, Food and Fuel Directorate ensured Express fuel tanks were full at installations in the storm's path.
- **Hurricane Zeta (October):** Gulf Coast Exchanges in Alabama, Georgia and Mississippi were stocked with water, batteries, generators and more well ahead of the storm's landfall.
- **Hurricane Eta (November):** Fuel, Logistics and Merchandising teams ensured emergency inventory and fuel supplies at Fort Buchanan in Puerto Rico and MacDill Air Force Base in Florida.

Thankfully, damage to Exchanges from these storms was mostly limited to water damage, leaks, temporary power outages and minor flooding. Even the most severe damage of the season—resulting from Hurricane Zeta—was relatively minor, with strong winds damaging the Keesler Air Force Base Express canopy and knocking over an Exchange trailer at the same location.

Left, the MacDill Air Force Base Exchange main store saw only minor flooding and leaks after Tropical Storm Eta. Right, the Exchange shipped nearly 150,000 emergency supplies to stores when Hurricane Dorian struck the Caribbean and the Carolinas in August and September.



Hurricane Zeta blew through the Gulf Coast in late October, toppling a trailer at Keesler Air Force Base.



FAMILY SERVING FAMILY: Lasting Careers for Veterans, Spouses and Military Families

For Air Force spouse Kris Cubacub, the Exchange is more than a job: It's an opportunity to serve his community.

Cubacub is one of many military spouses whose career has continued to grow after a permanent change of station thanks to the associate transfer program, one of many benefits the Exchange offers to recruit and retain military spouses.

Veterans and military spouses know Exchange shoppers best because they are Exchange shoppers. The Exchange remains committed to hiring 50,000 Veterans and spouses. In 2020, the organization drew ever closer to this goal, tallying 47,000 such hires by the end of the year.

The Exchange has long been recognized as one of the best places for Veterans and military spouses to work. In 2020, the Exchange was named:

- A Military Times Best for Vets Employer for the seventh year in a row
- One of the Top Government and Law Enforcement Agencies included on U.S. Veterans Magazine's 2020 Best of the Best list for the seventh consecutive year
- A Military Friendly® Spouse Employer by Vqictory Media, publisher of Military Spouse magazine, for the ninth time in a row

Veterans and military families have certainly taken notice of the benefit retention, retirement opportunity and stability offered by an Exchange career. Today, approximately 85% of Exchange associates share a connection with the military, and 45% are Veterans, spouses or dependents. More than 1,700 Wounded Warriors have also joined the Exchange since 2010.

As the Exchange marches onward to 50,000 Veteran and spouse hires, it continues to make a difference in the lives of Veterans and military family members committed to serving those who serve—a quality-of-life force multiplier that makes military communities worldwide better places to live, work and shop.

"The Exchange has provided an opportunity to have a meaningful career with a mission that is second to none. I am an example of the Exchange's unyielding support for our Armed Forces and their families."

Kris Cubacub, Exchange military spouse



From left, Peterson Air Force Base Military Clothing Manager Jackie Arns wore patches proclaiming herself a proud Air Force spouse and Navy mom; Fort Hood Exchange Customer Experience Associate and Army spouse Alisa Summers, pictured here with husband Staff Sgt. Terrell Summers, is one of 45% of Exchange associates who is a Veteran, spouse or dependent; and Warehouse Worker Harley Fox, the Exchange's 45,000th military spouse/Veteran hire since 2013, serves those who serve at the Eglin AFB Exchange.



Kris Cubacub, assistant store manager at the Joint Base San Antonio-Lackland BMT South Troop Store, has worked for the Exchange since 2013. Through the associate transfer program, he has moved twice with his wife, Air Force 1st Lt. Lauren Morales.



THE EXCHANGE BENEFIT IN ACTION



1 The Exchange enhanced the quality of life of Warfighters and their families in military communities worldwide with \$132 million in installation-level capital investments. The Burger King with drive-thru at Joint Base San Antonio-Fort Sam Houston was among 67 such projects, including store renovations, completed in 2020. The Exchange also opened 45 restaurants and 12 wellness services. **2** For the third year, the Exchange was a participating partner of the annual Army-Navy Game. The first played at West Point since 1943, the 121st matchup was an opportunity to share relevancy with millions of TV viewers and highlight the benefit to key stakeholders such as Chairman of the Joint Chiefs of Staff Gen. Mark Milley, United States Military Academy at West Point Superintendent Lt. Gen. Darryl Williams, President Donald Trump, Superintendent of the U.S. Naval Academy Vice Adm. Sean Buck and Acting Secretary of Defense Christopher Miller (REUTERS/Tom Brenner). **3** PXs and BXs worldwide provided a much-needed sense of normalcy during the pandemic. At Fort Knox, Soldiers and families gathered for a drive-in movie at the Exchange parking lot. **4** The Robins Air Force Base Exchange unveiled a 12,000-square-foot Express with an expanded merchandise assortment; a larger selection of better-for-you snacks and beverages; and a new quick-serve restaurant, Hunt Brothers Pizza. **5** The Exchange distributed 543,000 pieces of personal protective equipment, including reusable face masks, to associates before the Centers for Disease Control recommended face coverings and the Department of Defense mandated their wear. **6** When the COVID-19 pandemic meant friends and family could no longer attend Basic Military Training graduations at Fort Jackson, the Exchange launched My Fort Jackson Soldier, a program that allows



loved ones to buy Exchange gift cards for their graduate and receive a picture of their Soldier holding the gift card in return. **7** Exchange Director/CEO Tom Shull received the Department of Defense Distinguished Service Award from the National Defense Transportation Association, recognizing the Exchange's efforts to enhance military readiness, recruiting, retention and resiliency. Shull also received the Spirit of Oklahoma Outstanding Veteran Supporter of the Year award, the state's highest honor for Veteran supporters. **8** An updated 6,135-square-foot troop store at Camp Gruber enhanced the quality of life of National Guard members. **9** Exchange BE FIT ambassador Roy Montez strengthened resiliency and built community by leading weekly live workouts at Facebook.com/ShopMyExchange. **10** Nora Conlin, 11, received a \$1,500 Exchange gift card, the second-place prize in the Exchange's worldwide You Made the Grade sweepstakes at the Fort Bragg Exchange. The 21-year-old program honors the academic success of military kids. (Photo courtesy of 82nd Airborne Division Public Affairs) **11** Shoppers won a combined \$1.1 million in prizes through military-exclusive sweepstakes in 2020. Sip, Rip, Ultimate Trip winners Lt. Col. George Crockett and Installation Personnel Administration Center Clerk Peyton Kochenower are awarded \$10,000 Exchange shopping sprees at the Kadena Air Base Exchange. **12** The Exchange's 100+ self-serve micro markets, including one that opened at Schriever Air Force Base nearly three weeks before the COVID-19 pandemic, offered Warfighters 24/7 access to food, drink and more. The number of Exchange micro markets more than doubled in 2020 as demand for contactless shopping increased.

FINANCIAL STATEMENTS

Army and Air Force Exchange Service
Years Ended January 30, 2021 and February 1, 2020
With Reports of Independent Auditors

Ernst & Young LLP



Army and Air Force Exchange Service

Financial Statements

Years Ended January 30, 2021 and February 1, 2020

Contents

Report of Independent Auditors.....	1
Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	3
Financial Statements	
Balance Sheets	5
Statements of Earnings	6
Statements of Comprehensive Income (Loss)	7
Statements of Changes in Net Assets.....	8
Statements of Cash Flows.....	9
Notes to Financial Statements.....	10



Ernst & Young LLP
One Victory Park
Suite 2000
2323 Victory Avenue
Dallas, TX 75219

Tel: +1 214 969 8000
Fax: +1 214 969 8587
ey.com

Report of Independent Auditors

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

Report on the Financial Statements

We have audited the accompanying financial statements of Army and Air Force Exchange Service, which comprise the balance sheets as of January 30, 2021 and February 1, 2020, and the related statements of earnings, comprehensive income (loss), changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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



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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Army and Air Force Exchange Service at January 30, 2021 and February 1, 2020, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 25, 2021 on our consideration of Army and Air Force Exchange Service's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Army and Air Force Exchange Service's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Army and Air Force Exchange Service's internal control over financial reporting and compliance.

Ernst + Young LLP

May 25, 2021



Ernst & Young LLP
One Victory Park
Suite 2000
2323 Victory Avenue
Dallas, TX 75219

Tel: +1 214 969 8000
Fax: +1 214 969 8587
ey.com

Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

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

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Army and Air Force Exchange Service, which comprise the balance sheet as of January 30, 2021, and the related statements of earnings, comprehensive income (loss), changes in net assets and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated May 25, 2021.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Army and Air Force Exchange Service's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Army and Air Force Exchange Service's internal control. Accordingly, we do not express an opinion on the effectiveness of Army and Air Force Exchange Service's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Army and Air Force Exchange Service's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst & Young LLP

May 25, 2021

Army and Air Force Exchange Service

Balance Sheets

(Dollars in Thousands, Unless Otherwise Noted)

	January 30, 2021	February 1, 2020
Assets		
Current assets:		
Cash and cash equivalents	\$ 241,245	\$ 97,169
Trade and other accounts receivable, less allowance for uncollectible accounts of \$28,357 and \$29,667 at January 30, 2021 and February 1, 2020, respectively	2,507,536	2,820,048
Merchandise inventories	1,134,059	1,386,214
Short-term investments	9,791	9,391
Supplies and other current assets	70,229	76,044
Total current assets	3,962,860	4,388,866
Property and equipment:		
Buildings and improvements	3,347,607	3,722,269
Fixtures and equipment	1,397,837	1,354,640
Construction-in-progress	261,998	266,535
Total property and equipment, gross	5,007,442	5,343,444
Less accumulated depreciation	(3,242,761)	(3,491,155)
Total property and equipment, net	1,764,681	1,852,289
Other assets	16,614	820
Overfunded retirement plans	-	924
Long-term investments and supplemental plan assets	24,030	22,222
Total assets	\$ 5,768,185	\$ 6,265,121
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 391,313	\$ 420,393
Commercial paper and current maturities of long-term debt	194,236	419,887
Accrued salaries and other employee benefits	119,717	112,239
Dividends payable	30,860	29,932
Other current liabilities	166,563	153,119
Total current liabilities	902,689	1,135,570
Long-term debt	231,844	289,080
Accrued pension and other benefits	1,231,857	1,532,309
Other noncurrent liabilities	84,273	79,351
Total liabilities	2,450,663	3,036,310
Net assets:		
Accumulated other comprehensive loss:		
Pension and postretirement benefit liability	(2,158,152)	(2,290,921)
Derivative instruments	195	(25)
Total accumulated other comprehensive loss	(2,157,957)	(2,290,946)
Retained earnings	5,475,479	5,519,757
Total net assets	3,317,522	3,228,811
Total liabilities and net assets	\$ 5,768,185	\$ 6,265,121

See accompanying notes.

Army and Air Force Exchange Service

Statements of Earnings

(Dollars in Thousands, Unless Otherwise Noted)

	Year Ended	
	January 30, 2021	February 1, 2020
Net sales	\$ 5,884,122	\$ 6,575,724
Finance revenue	223,598	281,597
Concession income	184,879	232,394
Other operating income	28,677	32,631
Total revenue	6,321,276	7,122,346
Cost of sales and operating expenses:		
Cost of goods sold	4,375,955	4,920,659
Selling, general, and administrative:		
Employee compensation and benefits	1,103,210	1,148,406
Depreciation and amortization	250,115	254,044
Other	508,115	548,654
Total selling, general, and administrative expenses	1,861,440	1,951,104
Interest expense	3,802	11,708
Bad debt expense	23,819	19,755
Total expenses	6,265,016	6,903,226
Operating income	56,260	219,120
Other income	11,446	10,149
Non-service pension and postretirement income	41,073	69,737
Net earnings	\$ 108,779	\$ 299,006

See accompanying notes.

Army and Air Force Exchange Service

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

	Year Ended	
	January 30, 2021	February 1, 2020
Net earnings	\$ 108,779	\$ 299,006
Other comprehensive income (loss):		
Reclassification of unrealized gain on derivative instruments to earnings	220	203
Pension and postretirement benefits adjustments:		
Unrealized loss arising during the period	(34,020)	(648,846)
Amortization of net loss	166,789	88,019
Other comprehensive income (loss)	132,989	(560,624)
Comprehensive income (loss)	\$ 241,768	\$ (261,618)

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 Loss	Net Assets
Balance at February 2, 2019	\$ 5,438,068	\$ (1,730,322)	\$ 3,707,746
Net earnings	299,006	–	299,006
Pension and postretirement benefits adjustments	–	(560,827)	(560,827)
Reclassification of unrealized loss on derivative instruments to earnings	–	203	203
Dividends to the Central Welfare Funds, Departments of the Army, the Air Force, the Navy, and the Marine Corps	(217,317)	–	(217,317)
Balance at February 1, 2020	5,519,757	(2,290,946)	3,228,811
Net earnings	108,779	–	108,779
Pension and postretirement benefits adjustments	–	132,769	132,769
Reclassification of unrealized loss on derivative instruments to earnings	–	220	220
Dividends to the Central Welfare Funds, Departments of the Army, the Air Force, the Navy, and the Marine Corps	(153,057)	–	(153,057)
Balance at January 30, 2021	\$ 5,475,479	\$ (2,157,957)	\$ 3,317,522

See accompanying notes.

Army and Air Force Exchange Service

Statements of Cash Flows

(Dollars in Thousands, Unless Otherwise Noted)

	Year Ended	
	January 30, 2021	February 1, 2020
Operating activities		
Net earnings	\$ 108,779	\$ 299,006
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	281,281	281,989
Gain on disposals of property and equipment	(3,330)	(73)
Loss on supplemental pension plan assets	2,235	2,803
Bad debt expense	23,819	19,755
Change in operating assets and liabilities:		
Accounts receivable	288,693	46,808
Merchandise inventories	252,155	(77,162)
Supplies and other assets	(9,055)	(1,382)
Pension assets and liabilities	(169,389)	49,961
Long-term investments and supplemental plan assets	(2,235)	(2,803)
Accounts payable	(28,941)	5,783
Change in cash overdraft	25	-
Accrued salaries and other employee benefits	7,533	(4,248)
Other liabilities	20,072	27,848
Net cash provided by operating activities	771,642	648,285
Investing activities		
Purchases of property and equipment	(196,583)	(283,503)
Proceeds from the sale of property and equipment	6,240	5,137
Purchases of investments	(2,208)	(11,912)
Proceeds from the disposition of investments	-	10,200
Net cash used in investing activities	(192,551)	(280,078)
Financing activities		
Payments under line-of-credit agreements	-	(65,000)
Proceeds from (payments under) commercial paper agreement	(226,000)	37,000
Payment of long-term debt	(56,887)	(106,555)
Payment of dividends	(152,128)	(236,245)
Net cash used in financing activities	(435,015)	(370,800)
Net increase (decrease) in cash and cash equivalents	144,076	(2,593)
Cash and cash equivalents at beginning of year	97,169	99,762
Cash and cash equivalents at end of year	\$ 241,245	\$ 97,169

See accompanying notes.

Army and Air Force Exchange Service

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

January 30, 2021

1. Description of Business and Summary of Significant Accounting Policies

General

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

The Exchange utilizes accounting principles generally accepted in the U.S. (U.S. GAAP) applicable to "for profit" organizations because of the nature of its commercial-type operations. The Exchange's financial statements include the operations of all Exchange activities worldwide.

In March 2020, the World Health Organization declared the novel strain of coronavirus (COVID-19) a global pandemic and recommended containment and mitigation measures worldwide. In response to this coronavirus outbreak, the governments of many countries, states, cities, and other geographic regions that the Exchange operates in have taken preventative or protective actions, such as imposing restrictions on travel and business operations and advising or requiring individuals to limit or forego their time outside of their homes. Local military commands, while not required to adhere to state and local directives, have largely followed the same mitigations efforts to slow the spread of the virus.

The Exchange has been declared mission essential by local military commands, resulting in only a minimal number of temporary closures and reduced hours at select stores worldwide. While social distancing and shelter-in-place directives have impacted foot traffic in physical shopping locations, the effect has not been consistent across all lines of business and in all geographical regions in which the Exchange operates. The Exchange has proactively and aggressively taken steps to reduce costs to ensure the continued strength and financial position and limit the impact

Army and Air Force Exchange Service

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

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

COVID-19 pandemic had on the Exchange's ability to generate earnings and free cash flow. These efforts include, but are not limited to, delays of capital expenditures, reduction of nonessential operating expenses, and aggressive inventory management efforts.

Fiscal Year

The Exchange's fiscal year-end is the Saturday nearest January 31. References to fiscal year 2020 and fiscal year 2019 herein are to the fiscal years ended January 30, 2021 and February 1, 2020, respectively.

Net sales by geographic region are summarized below:

	Year Ended	
	January 30, 2021	February 1, 2020
Continental U.S., including Alaska	\$ 3,845,930	\$ 4,498,560
Pacific Rim	913,625	932,052
Europe, primarily Germany	596,150	655,730
Middle East, including Afghanistan and Iraq	191,055	218,401
Other countries	337,362	270,981
Total net sales	<u>\$ 5,884,122</u>	<u>\$ 6,575,724</u>

Appropriated Funds

In accordance with applicable U.S. Army and Air Force regulations, the Exchange is not required to pay rent for the use of properties owned by the U.S. Government or utility costs associated with overseas exchanges. Permanent structures that are constructed by the Exchange and paid for from Exchange funds become the property of the U.S. Government. The structures cannot be used for other than the Exchange's purposes without prior approval by the Exchange Director/Chief Executive Officer and the relevant department of the U.S. Government. As such, the Exchange has included the cost of the structures on its balance sheets 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.

Army and Air Force Exchange Service

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

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

Management has estimated the value of transportation costs paid by the U.S. Government for Exchange materials shipped to and from overseas Exchange facilities (excluding Middle East) to be approximately \$88,002 and \$90,956 for fiscal years 2020 and 2019, respectively. In addition, Middle East transportation costs of \$16,759 and \$40,281 were paid by the U.S. Government for fiscal years 2020 and 2019, respectively.

The Exchange receives reimbursements from the U.S. Government of certain incremental costs incurred by the Exchange in relation to support provided to contingency operations. Appropriated fund (APF) reimbursements are recorded when an incremental cost that qualifies for reimbursement has been incurred and reimbursement by responsible agency is probable. Such APF reimbursement receivables are classified as trade and other accounts receivable on the accompanying balance sheets and are recorded as an offset to the related expenses (as described below) on the statement of earnings. In fiscal years 2020 and 2019, the Exchange recorded APF reimbursements of \$24,720 and \$26,580, respectively. These amounts include expenses related to inventory markdowns and shortages, personnel costs, in-theater transportation, and other expenses.

As a result of Department of Defense Coronavirus Aid, Relief, and Economic Security funding, the Exchange received \$28,602 for personnel and COVID-19 related expenses during fiscal year 2020.

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

Army and Air Force Exchange Service

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

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

In pension accounting, the most significant actuarial assumptions are the discount rate, the long-term rate of return on plan assets, health care trend assumptions, and mortality rates. In determining the long-term rate of return on plan assets, the Exchange considers the nature of the plans' investments, an expectation of the plans' investment strategies, and the expected rate of return. Pension assets include investments in limited partnerships; real estate properties; and private equity, timber, agriculture, and debt, which do not have readily available market values. These investments are valued based on amounts reported to management by the respective general partners, investment managers, or appraisers, using net asset value (NAV) as a practical expedient for fair value or an equivalent measure. See Note 6 for additional information about benefit plans.

Cash and Cash Equivalents

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

Accounts Receivable, Finance Revenue, and Allowance for Credit Losses

As of January 30, 2021 and February 1, 2020, \$2,083,871 and \$2,321,625, respectively, of the Exchange's accounts receivable balance represents amounts due from cardholders under its in-house credit program, the MILITARY STAR[®] Card. The MILITARY STAR[®] Card program extends credit to eligible Exchange customers for the purchase of retail goods and services at Exchange activities worldwide.

Minimum payments are calculated based on 2.777% of the unpaid balance as of the customer's last purchase date. These payments are applied in accordance with the Credit CARD Act of 2009.

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

The Exchange's trade and accounts receivable balance also includes \$133,169 and \$145,550 of receivables from the Marine Exchange (MCX) for Marine MILITARY STAR[®] Card outstanding balances and related processing fees as of January 30, 2021 and February 1, 2020, respectively.

Army and Air Force Exchange Service

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

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

Finance revenue is calculated based upon the customer account balance outstanding during the period after consideration of the applicable grace period, typically 30 days following the billing date. The finance rate charged is a variable interest rate calculated at a variable amount above the U.S. Prime Rate reported in *The Wall Street Journal*. The standard annual percentage rate (APR) for retail purchases was 10.24% and 11.74% as of January 30, 2021 and February 1, 2020, respectively. Beginning at 90 days past due, the delinquency rate of 18.24% applies. Finance revenue is recorded unless an account balance has been outstanding for an extended period of time, generally 150 days. Customer receivables past due 90 days or more and still accruing interest were approximately \$19,282 and \$33,925 as of January 30, 2021 and February 1, 2020, respectively.

Accounts past due for 30 days or more are considered delinquent. Accounts delinquent for 150 days are placed on non-accrual status whereby finance income is no longer accrued and submitted to the Exchange's collection department. The Exchange utilizes various means to collect past-due accounts, as well as non-accrual status accounts, including some methods not available to other commercial credit card financial institutions. 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. The outstanding receivables related to accounts previously charged off (previously submitted to the collection department) were \$184,620 and \$225,327 at January 30, 2021 and February 1, 2020, respectively. These accounts are at least 150 days past due and are generally outstanding for one to five years.

The Exchange's credit card portfolio consists of smaller-balance, homogeneous loans. Due to the homogeneous nature of the credit card portfolios, a provision for credit loss is recorded related to the Exchange's current credit card portfolio based on a percentage of total projected charge-offs that are considered uncollectible.

The Exchange periodically evaluates the adequacy of the allowance using such factors as prior account loss experience, changes in the volume of the account portfolio, changes in the estimates of anticipated recoveries on delinquent or written off balances, and changes in credit policy. These factors were considered in establishing the Exchange's allowance for credit losses, and the net receivable related to accounts previously written off as of January 30, 2021 and February 1, 2020. 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

Army and Air Force Exchange Service

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

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

allowance for credit losses and net receivable related to accounts previously written off. Bad debt expense of \$23,819 recorded in fiscal year 2020 is primarily related to the Exchange's current credit card portfolio. This is compared to \$19,755 in bad debt expense recorded in fiscal year 2019.

With respect to accounts previously written off, the Exchange records and evaluates collectibility of a net receivable using a portfolio approach pooled by year based on estimated probable recoveries. Finance income and cash collections are applied to outstanding balances until 100% of the net receivables from each portfolio year has been collected. Subsequent cash collections in excess of amounts previously charged off are recorded as finance revenue upon collection. Collections on accounts previously written off and submitted to U.S. Government entities totaled approximately \$125,494 and \$149,017 in fiscal years 2020 and 2019, respectively. Finance revenue recognized in fiscal year 2020 related to non-accrual accounts totaled approximately \$12,882 compared to approximately \$14,522 in fiscal year 2019.

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

	January 30, 2021		February 1, 2020	
	Amount	Percentage of Receivables	Amount	Percentage of Receivables
	<i>(In Millions)</i>		<i>(In Millions)</i>	
Current	\$ 1,999	90.3%	\$ 2,099	85.2%
1–29 days past due	120	5.4	199	8.1
30–59 days past due	47	2.1	83	3.3
60–89 days past due	28	1.3	50	2.0
90+ days past due	19	0.9	33	1.4
Period-end gross credit card receivables	\$ 2,213	100.0%	\$ 2,464	100.0%

Army and Air Force Exchange Service

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

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

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

	2020	2019
	<i>(In Millions)</i>	
Allowance at beginning of period	\$ 25	\$ 26
Provision for bad debt	24	20
Net write-offs	(24)	(21)
Allowance at end of period	\$ 25	\$ 25

The following table sets forth the credit scores of the Exchange's credit card portfolio that have not yet been submitted to U.S. Government entities for collection as reported by FICO.

	January 30, 2021	February 1, 2020
	<i>(In Millions)</i>	
Nondelinquent accounts (current and 1–29 days past due):		
FICO score of 700 or above	\$ 704	\$ 787
FICO score of 600 to 699	1,027	1,082
FICO score below 600	388	429
Total nondelinquent accounts	2,119	2,298
Delinquent accounts (30+ days past due)	94	166
Period-end gross credit card receivables	\$ 2,213	\$ 2,464

Merchandise Inventories

The Exchange's inventories are valued at the lower of cost or net realizable value, as determined by the retail inventory method of accounting (RIM). Certain warehousing and distribution expense costs are included in the cost of inventory, which amounted to \$17,080 and \$17,244 at January 30, 2021 and February 1, 2020, respectively.

Army and Air Force Exchange Service

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

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

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

Buildings and Improvements

Buildings and improvements primarily represent permanent structures constructed and paid for by the Exchange and owned by the U.S. Government. These assets are recorded by the Exchange at cost with depreciation provided using the straight-line method over the estimated useful lives of the assets. The useful lives are governed, to a large extent, by the deployment of Army and Air Force personnel and, to some extent, by the requirements of the Departments of the Army and the Air Force with respect to space occupied by the Exchange. Buildings are generally depreciated over 30 years, and improvements are depreciated over periods 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. Although these facilities are segregated from the fixed asset portfolio, the Exchange closely monitors operations to ensure the highest level of efficiencies can be maintained while maximizing profits.

The carrying value of long-lived assets, including property and equipment, is evaluated annually or whenever events or changes in circumstances indicate that a potential impairment has occurred relative to a given asset or asset group. 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. The Exchange has not recorded any long-lived asset impairment charges during fiscal years 2020 or 2019.

Army and Air Force Exchange Service

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

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

Fixtures and Equipment

Fixtures and equipment are carried at cost with depreciation provided using the straight-line method over the estimated useful lives of the assets. Motor vehicles are depreciated over periods from 5 to 10 years, and equipment is depreciated over periods from 2 to 15 years.

Self-Insurance

The Exchange self-insures 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 reserve 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 Exchange's self-insurance reserves were \$79,823 and \$87,522 as of January 30, 2021 and February 1, 2020, respectively.

Reserves were discounted at a weighted average rate:

	January 30, 2021	February 1, 2020
Workers' compensation	2.58%	2.87%
Property liability	0.38	1.90
Public liability	0.41	1.81
General liability	0.40	1.84

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 Exchange and its actuaries make certain assumptions, including the amounts considered recoverable from foreign governments under existing agreement terms. Actual results may vary from these assumptions. Additionally, the liability for vacation leave earned by U.S. citizens is accrued as earned.

Army and Air Force Exchange Service

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

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

Advertising Costs

Advertising costs are expensed when the advertisement first occurs. Advertising expense was \$30,443 and \$46,515 for the years ended January 30, 2021 and February 1, 2020, respectively, and is included in selling, general, and administrative expenses. The Exchange's cooperative advertising allowances are generally accounted for as a reduction in the purchase price of inventory.

Revenue Recognition

The Exchange adopted Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers*, on February 3, 2019, using the modified retrospective approach. The adoption of ASC 606 did not materially impact the financial position or the results of operations for the year ended January 30, 2021.

The Exchange recognizes revenue when control of the merchandise is transferred to customers in an amount that reflects the consideration received in exchange for such merchandise. For sales at the retail locations, control is transferred at the point at which the customer receives and pays for the merchandise at the register. For e-commerce sales, control is transferred when merchandise is tendered to a third-party carrier for delivery to the customer. Cash is typically received on the day of or, in the case of credit or debit card transactions, within several days of the related sales. Finance revenue includes finance charges and administrative fees on credit sales. Concession income includes fees charged to concessionaires based on a percentage of their sales and is recognized at the time of sale.

Income Taxes

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

Army and Air Force Exchange Service

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

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

401(k) Plan

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

Foreign Currency Hedging

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

Benefit Plans

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

Army and Air Force Exchange Service

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

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

The Exchange adopted Accounting Standards Update (ASU) 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, in fiscal year 2019, which changes the presentation of net periodic benefit cost on the statements of earnings. On the statements of earnings, the service cost component of net periodic benefit cost is included in selling, general, and administrative expenses and the other components of net periodic benefit cost are included in non-service pension and postretirement income.

Fair Value Measurements

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

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

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-02, *Leases (Topic 842)*. ASC 2016-02 requires all leases that have a term of over 12 months to be recognized on the balance sheet with the liability for lease payments and the corresponding right-of-use asset initially measured at the present value of amounts expected to be paid over the term. Recognition of the costs of these leases on the income statement will be dependent upon their classification as either an operating or a finance lease. Costs of an operating lease will continue to be recognized as a single operating expense on a straight-line basis over the lease term. Costs for a financing lease will be disaggregated and recognized as both an operating expense (for the amortization of the right-of-use asset) and interest expense (for interest on the lease liability). For nonpublic companies, ASU 2016-02 is effective for reporting periods beginning after December 15, 2020. The Exchange evaluated ASC 842 and does not expect a material impact on the financial statements.

Army and Air Force Exchange Service

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

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

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This guidance will replace the incurred loss impairment methodology under current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The Exchange will be required to use a forward-looking expected credit loss model for accounts receivables, loans, and other financial instruments. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. The ASU is effective for fiscal years beginning after December 15, 2022. Early adoption is permitted for annual periods beginning after December 15, 2018, and interim periods therein. The Exchange does not expect ASU 2016-13 to have a material effect on its financial statements.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. This ASU eliminates, modifies, and adds disclosure requirements for fair value measurements. The amendments in this ASU are effective for fiscal years beginning after December 15, 2019, with early adoption permitted. The adoption of this ASU did not have a material impact on the Exchange's financial statements.

In August 2018, the FASB issued ASU 2018-14, *Compensation – Retirement Benefits – Defined Benefit Plans – General (Subtopic 715-20): Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans*, which amends the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. The amendments in this update removed disclosures that no longer are considered cost beneficial, clarify the specific requirements of disclosures, and add disclosure requirements identified as relevant. The amendment is effective in fiscal years ending after December 15, 2021. Early adoption is permitted. The adoption of this ASU did not have a material impact on the Exchange's financial statements.

Army and Air Force Exchange Service

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

2. Fair Value Measurements

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

- Level 1 – Quoted prices in active markets for identical assets or liabilities. The Exchange uses the unadjusted quoted prices in active markets for identical assets or liabilities to which the Exchange has access. An active market for the asset or liability is one in which transactions for the asset or liability occur with sufficient frequency and volume to provide ongoing pricing information.
- Level 2 – Observable inputs other than quoted prices in Level 1. The Exchange determines the value of the investment holding by evaluating its pro rata share of investments where it does not own the underlying securities but rather a proportional share of the fund, such as mutual fund and common collective trusts. Significant inputs, other than quoted market prices included in Level 1 that are observable, impact either directly or indirectly, the asset or liability. Level 2 inputs include, but are not limited to, quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted market prices that are observable for the asset or liability, such as interest rate curves and yield curves observable at commonly quoted intervals, volatilities, credit risk, and default rates.
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Inputs are unobservable for the assets or liabilities. The Exchange invests only with managers that provide financial statements that are independently audited at least once a year. The financial statements are accompanied by a report from the auditing firm, which discloses the accounting basis as well as an opinion regarding the reliability of the financial statements. In addition to the audited financial statements, the fund managers have provided the type of investments as well as the methods used to value and appraise all investments in the fund's portfolio. The Exchange's benefit plan Level 3 assets and liabilities are measured at fair value on a recurring basis.

Cash and cash equivalents, accounts payable, and accrued liabilities are reflected on the accompanying balance sheets at cost, which approximates fair market value due to the short-term nature of these instruments. Trade and other accounts receivable are reflected on the accompanying balance sheets at cost less an allowance for credit losses, which approximates fair value due either to the short-term nature of the instruments or the variable market rate of interest that is charged on outstanding credit card balances. The fair value of the Exchange's debt is disclosed in Note 3.

Army and Air Force Exchange Service

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

2. Fair Value Measurements (continued)

The Exchange holds investments related to the supplemental plan totaling \$23,814 and \$22,007 at January 30, 2021 and February 1, 2020, respectively, which are included in long-term investments and supplemental plan assets on the accompanying balance sheets. Supplemental plan assets are classified as trading securities since gains and losses from these investments are intended to offset the cost of the supplemental plan. Earnings on trading securities were \$2,235 and \$2,803 in fiscal years 2020 and 2019, respectively. The cost of securities sold is determined primarily on a specific identification method. Refer to Note 6 for further discussion of the supplemental plan, and refer to Note 4 for further discussion of the Exchange's derivative positions.

3. Indebtedness

Lines of Credit

The Exchange maintains three lines of credit aggregating to \$2,250,000. The first is a committed unsecured revolving line of credit that is facilitated by a ten-bank syndicate led by Wells Fargo Bank, N.A. aggregating to \$1,500,000 that was entered into on June 15, 2018, and expires on June 15, 2023. As of January 30, 2021, there is a zero balance outstanding and there were no borrowings under this line of credit during fiscal year 2020.

In addition, the Exchange has a committed line of credit for \$500,000 with Installation Management Command G-9 (IMCOM G-9). This agreement was renewed on December 4, 2019, for a five-year term. Borrowings under the IMCOM G-9 line of credit had interest rates ranging from 0.16% to 1.61% during fiscal year 2020 and 1.70% to 2.50% during fiscal year 2019. Renewal reviews will take place 24 months prior to expiration in order to have the renewal of future agreements in place prior to the one-year expiration time frame.

The third line of credit is an uncommitted Master Note Facility with New York Life for \$250,000 that was entered into on October 15, 2020, and expires on October 15, 2023. As of January 30, 2021, there is a zero balance outstanding and there were no borrowings under this facility during fiscal year 2020.

During fiscal year 2020, daily borrowings were generally due within 30 to 260 days. As of January 30, 2021, there was \$10,000 outstanding under the IMCOM G-9 line of credit, with all such borrowings currently scheduled to become due within fiscal year 2021. Historically, the Exchange has regularly replaced its line of credit facilities with similar borrowings with extended

Army and Air Force Exchange Service

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

3. Indebtedness (continued)

terms. The Exchange believes it has the ability and intent to refinance its outstanding borrowings coming due in fiscal year 2020 under the current agreement or replace such facilities on substantially the same or better terms and conditions. Accordingly, these outstanding borrowings have been classified as noncurrent at January 30, 2021, as they are not expected to require the use of current working capital during fiscal year 2021.

Commercial Paper

In June 2013, the Exchange implemented a commercial paper program. As of January 30, 2021 and February 1, 2020, the outstanding commercial paper obligations, inclusive of original issue discount, were \$187,000 and \$413,000, respectively. The commercial paper program is an open-ended agreement; however, outstanding balances as of January 30, 2021, have maturity dates that range from 1 to 270 days and, as such, were classified as current. Borrowings under the commercial paper program had interest rates ranging from 0.06% to 1.83% during fiscal year 2020, and 1.56% to 4.08% during fiscal year 2019.

Senior Notes

In October 2009, the Exchange completed a private placement debt offering of \$90,000 of 4.95% senior notes due in 2025 (the senior notes), which comprise a 15-year amortizing principal. As of January 31, 2021, the senior notes have a total remaining outstanding obligation of \$29,080.

Term Loans

A three-year syndicated term loan of \$250,000 was entered into as part of the Wells Fargo syndication agreement on June 15, 2018, with original maturity on June 15, 2021. During fiscal year 2020, the syndicated term loan agreement was amended to reduce the loan amount to \$200,000 and extend maturity to be coterminous with the syndication agreement on June 15, 2023. As part of the amendment in fiscal year 2020, the interest rate was increased 12.5 basis points to London Interbank Offered Rate plus 0.875%.

The average interest rates for all indebtedness, including lines of credit (both committed and uncommitted), commercial paper, senior notes and term loans were 0.68% and 2.02% for the years ended January 30, 2021 and February 1, 2020, respectively.

Army and Air Force Exchange Service

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

3. Indebtedness (continued)

Outstanding debt obligations consisted of the following:

	January 30, 2021	February 1, 2020
Outstanding debt principal balances:		
IMCOM G-9 committed line of credit	\$ 10,000	\$ 10,000
Senior notes	29,080	35,967
Term loan – Wells Fargo	200,000	250,000
Commercial paper – Truist	80,000	–
Commercial paper – Wells Fargo	32,000	159,000
Commercial paper – Fifth Third Bank	30,000	100,000
Commercial paper – Citibank	45,000	154,000
Total debt obligations	426,080	708,967
Current maturities	(194,236)	(419,887)
Total long-term debt obligations	\$ 231,844	\$ 289,080

The Exchange believes that the carrying values of amounts outstanding under its line of credit, commercial paper, and term loan agreements approximate fair value given the term of the debt and floating interest rates. As of January 30, 2021, the estimated fair value for the 2024 senior notes is \$31,529. Fair value is calculated using a discounted cash flow analysis (Level 2), with estimated interest rates offered for notes with similar terms and maturities.

Cash paid for interest for fiscal years 2020 and 2019 was approximately \$5,239 and \$15,366, respectively. The Exchange has complied with all financial and nonfinancial covenants per loan agreements as of January 30, 2021, and expects to comply through the period ending January 29, 2022.

Principal maturities of debt obligations as of January 30, 2021, are as follows:

2021	\$ 194,236
2022	7,602
2023	207,987
2024	16,255
	\$ 426,080

Army and Air Force Exchange Service

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

4. Derivative Financial Instruments

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

The Exchange 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 Exchange's forward and option collar foreign exchange contracts are recorded on the Exchange's balance sheets 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.

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 30, 2021, the Exchange had various foreign exchange contracts (option collars) outstanding related to approximately \$68,241 (€55,000) of its forecasted payroll and inventory purchase liabilities. The notional value of outstanding option collar contracts was \$68,241 (€55,000). The gain of \$49 for accrued salaries, separation pay and other benefits and \$146 for accounts payable totaling a net gain of \$195 on the accompanying balance sheet as of January 30, 2021, is included as a component of accumulated other comprehensive income. The balance of \$195 in accumulated other comprehensive gain is expected to be reclassified into earnings within the next 12 months. The effects of outstanding derivatives are revalued periodically. The Exchange has recognized approximately \$854 in gain on foreign currency hedge transactions settled during fiscal year 2020, compared to \$328 in gain during fiscal year 2019.

Army and Air Force Exchange Service

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

4. Derivative Financial Instruments (continued)

Unrealized gains and losses on foreign exchange hedges that are included in accumulated other comprehensive loss are recognized into earnings as the related payroll expenses are paid or the related inventory is sold through. As of January 30, 2021 and February 1, 2020, total derivatives designated as hedging instruments were \$195 and \$25, respectively.

5. Lease and Rental Obligations

The Exchange's operating lease and rental commitments primarily include real estate and information technology leases. The Exchange recorded rent expense of \$2,623 and \$2,578 for the fiscal years ended January 30, 2021 and February 1, 2020, respectively. The following is a schedule, by fiscal year, of the future minimum rental payments required under all leases as of January 30, 2021:

2021	\$	2,359
2022		2,250
2023		1,125
2024		746
2025		216
Thereafter		2,846
	\$	<u>9,542</u>

6. Benefit Plans

The Exchange has a defined benefit pension plan, the Retirement Annuity Plan (the Basic Plan), covering regular full-time civilian employees of the Exchange who are citizens or residents of the U.S. In addition, 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.

Army and Air Force Exchange Service

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

6. Benefit Plans (continued)

In addition to the Exchange's benefit plans discussed above, certain medical and dental (health care) and life insurance benefits are also provided to retired employees through the Postretirement Medical/Dental and Life Insurance (Postretirement) plans for employees of the Exchange. All regular full-time U.S. civilian employees who are paid on the U.S. dollar payroll may become eligible for these benefits if they satisfy eligibility requirements during their working lives. The Exchange's policy is to annually fund actuarially determined postretirement expense unless the respective plan is fully funded or unless an asset-liability model has shown the respective plan will likely become fully funded, even in the absence of future contributions.

The Exchange also provides certain life insurance and other disability benefits for active employees. Benefits are paid from a Voluntary Employee Beneficiary Association (VEBA) trust maintained by the Exchange and to which the Exchange contributes each year. As of January 30, 2021, the Exchange recorded a liability of approximately \$20,046 which represents an estimated liability of \$31,350 less trust assets of \$51,396. As of February 1, 2020, the Exchange recorded a liability of approximately \$13,363, which represents an estimated liability of \$29,208 less trust assets of \$42,571.

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

The Exchange measures the cost of its pension plans and other postretirement benefit plans in accordance with ASC 715, *Compensation – Retirement Benefits*. As the Exchange's fiscal year-end does not coincide with a month-end, the Exchange has elected to measure plan assets and benefit obligations using the month-end that is closest to the Exchange's fiscal year-end. The assets of the Supplemental Plan are not effectively restricted from being used by the Exchange for other purposes. Therefore, these assets do not qualify as plan assets as defined in ASC 715 and, as a result, are accounted for in accordance with ASC 320, *Investments – Debt and Equity Securities*.

Army and Air Force Exchange Service

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

6. Benefit Plans (continued)

The following table provides a reconciliation of the changes in the plans' benefit obligations and fair value of assets for fiscal years 2020 and 2019. Amounts are stated in millions.

	Pension Benefits				Other Benefits			
	The Basic Plan		Supplemental Plan		Postretirement		Foreign Plans	
	2020	2019	2020	2019	2020	2019	2020	2019
Change in projected benefit obligations (PBO)								
PBO at prior measurement date	\$ 5,261	\$ 4,575	\$ 26	\$ 19	\$ 2,533	\$ 2,164	\$ 82	\$ 76
Service cost	116	97	1	1	34	24	2	2
Interest cost	165	196	1	1	76	92	1	1
Plan participants' contributions	4	4	—	—	—	—	—	—
Actuarial loss (gain)	202	705	(3)	6	(130)	358	4	6
Foreign exchange impact	—	—	—	—	—	—	5	(1)
Benefits paid	(237)	(298)	(1)	(1)	(88)	(97)	(2)	(3)
Administrative expenses paid	(16)	(18)	—	—	(7)	(8)	(1)	1
Plan amendments	—	—	—	—	63	—	—	—
PBO at current measurement date	5,495	5,261	24	26	2,481	2,533	91	82
Change in plan assets								
Fair value of assets at prior measurement date	4,455	4,149	—	—	1,863	1,720	60	54
Actual return on assets	404	618	—	—	148	248	4	7
Employer contributions	255	—	—	—	23	—	2	2
Plan participants' contributions	4	4	—	—	—	—	—	—
Benefits paid	(237)	(298)	—	—	(88)	(97)	(3)	(3)
Foreign exchange impact	—	—	—	—	—	—	3	—
Administrative expenses paid/ foreign exchange impact	(16)	(18)	—	—	(7)	(8)	—	—
Fair value of assets at current measurement date	4,865	4,455	—	—	1,939	1,863	66	60
Funded status at fiscal year end	\$ (630)	\$ (806)	\$ (24)	\$ (26)	\$ (542)	\$ (670)	\$ (25)	\$ (22)

Supplemental Plan assets do not qualify as plan assets as discussed above.

Army and Air Force Exchange Service

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

6. Benefit Plans (continued)

The following table reflects amounts recognized in the balance sheets as of fiscal years 2020 and 2019. Amounts are stated in millions.

	Pension Benefits				Other Benefits			
	The Basic Plan		Supplemental Plan		Postretirement		Foreign Plans	
	2020	2019	2020	2019	2020	2019	2020	2019
Amounts recognized in the balance sheets								
Other current liabilities	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3	\$ 2
Net accrued pension and other benefits liability	630	806	24	26	542	670	25	21
Accumulated other comprehensive loss	(1,590)	(1,596)	(3)	(6)	(546)	(671)	(19)	(17)

A summary of the components of net periodic benefit cost (income) for the benefit plans is as follows for fiscal years 2020 and 2019. Amounts are stated in millions.

	Pension Benefits				Other Benefits			
	The Basic Plan		Supplemental Plan		Postretirement		Foreign Plans	
	2020	2019	2020	2019	2020	2019	2020	2019
Net periodic cost								
Service cost	\$ 116	\$ 96	\$ 1	\$ 1	\$ 34	\$ 24	\$ 3	\$ 2
Interest cost	165	196	1	1	76	92	1	1
Expected return on assets	(328)	(320)	-	-	(129)	(125)	(2)	(3)
Other adjustments	-	-	-	-	8	-	-	-
Net loss amortization	133	70	-	-	32	18	2	1
Net periodic benefit cost	\$ 86	\$ 42	\$ 2	\$ 2	\$ 21	\$ 9	\$ 4	\$ 1

Information for benefit plans with an accumulated benefit obligation in excess of plan assets is as follows for fiscal years 2020 and 2019. Amounts are stated in millions.

	Pension Benefits				Other Benefits			
	The Basic Plan		Supplemental Plan		Postretirement		Foreign Plans	
	2020	2019	2020	2019	2020	2019	2020	2019
Projected benefit obligation	\$ 5,495	\$ 5,261	\$ 24	\$ 26	\$ 2,481	\$ 2,533	\$ 91	\$ 81
Accumulated benefit obligation	5,131	4,911	9	9	2,481	2,533	83	74
Fair value of plan assets	4,865	4,455	-	-	1,939	1,863	66	60

Army and Air Force Exchange Service

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

6. Benefit Plans (continued)

Amounts included in accumulated other comprehensive loss for all plans at January 30, 2021, consist of a net actuarial loss of \$2,158,152. Amortization of this amount expected to be recognized in fiscal year 2021 is \$159,154.

Actuarial Assumptions

Actuarial weighted average assumptions used in determining plan obligations and the related expense are as follows for fiscal years 2020 and 2019:

	Pension Benefits				Other Benefits	
	The Basic Plan		Supplemental Plan		Postretirement	
	2020	2019	2020	2019	2020	2019
Assumptions used to determine expense and liabilities:						
Discount rate	3.16%	4.36%	3.16%	4.36%	3.19%	4.37%
Long-term rate of return on assets	7.69	7.69	–	–	7.79	7.79
Compensation increase rate	4.40	4.31	9.60	9.50	–	–
Assumptions used at disclosure:						
Discount rate	3.01	3.16	3.01	3.16	3.07	3.19
Compensation increase rate	4.40	4.31	9.65	9.73	–	–

Assumed Health Care Cost Trend Rates at Fiscal Year-End

	2020	2019
Health care cost trend rate assumed for next year	5.75%	6.00%
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	2026	2026

Army and Air Force Exchange Service

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

6. Benefit Plans (continued)

	Other Benefits		Other Benefits	
	UK Plan		Local National Plan	
	2020	2019	2020	2019
Assumptions used to determine expense:				
Discount rate	1.60%	2.50%	0.72%	0.79%
Long-term rate of return on assets	3.10	6.20	–	–
Compensation increase rate	2.50	2.80	2.38	2.37
Assumptions used at disclosure:				
Discount rate	1.50	1.60	0.48	0.79
Compensation increase rate	2.50	2.50	2.38	2.37

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

Pension Plan Assets

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

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

Army and Air Force Exchange Service

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

6. Benefit Plans (continued)

The following table sets forth the target allocations of plan assets for the fiscal years 2020 and 2019:

	Pension Benefits		Other Benefits			
			Postretirement			
	The Basic Plan		Plan		UK Plan	
	2020	2019	2020	2019	2020	2019
Domestic equity securities	14%	14%	15%	15%	–%	–%
International equity securities	10	10	10	10	20	20
Emerging market equity securities	3	3	4	4	–	–
Low-volatility global equity	9	9	10	10	–	–
Investment-grade fixed income	25	25	25	25	80	80
High-yield fixed income	4	4	–	–	–	–
Treasury inflation protected securities (TIPS)	3	3	3	3		
Real estate – private	4	4	4	4	–	–
Real estate – public	1	1	1	1	–	–
Private equity	9	9	10	10	–	–
Commodities	3	3	3	3	–	–
Alternative debt	5	5	5	5	–	–
Master Limited Partnerships (MLPs)	5	5	5	5	–	–
Timber/farmland	5	5	5	5	–	–
Total	100%	100%	100%	100%	100%	100%

Army and Air Force Exchange Service

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

6. Benefit Plans (continued)

The Exchange's benefit plan actual asset allocations at January 30, 2021 and February 1, 2020, by asset class category are as follows:

	Pension Benefits		Other Benefits			
			Postretirement			
	The Basic Plan		Plan		UK Plan	
	2020	2019	2020	2019	2020	2019
Domestic equity securities	14%	14%	15%	15%	–%	–%
International equity securities	10	10	11	10	20	19
Emerging market equity securities	4	3	4	4	–	–
Low-volatility global equity	9	9	9	10	–	–
Investment-grade fixed income	26	25	25	26	80	81
High-yield fixed income	4	4	–	–	–	–
Treasury inflation protected securities (TIPS)	3	3	3	3	–	–
Real estate – private	4	4	4	4	–	–
Real estate – public	1	1	1	1	–	–
Private equity	8	10	9	10	–	–
Commodities	4	4	3	3	–	–
Alternate debt	5	4	7	5	–	–
Master Limited Partnerships (MLPs)	5	5	5	5	–	–
Timber/farmland	3	4	4	4	–	–
Total	100%	100%	100%	100%	100%	100%

The Exchange uses the fair value hierarchy discussed in Note 2 to measure the fair value of assets held by pension and postretirement benefit plans.

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

Army and Air Force Exchange Service

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

6. Benefit Plans (continued)

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

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

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

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

Army and Air Force Exchange Service

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

6. Benefit Plans (continued)

The following table sets forth by level within the fair value hierarchy, the Exchange's benefit plan assets and liabilities that are measured at fair value as of January 30, 2021:

	Benefit Plans			
	Total	Level 1	Level 2	Level 3
Assets				
Temporary investments ^(a)	\$ 28,478	\$ 28,478	\$ —	\$ —
Equity securities:				
Common and preferred stock ^(b)	858,294	858,294	—	—
Foreign obligations ^(c)	9,938	9,938	—	—
Debt securities:				
Common and preferred stock ^(b)	2,193	2,193	—	—
Corporate bonds ^(d)	558,755	—	558,755	—
U.S. Government obligations ^(e)	240,846	240,846	—	—
Asset-backed securities ^(f)	403	—	403	—
Real estate and commodities:				
Common and preferred stock ^(b)	422,312	422,312	—	—
Other investments ^(m)	8,437	—	8,437	—
Total investments at fair value	<u>2,129,656</u>	<u>\$ 1,562,061</u>	<u>\$ 567,595</u>	<u>\$ —</u>
Investments measured at net asset value:				
Collective investment funds:				
Equity securities ^(g)	1,696,289			
Debt securities ^(h)	1,126,118			
Real estate and commodities ⁽ⁱ⁾	510,567			
Short-term investment funds ^(j)	92,469			
Limited partnerships:				
Equity securities ^(k)	775,907			
Debt securities ^(k)	404,428			
Real estate and commodities ^(k)	130,294			
Total investments measured at net asset value	<u>4,736,072</u>			
Plan assets not measured at fair value or net asset value ^(l)	4,553			
Total assets	<u>\$ 6,870,281</u>			

Army and Air Force Exchange Service

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

6. Benefit Plans (continued)

The following table sets forth by level within the fair value hierarchy, the Exchange's benefit plan assets and liabilities that are measured at fair value as of February 1, 2020:

	Benefit Plans			
	Total	Level 1	Level 2	Level 3
Assets				
Temporary investments ^(a)	\$ 45,690	\$ 45,690	\$ —	\$ —
Equity securities:				
Common and preferred stock ^(b)	820,247	820,247	—	—
Foreign obligations ^(c)	14,691	14,691	—	—
Debt securities:				
Common and preferred stock ^(b)	2,018	2,018	—	—
Corporate bonds ^(d)	620,122	—	620,122	—
U.S. Government obligations ^(e)	209,075	209,075	—	—
Asset-backed securities ^(f)	552	—	552	—
Real estate and commodities:				
Common and preferred stock ^(b)	181,686	181,686	—	—
Other investments ^(m)	5,372	—	5,372	—
Total investments at fair value	1,899,453	<u>\$ 1,273,407</u>	<u>\$ 626,046</u>	<u>\$ —</u>
Investments measured at net asset value:				
Collective investment funds:				
Equity securities ^(g)	1,639,120			
Debt securities ^(h)	1,104,406			
Real estate and commodities ⁽ⁱ⁾	485,930			
Short-term investment funds ^(j)	43,974			
Limited partnerships:				
Equity securities ^(k)	628,792			
Debt securities ^(k)	262,387			
Real estate and commodities ^(k)	289,354			
Total investments measured at net asset value	<u>4,453,963</u>			
Plan assets not measured at fair value or net asset value ^(l)	<u>33,802</u>			
Total assets	<u>\$ 6,387,218</u>			

Army and Air Force Exchange Service
Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

6. Benefit Plans (continued)

- (a) Primarily consist of cash held in foreign currencies.
- (b) 2020: Holdings are diversified as a percentage of total equity as follows: Domestic Markets (59%) and Developed International Markets (41%). Domestic Markets are diversified by Large Cap (26%), Small Cap (4%), Public Real Estate – REITS (12%), low-volatility investments (13%), and MLPs (45%). There are no significant concentrations of holdings by the Exchange.
- 2019: Holdings are diversified as a percentage of total equity as follows: Domestic Markets (53%) and Developed International Markets (47%). Domestic Markets are diversified by Large Cap (34%), Small Cap (11%), Public Real Estate – REITS (20%), low-volatility investments (17%), and MLPs (18%). There are no significant concentrations of holdings by the Exchange.
- (c) 2020: Holdings include International (78%) and Domestic (22%) securities in the form of American Depository Receipts which represent underlying securities, traded on non-U.S. exchanges.
- 2019: Holdings include International (75%) and Domestic (25%) securities in the form of American Depository Receipts which represent underlying securities, traded on non-U.S. exchanges.
- (d) 2020: Includes 89% and 11% of investments in corporate high-yield debt with S&P rating of B- and below as of January 30, 2021. The remaining investments are in investment-grade corporate bonds.
- 2019: Includes 81% and 19% of investments in corporate high-yield debt with S&P rating of B- and below as of February 1, 2020. The remaining investments are in investment-grade corporate bonds.
- (e) Includes fixed-income treasury securities backed by the full faith and credit of the U.S. Government. There are no significant foreign currency risks within this segment.
- (f) Holdings consist primarily of publicly traded fixed-income securities whose payments are based on the performance of an underlying asset.
- (g) 2020: 69% of holdings consist of BlackRock index funds, which are passive in nature and employ a strategy of investing in securities that provide beta (market) exposure to a specific index, including the S&P 500 and MSCI EAFE. The remaining 31% consists of international, small cap, and low-volatility investments in the form of mutual funds. The collective investment funds consist of Domestic (57%) and International (43%). Investments have a required notice of three days for any sales or liquidation. The fund's management may impose restrictions on cash redemptions in the

Army and Air Force Exchange Service

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

6. Benefit Plans (continued)

fund outside the normal course of business. Distributions may be made in cash or in kind or partly in cash or partly in kind at the sole discretion of the fund's trustee. There are no restrictions on withdrawals.

2019: 73% of holdings consist of BlackRock index funds, which are passive in nature and employ a strategy of investing in securities that provide beta (market) exposure to a specific index, including the S&P 500 and MSCI EAFE. The remaining 27% consists of international, small cap, and low-volatility investments in the form of mutual funds. The collective investment funds consist of Domestic (60%) and International (40%). Investments have a required notice of three days for any sales or liquidation. The fund's management may impose restrictions on cash redemptions in the fund outside the normal course of business. Distributions may be made in cash or in kind or partly in cash or partly in kind at the sole discretion of the fund's trustee. There are no restrictions on withdrawals.

- (h) 2020: 94% of the holdings consist of two core fixed income index funds, which both employ a strategy that seeks to match the performance of the Barclays Long Credit Index, and a Loomis Sayles high yield fund (6%), which employs a strategy that seeks to match the performance of the CS High Yield Index. Issuances and redemptions are made on each business day. Distributions may be made in cash or in kind or partly in cash or partly in kind at the sole discretion of the fund's trustee. The BlackRock funds have a required notice of three days for any sales or liquidation.

2019: 95% of the holdings consist of two core fixed income index funds, which both employ a strategy that seeks to match the performance of the Barclays Long Credit Index, and a Loomis Sayles high-yield fund (5%), which employs a strategy that seeks to match the performance of the CS High Yield Index. Issuances and redemptions are made on each business day. Distributions may be made in cash or in kind or partly in cash or partly in kind at the sole discretion of the fund's trustee. The BlackRock funds have a required notice of three days for any sales or liquidation.

- (i) 2020: Investments include both commodities and real estate, which provide diversified returns relative to stocks and bonds. The underlying commodity investments are actively traded futures, which have full pricing transparency and daily liquidity and are reported at net asset value. Real estate holdings include direct real estate investments in properties that are valued by appraisal and reported as Level 3. The investments are diversified by core 27% and value-added or opportunistic 10% investments. Commodity investments include farmland and timber, which represent 63% of the allocation. There is quarterly redemption available for the real estate investments with a 60-day notice.

Army and Air Force Exchange Service

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

6. Benefit Plans (continued)

2019: Investments include both commodities and real estate, which provide diversified returns relative to stocks and bonds. The underlying commodity investments are actively traded futures, which have full pricing transparency and daily liquidity and are reported at net asset value. Real estate holdings include direct real estate investments in properties that are valued by appraisal and reported as Level 3. The investments are diversified by core 31% and value-added or opportunistic 10% investments. Commodity investments include farmland and timber, which represent 59% of the allocation. There is quarterly redemption available for the real estate investments with a 60-day notice.

- (j) The State Street Bank and Trust Company Short-Term Investment Fund employs a strategy to provide safety of principal, daily liquidity, and a competitive yield by investing in high-quality money market instruments. Issuances and redemptions are made on each business day. The fund's management may impose restrictions on cash redemptions in the fund outside the normal course of business. Distributions may be made in cash or in kind or partly in cash or partly in kind at the discretion of the fund's trustee.
- (k) Includes limited partnerships that invest primarily in U.S. buy-out opportunities, as well as opportunistic debt of a range of privately held companies. The fund does not have to redeem its limited partnership investment at its net asset value. Instead, the fund receives distributions as the underlying assets of the fund are liquidated.
- (l) Holdings consist of net amounts due to or from brokers for the sale of securities as of the balance sheet date.
- (m) Includes two immediate participation guarantee contracts at contract value.

At January 30, 2021, the Exchange had commitments to fund limited partnerships held by the Exchange's benefit plans of \$630,851.

Employer Contributions

The Exchange made cash contributions totaling \$280,304 to the Basic, Post Retirement, and Foreign plans in fiscal year 2020.

Army and Air Force Exchange Service

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

6. Benefit Plans (continued)

Estimated Future Benefit Payments

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

Fiscal Years	Basic Plan	Supplemental Plan	Postretirement	Foreign Plans
2022	\$ 260,300	\$ 469	\$ 109,790	\$ 5,313
2023	264,871	475	113,013	4,589
2024	269,094	482	116,150	4,689
2025	272,776	488	118,564	4,657
2026	275,661	493	120,307	4,366
2027–2031	1,411,220	2,986	612,083	23,643

7. Dividends

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

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

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

Army and Air Force Exchange Service

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

8. Commitments and Contingencies

The Exchange 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 Exchange.

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

The Exchange's presence in Iraq, Qatar, Afghanistan, and Kuwait was supported by 40 stores as of January 30, 2021, and 50 stores as of February 1, 2020. Approximately \$190,482 (3%) and \$217,137 (3%) of the Exchange's net revenues in the fiscal years 2020 and 2019, respectively, were derived from sales to U.S. troops stationed in the Middle East, including OFS and OIR. The Exchange's inventory balance in this region, at cost, was \$22,051 and \$32,243 at January 30, 2021 and February 1, 2020, respectively. In the event the U.S. must quickly exit a country, any related loss on inventory would adversely affect the Exchange's results; however, such losses are eligible for reimbursement appropriations that are reasonably assured of collection.

10. Subsequent Events

The Exchange has evaluated subsequent events through May 25, 2021, the date the accompanying financial statements were available to be issued.

On April 12, 2021, the Exchange received, from the Office Secretary of Defense, approval authorization for civilian Common Access Card (CAC) holders to shop at any of the brick and mortar Exchange facilities, in addition to the Exchange's online shopping. This will increase the customer shopping demographics here in the Continental United States by an estimated half a million civilians.

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.

© 2021 Ernst & Young LLP.
All Rights Reserved.

ey.com

2020 BY THE NUMBERS

\$7.5B

REVENUE

\$218M

EARNINGS

\$153M

DIVIDENDS



85%

ASSOCIATES
CONNECTED TO THE
MILITARY

47,512

VETERANS/
SPOUSES HIRED
SINCE 2013

4,886

ASSOCIATES DEPLOYED
TO COMBAT ZONES
SINCE 9/11

1,719

WOUNDED
WARRIORS HIRED
SINCE 2010

691,000

COMBAT UNIFORMS
OUTFITTED AT COST

7 PLANTS

PROVIDING BAKED
GOODS & WATER
OVERSEAS

5.9M

BAKERY ITEMS
PRODUCED
OVERSEAS

4.3M

GALLONS OF
WATER BOTTLED

1,700

RESTAURANTS WITH
BE FIT OPTIONS

74M

MEALS SERVED
AT EXCHANGE
RESTAURANTS

1.8M

SCHOOL LUNCHES
SERVED AT OR
BELOW COST

5.1M

HAIRCUTS PROVIDED

335M

GALLONS OF FUEL
DISPENSED

11

DISTRIBUTION
CENTERS

45M

CASES
SHIPPED

13.8M

FLEET MILES
DRIVEN



ARMY & AIR FORCE
EXCHANGE SERVICE