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Mr. Chairman and Members of the Subcommittee. I am very proud to have the opportunity once again to testify before you and to tell the AAFES story. This is a very special occasion for me since today is my last official day as the Commander of AAFES. Tomorrow I begin my transition to my April 30<sup>th</sup> retirement. Thirty-one years ago to the day, I entered the Women's Army Corps Officer Basic Course at Fort McClellan, Alabama. I was thrilled to discover there were exchange privileges as part of my benefits for military service with quality merchandise and discount prices on my installation, just because I wore a uniform. I am even more convinced today just how critical the exchange benefit remains to the quality of life and well-being of the military family. Thus, the opportunity to lead AAFES in my final assignment has had special significance to me, working with an exceptional leadership team and dedicated associates to strengthen the exchange benefit to ensure its relevance to our Army and Air Force in the future.

Today I am proud to discuss with you our most recent successes and some of the challenges AAFES will continue to face. But first, I want to thank this subcommittee for the support you have provided military resale and your important focus on quality of life for our troops.

The AAFES story began 109 years ago in tents on the frontier to bring items of comfort and necessity to soldiers. The organization has matured as our Armed Forces have grown, modernized and deployed around the globe. Our goal, however, remains the same; to provide value, service and support to the military community wherever they are sent. Our two-fold mission guides everything we do: to provide quality merchandise and services at competitive prices and to generate earnings to support the Services' morale, welfare and recreation programs.

To this end AAFES employs some 48,000 associates in over 30 countries, 5 U.S. territories and 49 states. We operate over 3,100 facilities worldwide. Everyone recognizes our flagship; the PX or BX. We have 160 of those anchoring our operations on military installations with their department store format. But we also provide military communities with convenience stores and specialty stores for such things as video rental, books, furniture, alcoholic beverages, military uniforms and accessories. In our business portfolio also includes car care centers, gas stations, and a variety of vending operations. In

addition, AAFES operates some 1125 fast food restaurants: 52% are name brand fast food, and 48% are AAFES proprietary brands like Anthony's Pizza, Robin Hood specialty sandwiches and salads, and Extreme Frank's Franks, "the dogs with attitude." Working with local community businesses and small entrepreneurs we contract for a host of personal services and commodity sales to expand the support we provide to the military community. We operate movie theaters on installations worldwide and have partnered with the movie industry to host free movie screenings of some of the hottest films for military communities around the world.

Overseas we also operate bakeries, an ice cream plant and water bottling activities to provide our customers the same fresh, high quality branded products they would enjoy in the U.S.; "Wonder Bread," "Baskin Robbins Ice Cream," and "Culligan Water," just to name a few. These products are for sale in our stores and are also available for sale to commissaries, troop dining facilities, military hospitals, and MWR clubs. As the designated Food School Feeding Authority, AAFES provides 26,000 nutritious meals per day to 136 DoD schools in 10 countries on a break even basis.

Not to be overlooked is our direct marketing program. If customers can not be near an AAFES facility, AAFES will take the store to them, either with our catalog mail order business or the Exchange Online. We operate both for all the Service exchanges. Regardless of where customers are, they can shop via catalog or internet 24/7, 365 days a year. In addition to the large AAFES stock assortment, there are thousands of items offered by our virtual vendor partners like Dell and Hewlett Packard computers and Edwin Watts golf equipment. To further enhance the shopping experience, there is even more assortment offered through the AAFES online concession site, Centric Mall. The offerings continue to grow on this robust online program. Now in its 8<sup>th</sup> year, [www.aafes.com](http://www.aafes.com) allows AAFES to better meet the needs of our extremely mobile customer base.

We even make shopping AAFES easy with a proprietary credit card that we developed and manage for all the exchanges – the Military Star Card. The good news for customers is that we offer one of the most competitive interest rates in the country, very lenient credit terms and an even better policy for deployed troops with a reduced interest rate and optional payment plan. As part of our commitment to

those serving in harm's way, AAFES has absorbed almost \$700K in Star Card debt for those killed since 9/11.

From all of these businesses, AAFES earnings continue to grow. The AAFES fiscal year (the commercial business year) ended in January. The un-audited results for the '04 financial year ended with total revenue of \$8.3B, up 5.8% from last year. This includes \$7.99B in direct sales, financial revenue of \$153M and concession income of \$169M. Once cost of goods and other expenses are subtracted, AAFES '04 earnings are \$339.5M, this includes \$42.4 million in APF as a partial reimbursement of our authorized APF expenses in OEF/OIF. We will pay total dividends of \$242M to the military services, 5.5 higher than last year, and our per capita dividend payment for each soldier and airman is up \$44.59 in constant dollars over 10 years ago. Considering the OPTEMPO of our troops and the sacrifices our Nation has asked of them and their families, the dividend contribution to quality of life programs is more important than ever. We will continue to develop initiatives to grow the business so we in turn can generate the funding necessary to fuel a robust MWR program.

Improving the shopping experience is critical to business growth: to build loyalty, attract new customers, and increase sales, AAFES focuses on several aspects of our business: customer service, the assortment, and our value.

We measure customer satisfaction in a variety of ways. AAFES participates in the American Customer Satisfaction Index (ACSI) survey, an independent survey conducted annually by the University of Michigan. We were heartened this month to learn that our ACSI score had gained one point, from 71-72. Although this lags the industry average of 74, the AAFES score showed an improvement while the industry score actually declined by two points from the previous year. In a difficult service year, AAFES' increased focus on important elements of service obviously was recognized by our customers. AAFES is on the right track; our ACSI scores show an impressive 4.3% gain from the baseline in 1996.

AAFES also conducts its own customer satisfaction surveys, the CSI, at all our Exchanges annually. These trends mirror those of the ACSI. In 2004 AAFES scored its highest customer satisfaction rating ever, a 73. Less structured customer reporting mechanisms, like the mystery shopper

program and customer comment reports via handwritten cards, internet, and telephone also provide insight into our problems and the customer's perception of the benefit. I read these comments each day and routinely am amazed with the level of scrutiny and expectation. While we work hard to resolve the issues that are raised, it is encouraging to know that our customers feel such a vested interest in AAFES. Their comments tell me they do believe that AAFES is "their store."

Creating a new Marketing Directorate at AAFES has also enhanced our customer's perception of AAFES service. The organization has developed numerous programs, such as the "Patriot Tree" which invited customers and associates to write patriotic messages to hang on a special tree in our shopping centers during the holiday season. Programs like this provide a unique connection between the exchange and the military community. They tell customers that we are more than a benefit; we are a part of their lives. In addition, Marketing publishes a weekly "playbook" to advise our store managers of timely merchandising opportunities, "retailtainment" ideas, and promotions to build excitement and loyalty among our customers.

The condition of our facilities, modern technology, and our ability to replenish merchandise impact the service perception. AAFES fiscal year 04 capital expenditures totaled more than \$298.2M and included improvements in current facilities, information technology, and the AAFES fleet. AAFES invested \$168M in FY 04 to construct, expand, modernize, and sustain our facilities around the world; and \$97M to open more than 250 new retail, food and service activities, including four shopping centers. Construction also began on seven additional shopping centers. In addition, we spent \$71M to renovate more than 340 facilities. These investments marked a 30% increase over the FY 03 program. We currently have over \$315M in capital projects underway at installations like Ft Campbell, Schofield Barracks, and Ramstein Air Force Base.

A philosophy of "build it and they will come" does not totally satisfy what our customers want from the shopping experience. They also want to make sure that our merchandise assortment meets their needs as well as their pocket books. The AAFES customer base is very diverse. Single troops, with disposable income; young married military families on very tight budgets, some living from paycheck to

paycheck; retirees on limited fixed incomes and those more affluent with second careers and professional spouses; and senior officers and NCOs who earn just enough to want exceptional quality while still needing deep discounts. Unlike commercial retailers, we cannot target just one specific customer base. While we can't be everything to everyone, we try to be something for everybody. We work to identify location-specific demographics and target our primary audience while providing sufficient assortment to satisfy others. We have adopted a merchandise strategy of providing an assortment of entry price point merchandise, private label brands made exclusively for the AAFES customers, a variety of discounted national brands, and even some prestige merchandise, depending on installation demographics. Our priority is still the young service member and his/her family but we recognize that many AAFES patrons are lifelong customers, and we want to have merchandise that satisfies all lifestyles.

In the competitive retail environment driven by national discount store chains and big box specialty stores, price is a major driver of satisfaction with the AAFES shopping experience. Our customers expect that AAFES will provide them quality merchandise, but at the lowest price. We work hard to do that and sincerely appreciate all the brokers, vendors and manufacturers who have negotiated with us as we have worked to drive down the cost of goods and to obtain special trade discounts and allowances so we can pass savings on to our customers. We have spent the year telling our value story to our customers: our monthly local price surveys and reduction of prices based on the competition; our weekly sales, price cuts and clearances; and our promise to match a lower price if customers find one in the local community. And of course every service member appreciates the added benefit of military service: that every day is a tax free day at AAFES. Our troops pay a *huge price* in their commitment to the nation and their sacrifices for our national interests. So we believe they deserve a *huge price break* at their exchange.

We provide value to our customers in a variety of ways, but the most important is the fulfillment of our pledge to them, "We Go Where You Go." Today more than 425 AAFES associates are hard at work making this a reality: from the Balkans to the rugged terrain of Central Asia and the desert sands of Southwest Asia. We also rely on hundreds of local nationals and third country nationals, cleared by the

military, willing to work alongside our associates. Today AAFES operates some 62 exchanges in contingency operations; 31 of these are in Iraq, and 6 are in Afghanistan. As many of you have traveled into the contingency theaters, I hope you have had time to visit our stores. If so, you have seen the range of facilities from large to far too small, from old Iraqi facilities, to trailers, to prefabricated buildings, to new military construction. We have worked with camp commanders to improve shopping conditions for our customers, as well as living conditions for our associates. Despite the condition of the store, America's heroes find a home there. We continue to partner with the Marine Corps, working beside them and training the Exchange Marines on AAFES processes and providing logistical support so they can extend the exchange benefit to the areas of high Marine concentration.

We have overcome tremendous logistics challenges in Iraq. In FY 04 we lost over \$3.1M in merchandise to ambush or hijacking and another \$34.2M in goods that were spoiled or damaged in transit to camps where they were needed, and are grateful for your support in authorizing \$40M to help cover these kinds of contingency costs. We hope the Congress will support the President's pending request for supplemental funding for AAFES. To help mitigate insurgent challenges to movements throughout the AOR, we have redesigned our transportation network to take advantage of existing military convoy capabilities and security protection. We have expanded the number of airfields where we can safely land merchandise thus reducing exposure to risky ground movements on the most heavily trafficked routes. We have also limited the dollar amount of merchandise in each shipment to minimize potential loss. We have added technology into the theater so we have better visibility over the inventory and today maintain a consistent flow of merchandise into the theater. Each week we fly in music, video and periodicals, so the troops there get releases close to the same time they would at home.

We sell everything from a bottle of Gatorade to televisions and at prices comparable to those in our stores back in the states. Current sales are robust, an average of more than \$1.1M a day in Iraq, \$390K in Kuwait and \$173K in Afghanistan. But for AAFES, it isn't about the sales, it's about the smiles. For the troops it's not because they necessarily need anything. One Army Specialist at Camp Liberty in Baghdad told the Associated Press that he simply likes to walk through the PX when he has

free time, even if he doesn't intend to buy anything. "It reminds me of being back home at the mall," he told a reporter recently. "It doesn't feel like I'm in Iraq when I'm in the PX."

After a moratorium on fast food in contingency operations, name brand fast food has become our fastest growing business area. We now have 25 name brand fast food restaurants (Burger King, Pizza Hut, Subway, Green Bean Coffee) in Iraq with another 21 approved for development. We expect to have our first Taco Bell, in Kuwait at the end of the month and in Iraq by the end of May. We also opened name brand fast food in Afghanistan with eight outlets now operating in Bagram, Kandahar, and Kabul. The first of these, a Burger King, opened last July in the trailer that Burger King had used at the 9/11 recovery site at the Pentagon. Burger King sold us the trailer for \$1, and the USAF flew it to Bagram on a C-17 with only inches to spare. It is a most fitting tribute to the soldiers fighting the Global War on Terrorism. Fast food accounts for almost \$8M a month in contingency sales, despite free meals provided by dining facilities. It is the familiar taste of home name brand fast food provides that once again comforts our troops in hostile regions of the world.

We also provide a variety of commodity concessions and personal services in contingency operations; barber and beauty shops, rug vendors, gold merchants, among them. Partnering with AT&T we have extended the troops' connection to home through telephone call centers throughout the contingency theaters. Today troops can call from Tikrit to Tacoma, Mosul to Montgomery, Bagram to Baltimore for as low as 19 cents a minute, using an AAFES prepaid calling card. With DoD approval, AAFES offers these prepaid calling cards for sale to any American wanting to donate to "Help Our Troops Call Home" at [www.aafes.com](http://www.aafes.com). Some 73,000 cards have been purchased to date. There is a similar link on the website for the purchase of gift certificates for deployed troops that can be redeemed in any exchange in the world. Americans have donated over \$805,000 for these "Gifts from the Homefront."

On my last visit to Iraq, Marilyn Iverson, our Chief Operating Officer and I, held a Town Hall meeting with troops at Balad Airbase to hear concerns and recommendations about their PX. After a litany of unusual, seemingly unreasonable requests, especially given the hostile environment in which we



were operating, I thought to myself “Don’t these troops realize we’re at war?” And then I caught myself with the realization that it was for that very reason - the fact that they were at war - that AAFES needed to do everything we could to satisfy their expectations. Sales, smiles, satisfaction, pride and unprecedented support are all benefits of the AAFES contingency mission.

I believe that AAFES has made history with the unprecedented support we have provided the troops downrange. I was very proud that the Army recognized the extent of that support when they awarded AAFES the Meritorious Unit Commendation in 2004. We’ve also been honored by media coverage of this support with features in the Wall Street Journal and American Executive as well as other trade publications. We are similarly proud of the recognition by Consumer Reports, ranking AAFES as #3 of the Top 20 Places to Shop for Electronics. This seems to validate the Oser Communication Group award to AAFES as the Consumer Electronics Retailer of the Year for the 4<sup>th</sup> consecutive year. AAFES also received the Textile Retailer of the Year award, the International Franchiser of the Year award from Popeye’s Corporation and Developer of the Year from both Godfather’s Pizza and Cinnabon. In addition, AAFES celebrated our 20<sup>th</sup> anniversary in partnering with the Burger King Corporation, beginning our involvement with name brand fast food.

However, we cannot rest on our laurels when facing the many challenges ahead. As Service budget priorities are realigned and defense funding is stretched, the two percent of AAFES’ budget that is paid with appropriated funds will undoubtedly be carefully scrutinized. The largest component of this APF is the appropriation for Second Destination Transportation (SDT). AAFES is committed to fulfill the Congressional intent to maintain the quality of life of military families by offering an affordable American lifestyle to those serving overseas. We diligently manage our share of the Army’s SDT budget, continually seeking ways to reduce costs while improving customer service. AAFES has eliminated millions of dollars in annual SDT costs by implementing several key initiatives: loading containers to maximize cube capacity and minimize the number of shipments; loading our own containers at a rate cheaper than third party contracted sources; and leveraging our commercial air partners to receive the best possible service at the lowest rates available. AAFES is internally auditing our process to determine if

there is more we can do in this regard. We expect as troop strength overseas is reduced, that the SDT requirements will also be reduced. Notwithstanding, AAFES understands that there will still be significant numbers of deployed troops around the world and we look forward, to providing the same quality service, U.S. products, and prices enjoyed today.

We continue to work closely with the Unified Exchange Task Force and our sister exchange services on the exchange consolidation initiative directed by the Deputy Secretary of Defense two years ago. From the beginning, AAFES has supported the concept of integration, but we have been disappointed by the lengthy timelines and frustrated by the enormous cost, both in terms of manpower and talent as well as actual expenses. AAFES has spent over \$1.2M of nonappropriated funds and more than 20,000 man-hours to support the initiative and these numbers continue to grow; the longer the timeline, the greater the cost. Consolidation has the potential to result in a stronger, more efficient exchange system, but only if we get the timeline, the structure, and the implementation right.

AAFES is preparing for significant challenges as well in response to the next Base Realignment and Closure actions. The price of abandoning existing operations while expanding others to accommodate the changes has always been costly to AAFES. Our difficult decisions are all compounded by the Army's transformation initiatives. We have engaged at every level to anticipate moves and population changes to ensure we are positioned to provide enhanced support at gaining installations, both temporarily where necessary and permanently where appropriate and economically justified. At the same time, we are attempting to minimize the risk of untimely capital investment.

This issue is magnified when we look at force restationing overseas. The cost to AAFES and the MWR dividend is likely to be substantial in terms of loss of facilities, local workforce displacement, relocation of our U.S. workforce and lost sales. Nevertheless, we are confident that AAFES is up to the challenge.

We remain focused on growing our business and reducing our costs. We have made a major investment in our merchandise forecasting and replenishment systems. We have purchased and are in the process of implementing 12 modules from Retek, a suite of tools which will support adaptation of retail

industry best practices into AAFES business functions for merchandising, allocation, forecasting, replenishment, inventory management and price management.

Linking our strategic plan to measurable goals and objectives and measuring our progress using the Balanced Scorecard is enhancing organizational and individual performance. In the last two years we have seen a 20.4% increase in productivity, and look to boost sales even more with a small store strategy to better serve small communities with a more robust stock assortment. We also continue to work with the Army and Air Force military housing privatization initiatives to provide retail facilities and a variety of services within these new residential communities for the convenience and benefit of our customers and to drive business growth.

We will continue our marketing initiatives to drive traffic and sales, and are updating our stock assortment to appeal to our young, technologically savvy customers. We believe relief from the remaining assortment restrictions imposed by the Armed Services Exchange Regulation will be beneficial as well. I'd like to thank this subcommittee for your endorsement of these changes. I am disappointed I won't be able to work these with you, but my successor, Major General Bill Essex, who will assume command of AAFES in late June, will be fortunate to have your support on so many important issues that impact the benefit to soldiers and airmen.

I thank you for your support to me as the Commander of AAFES. AAFES faces the future with confidence, optimism and enthusiasm for our mission and the "Best Customers in the World." While continuing to focus on earnings and dividends, AAFES will never shy away from providing support to military members in ways other retailers can't provide and in places other retailer will not go.

As I leave the Army, I cherish our accomplishments, my experiences, the extraordinarily talented and committed AAFES workforce and the lives that we touched around the world. My belief in the importance of the exchange benefit is unwavering. The value, service and support are critical to quality of life and well-being, and thus to readiness itself. Customers depend on us because more than anything AAFES is the constant that anchors their military experience with a familiar and welcome environment no matter where their duties take them.