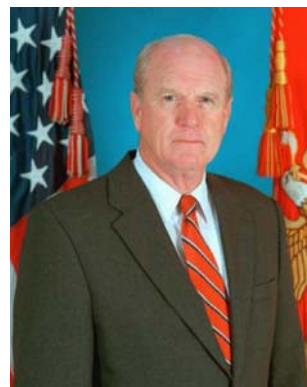


Marine Corps Community Services Fiscal Year 2005 Annual Report



Letter to Shareholders

As the U.S. Marine Corps continues its engagement in the Global War on Terrorism, Marine Corps Community Services (MCCS) support to Marines and their families has never been more important. Currently, 50 percent of the Marine Corps active duty force and 52 percent of Ready Reserve Marines have been deployed to Operation Enduring Freedom/Operation Iraqi Freedom (OEF/OIF). This long-term engagement has given us the opportunity to gain a considerable amount of experience in providing the right support to Marines and their families. Everyday, MCCS provides the caring support, programs, and services that make Marine Corps installations great places to live, work, and recreate. These programs help mitigate military lifestyle challenges and assure deployed Marines that their families are supported while they are away.



FY05 Financial Results

Despite the continuing impact extensive deployments are naturally having on our non-appropriated fund revenue generating businesses MCCS realized the landmark achievement of passing \$1 billion in direct and concessionaire sales in Fiscal Year 2005, while achieving a four percent increase in sales, and all of our installation MCCS operations met their budgeted financial objectives. Exchange sales were \$757 million, an increase of four percent over the prior year. Merchandise sales were up just under two percent, but while fuel sales were up over 15 percent, we reduced the profit margin to help minimize the increasing gas cost to our patrons. It is important to note that approximately \$100 million in sales was realized by AAFES for Marine-operated forward exchanges in Iraq. These sales do not directly translate to MCX sales results. After retained earnings, a dividend of \$39 million or \$220 per Marine was retained by MCCS to fund programs and facilities. In Fiscal Year 2005, MWR activities sales were \$123 million, an increase of eight percent from FY04. The net profit was \$8 million compared to (\$0.2) million for FY04. Our 55 clubs generated nearly \$50 million in sales and achieved a 12 percent profit to sales margin. Restaurant, quick service, and mobile foodservice operations saw sales of \$28 million with profits of \$6 million. At the close of year, MCCS had 68 national brand food operations with indirect sales of \$58 million compared to \$56 million the previous year. A second Burger King was added at Camp Lejeune, the former Burger King at MCAGCC Twentynine Palms is now a Carl's Jr., and Camp Pendleton has converted their Jack in the Box to a Wendy's.

Our 14 Temporary Lodging Facilities had an average facility occupancy rate of 82 percent and earned a net profit of \$8 million on sales of \$17 million. With the addition of 52 rooms at MCAS Miramar, our Marine Corps TLF program now has 928 quality rooms at 12 installations. These rooms achieved a 98 percent compliance rate to DoD Lodging Standards. Our guests using the TLF's saved approximately \$13.6 million in travel expenses as compared to per diem rates of commercial hotels.

More than 400,000 rounds of golf were played at the Marine Corps' 11 Golf courses in Fiscal Year 2005 for total sales of \$9 million, compared to \$8.4 million the previous year. More than 1.6 million games were bowled at the 21 Marine Corps bowling centers in Fiscal Year 2005 generating \$3 million in revenues.

Facilities Update

The MCCA construction program is well structured and we continue to build and renovate needed resale and MWR facilities. In FY05 there were 14 projects completed at a cost of \$25.1M. Some of the highlights were a TLF addition at MCAS Miramar, CA, for \$6.5M; an Exchange renovation on Camp Allen, VA, for \$3.6M; a youth center at MCAS Yuma for \$3.3M; a golf course club house at MCB Quantico VA, for \$2.5M; and a convenience store at Kaneohe Bay, HI, for \$2.9M. Planned for construction in FY06 are a TLF addition for \$5.3M and an auto skills development center for \$2.9M at Kaneohe Bay, HI; an expansion of the Warriors Club at MCAGCC Twentynine Palms, CA, for \$0.5M; replacement of the youth activities center at MCAS Miramar, CA, for \$5.1M; and a new TLF at MCB Camp Pendleton, CA, for \$11.9M

Over the next five years, the focus of the NAF construction program will be placed on renovation/replacement of our Exchanges. By improving the shopping experience, we hope to attract more customers and thus increase sales. For FY06 through FY09, the MCCA Board of Directors has approved 18 Exchange renovation, expansion, or replacement projects at a cost of \$81.6M.

Conclusion

It is my firm belief that MCCA is the right organization for the Marine Corps. MCCA is a transformational organization not seen in any other Service. It not only enables material efficiencies through a sharing of overhead costs, but also enables a strengthened infrastructure of resources and human talent. The credit for our success is largely due to the Installation Commanders and their MCCA professionals around the world. Thanks to their proactive engagement, Marines and their families are being provided 21st Century programs and services. I am proud to say that these dedicated professionals strive to ensure that the programs they deliver are commensurate with the dedication of the Marines and families they serve.



Michael P. Downs
Director, Personal and Family Readiness Division
Manpower and Reserve Affairs Department,
Headquarters, Marine Corps

Report of Independent Certified Public Accountants

Commandant of the Marine Corps
Quantico, Virginia

We have audited the accompanying consolidated balance sheet of Marine Corps Community Services (MCCS), as of January 31, 2006 and 2005, and the related consolidated statements of net worth, income, and cash flows for the years then ended. These financial statements are the responsibility of MCCS's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, as established by the Auditing Standards Board of the American Institute of Certified Public Accountants, 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 includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of MCCS's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used, and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note C, these financial statements were prepared in conformity with the accounting practices prescribed or permitted by the Department of Defense, which practices constitute a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph above present fairly, in all material respects, the financial position of MCCS as of January 31, 2006 and 2005, and the results of its operations for the year then ended, on the basis of accounting described in Note C.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 28, 2006, on our consideration of MCCS's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



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U.S. Marine Corps MCCS Balance Sheet

(Expressed in Thousands)

ASSETS	FY04	FY05	% of Change
<u>CURRENT ASSETS</u>			
Cash/Short-Term Investments	24,663	65,220	164.44%
Accounts Receivable	156,439	163,334	4.41%
Inventories	109,329	110,091	0.70%
Prepaid Expenses	4,259	4,608	8.19%
TOTAL CURRENT ASSETS	294,690	343,253	16.48%
<u>NONCURRENT ASSETS</u>			
Fixed Assets	666,272	703,434	5.58%
Less: Accumulated Depreciation	324,668	352,576	8.60%
Net Book Value	341,604	350,858	2.71%
Long-Term Receivables	0	0	0.00%
Long-Term Investments	102,699	75,695	-26.29%
TOTAL NONCURRENT ASSETS	444,303	426,553	-4.00%
TOTAL ASSETS	738,993	769,806	4.17%
<u>CURRENT LIABILITIES</u>			
Accounts Payable	46,596	54,671	17.33%
Other Current Liabilities	189,082	201,598	8.60%
Total Current Liabilities	235,678	256,269	8.74%
<u>NONCURRENT LIABILITIES</u>			
	12,004	11,910	-0.78%
TOTAL LIABILITIES	247,682	268,179	8.28%
NET WORTH	491,311	501,627	2.10%
TOTAL LIABILITIES and NET WORTH	738,993	769,806	4.17%
Working Capital	59,012	86,984	47.40%
Current Ratio	1.25:1	1.34:1	
Quick Ratio	0.79:1	0.91:1	

U.S. Marine Corps
MCCS Statement of Earnings
(Expressed in Thousands)

	FY04	FY05	% Change
Net Sales	841,912	879,597	4.48%
Cost of Goods Sold	592,137	619,812	4.67%
Gross Margin	249,775	259,785	4.01%
<u>Other Operating Income</u>			
Participation Fees and Charges	29,647	31,067	4.79%
Dues & Assessments	1,314	1,302	-0.91%
Concessionaire Payments	28,927	27,967	-3.32%
Other Operating Income ¹	31,907	29,038	-8.99%
Total Other Operating Income	91,795	89,374	-2.64%
Gross Operating Income	341,570	349,159	2.22%
<u>Operating Expenses</u>			
Personnel & Payroll Expenses ¹	157,063	159,293	1.42%
Other Operating Expenses ¹	191,388	192,751	0.71%
Total Operating Expenses	348,451	352,044	1.03%
Operating Margin	-6,881	-2,885	58.07%
<u>Non Operating Income</u>			
External Dividends	10,410	16,041	54.09%
Other Non Operating Income	670	188	-71.94%
Total Non Operating Income	11,080	16,229	46.47%
Other Expense	1,173	1,338	14.07%
Net Income before Extraordinary Items			
Extraordinary Items			
Extra Income	0	0	
Extra Expense	0	0	
Total Extraordinary Items	0	0	
Net Income	3,026	12,006	296.76%
Internal MWR Dividend	26,141	24,941	-4.59%
MCX Retained Earnings	3,249	3,516	8.21%

¹Per external audit report, these amounts have been reclassified to conform to the Fiscal Year 2005 presentation.



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