

## **TRAVEL RELATED SERVICES**

American Express Travel Related Services Company, Inc. (including its subsidiaries, unless the context indicates otherwise, "TRS") provides a variety of products and services, including, among others, global card network, issuing and processing services, the American Express<sup>®</sup> Card, the Optima<sup>®</sup> Card, a number of co-brand Cards, other consumer and corporate lending and banking products, a network of automated teller machines ("ATMs"), the American Express<sup>®</sup> Travelers Cheque, stored value products, business expense management products and services, corporate and consumer travel products and services, tax, accounting and business consulting services, magazine publishing, merchant transaction processing, and point of sale and back office products and services. TRS offers products and services in more than 200 countries. In certain countries, partly owned affiliates and unaffiliated entities offer some of these products and services under licenses from TRS.

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**Results of Operations** <sup>(1)</sup>

Travel Related Services reported net income of \$1.46 billion in 2001, a 24 percent decrease from \$1.93 billion in 2000. Excluding restructuring charges of \$414 million (\$267 million after-tax) and one-time costs and waived fees directly related to the September 11<sup>th</sup> terrorist attacks of \$87 million (\$57 million after-tax), earnings were \$1.78 billion, down 8 percent from last year.

In 2001, TRS' net revenues rose 4 percent as increased cards in force, growth in Cardmember loans outstanding, and higher fee revenue were partially offset by relatively flat worldwide billed business and lower travel commissions and fees. The 2001 performance reflects overall weakness in the economy, especially within the travel and entertainment sectors. In 2000, TRS' net revenues benefited from growth in worldwide billed business and Cardmember loans outstanding. Billed business rose less than 1 percent in 2001, after a 17 percent increase in 2000. The slower growth in worldwide billings during 2001 was due primarily to significantly lower corporate card spending in the travel and entertainment sector, particularly after the attacks on September 11<sup>th</sup>. U.S. billed business increased 1 percent reflecting 6 percent growth within the consumer card business on 12 percent higher transaction volume, a 2 percent increase within small business services and an 11 percent decline within Corporate Services. Excluding the impact of foreign exchange translation, total billed business outside the U.S. rose approximately 3 percent on growth in Europe and Asia, offset by declines in Canada and Latin America. U.S. non-travel and entertainment related volume categories (which represented approximately 60 percent of U.S. billed business during 2001) grew 9 percent versus last year. U.S. travel and entertainment volume declined 9 percent. Worldwide airline related volume declined 15 percent on high single digit declines in both the average airline charge and transaction volumes. In 2000, growth in billed business was due to higher average spending per basic Cardmember and growth in cards-in-force. U.S. cards-in-force rose 4 percent and 11 percent in 2001 and 2000, respectively. The smaller increase during 2001 reflected more selective consumer card and small business acquisition activities as the year progressed, in light of weakening economic conditions. International cards-in-force increased 12 percent and 14 percent in 2001 and 2000, respectively, due to growth in proprietary card products, as well as network card growth.

Discount revenue fell 1 percent in 2001 as slight billed business growth was offset by a lower discount rate. The decline in the discount rate from last year reflects the cumulative impact of stronger than average growth in the lower rate retail and other "everyday spend" merchant categories (eg., supermarkets, discounters, etc.), as well as significantly weaker T&E spending during the year. Conversely, discount revenue rose 15 percent in 2000 due to higher worldwide billed business.

(1) Results of Operations discussion addresses the managed basis statement of income.

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Net card fees increased slightly in 2001 and 2000, reflecting growth in cards-in-force. Lending net finance charge revenue rose 32 percent and 23 percent in 2001 and 2000, respectively, from higher worldwide lending balances and, in 2001, wider net interest margins. The wider margins were due to a decrease in the proportion of the portfolio on introductory rates and the benefit of lower funding costs, partially offset by the evolving mix of products toward more lower-rate offerings. In 2000, the higher volume was partly offset by a narrowing of net interest margins in the U.S. portfolio, as a greater portion of the portfolio was on lower introductory rates, and relatively more products were offered with fixed and lower rates.

Travel commissions and fees declined 16 percent in 2001 as a result of a 24 percent contraction in travel sales due to the effects of the September 11<sup>th</sup> terrorist attacks and the weaker corporate travel environment throughout the year. Travel commissions and fees increased slightly in 2000, reflecting the impact of the sale of an international leisure travel business. The increases in other revenues in 2001 and 2000 include the effect of higher card related fee income and larger insurance premiums.

Marketing and promotion expense declined 15 percent in 2001 as certain marketing efforts were rationalized in light of the weaker business environment. Marketing and promotion expense increased in 2000 reflecting higher media, card acquisition, and merchant-related advertising costs.

The worldwide Charge Card provision increased in both years due to higher volumes and, in 2001, generally weaker economic and business conditions. The worldwide lending provision rose in both 2001 and 2000, reflecting portfolio growth and the natural maturation process for loans added over the past several years. In 2001, the increase was also due to generally weaker industry conditions, as unemployment and bankruptcies increased. Charge Card interest expense rose in 2001 and 2000 as a result of higher borrowing rates which, in 2001, were partly offset by lower billed business volumes.

In 2001, human resources expenses decreased as a result of a lower average number of employees, reflecting ongoing reengineering efforts throughout the year, lower levels of incentive compensation, and reduced contract programmer expenses. Conversely, in 2000 human resources expense rose due to a higher average number of employees and merit increases. In 2001, other operating expenses rose due to Cardmember loyalty programs, business growth and lower gains than the prior year, partially offset by reengineering activities and other cost containment efforts. Similarly, in 2000, other operating expenses rose due to increased Cardmember loyalty programs and business growth as well as greater investment spending, partially offset by gains related to the sale of an international leisure travel business and an investment in an internet company.

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**Effect of Securitizations**

TRS securitizes loans, receivables, and, to a limited extent leases, in the normal course of its business. The above statements of income and related discussion present TRS results on a managed basis, as if there had been no loan or receivable securitization transactions.

One of TRS' primary sources of funding is securitization of Cardmember loans and receivables. TRS continues U.S. Cardmember loans and, in large part, transfers interests in those assets' cash flows to third party investors. TRS continues to service the accounts and receives a fee for doing so; the fair value and carrying amount of these future servicing fees, net of related costs, are not material. Each new sale of securitized loans results in the removal of the sold assets from the balance sheet, a reduction in a previously established reserve for credit losses and the recognition of the present value of the future net cash flows (i.e., finance charge income less interest paid to investors, credit losses and servicing fees) related to the sold assets. This present value amount represents a retained interest known as an interest-only strip. For the securitized assets whose interests are not sold, TRS retains the rights to all their related cash flows. Those assets, therefore, are not taken off the balance sheet and are known as seller's interests. In some instances, TRS, through affiliates, invests in subordinated interests issued by the securitization trust; these are recorded as Investments classified as Available-for-Sale.

The gain or loss recorded when loans are securitized is the difference between the proceeds of sale and the book basis of the assets sold. That book basis is determined by allocating the carrying amount of the assets, net of applicable reserves for credit losses, between the assets sold and the retained interests based on their relative fair values. Fair values are based on market prices at date of transfer for assets sold on the estimated present value of the future cash flows for retained interests.

On a GAAP reporting basis, TRS results included securitization gains of \$155 million (\$101 million after-tax) in 2001, \$142 million (\$92 million after-tax) in 2000, and \$154 million (\$100 million after-tax) in 1999. These gains were offset by expenses related to card acquisition initiatives and, therefore, had no material impact on net income or total expenses in any year.

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**Liquidity and Capital Resources**

The American Express Credit Account Master Trust (the Trust) securitized \$4.3 billion and \$4.0 billion of loans in 2001 and 2000, respectively, through the public issuance of investor certificates. During 2001, \$1.0 billion of investor certificates that were previously issued by the Trust matured, resulting in \$3.3 billion of net additional securitizations during the year. There were no certificate maturities in 2000. The securitized assets consist of loans arising in a portfolio of designated consumer American Express credit card, Optima Line of Credit and Sign & Travel/Extended Payment Option revolving credit accounts or features owned by American Express Centurion Bank (Centurion Bank), a wholly-owned subsidiary of TRS, and, in the future, may include other charge or credit accounts or features or products. At December 31, 2001 and 2000, TRS had a total of \$14.3 billion and \$11.0 billion, respectively, of Trust-related securitized loans, which are not on the Consolidated Balance Sheets. In early 2002, TRS securitized an additional \$920 million of loans.

Under the terms of the Trust pooling and servicing agreement, the occurrence of certain events, or triggers, could result in the Trust being required to pay down the investor certificates before their expected payment dates over an early amortization period. Examples of these events include: the failure or decline of the securitized assets to generate specified yields over a defined period of time, and the decline of the asset principal balances below a specified percentage of total investor certificates outstanding after failure to add additional securitized assets as required by the agreement. TRS does not expect an early amortization event to occur. In the event of a pay-down, \$13.1 billion of assets (\$14.3 billion securitized less \$1.2 billion retained subordinated interests) would come back on-balance sheet and an alternate source of funding of a commensurate amount would have to be obtained. Had a total pay-down hypothetically occurred at a single point in time at December 31, 2001, the one-time negative effect on results of operations would have been approximately \$600 million pretax, reflecting approximately \$445 million of additional reserve for credit losses related to the \$14.3 billion of Cardmember loans that would come back on the balance sheet, plus \$155 million of final amortization of the interest-only strip.

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The American Express Master Trust (the Master Trust) securitizes Charge Card receivables generated under designated American Express Card, Gold Card and Platinum Card consumer accounts through the issuance of trust certificates. In both 2001 and 2000, \$600 million accounts receivable trust certificates that were previously issued by the Master Trust matured from the Charge Card securitization portfolio. In 2001, the Master Trust securitized \$750 million of Charge Card receivables which remain on the Consolidated Balance Sheets. In early 2002, the Master Trust securitized \$750 million additional Charge Card receivables, which also remain on the balance sheet. As a result of TRS' adoption of SFAS No. 140 during 2001, TRS had securitized receivables of \$3.0 billion on the Consolidated Balance Sheets at December 31, 2001; whereas at December 31, 2000, TRS' \$2.85 billion of comparable securitized receivables were not reflected on the Consolidated Balance Sheets. The Master Trust specifies events, the occurrence of which would result in a pay-down. TRS does not expect a pay-down to occur. While virtually no financial statement impact would result from a pay-down, as the assets are already on-balance sheet, an alternate source of funding for \$3.0 billion of receivables would have to be obtained.

Further, with respect to both the American Express Credit Account Master Trust and the American Express Master Trust, a decline in the actual or implied short-term credit rating of TRS below A-1/P-1 will trigger a requirement that TRS, as servicer, transfer collections on the securitized assets to investors on a daily, rather than a monthly, basis or make alternative arrangements with the rating agencies so as to allow TRS to continue to transfer collections on a monthly basis. Examples of such alternative arrangements include obtaining appropriate guaranties for the performance of the payment and deposit obligations of TRS, as servicer.

TRS also securitizes equipment lease receivables. At December 31, 2001, the amount sold and outstanding to third party investors was \$800 million. These sales result in a reduction of interest expense and provisions for losses, as well as servicing revenue, all of which are insignificant to TRS' results of operations.

In 2000, American Express Credit Corporation (Credco), a wholly-owned subsidiary of TRS, called \$150 million 1.125% Cash Exchangeable Notes due 2003. The notes were exchangeable for an amount in cash which was linked to the price of the common shares of American Express. Credco had entered into agreements to fully hedge its obligations. Accordingly, the related hedging agreements were called at the same time.

TRS, primarily through Credco, maintained commercial paper outstanding of approximately \$18.0 billion at an average interest rate of 1.9% and approximately \$20.4 billion at an average interest rate of 6.4% at December 31, 2001 and 2000, respectively. Unused lines of credit of approximately \$10.4 billion, which expire in increments from 2002 through 2006, were available at December 31, 2001 to support a portion of TRS' commercial paper borrowings.

Borrowings under bank lines of credit totaled \$1.3 billion and \$1.4 billion at December 31, 2001 and 2000, respectively.

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In early 2002, Credco issued an aggregate of \$1.4 billion of medium-term notes at fixed and floating rates with maturities of one to three years.

**Financing Activities**

TRS, Centurion Bank, Credco, American Express Overseas Credit Corporation Limited, a wholly-owned subsidiary of Credco, and American Express Bank Ltd., a wholly owned indirect subsidiary of American Express (the Company), have established programs for the issuance, outside the United States, of debt instruments to be listed on the Luxembourg Stock Exchange. The maximum aggregate principal amount of debt instruments outstanding at any one time under the program will not exceed \$6.0 billion. At December 31, 2001, this program had the ability to issue \$4.7 billion of debt.

**Risk Management**

TRS' hedging policies are established, maintained and monitored by the Company's treasury department. TRS generally manages its exposures along product lines. A variety of interest rate and foreign exchange hedging strategies are employed to manage interest rate and foreign currency risks.

TRS funds its Charge Card receivables and Cardmember loans using various funding sources, such as long- and short-term debt, medium-term notes, commercial paper and asset securitizations. Cardmember receivables are predominantly funded by Credco and its subsidiaries; funding for Cardmember loans is primarily through Centurion Bank. For its Charge Card and fixed rate lending products, interest rate exposure is managed through the issuance of long- and short-term debt and the use of interest rate swaps and, to a lesser extent, caps. During 2001, TRS continued its strategy by augmenting its portfolio of interest rate swaps that convert a majority of its domestic funding from floating rate to fixed rate. TRS regularly reviews its strategy and may modify it. For the majority of its Cardmember loans, which are linked to a floating rate base and generally reprice each month, TRS uses floating rate funding.

The detrimental effect on TRS pretax earnings of a hypothetical 100 basis point increase in interest rates would be approximately \$48 million (\$31 million related to the U.S. dollar) and \$80 million (\$61 million related to the U.S. dollar), based on 2001 and 2000 year-end positions, respectively. This effect is primarily a function of the extent of variable rate funding of Charge Card and fixed rate lending products, to the degree that interest rate exposure is not managed by derivative financial instruments. With respect to the managed portion of that interest rate exposure, a substantial amount the \$296 million of net after-tax unrealized losses recorded in other comprehensive income on the consolidated balance sheet at December 31, 2001 represents the fair value of the related derivative financial instruments. These losses will be recognized in earnings during the terms of those derivatives contracts at the same time that TRS realizes the benefits of lower market rates of interest on its funding of Charge Card and fixed rate lending products. Notwithstanding the unrealized losses, TRS expects a year-over-year benefit from lower interest rates in 2002 that is in excess of \$400 million.

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TRS' foreign exchange risk arising from cross-currency charges and balance sheet exposures is managed primarily by entering into agreements to buy and sell currencies on a spot or forward basis. Additionally, in the latter parts of 2001 and 2000, foreign currency forward sales (with notional amounts of \$323 million and \$386 million, respectively) and, in the latter part of 2000, foreign currency forward purchases (with notional amounts of \$92 million) were contracted to manage a portion of anticipated cash flows from operations in major overseas markets for the subsequent year. In early 2002, TRS entered into additional forward contracts covering a substantial portion of the remaining cash flows from operations.

Based on the year-end 2001 and 2000 foreign exchange positions, but excluding the forward contracts managing the anticipated overseas operating results for the subsequent year, the effect on TRS' earnings of the hypothetical 10 percent strengthening of the U.S. dollar would be immaterial. With respect to the forward contracts related to anticipated overseas operating results for the subsequent year, the 10 percent strengthening would create hypothetical pretax gains of \$29 million and \$27 million related to the 2001 and 2000 year-end positions, respectively. Such gains, if any, would mitigate the negative effect of a stronger U.S. dollar on overseas earnings for the subsequent year.

TRS' Argentine card business is a small part of its global card operations. In December 2001 and January 2002, the Argentine government mandated the conversion of dollar denominated assets into pesos and simultaneously devalued the peso. This development has created a foreign exchange translation exposure that previously did not exist with respect to TRS' Argentine operations. The devaluation has been given effect in the financial statements as of December 31, 2001 by recording a loss of \$49 million in "foreign currency translation adjustments" in the shareholders' equity section of the consolidated balance sheet. TRS is taking steps to manage this risk to the extent practicable and efficient. The effect of the devaluation on the 2001 results of operations was immaterial.

**Accounting Developments**

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized but will be subject to annual impairment tests. TRS adopted the new rules as of January 1, 2002. As a result, goodwill is no longer being amortized. The impact on American Express' net income in 2001 and 2000 from goodwill amortization was \$106 million (\$82 million after-tax) and \$98 million (\$77 million after-tax), respectively. While TRS is currently evaluating the provisions of the new rules related to impairment testing, it does not expect that such tests will result in any material effect on the company's results of operations or financial position.

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In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." This Statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. TRS is required to adopt SFAS No. 143 as of January 1, 2003. The adoption of this Statement is not expected to have a material impact on TRS' financial position or results of operations.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which supercedes FASB No. 121, "Accounting for the Impairment of Long-lived Assets and for Long-Lived Assets to Be Disposed Of." This new Statement also supercedes certain aspects of Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," with regard to reporting the effects of a disposal of a segment of a business. The new rule requires operating losses from discontinued operations to be reported in future periods, as incurred. In addition, businesses below the operating segment level may qualify for discontinued operations treatment. TRS adopted the provisions of the Statement as of January 1, 2002, which will primarily affect TRS if and when qualifying future business dispositions occur.