

TRAVEL RELATED SERVICES **FINANCIAL REVIEW**

Description of the Business

American Express Travel Related Services Company, Inc. (including its subsidiaries, unless the context indicates otherwise, "TRS"), which includes the Card, travel, merchant and network businesses as well as the Travelers Cheque and Prepaid Services group, provides a variety of products and services worldwide, including, among others, global card network, issuing and processing services, the American Express® Card, the American Express® Rewards Green and Rewards Gold Cards, Blue from American Express, the Optima® Card, the American Express® Cash Rebate Card, a number of co-brand Cards, other consumer and corporate lending and banking products, American Express® Travelers Cheques, prepaid card products, business expense management products and services, corporate travel and travel management services, consumer travel services, tax, accounting and business consulting services, a network of automated teller machines ("ATMs"), magazine publishing, merchant transaction processing and point of sale and back-office products and services. In certain countries, partly owned affiliates and unaffiliated entities offer some of these products and services under licenses from TRS.

Results of Operations

Travel Related Services reported net income of \$2.1 billion in 2002, a 46 percent increase from \$1.5 billion in 2001. 2001 results included restructuring charges of \$414 million (\$267 million after-tax) and one-time costs and waived customer fees directly related to the September 11th terrorist attacks of \$87 million (\$57 million after-tax).

The following management discussion includes information on both a GAAP basis and managed basis. The managed basis presentation assumes there have been no securitization transactions, i.e. all securitized cardmember loans and related income effects are reflected in the balance sheet and income statement, respectively. TRS information is presented on a managed basis because that is the way management views and manages the business. Management believes that a full picture of trends in the cardmember lending business can only be derived by evaluating the performance of both securitized and non-securitized cardmember loans. Asset securitization is just one of several ways for TRS to fund cardmember loans. Use of a managed basis presentation, including non-securitized and securitized cardmember loans, presents a more accurate picture of the key dynamics of the cardmember lending business, avoiding distortions due to the mix of funding sources at any particular point in time. For example, irrespective of the mix, it is important for management and investors to see metrics, such as changes in delinquencies and write-off rates, for the entire cardmember lending portfolio because it is more representative of the economics of the aggregate cardmember relationships and ongoing business performance and trends over time. It is also important for investors to see the overall growth of cardmember loans and related revenue and changes in market share, which are significant metrics in evaluating TRS' performance and which can only be properly assessed when all non-securitized and securitized cardmember loans are viewed together on a managed basis.

TRAVEL RELATED SERVICES FINANCIAL REVIEW

TRS' owned portfolio is primarily comprised of cardmember receivables generated by the company's charge card products, unsecuritized U.S. cardmember loans, international cardmember loans and unsecuritized equipment leasing receivables.

As discussed more fully in Financing Activities, TRS securitizes U.S. cardmember loans as part of its financing strategy; consequently, the level of unsecuritized U.S. cardmember loans is primarily a function of TRS' financing requirements. As a portfolio, unsecuritized U.S. cardmember loans tend to be less seasoned than securitized loans, primarily because of the lead time required to designate and securitize each loan. TRS does not securitize international loans. Delinquency, reserve coverage and net write-off rates have historically been generally comparable between the owned and managed portfolios.

On a GAAP basis, results reflect only net finance charge revenue comprised of unsecuritized cardmember and other loans. Revenues relating to the TRS' retained interest in securitized loan receivables are shown in securitization income, which includes gains on securitizations (as discussed below), net finance charge revenue on retained interests in securitized loans and servicing income.

GAAP Basis

In 2002, TRS' net revenues rose 2 percent as a result of greater net finance charge revenue, greater securitization income, higher cardmember spending and increased cards-in-force, partially offset by lower travel commissions and fees, Travelers Cheque investment income and other revenues. These increases reflect the benefits of higher net finance charge revenue from the cardmember lending portfolio due to improved spreads and growth in worldwide billed business.

Discount revenue rose 3 percent during 2002 as a result of a 4 percent increase in billed business partially offset by a lower discount rate. The 4 percent increase in billed business in 2002 primarily resulted from a 4 percent growth in cards-in-force and higher spending per basic cardmember worldwide. U.S. cards-in-force rose 2 percent in 2002 reflecting the impact of more selective consumer card and small business acquisition activities during the past year in light of weak economic conditions. International cards-in-force increased 8 percent in 2002 due to growth in proprietary card products, as well as network card growth. Proprietary card growth was slower during 2002, reflecting attrition due to adverse business conditions in Argentina, Brazil and Hong Kong. Cards-in-force growth accelerated worldwide in the second half of 2002, including the addition of over 900,000 cards in the fourth quarter.

U.S. billed business rose 4 percent reflecting 8 percent growth within the consumer card business (on 10 percent higher transaction volume), 4 percent growth in small business services volume and a 3 percent decline within Corporate Services. U.S. non-T&E related volume categories (which represented approximately 63 percent of U.S. billed business during 2002) grew 9 percent versus last year while U.S. T&E volumes declined 2 percent. Worldwide airline related volume declined 6 percent on a single-digit decline in the average airline charge and flat transaction volumes.

TRAVEL RELATED SERVICES
FINANCIAL REVIEW

Net card fees increased slightly in 2002 reflecting the growth in cards-in-force. Average fee per card remained at \$34 in both 2002 and 2001.

Lending net finance charge revenue rose 4 percent in 2002. The net interest yield on the U.S. portfolio rose, as a decrease in the proportion of the portfolio on introductory rates and the benefit of declining funding costs were partially offset by the evolving mix of products toward more lower-rate offerings. Additionally, there was a higher level of securitizations in 2002 compared to the prior year.

Travel commissions and fees declined 8 percent in 2002 as a result of a 10 percent contraction in travel sales reflecting the weaker corporate travel environment throughout the year. Securitization income increased 35 percent in 2002 as a result of a higher average balance of cardmember lending securitizations and improved spreads. Other revenue decreased 10 percent in 2002 as a result of lower interest income on investment and liquidity pools held within card funding vehicles.

Marketing and promotion expense increased 18 percent in 2002 from the launch of the new brand advertising campaign, the introduction of the new charge cards with Membership Rewards built-in and the Cash Rebate card, more loyalty marketing, and an increase in selected card acquisition activities.

The charge card provision on card products decreased 20 percent in 2002 on strong credit quality reflected in an improved past due rate and loss ratio. The net loss ratio decreased to 0.38% in 2002 from 0.42% in 2001. The worldwide lending provision rose in 2002 reflecting portfolio growth and increased reserve coverage levels. The net write-off rate was 5.4% in 2002 versus 5.2% in 2001.

Charge card interest expense declined 31 percent in 2002 due to a lower effective cost of funds and lower average receivable balance.

In 2002, human resources expense decreased 12 percent as a result of a lower average number of employees, reflecting ongoing reengineering efforts and the impact of a technology outsourcing agreement. Other operating expenses increased 14 percent in 2002 due to higher costs related to cardmember loyalty programs, losses primarily from strategic investments versus gains in the prior year, as well as the impact of the technology outsourcing agreement, which transferred costs from human resources expense, although at a lower level. These increases were partially offset by reengineering initiatives and other cost containment efforts.

TRS' results for the years ended December 31, 2002 and 2001 included net cardmember lending securitization gains of \$136 million (\$88 million after-tax) and \$155 million (\$101 million after-tax), respectively. Management views the gains from securitizations as discretionary benefits to be used for card acquisition expenses, which are reflected in both marketing and promotion and other operating expenses. Consequently, the managed basis presentation for the years ended December 31, 2002 and 2001 assumes that lending securitization gains were offset by higher marketing and promotion expense of \$81 million and \$92 million, respectively, and other operating

TRAVEL RELATED SERVICES
FINANCIAL REVIEW

expense of \$55 million and \$63 million, respectively. Accordingly, the incremental expenses, as well as the gains, have been eliminated. The table on page 10 reconciles the GAAP basis for certain TRS income statement line items to the managed basis information, where different.

The following discussion addresses results on a managed basis.

Managed Basis

In 2002, TRS' net revenues rose 3 percent as a result of greater net finance charge revenue, higher cardmember spending and increased cards-in-force, partially offset by lower travel commissions and fees, Travelers Cheque investment income and other revenues. These increases reflect the benefits of higher net finance charge revenue from the cardmember lending portfolio due to higher loan balances and improved spreads and growth in worldwide billed business.

Discount revenue rose 3 percent during 2002 as a result of a 4 percent increase in billed business partially offset by a lower discount rate. The 4 percent increase in billed business in 2002 primarily resulted from a 4 percent growth in cards-in-force and higher spending per basic cardmember worldwide. U.S. cards-in-force rose 2 percent in 2002 reflecting the impact of more selective consumer card and small business acquisition activities during the past year in light of weak economic conditions. International cards-in-force increased 8 percent in 2002 due to growth in proprietary card products, as well as network card growth. Proprietary card growth was slower during 2002, reflecting attrition due to adverse business conditions in Argentina, Brazil and Hong Kong. Cards-in-force growth accelerated worldwide in the second half of 2002, including the addition of over 900,000 cards in the fourth quarter.

U.S. billed business rose 4 percent reflecting 8 percent growth within the consumer card business (on 10 percent higher transaction volume), 4 percent growth in small business services volume and a 3 percent decline within Corporate Services. U.S. non-T&E related volume categories (which represented approximately 63 percent of U.S. billed business during 2002) grew 9 percent versus last year while U.S. T&E volumes declined 2 percent. Worldwide airline related volume declined 6 percent on a single-digit decline in the average airline charge and flat transaction volumes.

Net card fees increased slightly in 2002 reflecting the growth in cards-in-force. Average fee per card remained at \$34 in both 2002 and 2001.

Lending net finance charge revenue rose 16 percent in 2002. During 2002, average worldwide lending balances increased 7 percent. The net interest yield on the U.S. portfolio rose, as a decrease in the proportion of the portfolio on introductory rates and the benefit of declining funding costs were partially offset by the evolving mix of products toward more lower-rate offerings.

Travel commissions and fees declined 8 percent in 2002 as a result of a 10 percent contraction in travel sales reflecting the weaker corporate travel environment throughout

TRAVEL RELATED SERVICES **FINANCIAL REVIEW**

the year. Other revenues decreased 2 percent in 2002 due to significantly lower interest income on investment and liquidity pools held within card funding vehicles, which partially offset higher insurance related revenues.

Marketing and promotion expense increased 20 percent in 2002 from the launch of the new brand advertising campaign, the introduction of the new charge cards with Membership Rewards built-in and the Cash Rebate card, more loyalty marketing, and an increase in selected card acquisition activities.

The charge card provision on card products decreased 22 percent in 2002 on strong credit quality reflected in an improved past due rate and loss ratio. The net loss ratio decreased to 0.38% in 2002 from 0.42% in 2001. The worldwide lending provision rose in 2002 reflecting portfolio growth and increased reserve coverage levels. The net write-off rate was 6.0% in 2002 versus 5.6% in 2001.

Charge card interest expense declined 33 percent in 2002 due to a lower effective cost of funds and lower average receivable balance.

In 2002, human resources expense decreased 12 percent as a result of a lower average number of employees, reflecting ongoing reengineering efforts and the impact of a technology outsourcing agreement. Other operating expenses increased 14 percent in 2002 due to higher costs related to cardmember loyalty programs, losses primarily from strategic investments versus gains in the prior year, as well as the impact of the technology outsourcing agreement, which transferred costs from human resources expense, although at a lower level. These increases were partially offset by reengineering initiatives and other cost containment efforts.

Financing Activities

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. In 2002, TRS shifted its funding strategy to reduce its reliance on short-term debt; at December 31, 2002, short-term debt was 56% of total debt versus 80% a year ago. Charge card receivables are predominantly funded by American Express Credit Corporation and its subsidiaries (Credco), a wholly-owned subsidiary of TRS, while funding for cardmember loans is primarily through American Express Centurion Bank (Centurion Bank), a wholly-owned subsidiary of TRS.

Securitizations

The American Express Credit Account Master Trust (the Trust) securitized \$4.6 billion and \$4.3 billion of loans in 2002 and 2001, respectively, through the public issuance of investor certificates. During 2002 and 2001, \$2 billion and \$1 billion, respectively, of investor certificates that were previously issued by the Trust matured. 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 Centurion Bank, and, in the future, may

TRAVEL RELATED SERVICES FINANCIAL REVIEW

include other charge or credit accounts, features or products. At December 31, 2002 and 2001, TRS had a total of \$16.9 billion and \$14.3 billion, respectively, of Trust-related securitized loans which are not on the Consolidated Balance Sheets. In early 2003, the company securitized an additional \$920 million of loans.

Under the terms of the Trust pooling and servicing agreement, the occurrence of certain events 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 the decline of the securitized assets to generate specified yields over a defined period of time, and the decline of the total of the securitized assets' principal balances below a specified percentage of total investor certificates outstanding after the failure to add additional securitized assets as required by the agreement. The company does not expect an early amortization event to occur. In the event of a pay down, \$15.4 billion of assets would revert to the 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, 2002, the one-time negative effect on results of operations would have been approximately \$693 million pretax, to re-establish reserves and accelerate amortization of the interest-only strip related to the \$16.9 billion of cardmember loans that would revert to the balance sheet.

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 2002 and 2001, the Master Trust securitized \$1.8 billion and \$750 million, respectively, which remain on the Consolidated Balance Sheets. In 2001, \$600 million of accounts receivable trust certificates that were previously issued by the Master Trust matured from the charge card securitization portfolio. The Master Trust specifies events, the occurrence of which would result in a pay down. The company does not expect a pay down to occur. While virtually no financial statement impact would result from a pay down. The company does not expect to pay down to occur. While virtually no financial statement impact would result from a paydown, an alternate source of funding for \$4.8 billion of receivables would have to be obtained.

With respect to both the Trust and the 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. Such alternative arrangements include obtaining appropriate guarantees for the performance of the payment and deposit obligations of TRS, as servicer.

TRS also securitizes equipment lease receivables. At December 31, 2002 and 2001, the amount sold and outstanding to third party investors was \$254 million and \$675 million, respectively. These sales result in a reduction of interest expense and provisions for losses, as well as servicing revenue, all of which are insignificant to the company's results of operations.

TRAVEL RELATED SERVICES FINANCIAL REVIEW

Other Financing Activities

TRS, primarily through Credco, maintained commercial paper outstanding of approximately \$11.2 billion at an average interest rate of 1.3% and approximately \$18.0 billion at an average interest rate of 1.9% at December 31, 2002 and 2001, respectively. Additionally, during 2002, Credco issued an aggregate of \$6.8 billion of medium-term notes at fixed and floating rates with maturities of one to three years. This reflects a shift in the funding strategy as the company is placing less reliance on short-term debt. In early 2003, Credco issued an additional \$2 billion of floating rate medium-term notes, with maturities of one-year that can be extended by the holder to up to five years.

Bank notes issued and Fed Funds purchased by Centurion Bank totaled approximately \$8 billion during 2002. Borrowings under bank lines of credit totaled \$1.2 billion and \$1.3 billion at December 31, 2002 and 2001, respectively.

As of December 31, 2002, Credco had the ability to issue approximately \$3.2 billion of debt securities under a shelf registration statement filed with the SEC which amount was increased to approximately \$18.2 billion in early 2003. In addition, approximately \$10 billion of the company's unused lines of credit supporting TRS' commercial paper borrowings were allocated to Credco at December 31, 2002. These lines expire in increments from 2003 through 2007. Also, TRS had \$2.6 billion in committed back-up lines of credit available at December 31, 2002 for other corporate purposes.

In addition, TRS, Centurion Bank, Credco, American Express Overseas Credit Corporation Limited, a wholly-owned subsidiary of Credco, and AEB 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, 2002 and 2001, \$0.5 billion and \$1.3 billion of debt, respectively, was outstanding under this program.

Risk Management

For TRS' Charge Card and fixed rate lending products, interest rate exposure is managed through a combination of shifting the mix of funding toward fixed-rate debt and through the use of derivative instruments, with an emphasis on interest rate swaps, that effectively fix TRS' interest expense for the length of the swap. The company endeavors to lengthen the maturity of interest rate hedges in periods of falling interest rates and to shorten their maturity in periods of rising interest rates. 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. TRS regularly reviews its strategy and may modify it. Nontrading interest rate products, primarily interest rate swaps, with notional amounts of approximately \$44 billion (a portion of which extends to 2005) were outstanding at December 31, 2002.

The detrimental effect on TRS pretax earnings of a hypothetical 100 basis point increase in interest rates would be approximately \$51 million (\$40 million related to the

TRAVEL RELATED SERVICES **FINANCIAL REVIEW**

U.S. dollar) and \$48 million (\$31 million related to the U.S. dollar), based on 2002 and 2001 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.

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. At December 31, 2002, foreign currency products with total notional amounts of approximately \$6.4 billion were outstanding including foreign currency forward sales with notional amounts of \$645 million which were contracted to manage a substantial portion of anticipated cash flows from operations in major overseas markets for 2003.

Based on the year-end 2002 and 2001 foreign exchange positions, but excluding the forward contracts managing the anticipated overseas operating results for the subsequent year, the effect on TRS' earnings of a 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, a 10 percent strengthening would create hypothetical pretax gains of \$59 million and \$29 million related to the 2002 and 2001 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.

Accounting Developments

In November 2002, FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45), which provides accounting and disclosure requirements for certain guarantees. The accounting provisions of FIN 45, which are effective for certain guarantees issued or modified beginning January 1, 2003, will impact TRS based upon the fair value amount of guarantees that are issued or modified beginning at that time. TRS is still evaluating the impact of adopting FIN 45 on the Consolidated Financial Statements.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46), which addresses consolidation by business enterprises of variable interest entities (VIE). The accounting provisions and disclosure requirements of FIN 46 are effective immediately for VIEs created after January 31, 2003, and are effective for reporting periods beginning after June 15, 2003, for VIEs created prior to February 1, 2003. The company is still evaluating the impact of adopting FIN 46 on the Consolidated Financial Statements. It is likely that the TRS will either consolidate or disclose additional information about VIEs when FIN 46 becomes fully effective. Certain disclosures are required for financial statements initially issued after January 31, 2003.

On December 31, 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure." The company has applied the recognition and measurement provisions of Accounting Principles Board Opinion No. 25 and related

TRAVEL RELATED SERVICES
FINANCIAL REVIEW

interpretations in accounting for its stock-based employee compensation plans. No stock-based employee compensation expense is reflected in net income for the years ended December 31, 2002 or 2001, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Effective January 1, 2003, TRS' parent, American Express, will adopt, prospectively, the fair value recognition provisions of SFAS No. 123 "Accounting for Stock-Based Compensation," and expense all new awards granted to employees after January 1, 2003.

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 has adopted the provisions of the Statement as of January 1, 2003. The impact to the financial statements is expected to be immaterial.

In July 2002, the FASB issued SFAS No. 146, "Obligations Associated with Disposal Activities." The Statement is effective for exit or disposal activities initiated after December 31, 2002. Previously issued financial statements shall not be restated. The provisions of EITF Issue 94-3 shall continue to apply for an exit activity initiated under an exit plan that met the criteria of Issue 94-3 prior to this Statement's initial application. This Statement will impact TRS' accounting for any future restructuring activities.