

## **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, provides a variety of products and services worldwide, including, among others, global card network, issuing and processing services, customized charge card and credit cards for consumers and businesses worldwide, other consumer and corporate lending and banking products American Express® Travelers Cheques and prepaid card products, business expense management products and services, corporate travel and travel management services, consumer travel services, tax, accounting and business consulting services, 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. TRS is a wholly-owned subsidiary of American Express Company ("American Express").

### **Results of Operations**

Travel Related Services reported net income of \$2.4 billion in 2003, a 14 percent increase from \$2.1 billion in 2002, which increased 46 percent from 2001. Results for 2001 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 quality of TRS' card customer base, the breadth of its product portfolio, the benefits of its reward-based, spend-oriented business model and its improved revolving credit capabilities combined to create a competitive advantage that was leveraged effectively to deliver strong results at TRS, despite the continuation of a difficult travel environment during most of 2003. TRS continued to expand into everyday spending categories, and TRS' investments in growth initiatives over the past two years drove strong cardmember spending, cards-in-force and lending balance growth.

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 TRS' 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

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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.

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

As discussed more fully in the Financing Activities section below, 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 currently securitize international loans. Delinquency, reserve coverage and net write-off rates have historically been broadly comparable between the owned and managed portfolios.

On a GAAP basis, results reflect finance charge revenue on the owned portfolio as well as finance charge revenue on retained, undivided interests in securitized loans, referred to as seller's interest. GAAP basis results also include interest income on TRS' subordinated securities, which are retained security interests of a U.S. cardmember loan securitization trust, as well as securitization income. Securitization income includes gains on securitizations (as discussed below), cash flows from a third retained interest known as interest-only strips (present value of future net cash flows related to securitized loan balances) and servicing revenue, net of related discounts. Net securitization income increased 10 percent in 2003 and 24 percent in 2002 primarily as a result of higher average balances of cardmember lending securitizations.

### **Results of Operations - GAAP Basis**

In 2003, TRS' net revenues were up 8 percent primarily due to greater cardmember spending, higher lending balances, increased cards-in-force and greater travel and other commissions and fees. Net revenues in 2002 were 2 percent higher than 2001 as a result of greater net finance charge and discount revenue, partially offset by lower travel commissions and fees, Travelers Cheque investment income and other revenues.

Revenues and expenses are affected by changes in the relative values of non-U.S. currencies to the U.S. dollar. The currency rate changes had a favorable effect on revenue growth of approximately 3 percentage points in 2003 and negligible effect on revenue in 2002. Currency rate changes increased expenses by approximately 3 percentage points in 2003 and had a negligible impact on expenses in 2002.

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Discount revenue rose 11 percent compared to a year ago as a result of a 13 percent increase in billed business partially offset by a lower discount rate that primarily reflects the cumulative impact of stronger than average growth in the lower rate retail and other “everyday spend” merchant categories (i.e., supermarkets, discounters, etc.). Based on TRS’ business strategy, it expects to see continued changes in the mix of business. This, along with volume-related pricing discounts and selective repricing initiatives, will probably continue to result in some discount rate erosion over time. 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 13 percent increase in billed business in 2003 resulted from 6 percent growth in cards-in-force on higher card acquisitions and an improved average customer retention level and 9 percent growth in spending per basic cardmember worldwide. U.S. cards-in-force rose 4 percent and 2 percent in 2003 and 2002, respectively, reflecting the continued benefit of increased card acquisition spending within the consumer and small business segments and, in 2003, a return to growth within corporate services. International cards-in-force increased 9 percent and 8 percent in 2003 and 2002, respectively, due to growth in both proprietary and network partnership cards.

U.S. billed business rose 12 percent reflecting 13 percent growth within the consumer card business, 16 percent growth in small business services volume and a 4 percent increase within corporate services. U.S. non-T&E related volume categories, which represented approximately 65 percent of U.S. billed business during 2003, increased 16 percent over 2002 while U.S. T&E volumes rose 4 percent reflecting continued strengthening across all T&E industries as the year progressed. Total billed business outside the U.S., excluding the impact of foreign exchange translation, grew 5 percent reflecting mid double-digit improvement in Latin America, high single-digit growth in both Canada and Asia and low single-digit growth in Europe. Worldwide airline volumes, which represented 13 percent of total volumes during 2003, increased 4 percent as a result of a 5 percent growth in transaction volumes partially offset by a 1 percent decrease in the average airline charge.

Net card fees increased 6 percent in 2003 reflecting 6 percent growth in cards-in-force and the benefit of selected annual fee increases. The average annual fee per proprietary card-in-force increased to \$35 in 2003 versus \$34 in both 2002 and 2001. Net card fees increased 2 percent in 2002 reflecting growth in cards-in-force.

Cardmember lending net finance charge revenue rose 12 percent in 2003 primarily due to a 13 percent increase in average worldwide lending balances partially offset by lower yields. The net interest yield on the worldwide lending portfolio decreased compared to 2002 reflecting an increase in the proportion of the portfolio on introductory rates and the evolving mix of products toward more lower-rate offerings, partially offset by lower funding costs. In 2002, cardmember lending net finance charge revenue increased 7 percent.

Travel commissions and fees increased 7 percent in 2003 due to higher revenue earned per dollar of sales coupled with a 3 percent increase in travel sales, primarily due to the acquisition of Rosenbluth International (Rosenbluth), a major corporate travel agency, in

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

Other commissions and fees increased 4 percent in 2003 due to higher card-related fees and assessments. The balances were relatively flat in 2002.

Net securitization income rose 10 percent in 2003 as a result of higher average balances of cardmember lending securitizations. Net securitization income rose 24 percent in 2002 primarily driven by higher average balances of cardmember lending securitizations as well as higher portfolio yields.

Other revenues increased 2 percent in 2003 primarily due to greater merchant-related revenues and larger insurance premiums partially offset by lower interest income on investment and liquidity pools held within card funding vehicles and lower ATM revenues. The decrease in other revenues in 2002 was primarily due to significantly lower interest income on investment and liquidity pools held within card funding vehicles, which partially offset higher insurance related revenues.

In 2003, TRS' expenses were up 7 percent primarily due to greater marketing, promotion, rewards and cardmember services expenses, higher human resources expense and increased other expenses, partially offset by lower interest costs, reduced provisions for losses and cost control initiatives. Expenses in 2002 were 5 percent lower than 2001 primarily due to decreases in interest costs, human resources expense and provisions for losses, partially offset by increases in marketing, promotion, rewards and cardmember services expenses and other operating expenses.

Marketing, promotion, rewards and cardmember services expenses increased 26 percent in 2003 on the continuation of brand and product advertising, an increase in selected card acquisition activities and higher cardmember rewards and services expenses reflecting higher volumes and greater program participation and penetration. While the amount of these expenses is expected to continue to rise, the growth rate for these costs is expected to be lower in 2004 as loyalty program utilization begins to stabilize and TRS further leverages expenditures made during 2003. Management believes, based on historical experience, that cardmembers enrolled in rewards and co-brand programs yield higher spend, better retention, stronger credit performance and greater profit for TRS. Marketing, promotion, rewards and cardmember services expense increased 14 percent in 2002 from the launch of a new brand advertising campaign, the introduction of charge cards with Membership Rewards built-in and the Cash Rebate card, more loyalty marketing, and an increase in selected card acquisition activities, as well as increases in cardmember rewards and services expenses reflecting higher volumes and greater program participation.

The provision for losses on charge card products decreased 11 percent on strong credit quality reflected in an improved past due percentage and loss ratio. The net loss ratio as a percentage of charge volume decreased to 0.28% in 2003 from 0.38% in 2002. The worldwide charge card provision also decreased in 2002 due to strong credit

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quality. The provision for losses on the worldwide lending portfolio decreased 11 percent in 2003 despite growth in outstanding loans and increased reserve coverage levels due to well-controlled credit practices and improving economic trends. The worldwide lending provision increased in 2002, reflecting portfolio growth and increased reserve coverage levels. The net write-off rate for the worldwide lending portfolio was 5.2% in 2003 versus 5.9% in 2002.

Charge card interest expense declined 20 percent in 2003 due to a lower effective cost of funds, partially offset by a higher average receivable balance. Charge card interest expense declined 33 percent in 2002 due to a lower effective cost of funds and a lower average receivable balance.

Human resources expense increased 9 percent in 2003 as employee merit increases, higher employee benefit expenses and increased management incentive costs were partially offset by the benefits from reengineering efforts. Increases in 2003 management incentive costs included higher stock-based compensation costs from both stock options and increased levels of restricted stock awards. The higher stock-based compensation expense from stock options reflects American Express' decision to expense stock options beginning in 2003. Higher expense related to restricted stock awards reflects American Express' decision to modify compensation practices and use restricted stock awards in place of stock options for middle management. In 2002, human resources expense decreased 12 percent as a result of a lower average number of employees, reflecting ongoing reengineering efforts throughout 2002 and the impact of technology outsourcing agreements.

Other operating expenses increased 8 percent reflecting, in part, the impact of greater business and service volume-related costs, including outsourcing activities. This increase was partially offset by the benefits of reengineering initiatives and other cost containment efforts. In 2002, other operating expenses rose due to losses primarily from strategic investments versus gains in the prior year, as well as the impact of outsourcing agreements, partially offset by reengineering initiatives and other cost containment efforts.

TRS' results for the years ended December 31, 2003, 2002 and 2001 included net cardmember lending securitization gains of \$124 million (\$81 million after-tax), \$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, promotion, rewards and cardmember services expenses and other operating expenses. Consequently, the managed basis presentation for the years ended December 31, 2003, 2002 and 2001 assumes that lending securitization gains were offset by higher marketing, promotion, rewards and cardmember services expenses of \$74 million, \$81 million and \$92 million, respectively, and other operating expenses of \$50 million, \$55 million and \$63 million, respectively. Accordingly, the incremental expenses, as well as the gains, have been eliminated. The table on page 17 compares and reconciles the GAAP basis for certain TRS income statement line items to the managed basis information, where different.

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*The following discussion addresses results on a managed basis.*

### **Results of Operations - Managed Basis**

In 2003, TRS' net revenues were up 8 percent primarily due to greater cardmember spending, higher lending balances, increased cards-in-force and greater travel and other commissions and fees. Net revenues in 2002 were 3 percent higher than 2001 as a result of greater net finance charge and discount revenue, partially offset by lower travel commissions and fees, Travelers Cheque investment income and other revenues.

Revenues and expenses are affected by changes in the relative values of non-U.S. currencies to the U.S. dollar. The currency rate changes had a favorable effect on revenue growth of approximately 3 percentage points in 2003 and negligible effect on revenue in 2002. Currency rate changes increased expenses by approximately 3 percentage points in 2003 and had a negligible impact on expenses in 2002.

Discount revenue rose 11 percent compared to a year ago as a result of a 13 percent increase in billed business partially offset by a lower discount rate that primarily reflects the cumulative impact of stronger than average growth in the lower rate retail and other "everyday spend" merchant categories (i.e., supermarkets, discounters, etc.). Based on TRS' business strategy, it expects to see continued changes in the mix of business. This, along with volume-related pricing discounts and selective repricing initiatives, will probably continue to result in some discount rate erosion over time. 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 13 percent increase in billed business in 2003 resulted from 6 percent growth in cards-in-force on higher card acquisitions and an improved average customer retention level and 9 percent growth in spending per basic cardmember worldwide. U.S. cards-in-force rose 4 percent and 2 percent in 2003 and 2002, respectively, reflecting the continued benefit of increased card acquisition spending within the consumer and small business segments and, in 2003, a return to growth within corporate services. International cards-in-force increased 9 percent and 8 percent in 2003 and 2002, respectively, due to growth in both proprietary and network partnership cards.

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expense increased 15 percent in 2002 from the launch of a new brand advertising campaign, the introduction of charge cards with Membership Rewards built-in and the Cash Rebate card, more loyalty marketing, and an increase in selected card acquisition activities, as well as increases in cardmember rewards and services expenses reflecting higher volumes and greater program participation.

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Other operating expenses increased 8 percent reflecting, in part, the impact of greater business and service volume-related costs, including outsourcing activities. This increase was partially offset by the benefits of reengineering initiatives and other cost containment efforts. In 2002, other operating expenses rose due to losses primarily from strategic investments versus gains in the prior year, as well as the impact of outsourcing agreements, partially offset by reengineering initiatives and other cost containment efforts.

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**Financing Activities**

TRS funds its charge card receivables and cardmember loans using various funding sources, such as short- and long-term debt, medium-term notes, and sales of cardmember receivables and loans in securitizations. In 2003, TRS had uninterrupted access to the money and capital markets to fund its business operations. TRS funds its receivables and loans primarily through two wholly-owned subsidiaries: American Express Credit Corporation (Credco) and American Express Centurion Bank (Centurion Bank). Credco funds the vast majority of charge card receivables and Centurion Bank funds mainly cardmember loans originated from TRS' lending activities. In addition, two trusts are used by TRS in connection with the securitization and sale of receivables and loans generated in the ordinary course of TRS' card businesses. The assets securitized consist principally of consumer cardmember receivables and loans arising from TRS' charge card and lending activities.

TRS' funding needs are met primarily through the following sources:

- Commercial paper issued by Credco
- Bank notes, institutional CDs and Fed Funds borrowed by Centurion Bank
- Medium-term notes and senior unsecured debentures
- Sale of cardmember receivables and loans through securitizations
- Local currency borrowings in selected markets

TRS' debt offerings are placed either directly, as in the case of its commercial paper program through Credco, or through securities brokers or underwriters. In certain international markets, bank borrowings are used to partially fund cardmember receivables and loans.

Short-term debt is defined as any debt with an original maturity of 12 months or less. The commercial paper market represents the primary source of short-term funding for TRS. Credco's commercial paper is a widely recognized name among short-term investors and is a principal source of debt for TRS. At December 31, 2003, Credco had \$8.8 billion of commercial paper outstanding, net of certain short-term investments. The outstanding amount, net of certain short-term investments, declined \$0.5 billion or 5.6 percent from a year ago as part of TRS' efforts to lessen its reliance on short-term funding sources. Average commercial paper outstanding, net of certain short-term investments, was \$7.7 billion and \$10.6 billion in 2003 and 2002, respectively. TRS currently manages the level of commercial paper outstanding, net of certain short-term investments, such that the ratio of its committed bank credit facility to total short-term debt, which consists mainly of commercial paper, is not less than 100%.

Centurion Bank raises short-term debt through various instruments. Bank notes issued and Fed Funds purchased by Centurion Bank totaled approximately \$7.6 billion as of December 31, 2003. Centurion Bank also raises customer deposits through the issuance of certificates of deposits to retail and institutional customers. At December 31, 2003, Centurion Bank held \$8.8 billion in customer deposits. Long-term funding needs are met principally through the sale of cardmember loans in securitization transactions. Centurion Bank maintained \$320 million of committed bank credit lines as a backup

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to its short-term funding programs. The Asset/Liability Committee of Centurion Bank provides management oversight to Centurion Bank with respect to formulating and ratifying funding strategy and to ensuring that all funding policies and requirements are met.

Medium- and long-term debt is raised through the offering of debt securities in the U.S. and international capital markets. Medium-term debt is generally defined as any debt with an original maturity greater than 12 months but less than 36 months. Long-term debt is generally defined as any debt with an original maturity greater than 36 months. At December 31, 2003, TRS and its subsidiaries had the following amounts of medium- and long-term debt outstanding:

| (Billions)                       | Credco  | Centurion | Other<br>Subsidiaries | Total<br>TRS |
|----------------------------------|---------|-----------|-----------------------|--------------|
| Medium-term debt                 | \$ 9.4  | \$ 0.1    | \$ 0.9                | \$ 10.4      |
| Long-term debt                   | 2.0     | —         | 4.2                   | 6.2          |
| Total medium- and long-term debt | \$ 11.4 | \$ 0.1    | \$ 5.1                | \$ 16.6      |

During 2003, TRS further diversified its term funding sources through the issuance of new types of debt instruments and through the issuance of debt at maturities attractive to investor segments new to TRS:

- \$2 billion of extendible medium-term notes, a new debt instrument issued by Credco for the first time, raised proceeds for up to 5 years at an attractive cost.
- \$1 billion of extendible notes issued through a private placement. This debt was offered to eligible money market fund investors and expanded Credco's investor base.
- \$1 billion of 5-year notes issued by Credco.

The following table highlights TRS' outstanding debt and off-balance sheet securitizations as of December 31, 2003 and 2002:

| (Billions)                        | 2003    | 2002    |
|-----------------------------------|---------|---------|
| Short-term debt                   | \$ 21.8 | \$ 21.7 |
| Long-term debt                    | 16.6    | 14.8    |
| Total debt (GAAP basis)           | \$ 38.4 | \$ 36.5 |
| Off-balance sheet securitizations | 19.5    | 17.2    |
| Total debt (managed basis)        | \$ 57.9 | \$ 53.7 |

In 2004, TRS along with its subsidiaries, Credco and Centurion Bank, expects to issue approximately \$20 billion in long-term debt to fund business growth and refinance maturing debt. This amount includes approximately \$2.6 billion in connection with TRS' liquidity portfolio (which is discussed further in the Liquidity section below). TRS expects that its planned funding during the next year will be met through a combination of sources similar to those on which it currently relies. However, TRS continues to assess its needs and investor demand and may change its funding mix. TRS' funding plan is subject to various risks and uncertainties, such as disruption of financial markets, market capacity and demand for securities offered by TRS, accounting or regulatory changes, ability to sell receivables, and the performance of receivables previously sold

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in securitization transactions. Many of these risks and uncertainties are beyond TRS' control.

As of December 31, 2003, Credco had the ability to issue approximately \$9.8 billion of debt securities under shelf registration statements filed with the SEC.

**Cost of Funds**

Cost of funds is generally determined by a margin or credit spread over a benchmark interest rate. Credit spreads are measured in basis points where 1 basis point equals one one-hundredth of one percentage point. It is the smallest measure used in quoting borrowing spreads. Commercial paper and other short-term debt funding costs are based on spreads benchmarked against London Interbank Offered Rate (LIBOR), a commonly used interest rate. Costs for unsecured long-term debt and securitized funding are based on spreads benchmarked against LIBOR, U.S. Treasury securities of similar maturities, or other rates. The table below highlights average indicative spreads for 5-year unsecured and securitized funding. Spreads shown are off of 1 month LIBOR for each respective time period:

| (Spread in basis points*) | 2003 | 2002 | 2001 |
|---------------------------|------|------|------|
| Unsecured debt            | 21   | 45   | 37   |
| Securitized debt**        | 11   | 12   | 13   |

\*Indicative spreads for each respective period.

\*\*For AAA Lending Asset Backed Certificates only.

**Securitizations**

TRS uses asset securitization as a part of its overall funding program. TRS' securitization programs are similar to those widely used by many financial institutions. The securitization market in the United States is highly liquid, efficient and mature with over \$1.3 trillion of asset-backed securities outstanding at December 31, 2003. This market provides TRS with very cost-effective funding for its long-term funding needs. TRS, through its special purpose subsidiaries, principally securitizes its cardmember charge card receivables and cardmember loans arising from its card businesses.

Asset securitization involves selling receivables or loans into a separate legal entity, typically a trust. The trust issues interest-bearing certificates, commonly referred to as asset-backed securities, to third-party investors which are secured by the future collections on the sold receivables or loans. The trust utilizes the proceeds from the sale of such securities to pay the purchase price for receivables or loans that were sold into the trust. TRS, through its subsidiaries, retains an interest in the securitized receivables that may be represented by subordinated securities, undivided interests in receivables or loans, restricted cash held in segregated reserve funds for the benefit of the trust and interest-only strips. TRS' use of trusts in its securitization programs conforms to standard practices in the securitization market. The trusts are used in securitizations to segregate the sold receivables or loans for the benefit of the asset-backed securities investors. Assuming the criteria of securitization accounting rules are met under generally accepted accounting principles, the sold receivables and loans are removed

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from the balance sheet of the trust's sponsor and the certificates are not recorded as a liability.

No officer, director or employee holds any equity interest in the trusts or receives any direct or indirect compensation from the trusts. The trusts in TRS' securitization programs do not own stock of American Express or the stock of any affiliate.

TRS' securitization programs are operated through its special purpose subsidiaries and two trusts. The American Express Credit Account Master Trust (the Master Trust) securitizes assets consisting 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. In the future, it may include other charge or credit accounts, features or products. The Master Trust securitized \$3.5 billion and \$4.6 billion of loans in 2003 and 2002, respectively, through the public issuance of investor certificates. During 2003 and 2002, \$1.0 billion and \$2.0 billion, respectively, of investor certificates that were previously issued by the Master Trust matured. When investor certificates mature, principal collections received from the Master Trust assets are used to redeem the certificates. At December 31, 2003 and 2002, TRS had a total of \$19.4 billion and \$16.9 billion, respectively, of trust-related securitized cardmember loans that are not on the Consolidated Balance Sheets. Retained subordinated interests related to these assets totaled \$1.8 billion and \$1.5 billion at December 31, 2003 and 2002, respectively, and are on the Consolidated Balance Sheets.

Under the terms of the Master Trust pooling and servicing agreement, the occurrence of certain events could result in the Master 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 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. TRS does not expect an early amortization event to occur. In the event of a pay down, \$17.6 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, 2003, the one-time negative effect on results of operations would have been approximately \$750 million pretax to re-establish reserves and accelerate amortization of the interest-only strip related to these securitizations that would revert to the balance sheet. Subject to the performance of the loans, the one-time negative effect would be offset by finance charge revenue over the life of the loans.

The second trust used by TRS, the American Express Master Trust (the Trust), securitizes charge card receivables generated under designated American Express Card, Gold Card and Platinum Card consumer accounts through the issuance of trust certificates. The assets in this Trust remain on TRS' Consolidated Balance Sheets. In 2002, the Trust securitized \$1.8 billion of accounts receivable trust certificates and, in 2003, \$2.0 billion of accounts receivable trust certificates that were previously issued by

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the Trust matured. The 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, an alternate source of funding for the December 31, 2003 outstanding balance of \$2.8 billion of receivables would have to be obtained.

With respect to both the Master Trust and the 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 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, 2003 and 2002, the amount sold and outstanding to third party investors was \$138 million and \$254 million, respectively. These sales resulted 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.

### Liquidity

TRS balances the trade-offs between having too much liquidity, which can be costly and limit financial flexibility, with having inadequate liquidity, which may result in financial distress during a liquidity crisis (see the Contingent Liquidity Planning section below). TRS considers various factors in determining its liquidity needs, such as economic and financial market conditions, seasonality in business operations, growth in business segments, cost and availability of alternative liquidity sources, and credit rating agency considerations.

In 2003, TRS continued to strengthen its liquidity position by reducing its reliance on short-term debt through extension of its debt maturities. Short-term debt on a GAAP basis as a percentage of total debt declined to 57% at December 31, 2003 from 59% at December 31, 2002. Additionally, short-term debt on a managed basis as a percentage of total debt declined to 38% at December 31, 2003 from 40% at December 31, 2002.

TRS estimates it will have liquidity requirements of approximately \$8.7 billion within the next year related to the maturity of long-term debt obligations. These requirements include \$3.8 billion related to certain securitization transactions that will enter their scheduled amortization period. In addition, TRS expects to maintain net short-term debt balances of approximately \$14 billion over the period. TRS believes that its funding plan is adequate to meet these liquidity requirements.

TRS believes that its available liquidity provides sufficient funding to meet normal operating needs at all times. In addition, alternative liquidity sources are available, mainly in the form of the liquidity portfolio, securitizations and committed bank credit

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facilities, to provide uninterrupted funding over a twelve-month period should access to unsecured debt sources become impaired.

### Liquidity Portfolio

During the normal course of business, funding activities may raise more proceeds than are necessary for immediate funding needs. These amounts are invested principally in overnight, highly liquid instruments. In addition, in the fourth quarter of 2003, TRS began a program to develop a liquidity portfolio in which proceeds raised from such borrowings are invested in two to three year U.S. Treasury securities. At December 31, 2003, TRS held \$800 million in two year U.S. Treasury notes under this program. This program was increased to approximately \$4 billion in the first quarter of 2004.

The invested amounts of the liquidity portfolio provide back-up liquidity, primarily for the commercial paper program at Credco, and also flexibility for other short-term funding programs at Centurion Bank. U.S. Treasury securities are the highest credit quality and most liquid of investment instruments available. TRS can easily sell these securities or enter into sale/repurchase agreements to immediately raise cash proceeds to meet liquidity needs.

From time to time, either Credco or Centurion Bank may increase its liquidity portfolio in order to pre-refund maturing debt obligations when financial market conditions are favorable. These levels are monitored and adjusted when necessary to maintain short-term liquidity needs in response to seasonal or changing business conditions.

### Committed Bank Credit Facilities

TRS maintained committed bank credit facilities with 60 large financial institutions totaling \$9.56 billion at December 31, 2003. These facilities expire as follows (billions): 2004, \$5.0; 2005, \$1.9; 2006, \$1.8 and 2007, \$0.9. The availability of the credit lines is subject to TRS' compliance with certain financial covenants, including the maintenance by American Express of consolidated tangible net worth of at least \$7.75 billion, the maintenance by Credco of a 1.25 ratio of combined earnings and fixed charges to fixed charges, and the compliance by Centurion Bank with applicable regulatory capital adequacy guidelines. At December 31, 2003, American Express' consolidated tangible net worth was approximately \$12.4 billion, Credco's ratio of combined earnings and fixed charges to fixed charges was 1.46 and Centurion Bank exceeded the Federal Deposit Insurance Corporation's "well capitalized" regulatory capital adequacy guidelines.

Committed bank credit facilities do not contain material adverse change clauses, which may preclude borrowing under the credit facilities. The facilities may not be terminated should there be a change in American Express' credit rating.

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### **Contingent Liquidity Planning**

TRS has developed a contingent funding plan that enables it to meet its daily funding obligations when access to unsecured funds in the debt capital markets is impaired or unavailable. This plan is designed to ensure that TRS and all of its main operating entities could continuously maintain normal business operations for at least a 12-month period in which its access to unsecured funds is interrupted. The contingent funding plan includes access to diverse sources of alternative funding, including but not limited to its liquidity investment portfolio, committed bank lines, intercompany borrowings, sale of consumer loans and cardmember receivables through its existing securitization programs and sale of other eligible receivables, such as corporate and small business receivables and international cardmember loans and receivables, through enhanced securitization programs. In addition, TRS maintains substantial flexibility to reduce its operating cash requirements, such as through American Express' share repurchase program, and the delay or deferment of certain operating expenses.

The funding sources that would be relied upon depend on the exact nature of such a hypothetical liquidity crisis; nonetheless, TRS' liquidity sources are designed with the goal of ensuring there is sufficient cash on hand to fund business operations over a 12-month period regardless of whether the liquidity crisis was caused by an external, industry or TRS-specific event. The contingent funding plan also addresses operating flexibilities in quickly making these funding sources available to meet all financial obligations. The simulated liquidity crisis is defined as a sudden and unexpected event that impairs access to or makes unavailable funding in the unsecured debt markets. It does not address asset quality deterioration. Asset quality deterioration, if it were to occur, would be expected to unfold over an extended time period and should allow management sufficient time to take appropriate corrective actions to mitigate further asset quality deterioration as it becomes more visible. TRS estimates that, under a worst case liquidity crisis scenario, it has in excess of \$25 billion in alternate funding sources available to cover cash needs over the first 60 days after a liquidity crisis has occurred.

### **Contingent Securitization Capacity**

A key source in TRS' contingent funding plan is asset securitization. Management expects that \$10 billion of additional consumer loans, cardmember receivables and small business loans could be sold to existing securitization trusts. In order to further enhance its flexibility, TRS is seeking to add the capabilities to sell other assets from the loan and cardmember receivables portfolios. The primary goal of adding this additional securitization capacity is to further enhance TRS' flexibility in accessing diverse funding sources on a contingency basis.

TRS believes that the securitized financing would be available even through adverse conditions due to the structure, size and relative stability of the securitization market. Proceeds from secured financings completed during a liquidity crisis could be used to meet current obligations, to reduce or retire other contingent funding sources such as bank credit lines, or a combination of the two. However, other factors affect TRS' ability

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to securitize loans and receivables and do so at a favorable cost, such as credit quality of the assets and the legal, accounting, regulatory and tax environment for securitization transactions. Material changes in any of these factors may potentially limit TRS' ability to securitize its loans and receivables and could introduce certain risks to TRS' ability to meet its financial obligations. In such a case, the use of investment securities, asset dispositions, asset monetization strategies and flexibility to reduce operating cash needs could be utilized to meet its liquidity needs.

**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. TRS 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. Non-trading interest rate products, primarily interest rate swaps, with notional amounts of approximately \$39 billion (a portion of which extends to 2011) were outstanding at December 31, 2003.

The detrimental effect on TRS' pretax earnings of a hypothetical 100 basis point increase in interest rates would be approximately \$64 million (\$50 million related to the U.S. dollar) and \$50 million (\$40 million related to the U.S. dollar), based on the 2003 and 2002 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, 2003, foreign currency products with total notional amounts of approximately \$9.9 billion were outstanding.

Based on the year-end 2003 and 2002 foreign exchange positions, but excluding forward contracts managing the anticipated overseas operating results for the subsequent year, the effect on TRS' earnings of a hypothetical 10 percent change in the value of the U.S. dollar would be immaterial. With respect to forward contracts related to anticipated overseas operating results for the subsequent year, a 10 percent change would hypothetically impact pretax income by \$57 million and \$59 million related to the 2003 and 2002 year-end positions, respectively.