THE OHIO STATE UNIVERSITY
FISHER COLLEGE OF BUSINESS

SIM Equity Research

American Express | Ticker: AXP | Financials Sector

Price as of 10/27/2023: $141.71 | Recommendation: BUY
Implied Equity Price: $199.13 (42.19% Upside)

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Company Description

American Express Company provides charge and credit payment card products, and travel-related services to customers worldwide. The company issues credit cards to individual consumers, small businesses, and corporations. Included in its products and services are payment and financing products, network services, accounts payable expense management products, and travel and lifestyle services.

Investment Thesis

Fueled by their premium cardholder base, coupled with their spend-centric model, dual revenue streams, and closed-loop network, American Express is defensively positioned to perform well despite being in an economically sensitive sector. A BUY is recommended with a target price of $199.13 and 42.19% implied upside.

Overview	
Market Cap	$103.016B
Sector	Financials
Industry	Diversified Financial Services
Current Stock Price	$141.71
Target Price	$199.13
Dividend Yield	1.67%
Total Projected Return	42.19%
52 Week Range	$138.77 - $182.15
Diluted Shares Outstanding	744,192,702

Risks

Decline in Personal Saving Rate: With Americans having historically low savings, general spending may begin to decline and nonessential spending on travel and entertainment may be the first consumers truly dial down on.

Threat to Affluent: Lower wage growth for the top percentile of income earners and job losses could indicate the affluent may be impacted by an economic downturn, more so than anticipated.

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Company Overview

American Express Company, together with its subsidiaries, provides charge and credit payment card products, and travel-related services worldwide. The company operates through four main segments: U.S. Consumer Services, Commercial Services, International Card Services, Global Merchant and Network Services and International Card Services. Its products and services include payment and financing products; network services; accounts payable expense management products and services; and travel and lifestyle services. The company's products and services also comprise merchant acquisition and processing, servicing and settlement, point-of-sale marketing, and information products and services for merchants, and fraud prevention services, as well as the design and operation of customer loyalty programs. It sells its products and services to consumers, small businesses, mid-sized companies, and large corporations. American Express Company was founded in 1850 and is headquartered in New York, New York [5].

Business Segments

U.S. Consumer Services (USCS)
USCS issues proprietary consumer cards and provides complementary services to U.S consumers such as travel, lifestyle, banking, and non-card financing products. USCS offers rewards catered to incentivize and retain their high-spending Card Members. They create innovative products and features to appeal to their target consumers, use incentives to drive spending on cards, and establish strategic partnerships to provide benefits to cardholders. USCS accounts for roughly 40% of American Express' revenue [24].

Commercial Services (CS)
CS offers card and payment programs, expense management tools, consulting services, business financing and cross-border payment solutions to small business, mid-size companies, and large corporations. They use a suite of business-to-business payment solutions to help companies better manage their spending while promoting cost savings, process control and efficiency, along with improved cash flow management. Consumer Services offers corporate cards in local currencies, revolving credit cards and non-card payment and financing solutions to small and mid-sized businesses in the United States and International Countries. The segment is currently working to become the leading payments and working capital provider to small and mid-sized business customers and leader in business-to-business payment for large and global enterprises. CS will achieve this scale by expanding core card business through increased value propositions, the launch of co-branded products, and designing innovative products and solutions for business customers. CS accounts for nearly 30% of American Express' total revenue [24].

International Card Services (ICS)

ICS issues a range of proprietary consumer, small business and corporate cards outside of the United States. International Card Services provides services to international customers including travel and lifestyle services, along with managing international joint ventures, and the loyalty coalition business. ICS brings in about 20% of American Express' total revenue [24].

Global Merchant and Network Services (GMNS)

GMNS operates a global payments network that processes and settles card transactions, acquires merchants, provides fraud-prevention tools, marketing solutions, data analytics and additional programs and services to leverage their global integrated network. Global Merchant and Network Services is responsible for managing relationships with millions of merchants around the world and establishing new merchants to accept their cards along with managing relations between merchant acquirers, aggregators and processors to handle servicing for their merchants. GMNS is currently working to increase merchant acceptance to rival that of Visa and Mastercard in the United States and increasing acceptance worldwide while licensing the American Express brand to expand global reach. GMNS accounts for the final 10% of total revenue [24].

Competitive Advantages

Integrated Payments Platform

American Express operates under a closed-loop network model where they control the entire transaction between customers and merchants. American Express generates revenue from merchant fees that are typically higher than competitors. The company is able to charge higher fees as they attract higher spending customers to merchants, incentivizing merchants to pay a greater discount fee and driving consumer spending through increased merchant acceptance. The closed-loop network further allows American Express to have direct access to information at each step within a single transaction and be the sole fee collector, distinguishing themself from bankcard networks and competitors like Visa and Mastercard who give a portion of discount fees to the issuing bank. With greater data from their closed-loop network, American Express can also create direct marketing to match merchants and Card Members to drive up spending.

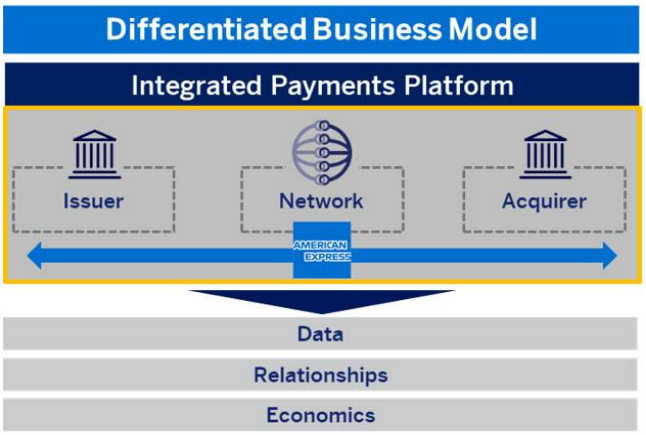

Figure 1: Business Model

Rewards and Partnerships

One of the key drivers of sales for American Express is their rewards program. American Express places a great emphasis on providing incentives to new cardholders and retaining existing ones by providing a wide range of benefits to their Card Members. Cardholders receive rewards as they spend which can then be redeemed for entertainment, travel, and dining related expenses.

To provide benefits to cardholders, American Express is continually establishing relationships with travel and lifestyle companies to increase their value proposition. These co-branded arrangements allow American Express to work with a wide range of business partners who help to drive the scale and popularity of the platform. Co-branded agreements allow American Express to expand their influence by having their brand on products that are reaching new markets and consumers. American Express has partnerships with companies like Delta Air Lines, Marriott International, Hilton Worldwide, and PayPal to offer cardholders exclusive rewards and benefits [24].

Delta is currently American Express' largest strategic partner with a co-branded agreement being in place until 2029. Through this partnership, American Express offers co-branded cards with Delta which in 2022, accounted for around 10% of worldwide network volumes and 21% of worldwide Card Member loans [24]. In this co-brand agreement, Card Members purchase airline tickets from Delta using their American Express cards. The Card Members are then able to generate fee revenue and interest income for American Express, Delta and other merchants profit from sales while paying American Express a discount fee for access to their cardholders.

Affluent Client-Base

American Express has a competitive advantage in their premium customer base and strategy to target the affluent. Targeting the affluent cardholder perfectly aligns with their "spend-centric" model to drive revenue by increasing card spending. American Express charges high fees and has high barriers of entry to their cards to gain more affluent customers and subsequently lower their risk through limiting delinquencies. Increased spending from this demographic drives American Express' earnings, making affluent consumers the most desirable market. Beyond affluent cardholders driving revenue by way of spending, their target cardholder further allows American Express to charge a premium fee to merchants to accept their cards. By having an affluent customer base, American Express can charge these higher fees and increase revenues as merchants are eager to obtain sales from these larger spenders and willing to pay a high discount fee.

Diverse Customer Base

American Express has a broad customer base that encompasses consumers, small businesses,

mid-sized enterprises, and large corporations globally. Figure 2 displays the business breakdown by percentage of worldwide network volumes for 2022 with U.S Consumer Services accounting for the greatest amount at 36% [24]. Despite this, American Express is continuing to expand their international merchant acceptance, having 66 million global merchants in 2022, compared to the 30 million merchants they had in 2017 [23]. New initiatives to broaden the cardholder base in China will see American Express' customer base continually expand as they create customized products for these new customers.

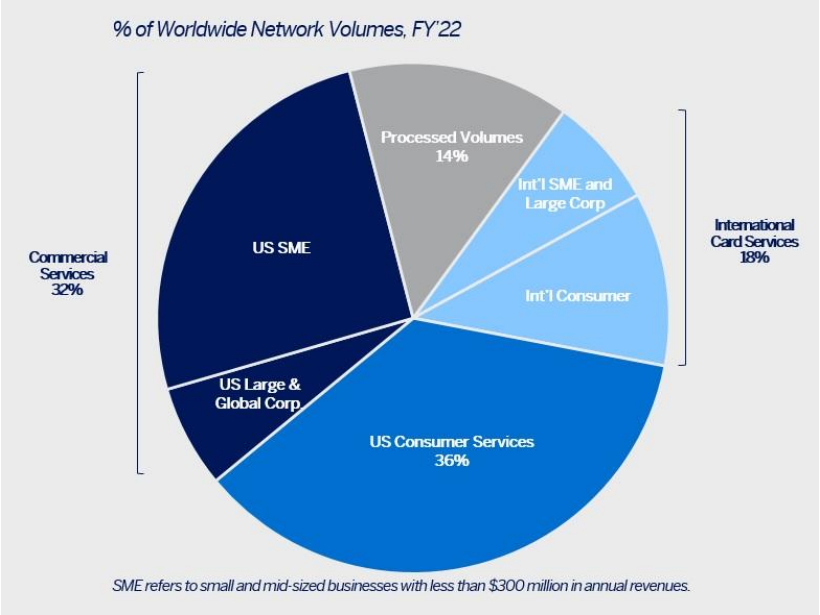

Figure 2: Business Breakdown by Worldwide Volume

Key Competitors

<u>Card Networks</u>

American Express' primary competitors are Visa and Mastercard, both companies within the Financial Services industry who offer general-purpose credit and debit cards. Visa is a leader in digital payments, offering credit, debit, and prepaid products to customers globally, with the majority of sales being generated outside the United States. Visa's range of products allows customers to access credit as a form of payment, use personal funds from their bank accounts or draw on prepaid balances. Mastercard provides financial transaction processing services and solutions to consumers to allow for electronic payment ease of use. The company has a huge global presence, with North America only accounting for 35% of its revenue. Visa and Mastercard both serve as main competitors to American Express because they are believed to have a larger presence in most countries based on purchase volume [5]. Due to a larger presence,

Visa and Mastercard members may have access to increased benefits, resources, and pricing, subsequently attracting customers worldwide and retaining existing ones.

Discover Financial, another player in the Financial Services industry, also serves as one of American Express' key competitors. Discover primarily issues credit cards but also provides electronic payment services to customers. The company's products include credit card loans, private student loans, personal loans, equity loans, and deposit products [4]. When attracting new business, American Express is targeting Millennials and Gen Z customers and is in direct competition with the student benefits Discover cardholders are privy to. Discover student cards provide cashback compared to American Express' benefits being primarily related to travel and entertainment of which may be less accessible for the average student [5].

Mobile-Based Payment Platforms

American Express further faces competition with mobile-based payment platforms such as Alipay, PayPal and Venmo who offer similar activities to those of their Global Merchant and Network Services business [24]. The aforementioned platforms all offer digitized wallets or payment apps where the user simply needs their personal device and the click of a button to make a purchase. Although these platforms are not at the core of American Express' business, they challenge American Express to innovate and provide ease of use to retain their customers and prevent them from switching to other platforms specializing in mobile-based payment.

Market Share

An estimated 70.2% of total retail spending in the United States is charged to credit cards with the United States credit card market currently being valued at $183.9 billion with projections of the market increasing to $195.1 billion in 2025. In 2022, 25.85 billion credit, debit, and prepaid cards were circulating worldwide. American Express cards accounted for 10 billion global transactions in 2022, making up only 2% of the total number of global transactions amongst the top five credit card processors. Despite a lower number of transactions than competitors, American Express accounted for 11% of the U.S. market by purchase volume, a figure that equates to $1.08 trillion, and the second largest in the industry as result of higher per transaction spend [22].

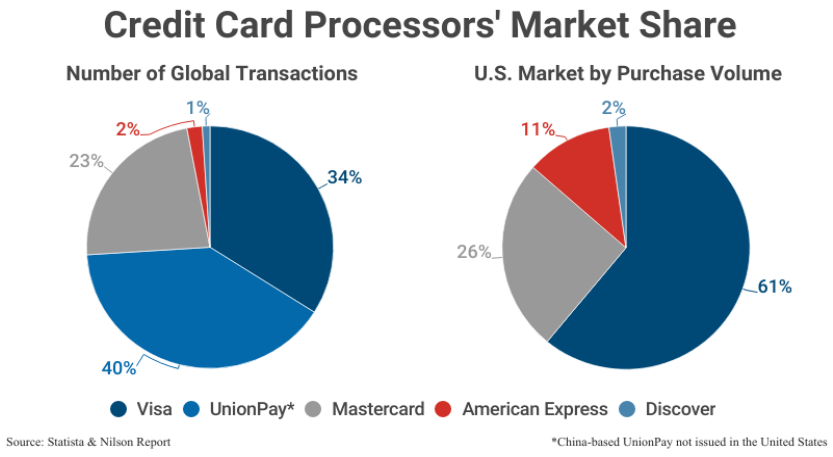

Figure 3: Credit Card Processors' Market Share

Growth Drivers

Development in China

The payments and cards market in China is worth an estimated $21 trillion as of 2021. Up until 2020, China allowed UnionPay to maintain a monopoly within the industry but has since started to open up to foreign investment in the sector. American Express aims to target premium consumers in China. According to the company's research, as of 2020, there were more than 2.2 million people in the country who had greater than 6 million yuan in investable assets and they expect 10% compound annual growth of this figure through 2025. In 2020, 57.4% of total card payment values in China utilized debit cards and thus in 2021, American Express partnered with China Industrial Bank to release two American Express branded debit cards. Fees charged by Chinese banks are lower than that of American Express and to combat this, American Express offers exclusive cardholder products to incentivize high net worth individuals to pay a higher fee compared to competitors [21].

Millenial and Gen-Z Impact

Millennial and Gen Z consumers are continuing to fuel growth for American Express as they accounted for more than 60% of total new consumer account acquisitions in Q1 2023. These consumers are the fastest growing demographic for American Express as it relates to spending, achieving growth of 28% compared to the year prior and making up 32% of consumer billed business [16]. The impact of Millenial and Gen-Z as generators of increased spending comes as they progress further in their careers, increasing their earnings and subsequent spending. Millennial and Gen-Z consumers may be drawn to American Express because of the travel and entertainment rewards they offer, as younger consumers are becoming increasingly willing and wanting to spend on experiences in a post-Covid landscape. According to American Express Travel's 2023 Global Travel Trends Report, 79% of surveyed Millenial and Gen-Z participants view leisure travel as an important budget priority and 84% would rather take a dream vacation over the purchase of a luxury item [26]. The prioritization of experience over luxury items is one that perfectly aligns with American Express' focus on Travel and Entertainment benefits.

Controversies

Banking Crisis

In March 2023, Silicon Valley Bank collapsed due to poor management of both their interest rate and liquidity risk causing depositors to quickly withdraw and the bank's assets to be sold to First-Citizens. A few weeks later, First Republic collapsed. With the collapse of these banks, there was an influx in negative sentiment toward the financial sector, causing American Express' stock price to fall as lending standards tightened. As of FY 2022, American Express only had 2.5% of their assets in long-term securities meaning their unrealized losses are minimal [24].

Loan Losses

April of 2023 saw further declines in stock price as American Express saw profits drop 13% compared to a year prior due to an increase in loan loss reserves [19]. The decision to raise their reserves comes as delinquency rates are rising. During Q1 2023, American Express generated record quarterly revenue of $14.3 billion, up 22% year over year, yet this growth was overshadowed by their decision to prepare for increased loan losses as the market continues to head in an uncertain direction with rates and inflation remaining high [5].

Q2 Earnings Report

After reporting Q2 2023 earnings, American Express saw a decline in stock price despite record high revenues of $15.1 billion, up 12% YOY, and growth for the last six consecutive quarters. This drop can be attributed to earnings falling short of expectations with expected at $15.4 billion compared to actual at $15.1 billion. Since earnings were released the stock has continued to fall from its July peak of $177 to $141.77 as of October 27, 2023 [4].

Recent News

American Express, Nuvei join forces

American Express announced its partnership with Canadian fintech company Nuvei. Nuvei was selected as the first acquirer authorized to promote and sell American Express' Pay with Bank transfer (PwBt's) Open Banking-enabled payment method. This payment method allows consumers the ability to complete transactions seamlessly from their bank accounts without requiring card information and additional authentication. Nuvei will promote PwBt to existing and prospective UK merchants and support the integration of the Open Banking payment method into their platforms while the payment method allows American Express to evolve in the digital payment and processing world [18].

Partnership with Formula 1

American Express recently announced their multi year partnership as the official payments partner of Formula 1 in the Americas. This announcement comes as American Express' first new sports vertical in over 10 years. With Formula 1 racing popularity having grown significantly in recent years, American Express is capitalizing on this opportunity to bring their unique experiences to the Formula 1 fan base and offer value to more consumers [17].

Amex Customers Kept Their Cards Even After Irksome Delta Changes

American Express has not seen an uptick in attrition after a series of changes were made with their largest co brand partner Delta Air Lines. Delta announced it will begin to limit the number of times Amex Platinum and Business Platinum Card Members will be able to access its Sky

Club airport lounges. Despite American Express cardholders pushing back against Delta, American Express has seen no decline in their cards.

Investment Thesis

Support a BUY decision on American Express based on a three pronged thesis: their premium cardholder base fueled by their spend-centric model, dual revenue streams, and their closed-loop network. Given the economic environment with elevated rates and the Fed working to slow down the economy, American Express has a defensive position and is well prepared to weather an economic downturn.

Fundamental Drivers

Premium Cardholder Base & Spend-Centric Model

American Express' target market is higher earning consumers who are subsequently greater spenders. On average, American Express cardholders spend 3x as much as non-card members [15]. High spending compared to competitors combined with an environment of strong consumer spending and an all time high Personal Consumption Expenditures at $18.8 trillion is fueling American Express' growth [25].

American Express having a lower credit risk relative to their competitors directly coincides with their affluent customer base. Having a customer base with higher credit scores than average suggests their cardholders are more reliable in paying back any debts they accrue. Centurion Card Members for example, have an average total net worth of $9.2 million with average household income of $1.4 million a year and Platinum Card Members have an average total net worth of $2.5 million with an average annual household income of $310,000 [28]. There further is a correlation between income and credit score with 87% of earners who make $150,000 or more having good to exceptional credit scores [29]. Due to higher average earnings, American Express' premium card holders create significantly lower credit risk for the company than the cardholders of their competitors.

In an economic downturn, American Express' higher earning consumers will be the last affected and to dial back on spending. When lower income consumers may start to curb spending on Travel and Entertainment due to an economic downturn, the average American Express consumer will continue spending as they previously had. American Express' premium card holder base coupled with their high spending on general expenses as well as travel and entertainment will drive their success despite declining economic indicators. High inflation and elevated rates pose a lesser threat to affluent American Express consumers who can afford to take these hits compared to the average earning consumer.

In addition to boasting a premium customer base and lower credit risk, American Express further employs a spend-centric model where they focus on generating revenue by driving spending on their cards and then fees. The company focuses heavily on marketing to increase card member acquisition, provide improved value to customers, and attract new card members. Their premium customer base is already composed of large spenders who can then be incentivized to spend more given increased value propositions, thus driving revenue for the company.

Dual Revenue Streams

The first revenue stream for American Express is cardholders who pay interest on outstanding balances, card fees, and conversion fees. Annual credit card fees for American Express can be up to $695 to allow Card Members access to exclusive rewards when competitors on average charge $128 annually [10] [30]. The second stream is through their merchants who are charged high discount fees for accepting their cards as payment. American Express charges a discount fee of 2.3% - 3.5% plus a 0.165% assessment fee compared to Visa on the lower end with discount fees of 1.4% - 2.5% and 0.14% in assessment fees [27]. American Express is able to charge merchants at a significantly higher rate as it increases the frequency of sales and generates larger transactions by purchase volume while bringing premium customers to their merchants. This dual system provides increased revenue for American Express as merchants are incentivized to pay the discount fee to gain a higher-spending customer base and American Express benefits from increased consumer spending at merchant locations.

Closed-Loop Network

American Express has distinguished itself from competitors in the payments processing industry by acting as the issuer and the acquirer. Operating under a closed-loop network allows American Express to realize synergies through gathering unique information on cardholders to provide customized offers, attract new customers, and retain existing ones. American Express is able to further utilize cardholder trends to maintain relationships with merchants and provide target marketing to align the right merchants and cardholders to drive revenue on both sides [24].

Economic Environment

Credit Risk

American Express faces a lower amount of credit risk than its competitors who offer credit cards through banks. The company has its own financial network to lend money to consumers which inherently means they are at risk of payment defaults. Although credit risk is always of concern and delinquency rates have increased to 2.77% for Q2, American Express cardholders boast high FICO scores allowing low delinquency rates and credit risk to continue [1].

Since the start of the COVID-19 Pandemic in March 2020, the government has issued nearly $1.8 trillion in stimulus money to individuals and families alone, with the total stimulus money equating to nearly $5 trillion [6]. The stimulus checks allowed the American public to have an influx of cash and subsequently the increase of the personal saving rate to an all time high of 32% in 2020 [3]. During this time there was also a spike in the number of people who improved their credit scores. Figure 4 depicts the share of people who have recently improved their credit score, with the percentage of people who improved their credit score since 2020 being higher for those in the most financially distressed zip codes in the country. The "most financially distressed" zip codes refer to the 20% of the U.S. population living in areas with the highest levels of credit card delinquencies [8]. The recent rise in delinquency rates can be explained by people whose credit scores improved during the pandemic when they were flush with cash. With savings decreasing, the people who had an influx of cash during the pandemic are now short of cash due to inflation and rising rates, and are prioritizing essential expenses over making their credit card payments on time, causing delinquency rates to subsequently rise.

The rise in delinquency of people with recently improved credit scores poses little threat to American Express as the company targets a very different bracket of income earners. American Express only approves customers with a minimum credit score within the good range of 670 - 739 for their credit card with no annual fee and lowest rewards [10]. As credit scores increase, customers are eligible for cards with higher annual fees and subsequently greater rewards. As mentioned previously, delinquency rates steadily decline as credit score increases, thus the delinquency rates of American Express cardholders are less than those of credit card processors overall and increased general delinquency should not impact the company.

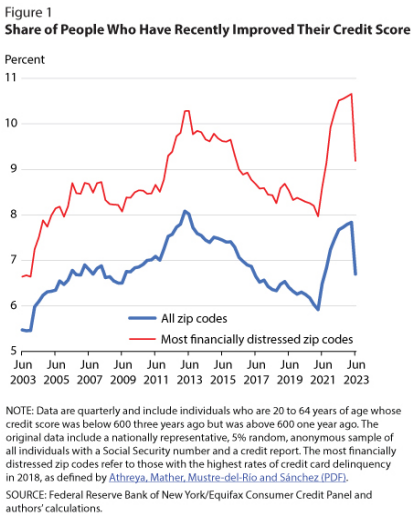

Figure 4: Recently Improved Credit Scores

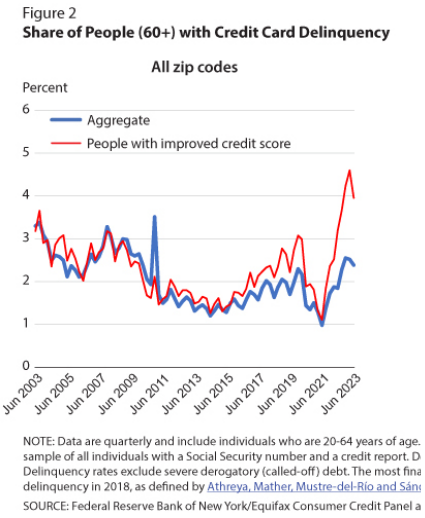

Figure 5: Credit Card Delinquency

<u>Interest Rates</u>

In March 2022, the Federal Reserve began raising rates to combat inflation and force an

economic slowdown. Since they started, the Fed has raised the Federal Funds Rate to 5.25% - 5.50%, up from nearly 0% at the beginning of the pandemic [5]. Higher rates will equate to American Express generating greater interest income as borrowing costs have gone up. As it relates to the consumer, American Express' premium cardholder is able to pay back their debts easier and is less affected by rate hikes than consumers with lower earnings and less cash to cover elevated interest payments.

Consumer Spending

The U.S. Consumer Services sector made up 45% of total sales for American Express in 2022 [24]. Consumer Services are highly dependent on consumer spending and overall confidence. The American consumer has remained resilient and spending has continued to increase with Personal Consumption Expenditure (PCE) rising by 0.4% in September 2023 [25].

The overall strength in spending could, however, be a result of a lag and the impact of elevated rates not having fully been realized by the consumer yet. Despite these sentiments and a potential decline in spending for the American consumer as a whole, American Express does not target this consumer and will not be greatly impacted. With higher-earning and premium Card Members, American Express will continue to see strong spending amongst their cardholders compared to the average consumer and payments processing industry at large.

Travel and Entertainment Expenditures

A large portion of Consumer Services consists of travel and entertainment expenditures which accounted for 25% of worldwide billed business in 2022 [13]. During Q2 2020, Travel and Entertainment (T&E) expenditures significantly declined due to the pandemic and extreme levels of uncertainty. Since the pandemic, T&E has rebounded with global air traffic reaching 94.2% of pre-pandemic levels as of June 2023 and domestic travel surpassing pre-pandemic levels [12]. In Q1 2023, American Express saw T&E spending soar by 39% on an FX-adjusted basis [20]. Consumers are eager to begin traveling once again which will see an increase in spending for American Express cardholders and increased discount revenue generated from merchants as well as greater interaction with company partnerships such as Delta and Marriott.

Financial Analysis

Given high interest rates, the collapse of Silicon Valley Bank in March 2023, and low personal saving rate, the financial sector as a whole has received a lot of negative attention. With the overall sector having poor YTD performance, American Express has experienced declines in their stock price as a residual impact, yet their financials and guidance for the year remain intact; as previously stated, American Express only has 2.5% of its assets tied up in long-term securities [24].

American Express is experiencing record revenue growth and has been for the past six quarters in a row despite all the noise going on in the greater industry [24]. Non-Interest Revenue Growth is projected to grow at 12% for 2023, above that of the 10.51% expectations. Revenue Growth is expected to decline in 2024 as the market catches up to the elevated rates and a slowdown occurs, with assumptions being at 9% growth which is still higher than that of consensus at 8.85% growth for the year. Outlook for 2025 includes the beginnings of recovery with revenue growth increasing by 9.50% compared to growth of 8.48% for consensus. Assumptions are higher than consensus based on the confidence in the resilience of American Express' consumers as well as their global expansion. Net Interest Income however remains in line with consensus estimates. EPS is expected to be higher than that of conesus by 14% in 2023, higher by 5% in 2024, and higher by 6% in 2025 in line with an economic recovery. American Express currently has $12.55 billion in debt outstanding over the next three years but has $30 billion in cash leaving them well prepared to pay off their debts [4].

Total Non-Interest Revenue Growth Rate (YoY)

FY	2023E	2024E	2025E
Model Assumptions	12.00%	9.00%	9.50%
Consensus	10.51%	7.85%	8.48%

Key Financial Ratios

Company	Market Cap (in Billions)	YTD Returns	Quarterly Revenue Growth (YoY)	Quarterly Earnings Growth (YoY)	Forward Dividend Yield	Operating Margin	Forward P/E
American Express	111.513	3.83%	10.70%	30.40%	1.54%	22.00%	12.27
Discover Financial	21.635	-10.11%	-13.10%	-32.60%	3.10%	37.92%	7.36
Mastercard	362.132	11.32%	13.50%	28.00%	0.59%	58.84%	27.03
PayPal	58.888	-24.78%	8.40%	-23.30%	N/A	15.99%	9.88
Visa	503.744	17.46%	10.60%	18.80%	0.85%	65.97%	24.63

The table above lists the key financial ratios for American Express along with its biggest competitors in the Financial Services segment. American Express has a market cap of $111.513 billion which is substantially lower than Mastercard and Visa. American Express boasts a P/E ratio of 12.27 compared to Mastercard and Visa at 27.03 and 24.63 respectively, making American Express have a cheaper valuation with shareholders paying less per dollar of earnings. Discover and PayPal are both experiencing negative YTD returns which can be explained by challenging macroeconomic conditions and corporate governance issues for the former and increased competition for the latter, causing returns and the stock price to decline.

Price Target

Using a DCF model, the expected target price of American Express within the next 12 months is $199.13, equating to 42.19% upside compared to the price of $141.71 on October 27, 2023. With the implied equity value being substantially greater than the current price, American Express is

undervalued and a cheaper way to gain exposure to the financial sector relative to its competitors. The assumptions used to arrive at the aforementioned price target are a decline in total non-interest revenue growth year over year into 2024 with a recovery the next year, followed by stabilizing yet lower growth rates thereafter. Another key assumption is the percent growth in net income following a similar arch of slowing in 2024, peaking in 2025 and returning to more stable growth rates going forward.

DCF Sensitivity Analysis

		Terminal FCF Growth Rate						
		1.50%	2.00%	2.50%	3.00%	3.50%	4.00%	4.50%
Terminal Discount Rate	9%	$234.83	$243.98	$254.54	$266.86	$281.41	$298.88	$320.23
	10%	$205.89	$212.40	$219.77	$228.20	$237.92	$249.27	$262.67
	11%	$183.03	$187.80	$193.13	$199.13	$205.93	$213.70	$222.66
	12%	$164.53	$168.11	$172.07	$176.47	$181.39	$186.92	$193.19
	13%	$149.25	$151.99	$155.00	$158.30	$161.96	$166.02	$170.56

The 12 month price target for American Express of $199.13 was calculated by using a 3% terminal FCF growth rate along with a terminal discount rate of 11%. A terminal discount rate of 11% was used to account for the riskiness and cyclical nature of American Express' business. Based on the DCF model and sensitivity analysis, price targets for American Express fall within the range of $149.25 to $320.23 in the next 12 months.

Risks

<u>Decline in Personal Saving Rate</u>

As the personal saving rate peaked in 2020 at 32% with government stimulus packages, American consumers had a surplus of cash [3]. Since then, the saving rate, as seen in Figure 6, has dwindled to 3.4% as of September 2023 [2]. This decrease represents a dip slightly below that of pre-pandemic levels. Although the decline is nothing unprecedented, it still means consumers are no longer flush with cash and may have to minimize spending overall but more specifically on discretionary items like travel and entertainment, where American Express generates significant revenue.

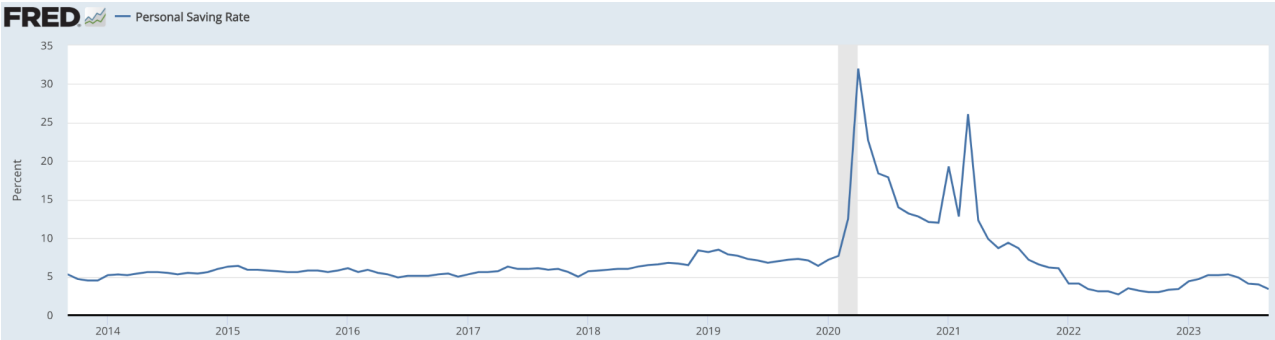

Figure 6: Personal Saving Rate

Threat to the Affluent

During economic downturns, those in lower income brackets are hit hardest yet other indicators could point to a "richcession," or a greater-than-expected impact to high earning workers in the event of an economic downturn. Figure 7 shows the lowest quartile of earners experiencing higher wage growth at nearly 7.5% compared to the top quartile of earners experiencing lower wage growth of less than 5%. In addition to lower wage growth amongst higher earners, layoffs amongst Fortune 500 companies and an emphasis on the technology sector in particular have skyrocketed in the last year. Google, Meta, and Amazon as of January 2023, had laid off more than 104,000 workers since the start of the prior year [31]. As of 2021, the median worker at Meta, earned $295,785 and Twitter, recently rebranded as X, workers earned a median $232,626. This group of workers are being hit particularly hard by industry layoffs as a correction to pandemic overhiring. Layoffs occurring amongst affluent white collar workers may put pressure on the American Express card holder who is tightening their spending as they look for a new job [9].

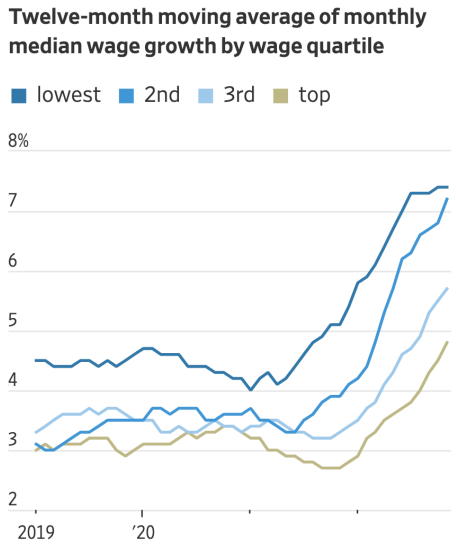

Figure 7: Moving Average of Wage Growth

Conclusion

Issue a BUY recommendation on American Express. At a current price of $141.71 but with an implied equity price of $199.13, American Express is undervalued and serves as an inexpensive way, relative to its competitors, to gain exposure to the financial sector. The 42.19% upside the stock has can be attributed to their economically defensive business model within an economically sensitive sector. Given their premium cardholder base which is fueled by their spend-centric model, their dual sources of revenue, and their closed-loop network, American Express is well prepared to not only weather an economic downturn but to capitalize on growth opportunities for the company.

Appendix 1: Income Statement

Financial Statement Model for American Express

$ in millions expect per share

Company Name	American Express
Ticker	AXP
Latest closing share price (10/27/23)	$141.71
Latest fiscal year end date	12/31/22

INCOME STATEMENT

Year	FY 2018A	FY 2019A	FY 2020A	FY 2021A	FY 2022A	FY 2023E	FY 2024E	FY 2025E
Total non-interest revenues	32,675	34,936	28,102	34,630	42,967	48,123	52,454	57,437
Consensus						**48,015**	**52,225**	**57,317**
Total interest income	10,606	12,084	10,083	9,033	12,658	19,493	21,443	21,764
Total Interest Expense	3,464	2,943	2,098	1,283	2,763	6,823	7,505	7,618
Net Interest Income	7,663	8,620	7,985	7,750	9,895	12,671	13,938	14,147
Consensus						**12,601**	**13,695**	**14,295**
Total revenues net of interest expense	43,556	40,338	36,087	42,380	52,862	60,794	66,392	71,584
Provisions for Credit Losses	3,573	3,352	4,730	-1419	2,182	3,648	4,647	4,295
Total revenues net of interest expense after Provision for Credit Losses	39,983	36,986	31,357	43,799	50,680	57,146	61,744	67,289
Expenses:								
Card Member Rewards	9,696	10,439	8,041	11,007	14,002	15,806	17,262	18,612
Business development	6,470	7,114	3,051	3,762	4,943	5,715	6,174	6,729
Card Member services	1,777	2,222	1,230	1,993	2,959	3,648	4,315	4,653
Marketing	0	0	3,696	5,291	5,458	6,079	6,838	7,373
Salaries and employee benefits	5,250	5,911	7,252	6,240	5,718	7,295	7,635	7,874
Other, net	5,671	5,868	5,325	4,817	6,481	6,687	7,635	8,590
Total Expenses	28,864	31,554	27,061	33,110	41,095	45,231	49,860	53,831
Pretax Income	8,122	8,429	4,296	10,689	9,585	11,916	11,884	13,458
Income Tax Provision	1,201	1,670	1,161	2,629	2,071	2,621	2,615	2,961
Net Income	6,921	6,759	3,135	8,060	7,514	9,294	9,270	10,497
Shares Outstanding - Basic	856	828	805	789	751	735	715	695
Shares Outstanding - Diluted	859	830	806	790	752	736	716	696
Earnings Per Share	7.91	7.99	3.77	10.02	9.85	12.63	12.95	15.08
Consensus Earnings Per Share						**11.08**	**12.35**	**14.26**
Sales								
Expenses as % of Sales								
Card Member Rewards	22.3%	25.9%	22.3%	26.0%	26.5%	26%	26%	26%
Business development	14.9%	17.6%	8.5%	8.9%	9.4%	9.4%	9.3%	9.4%
Card Member services	4.1%	5.5%	3.4%	4.7%	5.6%	6.0%	6.5%	6.5%
Marketing	0.0%	0.0%	10.2%	12.5%	10.3%	10.0%	10.3%	10.3%
Salaries and employee benefits	12.1%	14.7%	20.1%	14.7%	10.8%	12.0%	11.5%	11.0%
Other, net	13.0%	14.5%	14.8%	11.4%	12.3%	11.0%	11.5%	12.0%
Total Expenses	66.3%	78.2%	75.0%	78.1%	77.7%	77.7%	77.7%	77.7%
Revenue Growth								
Total non-interest revenues		6.9%	-19.6%	23.2%	24.1%	12.0%	9.0%	9.5%
Total interest income		13.9%	-16.6%	-10.4%	40.1%	54.0%	10.0%	1.50%
Interest Expense								
Interest Expense as % of Interest Income	32.7%	24.4%	20.8%	14.2%	21.8%	35%	35%	35%
Tax Rate								
Income Tax Provison as % of Pretax Income	14.8%	19.8%	27.0%	24.6%	21.6%	22%	22%	22%
Credit								
Credit Loss as % of Total Sales	8.2%	8.3%	13.1%	-3.3%	4.1%	6.0%	7.0%	6.0%

BALANCE SHEET and CASH FLOW STATEMENT

D&A	1,293	1,188	1,543	1,695	1,626	2,127.78	2,323.71	2,505.44
% of Sales	3.0%	2.9%	4.3%	4.0%	3.1%	3.50%	3.50%	3.50%
CapEx	1,310	1,645	1478	1550	1855	2,128	2,324	2,505
% of Sales	3.0%	4.1%	4.1%	3.7%	3.5%	3.5%	3.5%	3.5%
Receivables	55,320	56,794	43,434	53,581	57,384	60,793.70	66,391.84	71,584.04
% of Sales	127%	141%	120%	126%	109%	100%	100%	100%
ST and LT Investments	4,647	8,406	21,631	2,591	4,578			
% of Sales	10.7%	20.8%	59.9%	6.1%	8.7%			
Payables								
Accounts payable	12,255	12,738	9,444	10,574	12,133	15,806.36	17,261.88	18,611.85
% of Sales	28.1%	31.6%	26.2%	25.0%	23.0%	26%	26%	26%
Short-term borrowings	3,100	6,442	1,878	2,243	1,348	3,040	3,320	3,579
% of Sales	7.1%	16.0%	5.2%	5.3%	2.6%	5%	5%	5%
Change in Net Working Capital		(1,408)	(7,723)	10,388	(5,126)	6,533	(3,863)	(3,583)

Appendix 2: DCF Model

Company Name	American Express		
Ticker	AXP	**Terminal Discount Rate:**	11.0%
Date	10/27/23	**Terminal FCF Growth:**	3.0%

DCF

Year	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E	FY 2028E	FY 2029E	FY 2030E	FY 2031E	FY 2032E	FY 2033E	FY 2034E
Total non-interest revenues	48,123	52,454	57,437	61,745	66,376	69,695	72,483	74,657	76,897	79,204	81,580	84,027
% Growth		9.0%	7.5%	7.5%	7.5%	5.0%	4.0%	3.0%	3.0%	3.0%	3.0%	3.0%
Interest Income	19,493	21,443	21,764	22,091	22,422	22,758	23,100	23,446	23,798	24,155	24,517	24,885
% Growth		10.0%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
Interest Expense	7,505	7,618	7,618	7,732	7,848	7,965	8,085	8,206	8,329	8,454	8,581	8,710
As a % of Interest Income	35%	36%	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%
Net Interest Income	11,988	13,825	14,147	14,359	14,574	14,793	15,015	15,240	15,469	15,701	15,936	16,175
Total revenues net of interest expense	60,111	66,279	71,584	76,104	80,950	84,488	87,497	89,897	92,365	94,904	97,516	100,202
Provision for Credit Losses	3,648	4,647	4,295	2,283	2,429	2,535	2,625	2,697	2,771	2,847	2,925	3,006
% of Total revenues and net interest income	6.1%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
Total revenues net of interest expense after credit losses	56,464	61,632	67,289	73,821	78,522	81,953	84,872	87,200	89,594	92,057	94,590	97,196
Expenses	45,231	49,860	53,831	59,057	62,817	65,562	67,898	69,760	71,676	73,646	75,672	77,757
% of int income	80.1%	80.0%	80.0%	80.0%	80.0%	80.0%	80.0%	80.0%	80.0%	80.0%	80.0%	80.0%
Income before Taxes	11,233	11,772	13,458	14,764	15,704	16,391	16,974	17,440	17,919	18,411	18,918	19,439
Income Tax Provision	2,621	2,615	2,961	3,100	3,298	3,442	3,565	3,662	3,763	3,866	3,973	4,082
% Sales	23.3%	22.2%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%
Net Income	8,612	9,157	10,497	11,664	12,406	12,949	13,410	13,778	14,156	14,545	14,945	15,357
% Growth		6.3%	14.6%	11.1%	6.4%	4.4%	3.6%	2.7%	2.7%	2.7%	2.8%	2.8%

NPV of Cash Flows	**$76,924.77**	52.5%		**Terminal Value**	197,722
NPV of Terminal Value	**$69,634.49**	47.5%		**Terminal P/E**	12.88
Projected Equity Value	**$146,559.26**	100.0%			
Current P/E	16.22	11.39	9.94		
Projected P/E	17.02	16.01	13.96		

Shares Outstanding	736
Current Price	$141.71
Implied equity value/share	$199.13
Upside/(Downside) to DCF	40.5%
Debt	12,550
Cash	33,000
Cash/share	44.84

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