American Express Co AXP (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
80.77 USD	95.00 USD	66.50 USD	128.25 USD	Medium	Wide	Stable	Standard	Credit Services

American Express Has the Resources to Handle a Rough Patch

See Page 2 for the full Analyst Note from 17 Apr 2015

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The primary analyst covering this company does not own its stock.

Research as of 17 Apr 2015
Estimates as of 26 Mar 2015
Pricing data through 18 Jun 2015
Rating updated as of 18 Jun 2015

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.

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Investment Thesis 10 Feb 2015

American Express relies on powerful network effects and the valuable intangible asset associated with its brand in order to generate excess economic profits. Over the years, American Express has assembled a base of big-spending cardholders by offering exceptional rewards and services. These affluent customers are attractive to merchants, who willingly pay higher discount fees to American Express. In turn, high discount fees fund the company's rewards programs, making the company's offerings more appealing to cardholders and completing a virtuous circle.

American Express' closed-loop network both issues cards to consumers and acquires transactions from merchants. As such, American Express possesses a vast amount of valuable data about the spending habits of its prosperous cardholders. The company is still in the early stages of monetizing this data but American Express' unique knowledge of spending patterns is a clear source of opportunity. American Express' closed-loop network is also somewhat resistant to regulatory change compared with networks that set interchange fees for participants. Unfortunately, American Express' reliance on superior rewards is also the biggest competitive threat to the company. Other issuers are aggressively targeting American Express customers with ever-increasing levels of rewards and services, and we expect this phenomenon to slowly take a toll on the firm's profitability.

We were initially skeptical of American Express' attempts to go downmarket, as previous efforts to expand the company's lending activities resulted in skyrocketing charge-offs. However, its newer efforts are relatively low-risk experiments in disruptive realms like prepaid cards and offer the prospect of running far more transaction volume through the company's network. Yet we see these new customers as a double-edged sword--though they represent additional business for the company, the lower levels of customer service provided to them may eventually weaken the intangible assets associated with American Express' traditional business.

Vital Statistics

Market Cap (USD Mil)	82,046
52-Week High (USD)	96.24
52-Week Low (USD)	76.53
52-Week Total Return %	-14.4
YTD Total Return %	-12.6
Last Fiscal Year End	31 Dec 2014
5-Yr Forward Revenue CAGR %	-2.3
5-Yr Forward EPS CAGR %	6.5
Price/Fair Value	0.85

Valuation Summary and Forecasts

Fiscal Year:	2013	2014	2015(E)	2016(E)
Price/Earnings	18.4	16.7	*14.5*	*14.2*
Price/Book	5.2	4.0	*4.7*	*4.7*
Price/Tangible Book	5.2	4.0	*4.7*	*4.8*
Dividend Yield %	1.0	1.1	*1.3*	—

Financial Summary and Forecasts (USD Mil)

Fiscal Year:	2013	2014	2015(E)	2016(E)
Net Revenue	32,974	34,292	*34,131*	*35,245*
Net Revenue YoY %	4.4	4.0	*-0.5*	*3.3*
Net Interest Income	5,047	5,472	*5,312*	*4,994*
Net Interest Margin %	4.3	4.5	*4.5*	*4.5*
Pre-Tax Pre-Provision Earnings	9,998	11,035	*10,310*	*10,469*
Pre-Tax Pre-Provision Earnings YoY %	18.5	10.4	*-6.6*	*1.5*
Net Income	5,359	5,839	*5,597*	*5,549*
Net Income YoY %	19.6	9.0	*-4.1*	*-0.9*
Diluted EPS	4.92	5.56	*5.56*	*5.68*
Diluted EPS YoY %	25.3	12.9	*0.2*	*2.2*

Source for forecasts in the data tables above: Morningstar Estimates

Profile

American Express was founded as an express mail business in 1850. By the turn of the century, the company expanded into financial services and introduced its famous Travelers Cheques, before issuing the first American Express card in 1958. Today, the company provides charge and credit card products, travel services, network services, stored value products, loans, and other products and services to businesses and individuals. American Express issues cards to consumers and engages in merchant acquiring and processing globally.

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Morningstar Analysis

American Express Has the Resources to Handle a Rough Patch 17 Apr 2015

Despite the effects of a strong U.S. dollar versus other currencies and the pending loss of its co-brand relationship with Costco, American Express posted an 11% increase in diluted earnings per share and a 29% return on average equity during the quarter. We think the company's performance under these circumstances is indicative of its wide moat, and we do not intend to significantly alter our recently updated fair value estimate.

Management appears to be doing a reasonably good job steering the company through tough times in early 2015. American Express' strong capital position allowed the company to repurchase shares, contributing to an 11% increase in earnings per share on a 6% increase in net income. The company also offset increasing rewards and services expenses by lowering operating expenses across the board. American Express is also expanding its network—a key source of its economic moat—by adding new merchants through its OptBlue program. Though the loss of the Costco co-brand relationship is a large blow, we don't think American Express is down for the count. In fact, new relationships with companies like Charles Schwab are intriguing as the financial services landscape changes.

Helpfully, American Express is still benefiting from extraordinary credit quality, writing off only 1.5% of principal balances in the first quarter—and releasing $107 million in reserves. We think an improving economy and a greater emphasis on spending rather than lending among American Express' competitors could lead to an extended period of low loan losses, boosting the company's bottom line above and beyond "normal" levels. American Express' exceptional profitability, healthy capital levels, and pristine credit should provide the company quite a cushion to deal with temporary bumps in the road.

Most troubling during the quarter might have been the slowing pace of spending on the company's corporate cards. Billed business fell 1% as reported and grew by only 4% as adjusted for the effects of foreign currencies. Income in this segment fell slightly to $180 million from $184 million. However, we believe this is due to volatility in corporate spending rather than increased competition, and expect American Express to maintain its stronghold in this area.

We also see evidence that American Express is having to pass on more economic benefits to cardholders as other issues continue to vie for premium customers. Cardmember rewards grew by only 4% during the year, but services expense expanded by 18% as American Express redoubled its efforts to distinguish itself from peers.

Valuation, Growth and Profitability 26 Mar 2015

We are raising our fair value estimate to $95 per share from $82 as we reduce our cost of equity to 9% from 10% based on our new cost of capital methodology. Our new fair value estimate represents 17 times our 2016 earnings per share estimate. Over the next five years, we expect discount revenue to fall to 1.85% of billed business as competitive pressures continue. We think rewards expenses will consume 36% of discount revenue over the next five years, up significantly from the average over the past five years as a result of increased competition. However, we expect billed business/cards in force to increase both inside and outside the U.S. as the move toward electronic payments continues. As a result, we forecast noninterest revenue growth averaging 6% annually over the next five years. We believe marketing expense will eventually average 9% of revenue over the long run, in line with the company's goals. We expect the efficiency ratio to fall to 66% by the end of our forecast period. We forecast net interest margin averaging 4.3% (as we calculate) over the next five years, with net charge-offs averaging 4% of loans over the same time frame.

Scenario Analysis

In an upside scenario, we think American Express could be

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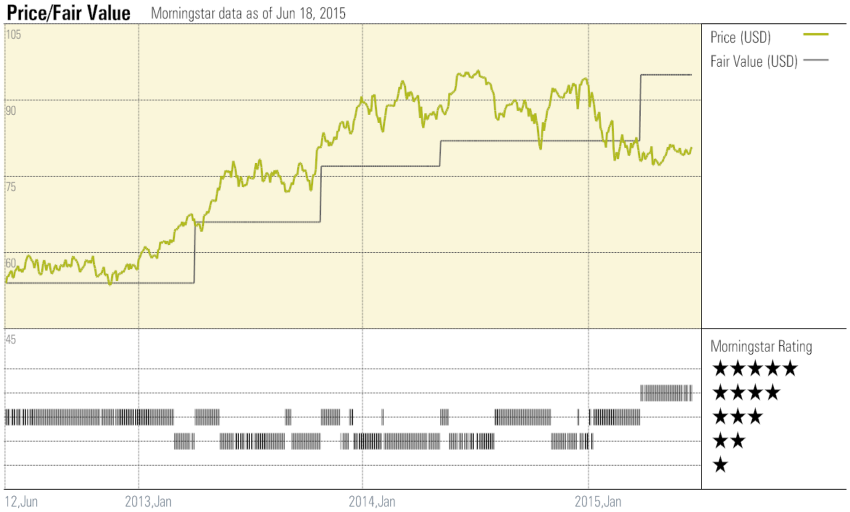
Morningstar Analysis

Price/Fair Value Morningstar data as of Jun 18, 2015



worth as much as $140 per share. In such an optimistic scenario, we think discount revenue could stabilize at 1.9% of revenue, with noninterest revenue growing by about 7% annually over our forecast period as billed business per card increasing substantially, especially outside the United States. If net interest margin were also to improve to 4.5%, the company's efficiency ratio would fall to 64%, resulting in return on assets increasing to an impressive 5%.

In a downside scenario, we think American Express could be worth as little as $50 per share. In this scenario, we think competition could reduce discount revenue to only 1.65% of billed business by the end of our five-year forecast period, resulting in noninterest revenue growth averaging 3%. We also forecast rewards consuming 40% of discount revenue by 2017. In this scenario, American Express would achieve an efficiency ratio of 72%. In this scenario, return on assets would fall to 2.8% over the next five years.

Economic Moat

American Express' closed-loop network and spend-centric model is the source of its wide economic moat. The network effect created by a large base of cardholders and merchants is strengthened even further by American Express' focus on the affluent--average annual spending on an American Express card is much larger than the amounts spent on competitors' cards. This makes the card more attractive to merchants, strengthening the American Express brand--a powerful intangible asset--as well as its pricing power and its ability to offer rewards to cardholders. Furthermore, as both issuer and merchant acquisitor, American Express possesses vast amounts of data on spending patterns that few competitors can match. This data can only benefit the company as commerce becomes increasingly digitized and merchants seek to offer personalized shopping experiences.

Moat Trend

We think American Express' moat trend is stable, with competitive pressures offset by new opportunities. Competition in the payment space is clearly intense, but although other issuers are offering higher rewards in an attempt to win over Amex customers, the American Express brand remains quite powerful, and its cardholders still spend considerably more than peers. Although the move from plastic cards to mobile payment technologies is likely to intensify pricing pressure, we think a complete disruption of the virtuous circle that creates the company's moat is still far off in the future. Furthermore, American Express' closed-loop network will provide opportunities to exploit its proprietary data for custom promotions, advertising, and other solutions as technology advances.

Risk

The biggest risk for American Express is the possibility that new types of technology will eventually bypass the traditional payment networks. It's also possible that digital wallets will shift some of the value now captured by the major network brands to cardholders, merchants, and wallet providers. American Express also faces competition in the rewards space and a consequent erosion of its pricing power. The company also faces regulatory risk--restrictions

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Morningstar Analysis

Nature of Liabilities

	2012	2013	2014	2015(E)	2016(E)
Loan/Deposit Ratio %	161.57	159.44	157.95	140.13	124.49
Short Term Debt (% of Liabilities)	2.47	3.75	—	—	—
Liquid Assets (% of Assets)	44.51	43.47	43.53	46.59	49.55

Leverage

	2012	2013	2014	2015(E)	2016(E)
Assets/Equity	8.11	7.87	7.55	7.55	7.69
Tangible Common Equity/Tangible Assets %	12.33	12.71	13.25	13.25	13.00
Tier I Ratio %	—	12.30	11.90	—	—

Source: Morningstar Estimates

on interchange fees could lead to reductions in the discount fees it earns. Finally, American Express faces credit risk in its lending business.

Financial Health

American Express is in good financial health, reflected in strong capital levels and low nonperforming loans. Capital remains solid, with a tangible common equity ratio of 12.6% as of the end of 2014. Based on the Dodd-Frank stress test results, Amex and other credit card companies score among the highest of the 31 bank holding companies. Nonperforming loans represent approximately 1% of assets, the lowest in our credit card universe. With predominantly credit card loans, deposits constitute only 35% of total liabilities, with most of the remainder from long-term senior notes. Liquidity is not a near-term concern as the company has dramatically reduced its dependence on securitizations and unsecured term debt over the past five years.

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Bulls Say/Bears Say

Bulls Say

- The combination of American Express' affluent cardholder base and its proprietary merchant and customer data provides opportunities to expand into additional wide-moat lines of business.
- American Express is allowing third parties to issue cards and acquire transactions, expanding the reach of its network.
- American Express accounts for a significant percentage of an electronic spending pie that is certain to expand for years to come.

Bears Say

- Mobile technology will alter the payment landscape in the biggest way since the advent of the credit card.
- Competitors are making inroads into the premium space with ever more lucrative rewards offerings.
- An increasing emphasis on low-end offerings will damage the American Express brand.

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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	InsiderActivity
MR. KENNETH I. CHENAULT	CEO/Chairman of the Board/ Director,Director	754,630	18 May 2015	769,000
MR. ROBERT D. WALTER	Director	230,300	12 Mar 2010	—
MR. STEPHEN J. SQUERI	President, Divisional	173,323	27 May 2015	431,913
MR. EDWARD P. GILLIGAN	President	172,989	26 Jan 2015	—
MR. ASHWINI GUPTA	Chief Risk Officer/President, Divisional	113,175	12 Mar 2015	—
MR. JAMES PETER BUSH	Executive VP, Divisional	63,674	26 Jan 2015	—
MR. JOHN D. HAYES	Executive VP/Chief Marketing Officer	56,853	26 Jan 2015	—

*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

Fund Ownership

Top Owners	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
Vanguard Total Stock Mkt Idx	1.78	0.35	13	31 May 2015
VA CollegeAmerica Washington Mutual	1.18	1.26	-6,300	31 Mar 2015
Davis New York Venture Fund	1.09	5.21	-2,617	31 Jan 2015
VA CollegeAmerica Fundamental Investors	1.08	1.25	750	31 Mar 2015
Vanguard Five Hundred Index Fund	0.98	0.37	70	31 May 2015
Concentrated Holders				
DUNCAN ROSS POOLED TRUST	0.04	13.44	—	30 Sep 2014
DUNCAN ROSS EQUITY	—	10.15	—	30 Sep 2014
Cinderella Value Fund	—	9.31	—	30 Apr 2015
BlackRock Exchange Portfolio	0.02	8.47	—	30 Apr 2015
Pozotoro Inversiones SICAV	—	7.89	2	31 Dec 2014

Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/ Sold (k)	Portfolio Date
American Express & Participating Subsidiaries Incentive Savings Plan	1.16	11.77	13,494	31 Dec 2008
MFS Investment Management K.K.	1.92	0.77	4,268	31 Mar 2015
Arnhold & S. Bleichroeder Advisers, LLC	1.16	2.18	3,818	31 Mar 2015
Veritas Asset Management LLP	0.33	4.11	3,340	31 Mar 2015
Viking Global Investors LP	0.29	0.90	2,973	31 Mar 2015
Top 5 Sellers				
Fidelity Management and Research Company	1.73	0.19	-13,985	31 Mar 2015
Capital World Investors	4.72	1.01	-8,665	31 Mar 2015
BlackRock Advisors LLC	4.78	—	-6,057	31 May 2015
Lansdowne Partners Limited Partnership	0.26	1.85	-3,912	31 Mar 2015
State Street Corp	4.08	0.33	-3,814	31 Mar 2015

Management 10 Feb 2015

We think management's stewardship of shareholder capital is standard. Unlike many financial firms, American Express managed to post a profit in each of the last 10 years. The firm is currently returning a vast majority of capital generated to shareholders via dividends and buybacks. However, these factors are offset by a few questionable decisions--American Express made dubious underwriting decisions in pursuit of growth prior to the financial crisis, and was arguably too dependent on short-term funding in those years as well.

CEO Kenneth Chenault has been with the company for more than 30 years, serving in a variety of capacities. Overall, we think he guided the company relatively well through a difficult period over the past five years, and we believe he is well-qualified to continue leading the firm.

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Analyst Notes

Citigroup Emerges From CCAR as Winner; Bank of America and Foreign Banks Disappoint 11 Mar 2015

The Federal Reserve announced late on March 11 that it has approved the capital plans of 28 banks (out of 31) participating in the Comprehensive Capital Analysis and Review while objecting to two banks' capital plans. For Bank of America, the Federal Reserve did not object to the capital plan but indicated that there were deficiencies in the capital planning process, which warranted near-term attention. The two objections (Deutsche Bank Trust Corporation and Santander Holdings USA) were over qualitative concerns because of widespread deficiencies across their capital planning processes. We do not anticipate changing our fair value estimates or moat ratings for any of the banks, but we think there are several key takeaways from the CCAR results.

U.S. money center banks continued to play a game of musical chairs with respect to their CCAR positioning, reinforcing our thesis that Bank of America, Citigroup, and JPMorgan are converging on a qualitative basis. The factors that once set JPMorgan apart from its more troubled peers are slowly disappearing--in part because Bank of America and Citigroup were forced to aggressively reduce risk. Among these three banks, Citigroup is the big winner in 2015, boosting its dividend and embarking on a large buyback program.

Last year, Bank of America was forced to adjust its capital plan, while this year JPMorgan was the firm that required a mulligan as the firm seemingly presented an overly aggressive request. JPMorgan's 2015 adjusted capital plan raised its minimum Tier 1 leverage ratio in a severely adverse scenario from 3.8% to 4.1%--just over the 4% limit. We estimate this change reduced planned distributions by roughly $8 billion, though the company will still boost its dividend by 10% and authorize $6.4 billion in buybacks--2.9% of its market capitalization. Bank of America, on the other hand, received no objection on a quantitative basis, but will need to correct deficiencies in its capital planning process, particularly its loss and revenue modeling, as well as improve certain internal control practices by September. In 2013, JPMorgan received a similar reprimand, but was still able to increase its dividend and repurchase shares as planned after complying with the Fed's demands. We therefore are not overly concerned by Bank of America's position. More discouraging, though, is the relatively small size of Bank of America's planned actions. The company plans only $4 billion in repurchases--just 2.4% of the company's market value--and no increases in dividends. We assume the company's inability to consistently demonstrate recurring earnings played a role.

Citigroup, on the other hand, appears to have passed with flying colors this year after posting the worst failure in 2014, based on qualitative factors. Citigroup will raise its dividend to $0.05 per quarter and repurchase up to $7.8 billion in shares beginning in the second quarter--a healthy 5% of its current market capitalization. Wells Fargo also received no objections, as we expected, and bumped its quarterly dividend to $0.375 from $0.35.

Not surprisingly, the credit card companies' excess capital and superb profitability also paid off. American Express is raising its dividend by 12% and buying back $6.6 billion in shares--8% of its market cap, while Discover will boost its quarterly dividend from $0.24 to $0.28 and repurchase $2.2 billion, or 8.5%, of its stock.

The large U.S. subsidiaries of foreign banks continued to have a difficult time with this process. Deutsche Bank Trust Corporation and Santander Holding USA both passed the stress tests on a quantitative basis, with Tier 1 ratios of 34.7% and 9.4%, respectively, in the severely adverse scenarios. But, their capital plans were rejected on a qualitative basis. For both banks, specific deficiencies were

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Analyst Notes

identified in a number of key areas including governance, internal controls, risk identification and risk management, management information systems, and assumptions and analysis that support the capital planning processes. For Deutsche Bank, the result was completely expected. Deutsche was entering the Comprehensive Capital Assessment and Review process for the first time in 2015, and foreign banks entering the process typically fail on their first attempt. For example, HSBC North America Holdings and RBS Citizens failed last year, which was their first time, but received Fed approval the second time around. Overall, the results for Deutsche are much less important than they are for U.S. banks--foreign banks that receive objections may not be allowed to distribute dividends from the U.S. subsidiary to the parent company, but cannot be prevented from paying dividends to shareholders at a parent level.

The Federal Reserve also issued a qualitative objection to the capital plans of Santander Holdings USA, a division of Spain's Banco Santander. This is the second year in a row that Santander Holdings USA received a qualitative objection from the Federal Reserve, and the reasoning behind the objection is exactly the same as the prior year. As such, it appears that Santander Holdings did little to improve the internal controls and risk management deficiencies highlighted by the Fed since last year. This sort of indifference certainly creates a negative perception of the bank, but actually has little impact on the bank's ability to pay dividends to its shareholders as a foreign bank. Like Deutsche Bank, the objection prevents Santander Holdings USA from distributing dividends to the parent company, but the parent company's dividend to shareholders is not dependent on this transfer of capital, as it can draw upon funds flowing to the parent from its several geographic subsidiaries to fund the dividend. Further, the Spanish parent may not be interested in extracting a dividend from its U.S. operations because the U.S. market represents one of the global bank's best organic growth opportunities. In our view, we think this result is suggestive that Banco Santander is more focused on meeting European capital regulations and guidelines and that the U.S. arm's risk controls and capital planning will improve in conjunction with the broader bank's progression.

Last, it is also noteworthy that along with JPMorgan Chase, both Goldman Sachs Group and Morgan Stanley received nonobjections to their resubmitted capital action plans since last week's stress test results were released. Under the adjusted plans, Goldman Sachs' minimum Tier 1 capital ratio will be 6.4% instead of 5.9%, and its total risk-based capital ratio will be 8.1% instead of 7.6%. For Morgan Stanley, its minimum Tier 1 capital ratio will be 6.2% instead of 6.0%, and its total risk-based capital ratio will be 8.2% instead of 7.4%. Overall, we remain satisfied with both companies' capital ratios under the Federal Reserve's severely adverse scenario.

Banks Breeze Through Federal Reserve's Annual Quantitative Stress Tests 05 Mar 2015

Late on March 5, the Fed released the results from the supervisory stress tests conducted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act. This year, the stress test differed from prior years in that the Federal Reserve used two scenarios, "adverse" and the newly added "severely adverse" scenarios, with the latter characterized by a substantial global weakening in economic activity, including a severe U.S. recession, large reductions in asset prices, significant widening of corporate bond spreads, and a sharp increase in equity market volatility. All 31 of the banks subject to the stress test passed as the minimum of their Tier 1 common ratio stayed above 5% under both the severely adverse and adverse stress-case scenarios. The results are no surprise to us as they are generally in line with Morningstar's own Stress Test analyses.

The Fed noted in its press release that for all 31 banks as group, that the cumulative loss rate for all accrual loan

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portfolios is 6.1% over a nine-quarter period, lower than the loss rate from the 2014 DFAST, or Dodd-Frank Act Stress Test. As stated in the Federal Reserve's press release, this reflects a "continuing a trend of declining loan loss rates under the severely adverse scenario over time, as borrower and loan characteristics have continued to improve." We also are interested to see that estimated losses relating to trading activities and large counterparty failures were manageable across the universe of large banks (public information on individual counterparty exposures is scarce) equaled $55 billion this year under the adverse scenario--nearly equaling the $57 billion in estimated losses last year. Under the severely adverse scenario, estimated losses totaled $103 billion.

Next on the calendar for the Fed is the March 11 release of the results from the Comprehensive Capital Analysis and Review. The CCAR takes into account each company's capital plans, such as dividend payments, stock repurchases, or planned acquisitions, along with a qualitative assessment of the bank's capital planning process. The Fed basically evaluates whether each bank would still pass the stress test even after planned capital releases. We think the capital return plans of the U.S. banks we cover will be accepted by the Fed, given these banks' experience with the process. We're more concerned, however, about Deutsche Bank, which is entering the process for the first time in 2015. In 2014, non-U.S. banks in their first go-around with the tests fared poorly--Banco Santander, HSBC, and Royal Bank of Scotland's capital return plans were rejected by the Fed on qualitative grounds.

In fact, we would not be surprised to see certain companies approved for significant dividend increases at that time. Given that all companies would maintain adequate capital buffers under a severely adverse scenario, we think firms with exceptionally low payout ratios like Bank of America and Citigroup could easily boost payout assuming their qualitative processes have improved. We also think the exceptionally high capital levels of American Express and Discover would allow these firms to boost buybacks or dividends.

Court Ruling Opens a Door for Amex Competitors, but its Advantages Remain Intact 19 Feb 2015

A New York District Court ruled against American Express in a long-standing antitrust case, finding that the company's rules constituted an unlawful restraint on trade. American Express's rules require that its merchants could not indicate a preference for other payment products or attempt to dissuade cardholders from using American Express, provisions that the court found to limit competition.

While the company plans to appeal, we view the case as another step in the direction of increased competition. We are not lowering our $82 fair value or moat rating for American Express, as we believe it will remain difficult for most merchants to steer customers away from American Express, and our fair value estimate incorporates continued pricing pressure on the company's discount fees. However, we will be closely monitoring American Express' market share and discount rates in coming quarters, as well as new promotions by merchants and card networks, in order to verify our thesis. Finally, we expect the reduction in competitive restraints to benefit Discover Financial and Synchrony Financial.

Our concern is moderated by the notion that competition of the sort previously prohibited by American Express is difficult even when allowable. The Durbin Amendment opened up similar competitive practices for debit cards, yet widespread steering to debit has not taken place in the years since the Durbin Amendment--though there are significant differences between debit and credit, as the court pointed out. Visa and MasterCard also settled their part in this issue in 2011, with few adverse effects to date. One reason is that consumers must balance current discounts against

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Analyst Notes

potential rewards, and manage spending volume across multiple cards in order to maximize their benefits. This can be a difficult calculation at the point of sale. It can also be difficult for merchants to balance the benefits of lower network pricing with the risk of alienating some of their best customers. Costco, for instance, maintains particularly strong customer loyalty among retailers, and yet many American Express customers were disappointed with the firm when the two companies disclosed the end of their relationship. Ironically, increasing competition in the premium space from Visa and MasterCard issuers may also make steering more difficult, as cards that look the same to cardholders may carry far different costs for merchants.

Second, American Express' powerful relationships with certain customers will be hard to break. The company is particularly strong with business travelers, capturing nearly two thirds of corporate card spending in the first half of 2013, according to the case documents. In fact, employers often mandate the use of the company's cards due to American Express' services for business users. Hence, the court found that such customer insistence was evidence of American Express' market power which is still a good thing for American Express. It's possible that attempting to steer customers to other cards may have the same deleterious effects on merchants as refusing to accept American Express has in the past. We note that American Express has occasionally allowed companies to steer customers to their own preferred payment methods, with little permanent effects on their loyalty to American Express.

Third, we still see American Express' closed-loop network as increasingly valuable due to its ability to collect mass amounts of data. JPMorgan Chase, for instance, made a deal with Visa to effectively achieve similar capabilities in transactions in which it serves as the card issuer and merchant acquirer. We don't attribute much explicit value to these offerings, but the capability to provide additional high-value services in the years to come provides a modest margin of safety.

We see this decision as a positive development for two firms we cover: Discover Financial Services and Synchrony Financial. Discover's management has indicated a desire to serve as a low-cost provider were it not for such rules, and this decision opens the door for the relative outsider to compete successfully on that basis. Discover's minimally profitable network would benefit significantly from additional volume, and this decision gives it the ability to gain it by undercutting on price and allowing merchants to pass on savings to customers. Merchants would very much like to provide their own rewards to customers, gain loyalty, and lower their costs of accepting payments. This ruling opens the door for merchants to compete harder in the payment space with the aid of private-label issuers like Synchrony.

American Express Loses Costco Relationship as Competition Heats Up 12 Feb 2015

American Express has announced that Costco stores will stop accepting its cards in early 2016 because they could not come to mutually agreeable terms to renew their relationship. This was widely anticipated after American Express was replaced in Costco's Canadian stores, and it validates our view about the increasing competition in the rewards space. Other card companies are fast encroaching on American Express' turf by increasing rewards to cardholders and offering better terms to merchants, as in this case. We think it's telling that American Express could not negotiate terms in line with an acceptable long-term return on equity.

That said, we don't think increasing competition has materially weakened American Express' moat. The company is still achieving exceptionally high return on equity and still offers enough benefits to consumers and merchants to maintain pricing power. Furthermore, American Express'

American Express Co AXP (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
80.77 USD	95.00 USD	66.50 USD	128.25 USD	Medium	Wide	Stable	Standard	Credit Services

Analyst Notes

closed-loop system has plenty of potential in an evolving payment market.

In terms of financial impact, American Express said that Costco co-branded cards make up about 8% of its billed business globally, though only about 2.4% of spending on these cards actually occurred within Costco stores. Costco spending by other American Express cardholders contributes about 1% of billed business. Thus, roughly 3.4% of billed business will surely disappear, though discount rates on this business are significantly lower than the American Express average. The loss of this business is likely to result in a lack of earnings per share growth in 2015, setting back management's plan to continue double-digit EPS growth over an extended period. Our previous forecast incorporated a cautious outlook, and we are maintaining our $82 fair value estimate, since the time value of money since our last update offsets the negative impact of the Costco loss.

Although this news represents the loss of another major partner for American Express, we think the company will be able to compete for much of the lost business outside of Costco stores. Just as the ability to shop with a credit card--and receive benefits--at Costco was a benefit for American Express customers, access to affluent customers was a benefit for Costco. It's by no means guaranteed that these cardholders will choose the Costco relationship over the American Express relationship, and American Express is now open to other co-branding relationships that were effectively prohibited by its partnership with Costco.

Competitors May be Gaining on American Express 22 Jan 2015

Wide-moat American Express continued to grow earnings per share at a healthy rate--15% from the previous year--in the fourth quarter, but the company's international operations actually provided a headwind as billed business in Latin America and Canada declined as a relationship with Costco ended, and foreign currency movements reduced reported revenue growth. At the same time, expenses rose as the company invested in marketing (up 9% during the year) and member rewards and services (both up 7% over the same time period). We incorporate generally heightened competition--and related rewards and marketing spending--into our long-term forecasts, and we don't plan to significantly alter our $82 fair value estimate as we incorporate the most recent results and the time value of money.

One indication of a tougher competitive environment came in the form of $109 million in upfront costs as the company renewed its relationship with Delta Air Lines, a material partner for the company. In recent years, other issuers have encroached on American Express' turf--Citigroup poached access to American Airlines lounges for its cardholders a year ago. In general, we think merchants are expanding their efforts to provide rewards directly to customers, rather than indirectly through bank issuers. We think this trend will affect merchant discount fees and rewards costs, and incorporate these pricing pressures into our valuation model over time.

The company is laying off 4,000 employees, which resulted in a restructuring charge during the quarter as it continues to reposition its business. We suspect the move came as a result of the competitive forces outlined above and their effect on revenue, as well as a continued shift to the use of technology across the financial-services sector. We don't

American Express Co AXP (NYSE) | ★★★★

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Analyst Notes

think this is necessarily unique to American Express, but believe there is little low-hanging fruit left after several years of cost-cutting in the lending sector.

American Express Co AXP (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
80.77 USD	95.00 USD	66.50 USD	128.25 USD	Medium	Wide	Stable	Standard	Credit Services

Morningstar Analyst Forecasts

Financial Summary and Forecasts

Growth (% YoY)	3-Year Hist. CAGR	Dec 2012	Dec 2013	Dec 2014	Forecast Dec 2015	Forecast Dec 2016	5-Year Proj. CAGR
Net Interest Income	5.6	-0.3	9.1	8.4	-2.9	-6.0	-2.3
Pre-Tax, Pre-Provision Earnings	11.0	4.6	18.5	10.4	-6.6	1.5	3.1
Net Income	6.0	-8.5	19.6	9.0	-4.1	-0.9	3.1
Diluted EPS	10.3	-5.1	25.3	12.9	0.2	2.2	6.5

Profitability	3-Year Hist. Avg	Dec 2012	Dec 2013	Dec 2014	Dec 2015	Dec 2016	5-Year Proj. Avg
Net Interest Margin %	4.3	4.0	4.3	4.5	4.5	4.5	4.5
Non-Interest Income (% of Revenue)	84.7	85.4	84.7	84.0	84.4	85.8	86.5
Efficiency Ratio %	70.3	73.3	69.7	67.8	69.8	70.3	69.6
Return on Average Assets %	3.4	2.9	3.5	3.7	3.6	3.7	4.0
Return on Average Equity %	26.9	23.8	27.9	28.8	27.2	28.2	31.1
Return on Tangible Equity %	26.3	23.7	27.5	27.8	27.8	28.9	31.5

Leverage	3-Year Hist. Avg	Dec 2012	Dec 2013	Dec 2014	Dec 2015	Dec 2016	5-Year Proj. Avg
Assets/Equity	7.84	8.11	7.87	7.55	7.55	7.69	7.92
Tangible Common Equity/Tangible Assets %	12.76	12.33	12.71	13.25	13.25	13.00	12.65
Tier I Ratio %	12.10	—	12.30	11.90	—	—	—

Valuation Summary and Forecasts

	2013	2014	2015(E)	2016(E)
Price/Fair Value	1.18	1.13	—	—
Price/Earnings	18.4	16.7	14.5	14.2
Price/Book	5.2	4.0	4.7	4.7
Price/Tangible Book	5.2	4.0	4.7	4.8
Dividend Yield %	1.0	1.1	1.3	—

Key Valuation Drivers

Cost of Equity %	9.0
Long-Run Tax Rate %	34.0
Stage II Net Income Growth Rate %	6.0
Stage II Return on New Invested Capital %	22.5
Perpetuity Year	20.0

Additional estimates and scenarios available for download at http://select.morningstar.com.

Discounted Cash Flow Valuation

	USD Mil	Firm Value (%)	Per Share Value
Present Value Stage I	12,246	14.5	12.93
Present Value Stage II	37,020	43.8	41.45
Present Value of the Perpetuity	35,200	41.7	39.41
Total Common Equity Value before Adjustment	**84,467**	**100.0**	**93.80**
Other Adjustments	—	—	—
Equity Value	**84,467**	—	**93.80**
Projected Diluted Shares	893		
Fair Value per Share (USD)	—		

American Express Co AXP (NYSE) | ★★★★

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Morningstar Analyst Forecasts

Income Statement (USD Mil)

				Forecast	
	Dec 2012	Dec 2013	Dec 2014	*Dec 2015*	*Dec 2016*
Net Interest Income	**4,628**	**5,047**	**5,472**	**5,312**	**4,994**
Provision for Losses on Loans	1,990	2,110	2,044	*1,830*	*2,061*
Net Interest Income after Provision	**2,638**	**2,937**	**3,428**	**3,482**	**2,933**
Non-Interest Income	26,954	27,927	28,820	*28,819*	*30,251*
Net Revenue	**31,582**	**32,974**	**34,292**	**34,131**	**35,245**
Net Revenue After Provision (excluding Gains on Sale)	29,592	30,864	32,248	*32,301*	*33,184*
Gains on Sale	—	—	—	—	—
Net Revenue After Provision (including Gains on Sale)	**29,592**	**30,864**	**32,248**	**32,301**	**33,184**
Non-Interest Expense	23,141	22,976	23,257	*23,821*	*24,776*
Operating Income (excluding Gains on Sale)	**6,451**	**7,888**	**8,991**	**8,481**	**8,408**
Taxes	1,969	2,529	3,106	*2,883*	*2,859*
Minority Interest, net of income taxes	—	—	46	—	—
Income after Taxes	**4,482**	**5,359**	**5,839**	**5,597**	**5,549**
Cumulative Effect of Accounting Change	—	—	—	—	—
After-tax Non-recurring Items	—	—	—	—	—
Discounted Operations	—	—	—	—	—
Preferred Dividends	**—**	**—**	**—**	**—**	**—**
Net Income attributable to common shareholders, Excluding All After-tax items	**4,482**	**5,359**	**5,839**	**5,597**	**5,549**
Net Income attributable to common shareholders, including all after-tax items	**4,482**	**5,359**	**5,839**	**5,597**	**5,549**
Average Diluted Shares Outstanding	1,141	1,089	1,051	*1,006*	*976*
Diluted EPS Excluding Charges	**3.93**	**4.92**	**5.56**	**5.56**	**5.68**
Diluted EPS Including Charges	**3.93**	**4.92**	**5.56**	**5.56**	**5.68**

American Express Co AXP (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
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Morningstar Analyst Forecasts

Balance Sheet (USD Mil)

Earning Assets	Dec 2013	Dec 2014	*Forecast* Dec 2015	*Forecast* Dec 2016
Cash and Due from Banks	19,486	22,000	*22,440*	*23,338*
Interest Bearing Deposits at Banks	—	—	—	—
Federal Funds Sold and Securities Borrowed or Purchased Under Agreement to Resell	—	—	—	—
Brokerage Receivables	—	—	—	—
Other Receivables (excluding interest receivables)	47,185	47,000	*48,410*	*49,862*
Trading Assets	—	—	—	—
Investment Securities Held to Maturity	5,016	4,000	*4,080*	*4,162*
Investment Securities Available-for-Sale	—	—	—	—
Financial Instruments Owned, at Fair Value (trading securities)	—	—	—	—
Other Earning Assets	—	—	*-3,825*	*-6,600*
Loans Held for Sale	—	—	—	—
Loans and Leases	67,859	71,000	*65,430*	*60,452*
Unearned Discount	—	—	—	—
Allowance for Loan Losses	-1,274	-1,500	*-1,309*	*-1,209*
Net Loans and Leases	**66,585**	**69,500**	**64,122**	**59,243**
Non-Earning Assets				
Premises & Equipment, Net	3,875	4,000	*4,853*	*5,734*
Premises & Equipment, Gross	9,853	10,000	*10,853*	*11,734*
(Accumulated Depreciation)	-5,978	-6,000	*-6,000*	*-6,000*
Interest Receivables	—	—	—	—
Goodwill	—	—	—	—
Identifiable Intangibles	—	—	—	—
Deferred Tax Assets	—	—	—	—
Other Non-Earning Assets (Other Real Estate Owned etc.)	11,228	12,000	*12,000*	*12,000*
Total Assets	**153,375**	**158,500**	**152,080**	**147,740**

Liabilities	Dec 2013	Dec 2014	*Forecast* Dec 2015	*Forecast* Dec 2016
Total Deposits	41,763	44,000	*45,760*	*47,590*
Customer Deposits	41,763	44,000	*45,760*	*47,590*
Federal Funds Purchased and Securities Loaned or Sold under Agreements to Repurchase	—	—	—	—
Brokerage Payables	—	—	—	—
Trading Liabilities	—	—	—	—
Financial Instruments Sold, but not yet purchased at Fair Value	—	—	—	—
Other Payables	10,615	3,000	*3,060*	*3,121*
Short-Term Debt	5,021	—	—	—
Long-Term Debt	55,330	58,000	*50,116*	*44,821*
Additional Debt	—	—	—	—
Total Short-Term, Long-Term and Other Debt	**60,351**	**58,000**	**50,116**	**44,821**
Deferred Tax Liabilities	—	—	—	—
Other Liabilities (bank acceptance outstanding, accrued expenses, etc.)	16,910	29,000	*29,000*	*29,000*
Total Liabilities	**133,879**	**138,000**	**131,936**	**128,533**
Equity				
Common Stock	213	213	*213*	*213*
Paid-in Capital	12,202	12,202	*8,377*	*5,602*
Retained Earnings	8,507	10,011	*13,042*	*14,880*
Preferred Equity	—	—	—	—
Treasury Stock	—	—	—	—
Accumulated Other Comprehensive Income	63	63	—	—
Other Equity	-1,489	-1,489	*-1,489*	*-1,489*
Shareholders?Equity	19,496	21,000	*20,143*	*19,206*
Total Liabilities & Shareholders?Equity (including Minority Interest)	**153,375**	**159,000**	**152,080**	**147,740**

American Express Co AXP (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
80.77 USD	95.00 USD	66.50 USD	128.25 USD	Medium	Wide	Stable	Standard	Credit Services

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Valuation Analysis

		Price/Earnings				Price/Book				Price/Tangible Book			
Company/Ticker	Price/Fair Value	2013	2014	*2015(E)*	*2016(E)*	2013	2014	*2015(E)*	*2016(E)*	2013	2014	*2015(E)*	*2016(E)*
Visa Inc V USA	1.0	—	—	—	—	—	—	—	—	—	—	—	—
MasterCard Inc MA USA	0.9	—	—	—	—	—	—	—	—	—	—	—	—
Capital One Financial Corp COF USA	0.9	10.4	10.9	*11.5*	*10.9*	1.2	1.1	*1.2*	*1.2*	1.7	1.6	*1.8*	*1.8*
Discover Financial Services DFS USA	0.9	11.3	13.4	*11.0*	*10.3*	3.1	2.6	*2.8*	*2.8*	3.3	2.7	*2.8*	*2.6*
Average		10.9	12.2	*11.3*	*10.6*	2.2	1.9	*2.0*	*2.0*	2.5	2.2	*2.3*	*2.2*
American Express Co AXP US	**0.9**	**18.4**	**16.7**	***14.5***	***14.2***	**5.2**	**4.0**	***4.7***	***4.7***	**5.2**	**4.0**	***4.7***	***4.8***

Returns Analysis

		Return on Average Equity %				Return on Average Assets %				Return on Tangible Equity %			
Company/Ticker	Last Historical Year Total Assets (Mil)	2013	2014	*2015(E)*	*2016(E)*	2013	2014	*2015(E)*	*2016(E)*	2013	2014	*2015(E)*	*2016(E)*
Visa Inc V USA	38,569 USD	—	—	—	—	—	—	—	—	—	—	—	—
MasterCard Inc MA USA	14,242 USD	—	—	—	—	—	—	—	—	—	—	—	—
Capital One Financial Corp COF USA	308,854 USD	10.7	10.2	*9.4*	*9.8*	1.4	1.5	*1.4*	*1.4*	17.1	15.7	*13.2*	*14.0*
Discover Financial Services DFS USA	83,126 USD	23.5	20.7	*21.5*	*22.9*	3.1	2.8	*2.7*	*2.8*	23.4	21.2	*23.1*	*22.7*
Average		17.1	15.5	*15.5*	*16.4*	2.3	2.2	*2.1*	*2.1*	20.3	18.5	*18.2*	*18.4*
American Express Co AXP US	**158,500** USD	**27.9**	**28.8**	***27.2***	***28.2***	**3.5**	**3.7**	***3.6***	***3.7***	**27.5**	**27.8**	***27.8***	***28.9***

Growth Analysis

		Net Revenue Growth %				Pre-Tax, Pre-Provision Earnings Growth %				EPS Growth %			
Company/Ticker	Last Historical Year Revenue (Mil)	2013	2014	*2015(E)*	*2016(E)*	2013	2014	*2015(E)*	*2016(E)*	2013	2014	*2015(E)*	*2016(E)*
Visa Inc V USA	— USD	—	—	—	—	—	—	—	—	—	—	—	—
MasterCard Inc MA USA	— USD	—	—	—	—	—	—	—	—	—	—	—	—
Capital One Financial Corp COF USA	22,290 USD	7.6	-0.4	*5.8*	*3.2*	4.4	2.4	*15.3*	*3.4*	12.5	3.1	*1.4*	*5.3*
Discover Financial Services DFS USA	9,873 USD	7.3	6.6	*-9.6*	*5.1*	9.3	2.1	*6.5*	*6.2*	11.1	-1.1	*9.3*	*6.2*
Average		7.5	3.1	*-1.9*	*4.2*	6.9	2.3	*10.9*	*4.8*	11.8	1.0	*5.4*	*5.8*
American Express Co AXP US	**34,292** USD	**4.4**	**4.0**	***-0.5***	***3.3***	**18.5**	**10.4**	***-6.6***	***1.5***	**25.3**	**12.9**	***0.2***	***2.2***

American Express Co AXP (NYSE) | ★★★★

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80.77 USD	95.00 USD	66.50 USD	128.25 USD	Medium	Wide	Stable	Standard	Credit Services

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Profitability Analysis

	Last Historical Year	Net Interest Margin %				Efficiency Ratio %				Non Interest Income % of Revenue			
Company/Ticker	Revenue (Mil)	2013	2014	2015(E)	2016(E)	2013	2014	2015(E)	2016(E)	2013	2014	2015(E)	2016(E)
Visa Inc V USA	— USD	—	—	—	—	—	—	—	—	—	—	—	—
MasterCard Inc MA USA	— USD	—	—	—	—	—	—	—	—	—	—	—	—
Capital One Financial Corp COF USA	22,290 USD	6.7	6.6	*6.8*	*6.8*	52.9	52.3	*50.6*	*50.5*	19.1	20.1	*20.2*	*20.2*
Discover Financial Services DFS USA	9,873 USD	8.5	8.8	*8.8*	*8.8*	45.7	48.0	*38.7*	*38.0*	36.1	34.6	*25.7*	*25.2*
Average		7.6	7.7	*7.8*	*7.8*	49.3	50.2	*44.7*	*44.3*	27.6	27.4	*23.0*	*22.7*
American Express Co AXP US	**34,292** USD	**4.3**	**4.5**	***4.5***	***4.5***	**69.7**	**67.8**	***69.8***	***70.3***	**84.7**	**84.0**	***84.4***	***85.8***

Leverage Analysis

	Last Historical Year	Assets/Equity				Tangible Common Equity/ Tangible Assets %				Tier I Ratio %			
Company/Ticker	Total Debt (Mil)	2013	2014	2015(E)	2016(E)	2013	2014	2015(E)	2016(E)	2013	2014	2015(E)	2016(E)
Visa Inc V USA	— USD	—	—	—	—	—	—	—	—	—	—	—	—
MasterCard Inc MA USA	— USD	—	—	—	—	—	—	—	—	—	—	—	—
Capital One Financial Corp COF USA	47,577 USD	7.1	6.9	*6.9*	*7.1*	9.8	10.5	*10.5*	*10.2*	—	—	—	—
Discover Financial Services DFS USA	22,657 USD	7.3	7.5	*8.3*	*8.3*	12.4	12.3	*10.9*	*11.0*	14.4	15.2	—	—
Average		7.2	7.2	*7.6*	*7.7*	11.1	11.4	*10.7*	*10.6*	14.4	15.2	—	—
American Express Co AXP US	**58,000** USD	**7.9**	**7.5**	***7.6***	***7.7***	**12.7**	**13.3**	***13.3***	***13.0***	**12.3**	**11.9**	**—**	**—**

Liquidity Analysis

	Last Historical Year	Loans/Deposits %				Short-Term Debt % of Liabilities				Liquid Assets (% of Total Assets)			
Company/Ticker	Market Cap (Mil)	2013	2014	2015(E)	2016(E)	2013	2014	2015(E)	2016(E)	2013	2014	2015(E)	2016(E)
Visa Inc V USA	170,060 USD	—	—	—	—	—	—	—	—	—	—	—	—
MasterCard Inc MA USA	109,520 USD	—	—	—	—	—	—	—	—	—	—	—	—
Capital One Financial Corp COF USA	48,369 USD	94.3	99.2	*101.9*	*105.0*	—	—	—	—	16.2	15.1	*15.0*	*14.9*
Discover Financial Services DFS USA	26,002 USD	142.6	148.0	*151.0*	*155.7*	—	0.2	*0.2*	*0.2*	14.8	13.6	*13.1*	*12.7*
Average		118.5	123.6	*126.5*	*130.4*	—	0.2	*0.2*	*0.2*	15.5	14.4	*14.1*	*13.8*
American Express Co AXP US	**82,046** USD	**159.4**	**158.0**	***140.1***	***124.5***	**3.8**	**—**	**—**	**—**	**43.5**	**43.5**	***46.6***	***49.6***

Research Methodology for Valuing Companies

Components of Our Methodology

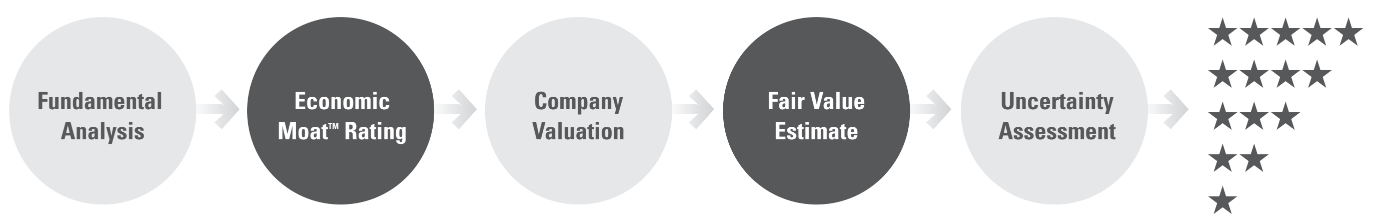
- Economic Moat™ Rating
- Moat Trend™ Rating
- Moat Valuation
- Three-Stage Discounted Cash Flow
- Weighted Average Cost of Capital
- Fair Value Estimate
- Scenario Analysis
- Uncertainty Ratings
- Margin of Safety
- Consider Buying/Selling
- Stewardship Rating

The Morningstar Rating for stocks identifies companies trading at a discount or premium to our analysts' assessment of their fair value. A number of components drive this rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's intrinsic value based on a discounted cash-flow model, (3) the margin of safety bands we apply to our Fair Value Estimate, and (4) the current stock price relative to our fair value estimate.

The concept of the Morningstar Economic Moat™ Rating plays a vital role not only in our qualitative assessment of a firm's investment potential, but also in our valuation process. We assign three moat ratings—none, narrow, or wide—as well as the Morningstar Moat Trend™ Rating—positive, stable, or negative—to each company we cover. There are two major requirements for firms to earn either a narrow or wide moat rating: (1) the prospect of earning above-average returns on capital; and (2) some competitive edge that prevents these returns from quickly eroding. The assumptions we make about a firm's moat determine the length of "economic outperformance" that we assume in the latter stages of our valuation model. We also quantify the value of each firm's moat, which represents the difference between a firm's enterprise value and the value of the firm if no future net investment were to occur. Said differently, moat value identifies the value generated by the firm as a result of any future net new investment. Our Moat Trend Rating reflects our assessment of whether each firm's competitive advantage is either getting stronger or weaker, since we think of moats as dynamic, rather than static.

At the heart of our valuation system is a detailed projection of a company's future cash flows. The first stage of our three-stage discounted cash flow model can last from 5 to 10 years and contains numerous detailed assumptions about various financial and operating items. The second stage of our model—where a firm's return on new invested capital (RONIC) and earnings growth rate implicitly fade until the perpetuity year—can last anywhere from 0 years (for no-moat firms) to 20 years (for wide-moat companies). In our third stage, we assume the firm's RONIC equals its weighted average cost of capital, and we calculate a continuing value using a standard

Morningstar Research Methodology for Valuing Companies



Analyst conducts company and industry research:

- Financial statement analysis
- Channel checks
- Trade-show visits
- Industry and company reports and journals
- Conference calls
- Management and site visits

Strength of competitive advantage is rated: None, Narrow, or Wide

Advantages that confer an economic moat:

High Switching Costs
(Microsoft)

Cost advantage
(Wal-Mart)

Intangible assets
(Johnson & Johnson)

Network Effect
(Mastercard)

Efficient Scale
(Lockheed Martin)

Analyst considers past financial results and focuses on competitive position and future prospects to forecast future cash flows.

Assumptions are entered into Morningstar's proprietary discounted cash-flow model.

Analyst uses a discounted cash-flow model to develop a Fair Value Estimate, which serves as the foundation for the Morningstar Rating for stocks.

The analyst then evaluates the range of potential intrinsic values for the company and assigns an Uncertainty Rating: Low, Medium, High, Very High, or Extreme.

The Uncertainty Rating determines the margin of safety required before we would recommend the stock. The higher the uncertainty, the wider the margin of safety.

The current stock price relative to Morningstar's Fair Value Estimate, adjusted for uncertainty, determines the Morningstar Rating for stocks.

The Morningstar Rating for stocks is updated each evening after the market closes.

Research Methodology for Valuing Companies

Detailed Methodology Documents and Materials*

- Comprehensive Equity Research Methodology
- Uncertainty Methodology
- Cost of Equity Methodology
- Morningstar DCF Valuation Model
- Stewardship Rating Methodology

* Please contact a sales representative for more information.

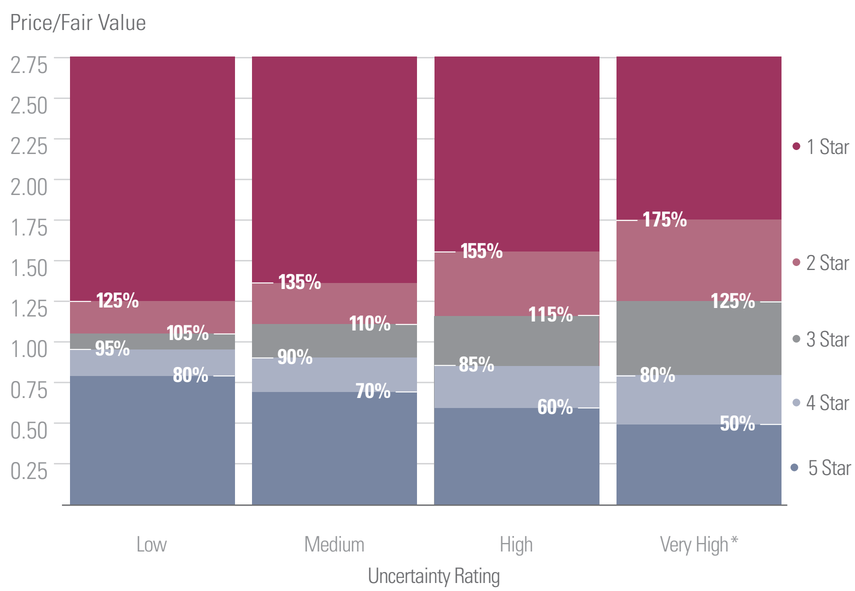
perpetuity formula. In deciding on the rate at which to discount future cash flows, we ignore stock-price volatility. Instead, we rely on a system that measures the estimated volatility of a firm's underlying future free cash flows, taking into account fundamental factors such as the diversity of revenue sources and the firm's fixed cost structure.

We also employ a number of other tools to augment our valuation process, including scenario analysis, where we assess the likelihood and performance of a business under different economic and firm-specific conditions. Our analysts typically model three to five scenarios for each company we cover, stress-testing the model and examining the distribution of resulting fair values.

The Morningstar Uncertainty Rating captures the range of these potential fair values, based on an assessment of a company's future sales range, the firm's operating and financial leverage, and any other contingent events that may impact the business. Our analysts use this range to assign an appropriate margin of safety—or the discount/premium to a fair value we apply in setting our consider buying/consider selling prices. Firms trading below our consider-buying prices receive our highest rating of five stars, whereas firms trading above our consider-selling prices receive our lowest rating of one star.

Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

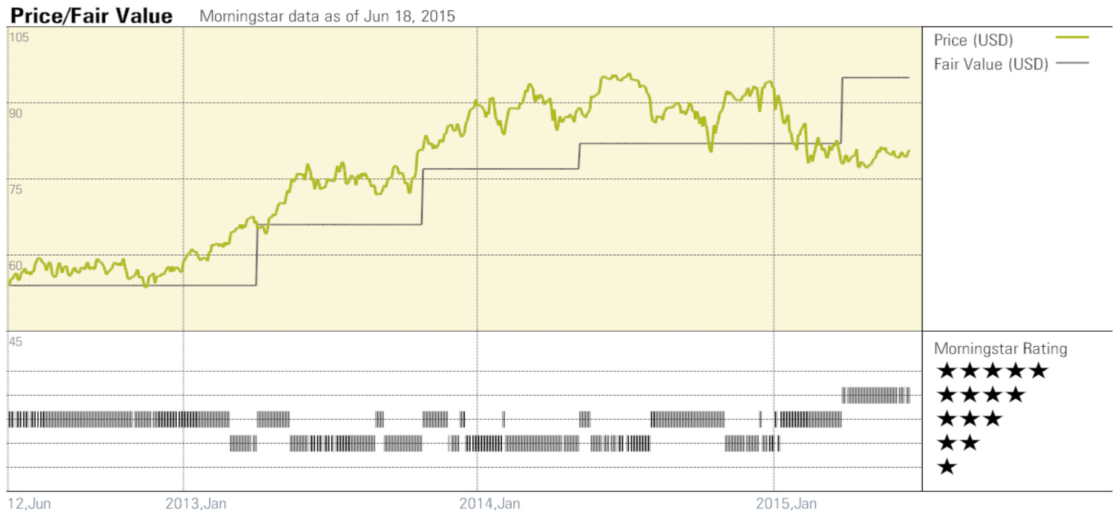
Morningstar Margin of Safety and Star Rating Bands



* Occasionally a stock's uncertainty will be too high for us to estimate, in which case we label it Extreme.

American Express Co AXP (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
80.77 USD	95.00 USD	66.50 USD	128.25 USD	Medium	Wide	Stable	Standard	Credit Services



The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic value.

Five-star stocks sell for the biggest risk-adjusted discount whereas one-star stocks trade at premiums to their intrinsic value. Based on a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's Equity Analysts, four key components drive the Morningstar Rating: 1. Assessment of the firm's economic moat, 2. Estimate of the stock's fair value, 3. Uncertainty around that fair value estimate and 4. Current market price. Further information on Morningstar's methodology is available from http://global.morningstar.com/equitydisclosures.

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