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American Express: 2Q15 results

2Q15 results: American Express (24 July 2015) - American Express (Amex) reported 2Q15 EPS, which came in at $1.42, down 0.7% on 2Q14 EPS which was $1.43. Bottom-line net income was down 4% in the quarter but the decline was largely offset by the effect of buying back c. 4% of outstanding shares. Management considered the quarter to reflect "solid core underlying EPS performance" and we agree with this comment. Amex had previously guided the market to expect earnings that would be flat to modestly down in FY15 and the company reaffirmed this expectation. The second quarter was significantly affected by the stronger US dollar, as well as the ramp up in investment spending on growth initiatives began during the quarter. So, while reported revenue was down 4% YoY, excluding the effect of FX changes and of the 'Business Travel JV' effect on the prior year, revenues actually rose 5% YoY. Previously disclosed sensitivity to the US dollar is that a 10% move in the currency against all other currencies translates to a 2% move in profits for Amex.

In our view, Amex faces two key challenges at present, a short-term challenge and a medium-term challenge. The short-term challenge is associated with temporary headwinds to earnings growth: US dollar strength, the loss of Costco and a period of heightened investment spending on growth opportunities. These are the principal drivers of its earnings growth guidance of "flat to modestly down" in FY15, and a "return to positive" growth in FY16. The medium-term challenge relates to whether or not the Group's core business model, and principally its ability to continue charging a premium rate, is to some degree damaged or being eroded by competition and legislation that in some cases is not friendly to the Group's business model.

The effect of legislation can be seen in Amex's dispute with the Department of Justice (DoJ) that has progressed unfavourably. Amex's request for a stay of the Court's decision was recently denied, thus the company can no longer enforce certain contractual provisions that prevents its US customers from steering their own customers towards other credit cards. Amex is again appealing the ruling. We note that this ruling has just taken effect, earlier this week. In management's view it is too early to tell what the consequences of the decision will be. This dispute has been ongoing for some time and Amex has previously characterised it as a fight against the commoditisation of payment cards; being the premium price supplier, Amex stands to lose most to the degree that such "commoditisation" occurs.

To reiterate a further important point: there is a very different interpretation of the Costco situation in the financial press to what Amex management have communicated. While the former see it as the "loss of Costco," the latter assert that they decided not to continue with Costco because they had even better long-term opportunities that they would prefer to pursue.

Amex continued its track record of strong return of capital to shareholders, returning 97% of capital generated during the quarter. Going forward, we believe it makes sense to expect a weak second half as EPS was actually slightly up for 1H15 and the company has maintained guidance for a flat to slightly down FY15.

Amex continues to identify its current situation as a "transitional period" associated with uneven earnings. The Group has also continued to affirm that it has a range of good growth opportunities and we are inclined to believe the company. One such growth initiative, OptBlue, has signed up over 700k new merchants in the US, year to date, an encouraging development, in our opinion. ***/continued***

Global Ideas is a newsletter published three times a week (Monday, Wednesday and Friday) and available only to clients of Investor Campus and Anchor Capital. The key objective of this newsletter is to provide ideas for investment in the global investment universe.

We scan the globe looking for good opportunities. We provide our model portfolios, as well as news and views on our watch-list, which is continually reviewed and updated.

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American Express continued... The company remains a high ROE (long-term goal remains >25% p.a.; 28.1% during 2Q15) business that is trading at a relatively low P/E multiple of c. 13.8x. Clearly there are risks to the company's business model but we believe that the potential upside associated with Amex's medium-term EPS growth outlook (12% - 15% p.a.), its ability to generate and return high levels of cash to shareholders, and a high ROE means the risks are worth taking.

Blake Allen

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