METRIS COMPANIES INC
Form 10-Q
November 09, 2004

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**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

x Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2004

or

o Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from___________________to___________________

Commission file number: 001-12351

**METRIS COMPANIES INC.**

(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| Delaware | 41-1849591 |
| (State of Incorporation) | (I.R.S. Employer Identification No.) |

10900 Wayzata Boulevard, Minnetonka, Minnesota 55305-1534
(Address of principal executive offices)

(952) 525-5020
(Registrant s telephone number)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes x No o

As of October 31, 2004, 57,970,527 shares of the registrant s common stock, par value $.01 per share, were outstanding.

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**METRIS COMPANIES INC.**

**FORM 10-Q**

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**September 30, 2004**

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## Part I. Financial Information

## ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

## METRIS COMPANIES INC. AND SUBSIDIARIES

Consolidated Balance Sheets
*(In thousands, except per share data)*

| | September 30, 2004 (Unaudited) | December 31, 2003 |
|---|---|---|
| **Assets:** | | |
| Cash and due from banks | $ 23,683 | $ 32,076 |
| Federal funds sold | 49,395 | 25,300 |
| Short-term investments | 330,452 | 121,109 |
| Cash and cash equivalents | 403,530 | 178,485 |
| Liquidity reserve deposit | 79,655 | 80,158 |
| Credit card loans | 70,389 | 128,615 |
| Less: Allowance for loan losses | 14,293 | 45,492 |
| Net credit card loans | 56,096 | 83,123 |
| Retained interests in loans securitized | 839,408 | 836,901 |
| Property and equipment, net | 26,399 | 33,680 |
| Purchased portfolio premium | 10,745 | 17,561 |
| Other receivables due from credit card securitizations, net | 74,941 | 80,714 |
| Other assets | 62,724 | 81,774 |
| **Total assets** | $1,553,498 | $1,392,396 |
| **Liabilities:** | | |
| Deposits | $ 3,735 | $ 6,262 |
| Debt | 448,398 | 350,448 |
| Accounts payable | 38,280 | 32,397 |
| Deferred income | 12,181 | 18,060 |
| Accrued expenses and other liabilities | 105,247 | 76,036 |

| | | |
|---|---|---|
| **Total liabilities** | 607,841 | 483,203 |
| **Stockholders Equity:** | | |
| Convertible preferred stock par value $.01 per share; 10,000,000 shares authorized, 1,350,931 and 1,263,699 shares issued and outstanding, respectively | 503,222 | 470,728 |
| Common stock, par value $.01 per share; 300,000,000 shares authorized, 65,099,618 and 64,862,314 shares issued, respectively | 651 | 649 |
| Paid-in capital | 233,042 | 229,655 |
| Unearned compensation | | (27) |
| Treasury stock 7,055,300 shares | (58,308) | (58,308) |
| Retained earnings | 267,050 | 266,496 |
| **Total stockholders equity** | 945,657 | 909,193 |
| **Total liabilities and stockholders equity** | $1,553,498 | $1,392,396 |

See accompanying Notes to Consolidated Financial Statements.

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**METRIS COMPANIES INC. AND SUBSIDIARIES**

Consolidated Statements of Income
*(In thousands, except earnings per-share data) (Unaudited)*

| | Three Months Ended September 30, 2004 | Three Months Ended September 30, 2003 | Nine Months Ended September 30, 2004 | Nine Months Ended September 30, 2003 |
|---|---|---|---|---|
| **Revenues:** | | | | |
| Loss on new securitization of receivables to the Metris Master Trust | $ | $ (23,015) | $ (91,886) | $ (55,214) |
| Loss on replenishment of receivables to the Metris Master Trust | (21,972) | (35,792) | $ (71,353) | $(127,574) |
| Discount accretion | 63,747 | 85,549 | 185,287 | 240,035 |
| Interest-only revenue | 87,316 | 60,694 | 217,385 | 151,374 |
| Change in fair value | 25,518 | 33,564 | 94,202 | (70,333) |
| Transaction and other costs | (6,634) | (27,221) | (91,018) | (64,772) |
| Securitization income | 147,975 | 93,779 | 242,617 | 73,516 |
| Servicing income on securitized receivables | 32,496 | 43,849 | 102,580 | 136,997 |
| Credit card loan and other interest income | 4,549 | 24,656 | 14,665 | 88,249 |
| Credit card loan fees, interchange and other income | 3,736 | 17,934 | 19,816 | 67,713 |
| Enhancement services income | 5,692 | 16,549 | 20,148 | 99,748 |
| Loss on sale of credit card loans | | (117,183) | | (117,183) |
| Gain on sale of membership and warranty business | | 80,391 | | 80,391 |
| **Total revenues** | 194,448 | 159,975 | 399,826 | 429,431 |
| **Expenses:** | | | | |
| Interest expense | 14,056 | 22,296 | 46,701 | 60,353 |
| Provision for loan losses | 1,408 | 33,019 | (5,175) | 107,838 |
| Credit card account and other product solicitation and marketing expenses | 17,190 | 19,325 | 48,848 | 85,045 |
| Employee compensation | 31,554 | 41,997 | 106,222 | 141,099 |
| Data processing services and communications | 12,203 | 16,770 | 42,452 | 52,982 |
| Credit protection claims expense | 3,421 | 6,585 | 14,805 | 26,537 |
| Occupancy and equipment | 5,442 | 8,716 | 17,827 | 27,253 |
| Purchased portfolio premium amortization | 2,241 | 8,107 | 6,743 | 21,102 |
| Asset impairments, lease write-offs and severance | 1,242 | 29,976 | 4,515 | 52,764 |
| Loss on sale of deposits | | 32,963 | | 32,963 |
| Other | 20,502 | 32,397 | 63,837 | 78,711 |

| | | | | |
|---|---|---|---|---|
| **Total expenses** | 109,259 | 252,151 | 346,775 | 686,647 |
| **Income (loss) before income taxes** | 85,189 | (92,176) | 53,051 | (257,216) |
| Income tax expense (benefit) | 23,425 | (17,198) | 20,003 | (74,660) |
| **Net income (loss)** | 61,764 | (74,978) | 33,048 | (182,556) |
| Convertible preferred stock dividends | 11,073 | 10,131 | 32,494 | 29,728 |
| **Net income (loss) after preferred dividends** | $ 50,691 | $ (85,109) | $ 554 | $(212,284) |
| **Earnings (loss) per common share:** | | | | |
| **Basic** | | | | |
| Distributed | $ | $ | $ | $ |
| Undistributed | 0.49 | (1.48) | 0.01 | (3.70) |
| **Total Basic** | $ 0.49 | $ (1.48) | $ 0.01 | $ (3.70) |
| **Total Diluted** | $ 0.48 | $ (1.48) | $ 0.01 | $ (3.70) |
| **Shares used to compute earnings (loss) per common share:** | | | | |
| Basic | 57,981 | 57,546 | 57,899 | 57,426 |
| Diluted | 58,915 | 57,546 | 58,830 | 57,426 |

See accompanying Notes to Consolidated Financial Statements.

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**METRIS COMPANIES INC. AND SUBSIDIARIES**

Consolidated Statements of Changes in Stockholders Equity
*(In thousands)*

| | Number of Preferred | Shares Common | Preferred Stock | Common Stock | Paid-in Capital | Unearned Compensation | Treasury Stock | Retained Earnings | Total Stockholders Equity |
|---|---|---|---|---|---|---|---|---|---|
| BALANCE AT DECEMBER 31, 2002 | 1,156 | 57,168 | $430,642 | $642 | $227,376 | $ | $(58,308) | $ 454,321 | $1,054,673 |
| Net loss | | | | | | | | (182,556) | (182,556) |
| Preferred dividends in kind | 80 | | 29,728 | | | | | (29,728) | |
| Issuance of common stock under employee benefit plans | | 426 | | 4 | 2,547 | | | | 2,551 |
| Deferred compensation obligation | | 303 | | 3 | 546 | (549) | | | |
| Restricted stock forfeitures | | (41) | | | (76) | 76 | | | |
| Amortization of restricted stock | | | | | | 315 | | | 315 |
| BALANCE AT SEPTEMBER 30, 2003 (Unaudited) | 1,236 | 57,856 | $460,370 | $649 | $230,393 | $(158) | $(58,308) | $ 242,037 | $ 874,983 |
| BALANCE AT DECEMBER 31, 2003 | 1,264 | 57,807 | $470,728 | $649 | $229,655 | $ (27) | $(58,308) | $ 266,496 | $ 909,193 |
| Net income | | | | | | | | 33,048 | 33,048 |
| Preferred dividends in kind | 87 | | 32,494 | | | | | (32,494) | |
| Issuance of common stock under employee benefit plans | | 287 | | 2 | 3,477 | | | | 3,479 |
| Deferred compensation | | | | | (85) | | | | (85) |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| obligation | | | | | | | | | |
| Restricted stock forfeitures | | (50) | | | (5) | 4 | | | (1) |
| Amortization of restricted stock | | | | | | 23 | | | 23 |
| BALANCE AT SEPTEMBER 30, 2004 (Unaudited) | 1,351 | 58,044 | $503,222 | $651 | $233,042 | $ | $(58,308) | $ 267,050 | $ 945,657 |

See accompanying Notes to Consolidated Financial Statements.

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**METRIS COMPANIES INC. AND SUBSIDIARIES**

Consolidated Statements of Cash Flows
*(Dollars in thousands) (Unaudited)*

| | Nine Months Ended September 30, 2004 | Nine Months Ended September 30, 2003 |
|---|---|---|
| **Operating Activities:** | | |
| Net income (loss) | $ 33,048 | $(182,556) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation, amortization, and accretion | (157,845) | (135,733) |
| Provision for loan losses | (5,175) | 107,838 |
| Loss from credit card securitizations | 163,239 | 182,788 |
| Gain on sale of membership club and warranty business | | (80,391) |
| Asset impairments, lease write-offs, and severance | 4,515 | 52,764 |
| Loss on sale of deposits | | 32,963 |
| Loss on sale of credit card loans | | 117,183 |
| Market loss on derivative financial instruments | 8,564 | 6,169 |
| Changes in operating assets and liabilities, net: | | |
| Liquidity Reserve deposit | 503 | (83,875) |
| Fair value of retained interests in loans securitized | (94,202) | 70,333 |
| Spread accounts receivable | 207,520 | (242,290) |
| Other receivables due from credit card securitizations | 5,773 | 24,981 |
| Accounts payable and accrued expenses | 30,579 | (12,007) |
| Deferred income | (5,879) | (37,568) |
| Other | 16,310 | (19,305) |
| Net cash provided by (used in) operating activities | 206,950 | (198,706) |
| **Investing Activities:** | | |
| Proceeds from transfers of portfolios to the Metris Master Trust | | 670,965 |
| Net cash from loan originations and principal collections on loans receivable | (89,993) | (534,797) |
| Proceeds from sales of credit card portfolios to third parties | 27,870 | 494,784 |
| Proceeds from sale of membership club and warranty business | | 45,000 |
| Net (additions) disposals of property and equipment | (1,984) | 24,613 |
| Net cash (used in) provided by investing activities | (64,107) | 700,565 |
| **Financing Activities:** | | |
| Proceeds from issuance of debt | 283,974 | 125,606 |
| Repayment of debt | (202,724) | (132,417) |

| | | |
|---|---|---|
| Sale of deposits | | (559,282) |
| Net decrease in deposits | (2,527) | (327,174) |
| Premium paid and transaction costs on sale of deposits | | (32,963) |
| Proceeds from issuance of common stock | 3,479 | 2,551 |
| Net cash provided by (used in) financing activities | 82,202 | (923,679) |
| Net increase (decrease) in cash and cash equivalents | 225,045 | (421,820) |
| Cash and cash equivalents at beginning of period | 178,485 | 580,232 |
| Cash and cash equivalents at end of period | $ 403,530 | $ 158,412 |
| **Supplemental disclosures and cash flow information:** | | |
| Cash paid (received) during the period for: | | |
| Interest | $ 36,945 | $ 59,395 |
| Income taxes | (34,997) | (78,131) |
| Tax benefit from employee stock option exercises | 208 | 1 |

See accompanying Notes to Consolidated Financial Statements.

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**METRIS COMPANIES INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements
*(Dollars in thousands, except as noted) (Unaudited)*

**NOTE 1 ORGANIZATION AND BASIS OF PRESENTATION**

The consolidated financial statements include the accounts of Metris Companies Inc. ( MCI ) and its subsidiaries. MCI s principal subsidiaries are Direct Merchants Credit Card Bank, National Association ( Direct Merchants Bank or the Bank ), Metris Direct, Inc. and Metris Receivables, Inc. ( MRI ). MCI and its subsidiaries, as applicable, may be referred to as we, us, our or the Company. We are an information-based direct marketer of consumer lending produ

All dollar amounts are presented as pre-tax amounts unless otherwise noted. We have eliminated all significant intercompany balances and transactions in consolidation.

During the first quarter of 2004 we reclassified financial statement line items to more accurately reflect the continuing operations of our business. In prior periods we classified interest income from credit card loans, federal funds sold, and other as total interest income. For all periods presented, total interest income is classified as Credit card loan and other interest income. In prior periods we classified interest expense from deposits and other as total interest expense. For all periods presented total interest expense has been reclassified as Interest expense.

**Interim Financial Statements**

We have prepared the unaudited interim consolidated financial statements and related unaudited financial information in the footnotes in accordance with accounting principles generally accepted in the United States of America ( GAAP ) and the rules and regulations of the Securities and Exchange Commission ( SEC ) for interim financial statements. These interim financial statements reflect all adjustments consisting of normal recurring accruals, which, in the opinion of management, are necessary to present fairly our consolidated financial position and the results of our operations and our cash flows for the interim periods. You should read these consolidated financial statements in conjunction with the financial statements and the notes thereto contained in our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2003. The nature of our business is such that the results of any interim period may not be indicative of the results to be expected for the entire year.

**Pervasiveness of Estimates**

We have prepared the consolidated financial statements in accordance with GAAP, which requires us to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. The most significant and subjective of these estimates are our determination of the valuation of our Retained interests in loans securitized and our determination of the Allowance for loan losses. The significant factors susceptible to future change that have an impact on these estimates include default rates, net interest spreads, payment rates, liquidity and the ability to finance future receivables activity and overall economic conditions. As a result, the fair value of our Retained interests in loans securitized and the actual losses in our Credit card loan portfolio as of September 30, 2004 and December 31, 2003, could materially differ from these estimates.

**Comprehensive Income**

SFAS No. 130 *Reporting Comprehensive Income,* does not apply to our current financial results and therefore, net income equals comprehensive income.

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## NOTE 2 ACCOUNTING CHANGES

In October, 2004, the Financial Accounting Standards Board ( FASB ) concluded that Statement 123R, *Share-Based Payment*, which will require all companies to measure and record in the income statement compensation cost for all share-based payments (including employee stock options) at fair value, would be effective for public companies for interim or annual periods beginning after June 15, 2005. The FASB plans to issue the final statement on or around December 15, 2004. We do not expect the adoption of Statement 123R will have a material impact on our financial statements.

In March 2004, the Emerging Issues Task Force ( EITF ) reached a consensus on EITF Issue No. 03-6 Participating Securities and the two-class method under FASB Statement 128, (the Consensus or EITF 03-6 ). The Consensus requires net income to be reduced by the amount of dividends declared in the current period for each class of stock and by the contractual amount of dividends or other participation payments that are paid or accumulated for the current period. Undistributed earnings for the period are allocated to participating securities based on the contractual participation rights of the security to share in those current earnings assuming all earnings for the period are distributed. Our preferred shareholders have contractual participation rights on a converted basis that are equivalent to those of common shareholders. Therefore, we allocate undistributed earnings to preferred and common shareholders based on their respective ownership percentage, on a converted basis, as of the end of the period. The guidance in EITF 03-6 is effective for fiscal periods (interim or annual) beginning after March 31, 2004. Companies are required to restate prior period earnings per share amounts to conform to the guidance in EITF 03-6 upon adoption.

The following table presents basic and diluted earnings (loss) per share using the two-class method for the first quarter of 2004 and the previous five annual periods:

| | **Three months ended March 31,** | **Twelve months ended December 31,** | | | | |
|---|---|---|---|---|---|---|
| | **2004** | **2003** | **2002** | **2001** | **2000** | **1999** |
| **As Previously Reported:** | | | | | | |
| Basic earnings (loss) per share | $ 0.47 | $ (3.27) | $ (0.66) | $ 1.64 | $ 2.08 | $ 1.50 |
| Diluted earnings (loss) per share | $ 0.47 | $ (3.27) | $ (0.66) | $ 1.61 | $ 2.01 | $ 1.44 |
| **As Restated:** | | | | | | |
| ***Basic Earnings (Loss) per Share*** | | | | | | |
| Distributed Preferred[1] | $ 8.38 | $32.78 | $34.00 | $33.99 | $33.79 | $147.43 |
| Undistributed Preferred | 10.80 | | | 43.19 | 52.06 | |
| Basic Preferred | $19.18 | $32.78 | $34.00 | $77.18 | $85.85 | $147.43 |
| Distributed Common | $ | $ | $ 0.04 | $ 0.04 | $ 0.03 | $ 0.02 |
| Undistributed Common | 0.30 | (3.27) | (0.70) | 1.25 | 1.72 | (0.31) |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Basic | Common | $ 0.30 | $ (3.27) | $ (0.66) | $ 1.29 | $ 1.75 | $ (0.29) |