

METRIS COMPANIES INC

Form 10-Q

August 09, 2005

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

(Mark One)

**Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2005**

or

**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 (State of Incorporation) 41-1849591 (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 No

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

Yes No

As of July 31, 2005, 58,454,018 shares of the Registrant's common stock, par value \$.01 per share, were outstanding.

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June 30, 2005**

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Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which are subject to the safe harbor created by those sections. Forward-looking statements include, without limitation: expressions of the belief, anticipation, intent, or expectations of management; statements and information as to our strategies and objectives; return on equity; changes in our managed loan portfolio; net interest margins; funding costs; liquidity; cash flow; operating costs and marketing expenses; delinquencies and charge-offs and industry comparisons or projections; statements as to industry trends or future results of operations of Metris Companies, Inc. and its subsidiaries (the Company); and other statements that are not historical fact. Forward-looking statements may be identified by the use of terminology such as may, will, believes, does not believe, no reason to believe, expects, plans, intends, estimates, anticipated, or anticipates and similar expressions, as they relate to the Company or our management. Forward-looking statements are based on certain assumptions by management and are subject to risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements.

These risks and uncertainties include, but are not limited to: the potential impact of any failure to operate in accordance with directives from the Office of the Comptroller of the Currency, including those included in our Modified Operating Agreement; the ability of regulators to impose restrictions on Direct Merchants Credit Card Bank, National Association, that could negatively impact our operations or financial results; the risk that failure to comply with applicable laws, regulations, and credit card association bylaws and adverse changes in those laws, regulations, or credit card association bylaws could have a negative impact on our financial results and could adversely affect our ability to conduct our business in a profitable manner; the fact that we are the subject of an investigation by the Securities and Exchange Commission; that the occurrence of certain events could result in early amortization (required repayment) of the securities issued by the Metris Master Trust; that credit card receivables generated by our target consumers generally have higher default rates and our target consumers may be impacted more by general economic and social factors than higher credit quality consumers; that we require a high degree of liquidity to operate our business, and an inability to access funding at the times and in the amounts that we need could adversely affect our ability to operate or our financial results; that we are the subject of an Internal Revenue Service examination; that changes in the interest rates on the funds we borrow and the amounts we loan to our credit card customers could adversely affect our financial results; the fact that we face intense competition; the fact that our financial results could be negatively impacted by fluctuations in the valuation of our retained interests in our securitizations; the fact that our restatements of financial results have had, and may in the future continue to have, adverse effects on us; the fact that changes in the credit card market as a result of recent judicial decisions with MasterCard® and Visa® could adversely affect our financial results; and the fact that we are exposed to other industry-wide risks that could adversely affect our financial performance.

These risks are discussed in our Annual Report on Form 10-K for the year ended December 31, 2004, in Item 1 of such report under the heading Risk Factors. Certain of these and other risks and uncertainties also are discussed in Legal Proceedings on page 44, Management's Discussion and Analysis of Financial Condition and Results of Operations on pages 23-43, and Quantitative and Qualitative Disclosures About Market Risk on pages 43-44 of this Report. Although we have attempted to list comprehensively the major risks and uncertainties, other factors may in the future prove to be important in causing actual results to differ materially from those contained in any forward-looking statement. Readers are cautioned not to place undue reliance on any forward-looking statement, which speaks only as of the date thereof. We undertake no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.

Table of Contents**Part I. Financial Information****ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS
METRIS COMPANIES INC. AND SUBSIDIARIES**

Consolidated Balance Sheets

(In thousands, except per share and share data)

	June 30, 2005 (Unaudited)	December 31, 2004
Assets		
Cash and due from banks	\$ 23,487	\$ 25,198
Federal funds sold	27,395	22,450
Short-term investments	126,083	43,070
Cash and cash equivalents	176,965	90,718
Available for sale securities	109,991	306,409
Liquidity reserve deposit	70,044	79,746
Credit card loans, net of allowance of \$3,751 and \$12,409, respectively	2,754	55,821
Retained interests in loans securitized	769,184	784,135
Property and equipment, net	22,936	24,135
Other receivables due from credit card securitizations, net	66,847	68,021
Other assets	47,345	72,494
Total assets	\$ 1,266,066	\$ 1,481,479
Liabilities		
Debt	\$ 78,626	\$ 373,624
Accounts payable	34,448	37,619
Accrued expenses and other liabilities	142,828	122,934
Total liabilities	255,902	534,177
Stockholders Equity		
Convertible preferred stock, par value \$.01 per share; 10,000,000 shares authorized, 1,444,186 and 1,381,327 shares issued and outstanding, respectively	537,960	514,545
Common stock, par value \$.01 per share; 300,000,000 shares authorized, 65,501,049 and 65,182,416 issued, respectively	655	652
Paid-in capital	237,168	233,989
Unearned compensation	(404)	
Treasury stock 7,055,300 shares	(58,308)	(58,308)
Retained earnings	293,093	256,424
Total stockholders equity	1,010,164	947,302
Total liabilities and stockholders equity	\$ 1,266,066	\$ 1,481,479

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Consolidated Statements of Income

(In thousands, except per-share data) (Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2005	2004	2005	2004
Revenues				
Loss on new securitizations of receivables to the Metris Master Trust	\$ (13,046)	\$ (90,640)	\$ (42,207)	\$ (91,886)
Loss on replenishment of receivables to the Metris Master Trust	(11,129)	(25,454)	(22,626)	(49,381)
Discount accretion	60,503	61,570	121,832	121,540
Interest-only revenue	96,503	55,137	185,388	130,069
Change in fair value of retained interests in loans securitized	15,696	20,718	20,808	68,683
Transaction and other costs	(5,886)	(45,674)	(12,498)	(84,383)
Securitization income (expense)	142,641	(24,343)	250,697	94,642
Servicing income on securitized receivables	28,273	33,847	57,693	70,084
Credit card loan and other interest income	3,211	5,010	8,159	10,116
Credit card loan fees, interchange and other income	1,920	5,264	4,700	16,080
Enhancement services income	2,961	6,976	6,426	14,456
Gain on sale of membership and warranty business			1,800	
Total revenues	179,006	26,754	329,475	205,378
Expenses				
Interest	4,520	18,714	15,901	32,645
Benefit for loan losses	(4,603)	(491)	(5,551)	(6,583)
Marketing	33,924	15,726	53,071	31,658
Employee compensation	38,086	35,723	74,595	74,668
Data processing services and communications	11,832	13,777	23,832	30,249
Credit protection claims	4,030	5,036	9,443	11,384
Occupancy and equipment	4,761	5,984	9,654	12,385
Other	36,448	28,735	56,207	51,110
Total expenses	128,998	123,204	237,152	237,516
Income (loss) before income taxes	50,008	(96,450)	92,323	(32,138)
Income tax expense (benefit)	17,505	(26,124)	32,239	(3,422)
Net income (loss)	32,503	(70,326)	60,084	(28,716)
Convertible preferred stock dividends	11,838	10,830	23,415	21,421

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Net income (loss) after preferred dividends	\$ 20,665	\$ (81,156)	\$ 36,669	\$ (50,137)
Earnings (loss) per share				
Distributed	\$	\$	\$	\$
Undistributed	0.20	(1.40)	0.35	(0.87)
Total Basic	\$ 0.20	\$ (1.40)	\$ 0.35	\$ (0.87)
Total Diluted	\$ 0.20	\$ (1.40)	\$ 0.35	\$ (0.87)

Shares used to compute earnings (loss) per share

Basic	58,295	57,924	58,221	57,857
Diluted	59,045	57,924	58,981	57,857

See accompanying Notes to Consolidated Financial Statements.

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Consolidated Statements of Changes in Stockholders' Equity

(In thousands)

	Number of		Convertible				Treasury	Retained	Total
	Preferred	Common	Preferred	Common	Paid	In			
	Shares	Shares	Stock	Stock	Capital	Unearned	Stock		Equity
Balance at December 31, 2003	1,264	57,807	\$470,728	\$649	\$229,655	\$ (27)	\$(58,308)	\$266,496	\$ 909,193
Net loss								(28,716)	(28,716)
Convertible preferred stock dividends	57		21,421					(21,421)	
Issuance of common stock under employee benefit plans		200		1	2,331				2,332
Deferred compensation obligations								(85)	(85)
Restricted stock forfeitures		(50)			(5)	4			(1)
Amortization of restricted stock						23			23
Balance at June 30, 2004 (Unaudited)	1,321	57,957	492,149	650	231,896		(58,308)	216,359	882,746
Balance at December 31, 2004	1,381	58,127	\$514,545	\$652	\$233,989	\$	\$(58,308)	\$256,424	\$ 947,302
Net income								60,084	60,084
Convertible preferred stock dividends	63		23,415					(23,415)	
Issuance of common stock under employee benefit and compensation plans		281		3	2,711				2,714
Issuance of restricted stock		38			468	(468)			
Amortization of restricted stock						64			64

**Balance at
June 30, 2005
(Unaudited)**

1,444	58,446	\$537,960	\$655	\$237,168	\$(404)	\$(58,308)	\$293,093	\$1,010,164
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See accompanying Notes to Consolidated Financial Statements.

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Consolidated Statements of Cash Flows

(In thousands) (Unaudited)

	Six Months Ended	
	June 30,	
	2005	2004
Operating Activities		
Net income (loss)	\$ 60,084	\$ (28,716)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, amortization and accretion	(105,557)	(100,583)
Benefit for loan losses	(5,551)	(6,583)
Loss from credit card securitizations	64,833	141,267
Gain on sale of membership and warranty business	(1,800)	
Market loss on derivative financial instruments	1,578	7,572
Changes in operating assets and liabilities, net:		
Liquidity reserve deposit	9,702	5,295
Fair value of retained interests in loans securitized	(20,808)	(68,683)
Spread accounts receivable	38,544	163,728
Other receivables due from credit card securitizations, net	1,174	4,941
Accounts payable	(3,171)	1,800
Accrued expenses and other liabilities	17,093	11,844
Other	19,620	17,081
Net cash provided by operating activities	75,741	148,963
Investing Activities		
Proceeds from sales of available for sale securities	1,266,326	1,206,831
Purchases of available for sale securities	(1,069,908)	(1,393,563)
Net loans collected	610,234	408,127
Net repayments of securitized loans	(497,402)	(420,000)
Net (additions to) disposals of property and equipment	(3,374)	2,072
Net cash provided by (used in) investing activities	305,876	(196,533)
Financing Activities		
Proceeds from issuance of debt		283,974
Repayment of debt	(295,883)	(202,724)
Proceeds from issuance of common stock	513	2,332
Net cash (used in) provided by financing activities	(295,370)	83,582
Net increase in cash and cash equivalents	86,247	36,012
Cash and cash equivalents at beginning of period	90,718	178,485
Cash and cash equivalents at end of period	\$ 176,965	\$ 214,497

Supplemental disclosures and cash flow information

Cash paid (received) during the period for:

Interest	\$	19,704	\$	23,183
Income taxes		15,803		(35,820)

See accompanying Notes to Consolidated Financial Statements.

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Notes to Consolidated Financial Statements

*(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 products.

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

During the first quarter of 2005, we reclassified certain financial statement line items to reflect the continuing operations of our business. In prior periods, we classified purchased portfolio premium as an individual line item in Total assets. For all periods presented, purchased portfolio premium is classified as Other assets on the consolidated balance sheets. In prior periods, we classified deposits and deferred income as individual line items in Total liabilities. For all periods presented, deposits and deferred income are classified as Accrued expenses and other liabilities. In prior periods, we classified purchased portfolio premium amortization and asset impairments, lease write-offs and severance as individual line items in Total expenses. For all periods presented, purchased portfolio premium amortization and asset impairments, lease write-offs and severance are classified as Other expenses on the consolidated statements of income.

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 or the Commission) 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 for the fiscal year ended December 31, 2004. 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 is our determination of the fair value of Retained interests in loans securitized. The significant factors susceptible to future change that have an impact on this estimate 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 as of June 30, 2005 and December 31, 2004, could materially differ from these estimates.

Comprehensive Income

During the three- and six-month periods ended June 30, 2005 and 2004, we did not have any other comprehensive income as defined by Statement of Financial Accounting Standards (SFAS) No. 130 Reporting Comprehensive Income. As such, net income equals comprehensive income for all periods presented.

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We calculate earnings per share in accordance with Emerging Issues Task Force (EITF) Issue No. 03-6 *Participating Securities and the two-class method under FASB Statement 128*. This method 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 stockholders have contractual participation rights on a converted basis that are equivalent to those of common stockholders. Therefore, we allocate undistributed earnings to preferred and common stockholders based on their respective ownership percentage, on a converted basis, as of the end of the period.

The following table presents the computation of earnings per share.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2005	2004	2005	2004
Net income (loss)	\$32,503	\$(70,326)	\$60,084	\$(28,716)
Convertible preferred stock dividends	11,838	10,830	23,415	21,421
Net income (loss) after preferred dividends	\$20,665	\$(81,156)	\$36,669	\$(50,137)
Convertible preferred stock dividends	\$11,838	\$ 10,830	\$23,415	\$ 21,421
Weighted average preferred shares	1,412	1,292	1,397	1,278
Distributed earnings per share Preferred	\$ 8.38	\$ 8.38	\$ 16.76	\$ 16.76
Undistributed income (loss)	\$20,665	\$(81,156)	\$36,669	\$(50,137)
Preferred ownership on a converted basis	44%			