

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

METRIS COMPANIES INC.

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Consolidated Balance Sheets

(In thousands, except per share data)

	September 30, 2004 (Unaudited)	December 31, 2003
	<hr/>	<hr/>
Assets:		
Cash and due from banks	\$ 23,683	\$ 32,076
Federal funds sold	49,395	25,300
Short-term investments	330,452	121,109
	<hr/>	<hr/>
Cash and cash equivalents	403,530	178,485
	<hr/>	<hr/>
Liquidity reserve deposit	79,655	80,158
Credit card loans	70,389	128,615
Less: Allowance for loan losses	14,293	45,492
	<hr/>	<hr/>
Net credit card loans	56,096	83,123
	<hr/>	<hr/>
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
	<hr/>	<hr/>
Total assets	\$1,553,498	\$1,392,396
	<hr/>	<hr/>
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
	<hr/>	<hr/>

Total liabilities	<u>607,841</u>	<u>483,203</u>
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	<u>267,050</u>	<u>266,496</u>
Total stockholders equity	<u>945,657</u>	<u>909,193</u>
Total liabilities and stockholders equity	<u>\$ 1,553,498</u>	<u>\$ 1,392,396</u>

See accompanying Notes to Consolidated Financial Statements.

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Consolidated Statements of Income

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2004	2003	2004	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

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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	\$ 0.49	\$ (1.48)	\$ 0.01	\$ (3.70)
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.

Table of Contents**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 Capita	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.

Table of Contents**METRIS COMPANIES INC. AND SUBSIDIARIES**

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

	Nine Months Ended September 30,	
	2004	2003
	<hr/>	<hr/>
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)
	<hr/>	<hr/>
Net cash provided by (used in) operating activities	206,950	(198,706)
	<hr/>	<hr/>
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
	<hr/>	<hr/>
Net cash (used in) provided by investing activities	(64,107)	700,565
	<hr/>	<hr/>
Financing Activities:		
Proceeds from issuance of debt	283,974	125,606
Repayment of debt	(202,724)	(132,417)

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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
	<u> </u>	<u> </u>
Net cash provided by (used in) financing activities	82,202	(923,679)
	<u> </u>	<u> </u>
Net increase (decrease) in cash and cash equivalents	225,045	(421,820)
Cash and cash equivalents at beginning of period	178,485	580,232
	<u> </u>	<u> </u>
Cash and cash equivalents at end of period	\$ 403,530	\$ 158,412
	<u> </u>	<u> </u>
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 products.

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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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, 2004	Twelve months ended				
		2003	2002	December 31, 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	
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Basic Preferred	\$19.18	\$32.78	\$34.00	\$77.18	\$85.85	\$147.43
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Distributed Common	\$	\$	\$ 0.04	\$ 0.04	\$ 0.03	\$ 0.02
Undistributed Common	0.30	(3.27)	(0.70)	1.25	1.72	(0.31)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

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Basic	Common	\$ 0.30	\$ (3.27)	\$ (0.66)	\$ 1.29	\$ 1.75	\$ (0.29)
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