METRIS COMPANIES INC
Form 10-Q
November 09, 2005

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

FORM 10-Q

(Mark One)

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

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 þ No o

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

Yes þ No o

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

As of October 31, 2005, 58,492,676 shares of the Registrant s common stock, par value $.01 per share, were outstanding.

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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 informatio 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 the Company and its subsidiaries; 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, 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: our actions, combined with the actions of other credit card companies, to change cardholder terms and conditions in order to comply with regulations issued by the Federal Financial Institutions Examination Council (FFIEC) create additional uncertainty regarding future levels of delinquencies, charge-offs and excess spread and the performance of our credit card portfolio in the future; the potential impact of any failure to operate in accordance with directives from the Office of the Comptroller of the Currency (OCC), including those 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; 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 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 changes in the credit card market as a result of recent judicial decisions with MasterCard® and Visa® could adversely affect our financial results; the long-term impact from recent changes in bankruptcy legislation could adversely impact the excess spread generated in the Metris Master Trust; and the fact that we are exposed to other industry-wide risks that could adversely affect our financial performance.

In addition, our proposed merger with HSBC Finance Corporation entails the following additional risks and uncertainties: the fact that completion of the merger is dependent on, among other things, receipt of stockholder and regulatory approvals, the timing of which cannot be predicted with precision and which may not be received at all; the occurrence of any circumstance or event that would constitute a material adverse effect with respect to the Company for purposes of the merger agreement; adverse governmental or regulatory policies; failure to resolve the Company s pending Securities and Exchange Commission (SEC) investigation in the manner contemplated by the terms of the merger agreement; and the loss of key employees as the result of the announcement of the proposed merger.

The risks and uncertainties not associated with completion of the merger with HSBC Finance Corporation 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, including matters related to the completion of the merger with HSBC Finance Corporation, are also discussed herein in Legal Proceedings on pages 39-40, Management s Discussion and Analysis of Financial Condition and Results of Operations on pages 16-38 hereof, and Quantitative and Qualitative Disclosures About Market Risk on page 38-39 hereof. 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.

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Part I. Financial Information

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

METRIS COMPANIES INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(In thousands, except share data)

	September 30, 2005 (unaudited)	December 31, 2004
Assets		
Cash and due from banks	$ 25,248	$ 25,198
Federal funds sold	22,005	22,450
Short-term investments	58,786	43,070
Cash and cash equivalents	106,039	90,718
Available for sale securities	61,100	306,409
Liquidity reserve deposit	86,284	79,746
Credit card loans, net of allowance of $1,645 and $12,409, respectively	2,586	55,821
Retained interests in loans securitized	851,143	784,135
Property and equipment, net	21,737	24,135
Other receivables due from credit card securitizations, net	80,874	68,021
Other assets	51,707	72,494
Total assets	$ 1,261,470	$ 1,481,479
Liabilities		
Debt	$	$ 373,624
Accounts payable	34,766	37,619
Accrued expenses and other liabilities	162,064	122,934
Total liabilities	196,830	534,177
Stockholders Equity		
Convertible preferred stock par value $.01 per share; 10,000,000 shares authorized, 1,476,680 and 1,381,327 shares issued and outstanding, repectively	550,064	514,545
Common stock, par value $.01 per share; 300,000,000 shares authorized, 65,547,601 and 65,182,416 shares issued, respectively	655	652
Paid-in capital	237,865	233,989
Unearned compensation	(286)	
Treasury stock - 7,055,300 shares	(58,308)	(58,308)
Retained earnings	334,650	256,424
Total stockholders equity	1,064,640	947,302

Total liabilities and stockholders equity	$	1,261,470	$	1,481,479

See accompanying Notes to Consolidated Financial Statements.

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METRIS COMPANIES INC. AND SUBSIDIARIES
Consolidated Statements of Income
(In thousands, except per-share data) (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Revenues				
Loss on new securitizations of receivables to the Metris Master Trust	$ (7,106)	$	$ (49,313)	$ (91,886)
Gain (loss) on replenishment of receivables to the Metris Master Trust	736	(21,972)	(21,890)	(71,353)
Discount accretion	58,355	63,747	180,187	185,287
Interest-only revenue	121,798	87,316	307,186	217,385
Change in fair value of retained interests in loans securitized	(20,027)	25,518	781	94,202
Transaction and other costs	(2,755)	(6,634)	(15,253)	(91,018)
Securitization income	151,001	147,975	401,698	242,617
Servicing income on securitized receivables	27,947	32,496	85,640	102,580
Credit card loan and other interest income	2,161	4,549	10,320	14,665
Credit card loan fees, interchange and other income	652	3,736	5,352	19,816
Enhancement services income	2,748	5,692	9,174	20,148
Gain on sale of membership and warranty business			1,800	
Total revenues	184,509	194,448	513,984	399,826
Expenses				
Interest	456	14,056	16,357	46,701
(Benefit) provision for loan losses	(771)	1,408	(6,322)	(5,175)
Marketing	34,455	17,190	87,526	48,848
Employee compensation	36,501	31,554	111,096	106,222
Data processing services and communications	12,608	12,203	36,440	42,452
Credit protection claims	4,063	3,421	13,506	14,805
Occupancy and equipment	4,621	5,442	14,275	17,827
Other	18,346	23,985	74,553	75,095
Total expenses	110,279	109,259	347,431	346,775
Income before income taxes	74,230	85,189	166,553	53,051
Income tax expense	20,569	23,425	52,808	20,003
Net income	53,661	61,764	113,745	33,048
Convertible preferred stock dividends	12,104	11,073	35,519	32,494
Net income after preferred dividends	41,557	50,691	78,226	554

Earnings per share				
Distributed	$	$	$	$
Undistributed	0.40	0.49	0.75	0.01
Total Basic	$ 0.40	$ 0.49	$ 0.75	$ 0.01
Total Diluted	$ 0.39	$ 0.48	$ 0.74	$ 0.01
Shares used to compute earnings per share				
Basic	58,435	57,981	58,293	57,899
Diluted	59,361	58,915	59,095	58,830

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) (unaudited)

	Number of Shares Preferred	Number of Shares Common	Convertible Preferred Stock	Common Stock	Paid-In Capital	Unearned Compensation	Treasury Stock	Retained Earnings	Total Stockholders Equity
Balance at December 31, 2003	1,264	57,807	$ 470,728	$ 649	$ 229,655	$ (27)	$ (58,308)	$ 266,496	$ 909,193
Net loss								33,048	33,048
Convertible preferred stock dividends	87		32,494					(32,494)	
Issuance of common stock under employee benefit plans		287		2	3,477				3,479
Deferred compensation obligations					(85)				(85)
Restricted stock forfeitures		(50)			(5)	4			(1)
Amortization of restricted stock						23			23
Balance at September 30, 2004	1,351	58,044	$ 503,222	$ 651	$ 233,042	$	$ (58,308)	$ 267,050	$ 945,657
Balance at December 31, 2004	1,381	58,127	$ 514,545	$ 652	$ 233,989	$	$ (58,308)	$ 256,424	$ 947,302
Net income								113,745	113,745
Convertible preferred stock dividends	96		35,519					(35,519)	
Issuance of common stock under employee benefit plans		327		3	3,408				3,411
Issuance of restricted stock		38			468	(468)			
Amortization of restricted stock						182			182
	1,477	58,492	$ 550,064	$ 655	$ 237,865	$ (286)	$ (58,308)	$ 334,650	$ 1,064,640

Balance at September 30, 2005

See accompanying Notes to Consolidated Financial Statements.

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METRIS COMPANIES INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(In thousands) (unaudited)

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
Operating Activities		
Net income	$ 113,745	$ 33,048
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	(159,273)	(157,845)
Benefit for loan losses	(6,322)	(5,175)
Loss from credit card securitizations	71,203	163,239
Gain on sale of membership and warranty business	(1,800)	
Market loss on derivative financial instruments	1,297	8,564
Changes in operating assets and liabilities, net:		
Liquidity reserve deposit	(6,538)	503
Fair value of retained interests in loans securitized	(781)	(94,202)
Spread accounts receivable	21,024	207,520
Other receivables due from credit card securitizations, net	(12,853)	5,773
Accounts payable	(2,853)	5,883
Accrued expenses and other liabilities	34,199	16,290
Other	16,223	20,825
Net cash provided by operating activities	67,271	204,423
Investing Activities		
Proceeds from sales of available for sale securities	1,743,076	1,982,187
Purchases of available for sale securities	(1,497,767)	(2,097,891)
Net loans collected	708,692	1,125,207
Net repayments of securitized loans	(627,402)	(1,215,200)
Proceeds from sales of credit card portfolios to third parties		27,870
Net additions to property and equipment	(4,230)	(1,984)
Net cash provided by (used in) investing activities	322,369	(179,811)
Financing Activities		
Proceeds from issuance of debt		283,974
Repayment of debt	(375,000)	(202,724)
Proceeds from issuance of common stock	681	3,479
Net cash (used in) provided by financing activities	(374,319)	84,729
Net increase in cash and cash equivalents	15,321	109,341
Cash and cash equivalents at beginning of period	90,718	130,510
Cash and cash equivalents at end of period	$ 106,039	$ 239,851

Supplemental disclosures and cash flow information				
Cash paid (received) during the period for:				
Interest	$	24,124	$	36,945
Income taxes		15,956		(34,997)

See accompanying Notes to Consolidated Financial Statements.

METRIS COMPANIES INC. AND SUBSIDIARIES
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 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 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 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 consolidated 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, including the timing of asset-backed securitization transactions and seasonal payment patterns, 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 September 30, 2005 and December 31, 2004, could materially differ from these estimates.

Comprehensive Income

During the three- and nine-month periods ended September 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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NOTE 2 EARNINGS PER SHARE

We calculate earnings per share in accordance with Emerging Issues Task Force 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.