

Edgar Filing: METRIS COMPANIES INC - Form 10-Q/A

METRIS COMPANIES INC  
Form 10-Q/A  
April 12, 2004

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

-----  
FORM 10-Q/A

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

For the quarterly period ended June 30, 2003

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 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  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, 2003, 57,798,577 shares of the registrant's common stock, par value \$.01 per share, were outstanding.

METRIS COMPANIES INC.

FORM 10-Q

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### EXPLANATORY NOTE

As previously disclosed, Metris Companies Inc. (the "Company") has determined that it will restate its financial results for 1998 through 2002 and for the first three quarters of 2003. This determination was made in connection with the Company's analysis of its method of valuing "Retained interests in loans securitized."

This Amendment No. 1 to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2003, initially filed with the Securities and Exchange Commission ("SEC") on August 14, 2003 (the "Original 10-Q"), is being filed to reflect restatements of the following financial statements: (a) consolidated balance sheets as of December 31, 2002 and June 30, 2003; (b) consolidated statements of income for the three and six-months ended June 30, 2003 and 2002 and (c) consolidated statements of cash flows for the three and six-months ended

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June 30, 2003 and 2002. Included in these restatements, in addition to changes made as a result of the Company's revised accounting policies and procedures related to valuing its retained interests, are corrections to conform with accounting principles generally accepted in the United States of America ("GAAP") related to securitization transaction costs, credit card solicitation costs, interest rate caps and debt waiver revenue associated with credit card receivables sold to the Metris Master Trust, as well as the transfer of allowance for loan losses that was incorrectly classified as a valuation reserve in "Retained interests in loans securitized" as of December 31, 2001. In addition, we have restated certain other prior period amounts to conform with the current period's presentation. For a more detailed description of the restatements, see Note 2 to the accompanying unaudited consolidated financial statements and "Restatements" in Management's Discussion and Analysis of Financial Condition and Results of Operations contained in this Quarterly Report on Form 10-Q/A.

This Amendment No. 1 amends and restates Items 1, 2, and 4 of Part I and Item 6 of Part II of the Original 10-Q. No other information in the Original 10-Q is amended hereby. The foregoing items have been amended to reflect the restatements and have not been updated to reflect other events occurring after the filing of the Original 10-Q or to modify or update those disclosures affected by subsequent events. Such matters have been or will be addressed in the Quarterly Report on Form 10-Q for the quarter ended September 30, 2003, filed on March 2, 2004, the Current Report on Form 8-K filed on March 15, 2004 and any reports filed with the SEC subsequent to the date of this filing.

We are concurrently filing an amended Annual Report on Form 10-K/A for the year ended December 31, 2002 and amended Quarterly Reports on Form 10-Q/A for the quarter ended March 31, 2003 and for the quarter ended September 30, 2003, containing restated financial statements for the relevant periods. We did not amend our Annual Reports on Form 10-K or Quarterly Reports on Form 10-Q for periods affected by the restatements that ended prior to December 31, 2002, and, therefore, the financial statements, auditors' reports and related financial information for the affected periods contained in such reports should no longer be relied upon.

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### PART I. FINANCIAL INFORMATION

#### ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

##### METRIS COMPANIES INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(Dollars in thousands)

|                           | JUNE 30,<br>2003<br>AS RESTATED<br>(UNAUDITED) |
|---------------------------|--|
|                           | -----  |
| ASSETS:                   |  |
| Cash and due from banks   | \$ 86,518                                      |
| Federal funds sold        | 33,700   |
| Short-term investments    | 266,373  |
|                           | -----  |
| Cash and cash equivalents | 386,591  |

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|  |                     |
|--|---------------------|
| Liquidity reserve deposit  | 80,590              |
| Credit card loans  | 632,913             |
| Less: Allowance for loan losses  | 109,162             |
| Net credit card loans  | 523,751             |
| Retained interests in loans securitized  | 852,215             |
| Property and equipment, net  | 51,510              |
| Purchased portfolio premium, net   | 51,584              |
| Other receivables due from credit card securitizations, net  | 92,611              |
| Other assets   | 207,397             |
| <b>TOTAL ASSETS</b>  | <b>\$ 2,246,249</b> |
| <b>LIABILITIES:</b>  |                     |
| Deposits   | \$ 641,934          |
| Debt   | 383,237             |
| Accounts payable   | 49,996              |
| Deferred income  | 106,134             |
| Accrued expenses and other liabilities   | 115,274             |
| <b>TOTAL LIABILITIES</b>   | <b>1,296,575</b>    |
| <b>STOCKHOLDERS' EQUITY:</b>   |                     |
| Convertible preferred stock - Series C, par value \$.01 per share; 10,000,000 shares authorized, 1,208,695 and 1,156,086 shares issued and outstanding, respectively | 450,239             |
| Common stock, par value \$.01 per share; 300,000,000 shares authorized, 64,853,877 and 64,223,231 shares issued, respectively  | 648                 |
| Paid-in capital  | 230,241             |
| Unearned compensation  | (292)               |
| Treasury stock - 7,055,300 shares  | (58,308)            |
| Retained earnings  | 327,146             |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>  | <b>949,674</b>      |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>  | <b>\$ 2,246,249</b> |

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  
 JUNE 30,  
 AS RESTATED  
 -----  
 2003                      2002  
 -----

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INTEREST INCOME:

|   |    |          |    |          |    |
|---|----|----------|----|----------|----|
| Credit card loans                                       | \$ | 29,713   | \$ | 66,324   | \$ |
| Federal funds sold                                      |    | 164      |    | 110      |    |
| Other   |    | 1,555    |    | 2,358    |    |
|   |    | -----    |    | -----    |    |
| Total interest income                                   |    | 31,432   |    | 68,792   |    |
|   |    | -----    |    | -----    |    |
| Deposit interest expense                                |    | 9,597    |    | 18,334   |    |
| Other interest expense                                  |    | 9,119    |    | 8,621    |    |
|   |    | -----    |    | -----    |    |
| Total interest expense                                  |    | 18,716   |    | 26,955   |    |
|   |    | -----    |    | -----    |    |
| NET INTEREST INCOME                                     |    | 12,716   |    | 41,837   |    |
| Provision for loan losses                               |    | 30,033   |    | 90,601   |    |
|   |    | -----    |    | -----    |    |
| NET INTEREST EXPENSE AFTER<br>PROVISION FOR LOAN LOSSES |    | (17,317) |    | (48,764) |    |
|   |    | -----    |    | -----    |    |

OTHER OPERATING INCOME:

|   |  |         |  |         |  |
|---|--|---------|--|---------|--|
| Securitization income (expense)                               |  | 17,707  |  | 42,746  |  |
| Servicing income on securitized / sold<br>receivables         |  | 45,335  |  | 47,528  |  |
| Credit card fees, interchange and other<br>credit card income |  | 23,460  |  | 40,538  |  |
| Enhancement services revenue                                  |  | 39,690  |  | 36,744  |  |
|   |  | -----   |  | -----   |  |
|   |  | 126,192 |  | 167,556 |  |
|   |  | -----   |  | -----   |  |

OTHER OPERATING EXPENSE:

|  |    |          |    |          |    |
|--|----|----------|----|----------|----|
| Credit card account and other product<br>solicitation and marketing expenses |    | 32,032   |    | 45,624   |    |
| Employee compensation  |    | 45,721   |    | 54,365   |    |
| Data processing services and communications                                  |    | 17,034   |    | 20,795   |    |
| Credit protection claims expense   |    | 7,646    |    | 13,632   |    |
| Occupancy and equipment  |    | 8,924    |    | 12,291   |    |
| Purchased portfolio premium amortization                                     |    | 6,499    |    | 7,743    |    |
| MasterCard/Visa assessment and fees  |    | 2,231    |    | 3,583    |    |
| Credit card fraud losses   |    | 1,069    |    | 2,953    |    |
| Asset impairments, lease write-offs and<br>severance                         |    | 6,011    |    | 9,523    |    |
| Other  |    | 19,307   |    | 28,445   |    |
|  |    | -----    |    | -----    |    |
|  |    | 146,474  |    | 198,954  |    |
|  |    | -----    |    | -----    |    |
| LOSS BEFORE INCOME TAXES   |    | (37,599) |    | (80,162) |    |
| Income tax benefit   |    | (12,851) |    | (30,040) |    |
|  |    | -----    |    | -----    |    |
| NET (LOSS) INCOME  |    | (24,748) |    | (50,122) |    |
| Convertible preferred stock dividends  |    | 9,908    |    | 9,394    |    |
|  |    | -----    |    | -----    |    |
| NET LOSS APPLICABLE TO COMMON STOCKHOLDERS                                   | \$ | (34,656) | \$ | (59,516) | \$ |
|  |    | =====    |    | =====    |    |

LOSS PER SHARE:

|         |    |        |    |        |    |
|---------|----|--------|----|--------|----|
| Basic   | \$ | (0.60) | \$ | (0.97) | \$ |
| Diluted | \$ | (0.60) | \$ | (0.97) | \$ |

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SHARES USED TO COMPUTE LOSS PER SHARE:

|                                     |        |         |
|-------------------------------------|--------|---------|
| Basic                               | 57,462 | 61,503  |
| Diluted                             | 57,462 | 61,503  |
|                                     |        |         |
| DIVIDENDS DECLARED PER COMMON SHARE | --     | \$ 0.01 |

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<br>PREFERRED | COMMON  | PREFERRED<br>STOCK | COMMON<br>STOCK |
|---|-------------------------------|---------|--------------------|-----------------|
|   |                               |         |                    |                 |
| BALANCE AT DECEMBER 31, 2001 AS<br>PREVIOUSLY REPORTED      | 1,058                         | 63,419  | \$ 393,970         | \$ 642          |
| Cumulative restatements to<br>prior periods, see Note 2     | --                            | --      | --                 | --              |
|   |                               |         |                    |                 |
| BALANCE AT DECEMBER 31, 2001, AS RESTATED                   | 1,058                         | 63,419  | \$ 393,970         | \$ 642          |
| Net income (as restated)                                    | --                            | --      | --                 | --              |
| Cash dividends  | --                            | --      | --                 | --              |
| Common stock repurchased                                    | --                            | (2,720) | --                 | --              |
| Preferred dividends in kind                                 | 48                            | --      | 17,928             | --              |
| Issuance of common stock<br>under employee benefit plans    | --                            | 161     | --                 | 2               |
| Deferred compensation obligations                           | --                            | 76      | --                 | 1               |
| Amortization of restricted<br>stock                         | --                            | --      | --                 | --              |
|   |                               |         |                    |                 |
| BALANCE AT JUNE 30, 2002,<br>AS RESTATED                    | 1,106                         | 60,936  | \$ 411,898         | \$ 645          |
|   |                               |         |                    |                 |
| BALANCE AT DECEMBER 31, 2002 AS PREVIOUSLY<br>REPORTED      | 1,156                         | 57,168  | \$ 430,642         | \$ 642          |
| Cumulative restatements to prior<br>periods, see Note 2     | --                            | --      | --                 | --              |
| BALANCE AT DECEMBER 31, 2002, AS RESTATED                   | 1,156                         | 57,168  | \$ 430,642         | \$ 642          |
| Net loss (as restated)                                      | --                            | --      | --                 | --              |
| Preferred dividends in kind                                 | 53                            | --      | 19,597             | --              |
| Issuance of common stock<br>under employee benefit<br>plans | --                            | 352     | --                 | 3               |
| Deferred compensation<br>obligations                        | --                            | 303     | --                 | 3               |
| Restricted stock forfeitures                                | --                            | (24)    | --                 | --              |
| Amortization of restricted<br>stock                         | --                            | --      | --                 | --              |
|   |                               |         |                    |                 |
| BALANCE AT JUNE 30, 2003,                                   |                               |         |                    |                 |

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|   |                   |                      |                                  |        |
|---|-------------------|----------------------|----------------------------------|--------|
| AS RESTATED   | 1,209             | 57,799               | \$ 450,239                       | \$ 648 |
|   | =====             | =====                | =====                            | =====  |
|   | TREASURY<br>STOCK | RETAINED<br>EARNINGS | TOTAL<br>STOCKHOLDERS'<br>EQUITY |        |
|   | -----             |                      |                                  |        |
| BALANCE AT DECEMBER 31, 2001 AS<br>PREVIOUSLY REPORTED      | \$ (13,014)       | \$ 532,924           | \$ 1,141,955                     |        |
| Cumulative restatements to<br>prior periods, see Note 2     | --                | (36,619)             | (36,619)                         |        |
|   | -----             | -----                | -----                            |        |
| BALANCE AT DECEMBER 31, 2001, AS RESTATED                   | \$ (13,014)       | \$ 496,305           | \$ 1,105,336                     |        |
| Net income (as restated)                                    | --                | (5,842)              | (5,842)                          |        |
| Cash dividends  | --                | (1,892)              | (1,892)                          |        |
| Common stock repurchased                                    | (32,951)          | --                   | (32,951)                         |        |
| Preferred dividends in kind                                 | --                | (17,928)             | --                               |        |
| Issuance of common stock under employee<br>benefit plans    | --                | --                   | 2,257                            |        |
| Deferred compensation<br>obligations                        | --                | --                   | --                               |        |
| Amortization of restricted<br>stock                         | --                | --                   | 911                              |        |
|   | -----             | -----                | -----                            |        |
| BALANCE AT JUNE 30, 2002,<br>AS RESTATED                    | \$ (45,965)       | \$ 470,643           | \$ 1,067,819                     |        |
|   | =====             | =====                | =====                            |        |
| BALANCE AT DECEMBER 31, 2002 AS<br>PREVIOUSLY REPORTED      | \$ (58,308)       | \$ 458,673           | \$ 1,059,025                     |        |
| Cumulative restatements to prior<br>periods, see Note 2     | --                | (4,352)              | (4,352)                          |        |
| BALANCE AT DECEMBER 31, 2002, AS RESTATED                   | \$ (58,308)       | \$ 454,321           | \$ 1,054,673                     |        |
| Net loss (as restated)                                      | --                | (107,578)            | (107,578)                        |        |
| Preferred dividends in kind                                 | --                | (19,597)             | --                               |        |
| Issuance of common stock<br>under employee benefit<br>plans | --                | --                   | 2,370                            |        |
| Deferred compensation obligations                           | --                | --                   | --                               |        |
| Restricted stock forfeitures                                | --                | --                   | (2)                              |        |
| Amortization of restricted<br>stock                         | --                | --                   | 211                              |        |
|   | -----             | -----                | -----                            |        |
| BALANCE AT JUNE 30, 2003,<br>AS RESTATED                    | \$ (58,308)       | \$ 327,146           | \$ 949,674                       |        |
|   | =====             | =====                | =====                            |        |

See accompanying Notes to Consolidated Financial Statements.

METRIS COMPANIES INC. AND SUBSIDIARIES

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

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|   | SIX MONTHS ENDED<br>JUNE 30,<br>----- |                              |
|---|---------------------------------------|------------------------------|
|   | 2003<br>AS RESTATED<br>-----          | 2002<br>AS RESTATED<br>----- |
| <b>OPERATING ACTIVITIES:</b>  |                                       |                              |
| Net loss  | \$ (107,578)                          | \$ (5,842)                   |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: |                                       |                              |
| Depreciation, amortization, and accretion   | (81,545)                              | (92,351)                     |
| Provision for loan losses   | 74,819                                | 152,477                      |
| (Gain) loss from credit card securitization   | 123,982                               | 20,695                       |
| Asset impairments, lease write-offs, and severance  | 22,788                                | 9,523                        |
| Market loss on derivative financial instruments   | 8,161                                 | 12,248                       |
| Changes in operating assets and liabilities, net:   |                                       |                              |
| Liquidity Reserve deposit   | (80,590)                              | --                           |
| Fair value of retained interests in loans securitized                                     | 103,897                               | 183,201                      |
| Spread accounts receivable  | (201,314)                             | 29,491                       |
| Other receivables due from credit card securitizations, net                               | 17,860                                | 27,888                       |
| Accounts payable and accrued expenses   | 4,473                                 | 43,459                       |
| Deferred income   | (37,014)                              | (21,008)                     |
| Other   | (67,123)                              | 1,759                        |
|   | -----                                 | -----                        |
| Net cash provided by (used in) operating activities                                       | (219,184)                             | 361,540                      |
|   | -----                                 | -----                        |
| <b>INVESTING ACTIVITIES:</b>  |                                       |                              |
| Proceeds from transfers of portfolios to the Metris Master Trust                          | 315,065                               | 1,486,993                    |
| Net cash from loan originations and principal collections on loans receivable             | (84,739)                              | (370,193)                    |
| Disposal of property and equipment  | 19,252                                | --                           |
| Additions to property and equipment   | (727)                                 | (3,538)                      |
|   | -----                                 | -----                        |
| Net cash provided by investing activities   | 248,851                               | 1,113,262                    |
|   | -----                                 | -----                        |
| <b>FINANCING ACTIVITIES:</b>  |                                       |                              |
| Proceeds from issuance of debt  | 125,348                               | 153                          |
| Repayment of debt   | (100,206)                             | (292,000)                    |
| Net decrease in deposits  | (250,820)                             | (736,147)                    |
| Cash dividends paid   | --                                    | (1,892)                      |
| Proceeds from issuance of common stock  | 2,370                                 | 2,257                        |
| Repurchase of common stock  | --                                    | (32,951)                     |
|   | -----                                 | -----                        |
| Net cash used in financing activities   | (223,308)                             | (1,060,580)                  |
|   | -----                                 | -----                        |
| Net increase (decrease) in cash and cash equivalents                                      | (193,641)                             | 414,222                      |
| Cash and cash equivalents at beginning of period  | 580,232                               | 381,639                      |
|   | -----                                 | -----                        |
| Cash and cash equivalents at end of period  | \$ 386,591                            | \$ 795,861                   |
|   | =====                                 | =====                        |
| <b>SUPPLEMENTAL DISCLOSURES AND CASH FLOW INFORMATION:</b>                                |                                       |                              |
| Cash paid (received) during the period for:   |                                       |                              |
| Interest  | \$ 36,280                             | \$ 61,345                    |
| Income taxes  | (31,846)                              | (16,488)                     |



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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. 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 and enhancement services.

All dollar amounts are presented as pre-tax amounts unless otherwise noted. We have eliminated all significant intercompany balances and transactions in consolidation. In the second quarter of 2003, certain subsidiaries were designated as guarantors which had previously been classified as non-guarantors. The supplemental consolidating financial statements have been reclassified for all periods presented.

### 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, 2002, filed concurrently with this Quarterly Report on Form 10-Q/A. All dollar amounts are presented as pre-tax amounts unless otherwise noted. We have eliminated all significant intercompany balances and transactions in consolidation. 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 require 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 adequacy of the allowance for loan losses and our determination of the "Fair value of retained interests in loans securitized." The significant factors susceptible to future change that have an impact on these estimates include default rates, payment rates, net interest spreads, liquidity and the ability to finance future receivables activity, and overall economic conditions. As a result, the actual losses in our loan portfolio and the fair value of our retained interests as of June 30, 2003 and December 31, 2002 could materially differ from these estimates. The accompanying unaudited consolidated financial statements do not include an adjustment to the fair value of retained interests that might result from the inability to finance future

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receivables.

### 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 - RESTATEMENTS

The consolidated statements of income and cash flows as presented for the three and six-month periods ended June 30, 2003 and 2002 and the consolidated balance sheets as of June 30, 2003 and December 31, 2002 have been restated to reflect the following:

- The valuation model and related collateral assumptions used to estimate the fair value of the Company's "Retained interests in loans securitized" did not properly reflect the structure of the Metris Master Trust and related series supplements. All periods presented have been restated to reflect the changes in the valuation model and the related collateral assumptions. These restatements impact "Retained interests in loans securitized," "Other receivables due from credit card securitizations, net" and "Securitization income."
- The Company's policy for recognizing transaction costs related to the securitization of receivables through the Metris Master Trust or a conduit was not in accordance with GAAP. Historically, these costs had been capitalized and amortized over the estimated life of the new debt securities. These costs are now allocated and recognized over the initial and reinvestment periods of the respective debt securities or Metris Master Trust financing unless the transaction results in a loss, in which case the costs are expensed as incurred. All periods presented have been restated to reflect the revised policy. This restatement impacts "Other assets" and "Securitization income."
- The Company's policy for recognizing expenses related to credit card solicitation costs was not in accordance with GAAP. Historically, the Company had capitalized and expensed these costs over the estimated period over which the new credit card accounts were established, approximately three months. These costs are now expensed as incurred. All periods presented have been restated to reflect the revised policy. This restatement impacts "Other assets" and "Credit card account and other product solicitation and marketing expenses."
- The Company corrected its accounting for interest rate caps purchased in May of 2002 and forward to comply with SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," as amended. These costs had been deferred and amortized over the estimated life of the new debt securities. These instruments are now recorded at fair value. Periods from May 2002 forward have been restated to reflect this correction. This restatement impacts "Retained interests in loans securitized," "Other assets" and "Securitization income."
- The Company historically recognized revenue in the month following completion of the cancellation period, generally one month. Cash flows related to debt waiver are now included in the valuation of the interest-only strip receivable. All periods presented have been restated to reflect the revised policy. This restatement impacts "Retained interests in loans securitized," "Deferred revenue," "Enhancement services revenue," and "Securitization income."

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- At December 31, 2001 we had \$50 million of "Allowance for loan losses" classified as valuation reserve in our "Retained interests in loans securitized." The valuation reserve was transferred to "Allowance for loan losses" through "Provision for loans losses" during the first quarter of 2002. We have restated the December 31, 2001 balance sheet and 2001 income statement and June 30, 2002 income statement to reflect this transfer occurring during the fourth quarter of 2001. This restatement impacts "Allowance for loan losses," "Retained interests in loans securitized," "Provision for loan losses" and "Securitization income."

The cumulative impact of the above restatements as of December 31, 2001 is a \$36.6 million decrease in retained earnings and consists of the following adjustments:

|   |    |        |
|---|----|--------|
| Retained interests in loans securitized | \$ | 4.6    |
| Allowance for loan losses               |    | (50.0) |
| Transaction costs                       |    | 6.6    |
| Pre-paid costs                          |    | (17.9) |
| Income tax                              |    | 20.1   |
|   |    | -----  |
|   | \$ | (36.6) |
|   |    | =====  |

In addition, we have restated certain prior-period amounts to conform with the current period's presentation.

- In prior periods, we classified interest income, provision for loan losses, and related credit card loan fees generated from retained interests in loans securitized on the income statement as "Interest Income-Credit card loans and retained interests in loans securitized," "Provision for loan losses" and "Credit card fees, interchange and other credit card income." For all periods presented, these amounts are now included in the estimation of the fair value of the interest-only strip receivable and "Securitization income."
- In prior periods we classified spread accounts receivable in "Other receivables due from credit card securitizations, net." For all periods presented, we have reclassified our spread accounts receivable from "Other receivables due from credit card securitizations, net" to "Retained interests in loans securitized."
- In prior periods, we classified servicing income in "Net securitization and credit card servicing income." For all periods presented, we have reclassified these amounts to "Servicing income."
- In prior periods, income from our debt waiver product sold to customers of Direct Merchants Bank with receivables held by Direct Merchants Bank was included in "Enhancement services revenue." For all periods

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presented we have reclassified this income to "Credit card fees, interchange and other credit card income."

- We classified the liquidity reserve deposit established in March 2003 and other restricted cash deposits maintained at Direct Merchants Bank as "Short-term investments." We have reclassified these items to "Liquidity reserve deposit" for all periods presented.
- Revenue related to our membership club and warranty business for current and prior periods is classified as "Enhancement services revenue." Claims expense related to this business has been reclassified as "Other" expenses for all periods presented.
- In addition to the tax effects of the pre-tax restatement amounts, the restated presentation also reflects revised probable amounts of future taxable and deductible temporary differences, resulting in a reclassification of certain deferred income taxes to current income taxes.

See Notes 4,6,7,8,9, 10, 11 and 12, all of which are impacted by these changes.

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The following tables present certain captions of the consolidated financial statements, for all periods presented, which were affected by the restatements.

|   | JUNE 30, 2003                |             |    |
|---|------------------------------|-------------|----|
|   | AS<br>PREVIOUSLY<br>REPORTED | AS RESTATED |    |
|   | -----                        | -----       |    |
| <b>BALANCE SHEETS:</b>                                      |                              |             |    |
| <b>ASSETS:</b>  |                              |             |    |
| Short-term investments                                      | \$ 346,963                   | \$ 266,373  | \$ |
| Liquidity reserve deposit                                   | --                           | 80,590      |    |
| Retained interests in loans securitized                     | 1,623,652                    | --          |    |
| Less: Valuation allowance                                   | 858,605                      | --          |    |
| Net retained interests in loans securitized                 | 765,047                      | 852,215     |    |
| Other receivables due from credit card securitizations, net | 281,233                      | 92,611      |    |
| Other assets  | 167,783                      | 207,397     |    |
| <b>LIABILITIES:</b>   |                              |             |    |
| Deferred income   | \$ 119,807                   | \$ 106,134  | \$ |
| Accrued expenses and other liabilities                      | 92,173                       | 115,274     |    |
| <b>STOCKHOLDERS' EQUITY</b>                                 |                              |             |    |
| Retained earnings   | \$ 398,414                   | \$ 327,146  | \$ |

THREE-MONTHS ENDED

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JUNE 30, 2003

|   | AS<br>PREVIOUSLY<br>REPORTED<br>----- | AS RESTATED<br>----- |
|---|---------------------------------------|----------------------|
| STATEMENTS OF INCOME:   |                                       |                      |
| Other operating income:   |                                       |                      |
| Securitization income   | \$ --                                 | \$ 17,707            |
| Servicing income on securitized/sold receivables                          | --                                    | 45,335               |
| Net securitization and credit card servicing income                       | 31,110                                | --                   |
| Credit card fees, interchange and other credit card income                | 20,146                                | 23,460               |
| Enhancement services revenue  | 84,954                                | 39,690               |
| Other operating expenses:   |                                       |                      |
| Credit card account and other product solicitation and marketing expenses | 28,138                                | 32,032               |
| Enhancement services claims expense                                       | 8,087                                 | --                   |
| Credit protection claims expenses   | --                                    | 7,646                |
| Other   | 18,866                                | 19,307               |
| Loss Before Income Taxes  | (23,686)                              | (37,599)             |
| Income tax benefit  | (7,982)                               | (12,851)             |
| Net loss  | (15,704)                              | (24,748)             |
| Loss per share  | (0.44)                                | (0.60)               |
| Diluted loss per share  | (0.44)                                | (0.60)               |

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|   | SIX-MONTHS ENDED<br>JUNE 30, 2003<br>----- |                      | SIX-MONTHS ENDED<br>JUNE 30, 2002<br>----- |             |
|---|--|----------------------|--|-------------|
|   | AS<br>PREVIOUSLY<br>REPORTED<br>-----      | AS RESTATED<br>----- | AS<br>PREVIOUSLY<br>REPORTED<br>-----      | AS<br>----- |
| STATEMENTS OF INCOME:   |  |                      |  |             |
| Provision for loan losses   | \$ 74,819                                  | \$ 74,819            | \$ 202,477                                 | \$          |
| Net interest expense after provision for loan losses                      | (49,283)                                   | (49,283)             | (102,960)                                  |             |
| Other operating income:   |  |                      |  |             |
| Securitization (expense) income   | --   | (20,263)             | --   |             |
| Servicing income on securitized/sold receivables                          | --   | 93,148               | --   |             |
| Net securitization and credit card servicing income                       | 87,506                                     | --                   | 228,642                                    |             |
| Credit card fees, interchange and other credit card income                | 41,903                                     | 49,779               | 93,759                                     |             |
| Enhancement services revenue  | 178,638                                    | 83,199               | 190,645                                    |             |
| Other operating expenses:   |  |                      |  |             |
| Credit card account and other product solicitation and marketing expenses | 64,192                                     | 65,720               | 96,745                                     |             |

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|                                     |          |           |        |
|-------------------------------------|----------|-----------|--------|
| Enhancement services claims expense | 21,109   | --        | 27,124 |
| Credit protection claims expense    | --       | 19,952    | --     |
| Other                               | 38,505   | 39,659    | 42,622 |
| (Loss) Income Before Income Taxes   | (61,330) | (165,040) | 26,174 |
| Income tax (benefit) expense        | (20,668) | (57,462)  | 10,208 |
| Net (loss) income                   | (40,662) | (107,578) | 15,966 |
| Loss per share                      | (1.05)   | (2.22)    | (0.04) |
| Diluted loss per share              | (1.05)   | (2.22)    | (0.04) |

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|  | SIX-MONTHS ENDED<br>JUNE 30, 2003<br>----- |                      |
|--|--|----------------------|
|  | AS<br>PREVIOUSLY<br>REPORTED<br>-----      | AS RESTATED<br>----- |
| STATEMENTS OF CASH FLOWS:  |  |                      |
| Net (loss) income  | \$ (40,662)                                | \$ (107,578)         |
| Depreciation, amortization and accretion   | 67,518                                     | (81,545)             |
| Provision for loan losses  | 74,819                                     | 74,819               |
| Retained interests valuation (income)<br>Expense                                 | (131,893)                                  | --                   |
| Loss (gain) from credit card securitizations                                     | --   | 123,982              |
| Changes in fair value of retained interests<br>in loans securitized              | --   | 103,897              |
| Market loss on derivative financial instruments                                  | --   | 8,161                |
| Changes in operating assets and liabilities, net:                                |  |                      |
| Liquidity reserve deposit  | --   | (80,590)             |
| Other receivables due from credit card<br>securitizations, net                   | (104,500)                                  | 17,860               |
| Accounts payable and accrued expenses  | (2,111)                                    | 4,473                |
| Deferred income  | (39,460)                                   | (37,014)             |
| Spread accounts receivable   | --   | (201,314)            |
| Other  | (29,477)                                   | (67,123)             |
| Net cash (used in) provided by operating activities                              | (182,978)                                  | (219,184)            |
| Net use of cash from sales and repayments of<br>securitized loans                | (773,955)                                  | --                   |
| Net loans collected  | 733,600                                    | --                   |
| Net cash from loan originations and principal<br>collections on loans receivable | --   | (84,739)             |
| Net cash provided by investing activities  | 293,235                                    | 248,851              |
| Net increase (decrease) in cash and cash equivalents                             | (113,051)                                  | (193,641)            |
| Cash and cash equivalents at end of period                                       | 467,181                                    | 386,591              |

The following is a summary of the Company's revised accounting policies related to retained interests:

Upon securitization, the Company removes the applicable credit card loans from the balance sheet and recognizes the "Retained interests in loans securitized" at their allocated carrying value in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125"

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("SFAS No. 140"). Credit card receivables are sold to the Metris Master Trust at the inception of a securitization series. We also sell credit card receivables to the Metris Master Trust to replenish receivable balances that have decreased due to payments and charge-offs. The difference between the allocated carrying value and the proceeds from the assets sold is recorded as a gain or loss on sale and is included in "Securitization (expense) income." At the same time, the Company recognizes the "Retained interests in loans securitized."

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The "Retained interests in loans securitized" are financial assets measured at fair value consistent with trading securities in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and includes the contractual retained interests, an interest-only strip receivable, excess transferor's interests and spread accounts receivable. The contractual retained interests consist of non-interest bearing securities held by the Company. The interest-only strip receivable represents the present value of the excess of the estimated future interest and fee collections expected to be generated by the securitized loans over the period the securitized loans are projected to be outstanding above the interest paid on investor certificates, credit losses, contractual servicing fees, and other expenses. The excess transferor's interests represent principal receivables held in the Metris Master Trust above the contractual retained interests. Spread accounts receivable represents restricted cash reserve accounts held by the Metris Master Trust that can be used to fund payments due to securitization investors and credit enhancers if cash flows are insufficient. Cash held in spread accounts is released to us if certain conditions are met or a securitization series terminates with amounts remaining in the spread accounts. The fair value of the "Retained interests in loans securitized" is determined through estimated cash flows discounted at rates that reflect the level of subordination, the projected repayment term, and risk of the securitized loans.

At least quarterly, the Company reviews its "Retained interests in loans securitized" for changes in fair value and recognizes those changes as "Securitization (expense) income." The changes in fair value reflect the Company's revisions in the expected timing and amount of future cash flows. The significant factors that affect the timing and amount of future cash flows relate to the collateral assumptions, which include payment rate, default rate, gross yield and discount rate.

The Company recognizes future cash flows associated with its retained interests using the effective yield method in accordance with EITF 99-20 "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets." Accordingly, "Securitization (expense) income" includes discount accretion associated with the contractual retained interests, the excess transferor's interests, the interest-only strip receivable, spread accounts receivable as well as the difference in the actual excess spread received as compared to the estimated amount recorded related to the interest-only strip. Since the Company's retained interests are trading securities, the impairment provisions of EITF 99-20 are not applicable.

Up-front transaction costs related to securitizations are allocated and recognized over the initial and reinvestment periods unless the transaction results in a loss, in which case, the costs are expensed as incurred and recorded as "Securitization (expense) income."

The Company services the receivables held by the Metris Master Trust,

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and receives annual servicing fees based upon the principal receivables outstanding. "Servicing income" is recognized when earned. We consider these fees to be adequate compensation and as a result no servicing asset or liability is recorded.

"Other receivables due from credit card securitizations, net" primarily represents cash accumulated in the Metris Master Trust during a month, which is released to Metris Receivables, Inc. the following month.

### NOTE 3 - EARNINGS (LOSS) PER SHARE

The earnings per share calculation for the three- and six-month periods ended June 30, 2003 and 2002 excludes the assumed conversion of the convertible preferred stock and the outstanding stock options, as they are anti-dilutive.

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### NOTE 4 - STOCK-BASED COMPENSATION PLANS

We recognize compensation cost for stock-based employee compensation plans based on the difference, if any, between the quoted market price of the stock on the date of grant and the amount an employee must pay to acquire the stock. No expense was reflected in net income related to stock options as all options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. We recorded \$0.2 million of amortization of deferred compensation obligation, net of related tax benefit, in employee compensation related to restricted stock granted in 2003.

Pro forma information regarding net (loss) income and (loss) earnings per share has been determined as if we accounted for our employee stock options under the fair value method. The fair value of the options was estimated at the grant date using a Black-Scholes option pricing model. The fair value of the options is amortized to expense over the options' vesting periods. Under the fair value method, our net (loss) earnings and (loss) earnings per share would have been recorded at the pro forma amounts indicated below:

|   | THREE MONTHS ENDED<br>JUNE 30, |             | SIX MO<br>J |
|---|--------------------------------|-------------|-------------|
|   | 2003                           | 2002        | 2003        |
| Net loss, as restated   | \$ (24,748)                    | \$ (50,122) | \$ (107,57  |
| Deduct: Annual stock-based employee<br>compensation expense (benefit) determined<br>based on the fair value for all awards, net<br>of related tax effects | 3,003                          | 8,631       | (4,89       |
| Pro forma net (loss) income   | \$ (21,745)                    | \$ (41,491) | \$ (102,68  |
| Loss per share:   |                                |             |             |
| Basic-as restated   | (0.60)                         | (0.97)      | (2.2        |
| Basic-pro forma   | (0.66)                         | (1.11)      | (2.1        |
| Diluted-as restated   | (0.60)                         | (0.97)      | (2.2        |



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|   |        |        |       |
|---|--------|--------|-------|
| Diluted-pro forma                                 | (0.66) | (1.11) | (2.1) |
|   | =====  | =====  | ===== |
| Weighted-average assumptions in option valuation: |        |        |       |
| Risk-free interest rates                          | 1.5%   | 3.7%   | 1.    |
| Dividend yields                                   | --     | 1.6%   | -     |
| Stock volatility factor                           | 124.2% | 92.9%  | 110.  |
| Expected life of options (in years)               | 2.7    | 6.0    | 4.    |

The above pro forma amounts may not be representative of the effects on reported net income for future periods.

### NOTE 5 - ACCOUNTING CHANGES

In January 2003, FASB issued SFAS No. 148 "Accounting for Stock-Based Compensation-Transition and Disclosure," which amends SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. SFAS No. 148 requirements are effective for fiscal years ending after December 15, 2002. The adoption of SFAS No. 148 did not have a material impact on our financial statements.

In January 2003, FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" in an effort to expand upon and strengthen existing accounting guidance that addresses when a company should include in its financial statements the assets, liabilities and activities of another entity. FASB Interpretation No. 46 requires a variable interest entity to be

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consolidated by a company, if that company is subject to a majority of the risk of loss from the variable interest entity activities or entitled to receive a majority of the entity's residual returns or both. The Interpretation also requires disclosures about variable interest entities that the company is not required to consolidate, but in which it has a significant variable interest. The consolidation requirements of Interpretation No. 46 apply immediately to variable interest entities created after January 31, 2003, and apply to existing variable interest entities in the first fiscal year or interim period beginning after June 15, 2003. Interpretation No. 46 provides a specific exemption for entities qualifying as Qualified Special Purpose Entities as described in SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125." All of our non-consolidated entities are Qualified Special Purpose Entities under the definition in SFAS No. 140. We do not expect the adoption of this Interpretation to have a material impact on our financial statements.

In April 2003, FASB issued SFAS No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003. In addition, certain provisions relating to forward purchases or sales of when-issued securities or other securities that do not yet exist, should be applied to existing contracts as well as new contracts entered into after June 30, 2003. We do not expect the adoption of SFAS No. 149 to have a material impact on our financial statements.

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In May 2003, FASB issued SFAS No. 150 "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This Statement establishes standards for classification and measurement of certain instruments with characteristics of both liabilities and equity. It requires that financial instruments within its scope be classified as a liability (or asset in some circumstances). Many of those instruments were classified as equity under previous accounting guidance. The statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 does not have a material impact on our financial statements at this time.

### NOTE 6 - LIQUIDITY RESERVE DEPOSIT

Direct Merchants Bank has established restricted deposits with third-party depository banks for the purpose of supporting Direct Merchants Bank's funding needs and to satisfy banking regulators' requirements under the Operating Agreement, dated March 18, 2003, among Direct Merchants Bank, MCI and the Office of the Comptroller of the Currency. These deposits are invested in short term liquid investments. As of June 30, 2003, the balance of these deposits was \$80.6 million and is classified on the balance sheets as "Liquidity reserve deposit."

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### NOTE 7 - ALLOWANCE FOR LOAN LOSSES

The activity in the allowance for loan losses is as follows:

|   | THREE MONTHS ENDED<br>JUNE 30, |            | SIX MONTHS ENDED<br>JUNE 30, |            |
|---|--------------------------------|------------|------------------------------|------------|
|   | 2003                           | 2002       | 2003                         | 2002       |
| Balance at beginning of period                              | \$ 125,357                     | \$ 416,914 | \$ 90,315                    | \$ 460,158 |
| Allowance related to assets transferred to the Metris Trust | (2,526)                        | (147,137)  | (3,981)                      | (168,581)  |
| Provision for loan losses                                   | 30,033                         | 90,601     | 74,819                       | 152,479    |
| Principal receivables charged-off                           | (44,789)                       | (91,595)   | (53,470)                     | (180,481)  |
| Recoveries  | 1,087                          | 6,496      | 1,479                        | 11,701     |
|   | (43,702)                       | (85,099)   | (51,991)                     | (168,771)  |
| Balance at end of period                                    | \$ 109,162                     | \$ 275,279 | \$ 109,162                   | \$ 275,279 |

Credit card loans greater than 30 days contractually past due for the periods ended June 30, 2003, December 31, 2002 and June 30, 2002 were \$48.3 million, \$7.9 and \$148.9 million, respectively.

### NOTE 8 - RETAINED INTERESTS IN LOANS SECURITIZED

Our credit card receivables are primarily funded through asset securitizations. As part of the asset securitizations, credit card receivables are transferred to the Metris Master Trust, a non-consolidated, qualifying special purpose entity that issues asset backed securities representing

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undivided interests in receivables held in the Metris Master Trust and the right to receive future collections of principal, interest and fees related to those receivables. The senior classes of these securities are sold to third party investors. We retain subordinated interests in the securitized receivables, including contractual retained interests, an interest-only strip receivable, excess transferor's interests maintained above the contractual retained interests, and spread accounts receivable. The components of these retained interests are recorded at their fair value.

The following table shows the fair value of the components of the "Retained interests in loans securitized" as of June 30, 2003 and December 31, 2002.

|   | JUNE 30,<br>2003<br>---- | DEC<br>----- |
|---|--------------------------|--------------|
| Contractual retained interests          | \$ 620,943               | \$           |
| Excess transferor's interests           | 54,850                   |              |
| Interest-only strip receivable          | 766                      |              |
| Spread accounts receivable              | 175,656                  |              |
|   | -----                    | -----        |
| Retained interests in loans securitized | \$ 852,215               | \$           |
|   | =====                    | =====        |

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The following table illustrates the significant assumptions used for estimating the fair value of retained interests as of June 30, 2003 and December 31, 2002.

|  | JUNE 30,<br>2003<br>---- |
|--|--------------------------|
| Monthly payment rate                       | 6.7%                     |
| Gross yield (1)                            | 25.6%                    |
| Annual interest expense and servicing fees | 3.8%                     |
| Annual gross principal default rate        | 22.6%                    |
| Discount rate:                             |                          |
| Contractual retained interests             | 16.0%                    |
| Excess transferor's interests              | 16.0%                    |
| Interest-only strip receivable             | 30.0%                    |
| Spread accounts receivable (2)             | 15.0%                    |

(1) Includes expected cash flows from finance charges, late and overlimit fees, debt waiver premiums and bad debt recoveries, net of finance charge and fee charge-offs. Gross yield for purposes of estimating fair value does not include interchange income, or cash advance fees.

(2) Beginning on March 31, 2003 the discount rate on spread account balances has been reduced by interest income expected to be earned.

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At June 30, 2003, the sensitivity of the current fair value of the retained interests to immediate 10% and 20% adverse changes are as follows (in millions):

|  | ADVERSE IMPACT ON FAIR |                    |
|--|------------------------|--------------------|
|  | 10% ADVERSE CHANGE     | 20% ADVERSE CHANGE |
| Annual discount rate                       | \$ 22.2                |                    |
| Monthly payment rate                       | 184.0                  |                    |
| Gross yield                                | 166.7                  |                    |
| Annual interest expense and servicing fees | 28.1                   |                    |
| Annual gross principal default rate        | 139.5                  |                    |

As the sensitivity indicates, the value of the Company's retained interests on its balance sheet, as well as reported earnings, could differ significantly if different assumptions or conditions prevail.

NOTE 9 - SECURITIZATION INCOME

The following summarizes "Securitization (expense) income" for the three and six-month periods ended June 30, 2003 and 2002.

|  | THREE-MONTHS ENDED<br>JUNE 30, |             | SIX-MONTHS ENDED |
|--|--------------------------------|-------------|------------------|
|  | 2003                           | 2002        | 2003             |
| Loss on new securitization of receivables to the Metris Master Trust   | \$ (12,244)                    | \$ (45,509) | \$ (32,190)      |
| (Loss) gain on replenishment of receivables to the Metris Master Trust | (45,529)                       | 63,900      | (91,780)         |
| Discount accretion   | 78,812                         | 73,698      | 154,480          |
| Change in fair value   | (20,289)                       | (134,333)   | (103,890)        |
| Interest-only revenue  | 32,243                         | 96,926      | 90,670           |
| Transaction and other costs  | (15,286)                       | (11,936)    | (37,540)         |
| Securitization (expense) income  | \$ 17,707                      | \$ 42,746   | \$ (20,260)      |

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NOTE 10 - INCOME TAX BENEFIT

The components of the (benefit) provision for income taxes consisted of the following:

|  | THREE-MONTHS ENDED<br>JUNE 30, |      | SIX-MONTHS ENDED |
|--|--------------------------------|------|------------------|
|  | 2003                           | 2002 | 2003             |
|  | ----                           | ---- | ----             |

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|                    |             |             |         |
|--------------------|-------------|-------------|---------|
| Current:           |             |             |         |
| Federal            | \$ (34,699) | \$ 34,373   | \$ (36, |
| State              | (483)       | 1,191       |         |
|                    | -----       | -----       | -----   |
|                    | (35,182)    | 35,564      | (36,    |
|                    | -----       | -----       | -----   |
| Deferred:          |             |             |         |
| Federal            | 21,731      | (63,165)    | (20,    |
| State              | 600         | (2,439)     | (       |
|                    | -----       | -----       | -----   |
|                    | 22,331      | (65,604)    | (20,    |
|                    | -----       | -----       | -----   |
| Income tax benefit | \$ (12,851) | \$ (30,040) | \$ (57, |
|                    | =====       | =====       | =====   |

A reconciliation of our effective income tax rate compared to the statutory federal income tax rate is as follows:

|  | THREE-MONTHS ENDED<br>JUNE 30, |       | SIX-MONTHS E<br>JUNE 30 |
|--|--------------------------------|-------|-------------------------|
|  | 2003                           | 2002  | 2003                    |
|  | ----                           | ----  | ----                    |
| Statutory federal income tax rate          | 35.0%                          | 35.0% | 35.0%                   |
| State income taxes, net of federal benefit | (0.2)                          | 1.0   | 0.3                     |
| Other, net                                 | (0.6)                          | 1.5   | (0.5)                   |
|  | ----                           | ----  | ----                    |
| Effective income tax rate                  | 34.2%                          | 37.5% | 34.8%                   |
|  | =====                          | ===== | =====                   |

Our deferred tax assets and liabilities are as follows:

|   | JUNE 30,  | DECEMBER 31, |
|---|-----------|--------------|
|   | 2003      | 2002         |
|   | ----      | ----         |
| Deferred income tax assets resulting from future deductible and taxable temporary differences:      |           |              |
| Allowance for loan losses and retained interests fair value adjustments                             | \$183,846 | \$17,846     |
| Deferred revenues   | 44,626    | 5,626        |
| Other   | 72,795    | 6,795        |
|   | -----     | -----        |
| Total deferred tax assets   | 301,267   | 29,267       |
| Deferred income tax liabilities resulting from future taxable and deductible temporary differences: |           |              |
| Accrued interest on credit card loans   | 207,130   | 20,130       |
| Deferred marketing costs  | 24,864    | 3,864        |
| Other   | 27,735    | 3,735        |
|   | -----     | -----        |
| Total deferred tax liabilities  | 259,729   | 27,729       |

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Net deferred tax assets

-----  
\$ 41,538  
=====

-----  
\$ 2  
=====

In addition to the tax effects of the pre-tax restatement amounts, the restated presentation also reflects revised probable amounts of future taxable and deductible temporary differences, resulting in a reclassification of certain deferred income taxes to current income taxes. The effects of the reclass for the year ended December 31, 2002 and six-months ended June 30, 2003 amounted to an addition to deferred income taxes of \$16.5 million. Such reclasses did not result in any adjustment to net income.

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The Internal Revenue Service ("IRS") has completed its examination of the Company's tax returns through December 31, 1998. The IRS has proposed adjustments to increase the Company's federal income tax by \$42.9 million, plus interest of more than \$15 million, pertaining to the Company's treatment of certain credit card fees as original issue discount ("OID"). Although these fees are primarily reported as income when billed for financial reporting purposes, we believe the fees constitute OID and must be deferred and amortized over the life of the underlying credit card loans for tax purposes. Cumulatively through June 30, 2003, the Company has deferred approximately \$213.9 million in federal income tax under the OID rules. Any assessment similar to what has been proposed by the IRS may ultimately require the Company to pay the federal tax plus state taxes and related interest.

The Company believes its treatment of these fees is appropriate and continues to work with the IRS to resolve the proposed adjustments. The Company's position on the treatment of credit card fees is consistent with that of many other U.S. credit card issuers. We do not expect final settlement or additional tax to be paid over the next twelve months. However, both the timing and amount of the final resolution of this matter are uncertain.

NOTE 11 - SEGMENTS

We operate in two principal areas: consumer lending products and enhancement services. Our consumer lending products are primarily unsecured and secured credit cards, including the Direct Merchants Bank MasterCard(R) and Visa(R). Our credit cardholders include customers obtained from third-party lists and other customers for whom general credit bureau information is available.

We market our enhancement services, including: (1) debt waiver protection for unemployment, disability, death and family leave; (2) membership programs such as card registration, purchase protection and other club memberships; and (3) third-party insurance, directly to our credit card customers and customers of third parties. We administer extended service plans issued through a third party retailer, which are no longer being sold, and will expire by first quarter, 2005. We sell extended service plans for homeowners through third party distribution partnerships as well as directly to consumers.

On July 29, 2003, CPP Holdings Limited, a privately owned provider of assistance products and services throughout Europe, and CPP US Operations Group (collectively with CPP Holding Limited "CPP") purchased the membership and warranty products and operations of the Company's enhancement services segment. Further details are described in Footnote 8 "Subsequent Events." The Company will retain the credit protection and insurance business, and CPP will become the Company's preferred provider of membership and warranty products.

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We have presented the segment information reported below on a managed basis. We use this basis to review segment performance and to make operating decisions. In doing so, the income statement and balance sheet are adjusted to reverse the effects of securitizations. Presentation on a managed basis is not in conformity with accounting principles generally accepted in the United States of America. The adjustment columns in the segment table include adjustments to present the information on an owned basis as reported in the financial statements of this quarterly report.

We do not allocate the expenses, assets and liabilities attributable to corporate functions to the operating segments, such as employee compensation, data processing services and communications, third-party servicing expenses, and other expenses including occupancy, depreciation and amortization, professional fees, and other general and administrative expenses. We include these expenses in the reconciliation of the income before income taxes, for the reported segments to the consolidated total. We do not allocate capital expenditures for leasehold improvements, capitalized software and furniture and equipment to operating segments. There were no material operating assets located outside of the United States for the periods presented.

The enhancement services operating segment has paid fees to our consumer lending products segment for successful marketing efforts to cardholders at a rate similar to those paid to other third parties. The enhancement services segment reports interest income and our consumer lending

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products segment reports interest expense at our weighted-average borrowing rate for the excess cash flow generated by the enhancement services segment and used by the consumer lending products segment to fund the growth of cardholder balances.

|                               | THREE MONTHS ENDED JUNE 30, 2003 |                         |                                   |                |
|-------------------------------|----------------------------------|-------------------------|-----------------------------------|----------------|
|                               | CONSUMER<br>LENDING<br>PRODUCTS  | ENHANCEMENT<br>SERVICES | SECURITIZATION<br>ADJUSTMENTS (a) | OTH<br>ADJUSTM |
|                               | -----                            | -----                   | -----                             | -----          |
| Interest income               | \$ 451,176                       | \$ 34                   | \$ (419,744)                      | \$             |
| Interest<br>(expense) income  | (60,198)                         | --                      | 41,448                            |                |
| Net interest<br>income        | 390,978                          | 34                      | (378,296)                         |                |
| Other operating<br>income     | 87,074                           | 84,954                  | (45,836)                          |                |
| Total revenue                 | 478,052                          | 84,988                  | (424,132)                         |                |
| Income before<br>income taxes | 8,988 (c)                        | 58,703 (c)              | --                                |                |
| Total assets                  | \$ 9,467,542                     | \$ 50,431               | \$ (7,860,000)                    | \$             |

|  | THREE MONTHS ENDED JUNE 30, 2002 |             |                |       |
|--|----------------------------------|-------------|----------------|-------|
|  | CONSUMER<br>LENDING              | ENHANCEMENT | SECURITIZATION | OTHER |

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|                               | PRODUCTS<br>----- | SERVICES<br>----- | ADJUSTMENTS (a)<br>----- | ADJUSTMENTS (b)<br>----- |
|-------------------------------|-------------------|-------------------|--------------------------|--------------------------|
| Interest income               | \$ 509,821        | \$ 58             | \$ (441,029)             | \$ (58)                  |
| Interest<br>(expense) income  | (80,946)          | --                | 53,933                   | 58                       |
| Net interest<br>Income        | 428,875           | 58                | (387,096)                | --                       |
| Other operating<br>income     | 118,731           | 95,649            | (46,824)                 | --                       |
| Total revenue                 | 547,606           | 95,707            | (433,920)                | --                       |
| Income before<br>income taxes | (3,261) (c)       | 57,556 (c)        | --                       | (134,457)                |
| Total assets                  | \$ 10,947,147     | \$ 104,240        | \$ (8,936,263)           | \$ 1,007,791 (d)         |

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|                               | SIX MONTHS ENDED JUNE 30, 2003           |                                  |  |
|-------------------------------|--|----------------------------------|--|
|                               | CONSUMER<br>LENDING<br>PRODUCTS<br>----- | ENHANCEMENT<br>SERVICES<br>----- | SECURITIZATION<br>ADJUSTMENTS (a)<br>----- |
| Interest income               | \$ 936,435                               | \$ 63                            | \$ (872,842)                               |
| Interest<br>(expense) income  | (124,209)                                | --                               | 86,089                                     |
| Net interest<br>Income        | 812,226                                  | 63                               | (786,753)                                  |
| Other operating<br>income     | 175,216                                  | 178,638                          | (147,991)                                  |
| Total revenue                 | 987,442                                  | 178,701                          | (934,744)                                  |
| Income before<br>Income taxes | (38,358) (c)                             | 106,103 (c)                      | --   |
| Total assets                  | \$ 9,467,542                             | \$ 50,431                        | \$ (7,860,000)                             |

|                              | SIX MONTHS ENDED JUNE 30, 2002           |                                  |  |                                   |
|------------------------------|--|----------------------------------|--|-----------------------------------|
|                              | CONSUMER<br>LENDING<br>PRODUCTS<br>----- | ENHANCEMENT<br>SERVICES<br>----- | SECURITIZATION<br>ADJUSTMENTS (a)<br>----- | OTHER<br>ADJUSTMENTS (b)<br>----- |
| Interest income              | \$ 1,036,499                             | \$ 2,386                         | \$ (877,863)                               | \$ (2,386)                        |
| Interest<br>(expense) Income | (169,351)                                | --                               | 107,845                                    | 2,386                             |
| Net interest<br>Income       | 867,148                                  | 2,386                            | (770,018)                                  | --                                |



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|                            |               |             |                |                       |
|----------------------------|---------------|-------------|----------------|-----------------------|
| Other operating income     | 248,702       | 190,645     | (14,373)       | --                    |
| Total revenue              | 1,115,850     | 193,031     | (784,391)      | --                    |
| Income before Income taxes | 123,440 (c)   | 123,389 (c) | --             | (254,860)             |
| Total assets               | \$ 10,947,147 | \$ 104,240  | \$ (8,936,263) | \$ 1,007,791 (d) \$ 3 |

- (a) This column reflects adjustments to the Company's internal financial statements, which are prepared on a managed basis, to eliminate investors' interests in securitized loans.
- (b) The other adjustments column includes: intercompany eliminations and amounts not allocated to segments.
- (c) Income before income taxes includes intercompany commissions paid by the enhancement services segment to the consumer lending products segment for successful marketing efforts to cardholders of \$3.1 million for the three months ended June 30, 2003 and \$3.0 million for the three months ended June 30, 2002, \$6.1 million for the six months ended June 30, 2003 and \$6.3 million for the six months ended June 30, 2002.
- (d) Total assets include the assets attributable to corporate functions not allocated to operating segments and the removal of investors' interests in securitized loans to present total assets on an owned basis.

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NOTE 12 - SUBSEQUENT EVENTS

On July 29, 2003, we announced the sale of the membership and warranty business of the Enhancement Services segment for proceeds of approximately \$45.0 million. We will record a gain related to the sale in the third quarter of 2003.

In July of 2003, the Office of the Comptroller of the Currency ("OCC") requested and Direct Merchants Bank agreed to eliminate federally insured deposits at the Bank, or the risk thereof to the Federal Deposit Insurance Corporation ("FDIC"), by September 30, 2003. We have received preliminary proposals from financing sources, and we are working with our financial advisors on a variety of options to achieve this goal, however, there can be no assurance that we will be successful. These options may include additional conduit financing or the sale of credit card receivables to third parties.

NOTE 13 - SUPPLEMENTAL CONSOLIDATING FINANCIAL STATEMENTS

We have various indirect subsidiaries that do not guarantee Company debt. We have prepared condensed consolidating financial statements of the Company, the Guarantor subsidiaries and the non-guarantor subsidiaries for purposes of complying with SEC reporting requirements. Separate financial statements of the guaranteeing subsidiaries and non-guaranteeing subsidiaries are not presented because we have determined that the subsidiaries' financial information would not be material to investors. In the second quarter of 2003, certain subsidiaries were designated as guarantors, which had previously been classified as non-guarantors. The supplemental consolidating financial statements have been reclassified for all periods presented.

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METRIS COMPANIES INC.  
 SUPPLEMENTAL CONSOLIDATING BALANCE SHEETS  
 JUNE 30, 2003  
 (DOLLARS IN THOUSANDS)  
 UNAUDITED (AS RESTATED)

|  | METRIS<br>COMPANIES<br>INC. | GUARANTOR<br>SUBSIDIARIES | NON-GUARANTOR<br>SUBSIDIARIES | ELI         |
|--|-----------------------------|---------------------------|-------------------------------|-------------|
|  | -----                       | -----                     | -----                         | -----       |
| <b>ASSETS:</b>   |                             |                           |                               |             |
| Cash and cash equivalents                                      | \$ (49)                     | \$ 1,234                  | \$ 385,406                    | \$          |
| Retained interests in loans<br>securitized                     | 24,292                      | --                        | 827,923                       |             |
| Liquidity reserve deposit                                      | --                          | --                        | 80,590                        |             |
| Net credit card loans  | 8,393                       | --                        | 515,358                       |             |
| Property and equipment, net                                    | --                          | 50,997                    | 513                           |             |
| Purchased portfolio premium,<br>net                            | 107                         | --                        | 51,477                        |             |
| Other receivables due from credit card<br>securitizations, net | 7                           | --                        | 92,604                        |             |
| Other assets   | 41,114                      | 57,694                    | 132,237                       |             |
| Investment in subsidiaries                                     | 1,348,741                   | 918,107                   | --                            | (           |
|  | -----                       | -----                     | -----                         | -----       |
| <b>TOTAL ASSETS</b>  | <b>\$ 1,422,605</b>         | <b>\$ 1,028,032</b>       | <b>\$ 2,086,108</b>           | <b>\$ (</b> |
|  | =====                       | =====                     | =====                         | =====       |
| <b>LIABILITIES:</b>  |                             |                           |                               |             |
| Deposits   | \$ (1,000)                  | \$ --                     | \$ 642,934                    | \$          |
| Debt   | 417,023                     | 9,214                     | --                            |             |
| Accounts payable   | 97                          | 22,026                    | 32,230                        |             |
| Deferred income  | --                          | 10,003                    | 98,206                        |             |
| Accrued expenses and other<br>liabilities                      | 56,811                      | (361,952)                 | 394,631                       |             |
|  | -----                       | -----                     | -----                         | -----       |
| <b>TOTAL LIABILITIES</b>                                       | <b>472,931</b>              | <b>(320,709)</b>          | <b>1,168,001</b>              |             |
|  | -----                       | -----                     | -----                         | -----       |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>                              | <b>949,674</b>              | <b>1,348,741</b>          | <b>918,107</b>                | <b>(</b>    |
|  | -----                       | -----                     | -----                         | -----       |
| <b>TOTAL LIABILITIES AND<br/>    STOCKHOLDERS' EQUITY</b>      | <b>\$ 1,422,605</b>         | <b>\$ 1,028,032</b>       | <b>\$ 2,086,108</b>           | <b>\$ (</b> |
|  | =====                       | =====                     | =====                         | =====       |

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METRIS COMPANIES INC.  
 SUPPLEMENTAL CONSOLIDATING BALANCE SHEETS  
 DECEMBER 31, 2002 (AS RESTATED)  
 (DOLLARS IN THOUSANDS)  
 UNAUDITED

METRIS  
COMPANIES

GUARANTOR

NON-GUARANTOR

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|  | INC.                | SUBSIDIARIES        | SUBSIDIARIES        |           |
|--|---------------------|---------------------|---------------------|-----------|
|  | -----               | -----               | -----               | -----     |
| <b>ASSETS:</b>   |                     |                     |                     |           |
| Cash and cash equivalents                                      | \$ (3,795)          | \$ 8,109            | \$ 575,918          | \$        |
| Net credit card loans  | 3,813               | --                  | 752,289             |           |
| Retained interests in loans<br>securitized                     | --                  | --                  | 808,026             |           |
| Property and equipment, net                                    | --                  | 63,395              | 20,436              |           |
| Purchased portfolio premium, net                               | 128                 | --                  | 64,451              |           |
| Other receivables due from credit card<br>securitizations, net | 13                  | --                  | 110,458             |           |
| Other assets   | 10,160              | 44,252              | 180,591             |           |
| Investment in subsidiaries                                     | 1,594,352           | 1,549,307           | --                  |           |
| <b>TOTAL ASSETS</b>  | <b>\$ 1,604,671</b> | <b>\$ 1,665,063</b> | <b>\$ 2,512,169</b> | <b>\$</b> |
|  | =====               | =====               | =====               | =====     |
| <b>LIABILITIES:</b>  |                     |                     |                     |           |
| Deposits   | \$ (1,000)          | \$ --               | \$ 893,754          | \$        |
| Debt   | 391,228             | 9,421               | --                  |           |
| Accounts payable   | 71                  | 20,683              | 38,949              |           |
| Deferred income  | --                  | 16,681              | 129,978             |           |
| Accrued expenses and other<br>liabilities                      | 159,699             | 23,926              | (99,819)            |           |
| <b>TOTAL LIABILITIES</b>                                       | <b>549,998</b>      | <b>70,711</b>       | <b>962,862</b>      |           |
|  | -----               | -----               | -----               | -----     |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>                              | <b>1,054,673</b>    | <b>1,594,352</b>    | <b>1,549,307</b>    |           |
|  | -----               | -----               | -----               | -----     |
| <b>TOTAL LIABILITIES AND<br/>    STOCKHOLDERS' EQUITY</b>      | <b>\$ 1,604,671</b> | <b>\$ 1,665,063</b> | <b>\$ 2,512,169</b> | <b>\$</b> |
|  | =====               | =====               | =====               | =====     |

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METRIS COMPANIES INC.  
SUPPLEMENTAL CONSOLIDATING STATEMENTS OF INCOME  
THREE MONTHS ENDED JUNE 30, 2003  
(DOLLARS IN THOUSANDS)  
UNAUDITED (AS RESTATED)

|  | METRIS<br>COMPANIES<br>INC. | GUARANTOR<br>SUBSIDIARIES | NON-GUARANTOR<br>SUBSIDIARIES | ELIMINA |
|--|-----------------------------|---------------------------|-------------------------------|---------|
|  | -----                       | -----                     | -----                         | -----   |
| NET INTEREST INCOME<br>(EXPENSE)   | \$ (8,682)                  | 915                       | 20,483                        |         |
| Provision for loan losses  | 540                         | --                        | 29,759                        | (       |
| <b>NET INTEREST INCOME<br/>(EXPENSE) AFTER PROVISION FOR LOAN LOSSES</b> | <b>(9,222)</b>              | <b>915</b>                | <b>(9,276)</b>                |         |
|  | -----                       | -----                     | -----                         | -----   |
| <b>OTHER OPERATING INCOME:</b>   |                             |                           |                               |         |
| Securitization income  | (443)                       |                           | 19,510                        | (1,     |
| Servicing income on  |                             |                           |                               |         |

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|   |             |             |             |        |
|---|-------------|-------------|-------------|--------|
| securitized / sold<br>receivables   | --          | --          | 45,335      |        |
| Credit card fees,<br>interchange and other<br>credit card income                | 1,036       | 19,004      | 21,476      | (18,   |
| Enhancement services<br>Revenues  | --          | 7,100       | 34,856      | (2,    |
| Intercompany allocations  | 5,264       | 73,725      | 8,247       | (87,   |
|   | -----       | -----       | -----       | -----  |
|   | 5,857       | 99,829      | 129,424     | (108,  |
|   | -----       | -----       | -----       | -----  |
| OTHER OPERATING EXPENSE:  |             |             |             |        |
| Credit card account and<br>other product solicitation and marketing<br>expenses | --          | 18,209      | 32,733      | (18,   |
| Employee compensation   | --          | 41,860      | 3,861       |        |
| Data processing services and communications                                     | 5           | (19,717)    | 39,062      | (2,    |
| Credit protection claims<br>expense   | --          | (97)        | 7,743       |        |
| Occupancy and equipment   | --          | --          | 8,924       |        |
| Purchased portfolio premium<br>amortization                                     | 10          | --          | 7,621       | (1,    |
| MasterCard/Visa assessment<br>and fees  | --          | --          | 2,231       |        |
| Credit card fraud losses  | 10          | --          | 1,059       |        |
| Asset impairments, lease<br>write-offs and severance                            | --          | --          | 6,011       |        |
| Other   | 5,258       | 25,342      | (11,286)    |        |
| Intercompany allocations  | 24          | 27,420      | 59,792      | (87,   |
|   | -----       | -----       | -----       | -----  |
|   | 5,307       | 93,017      | 157,751     | (109,  |
|   | -----       | -----       | -----       | -----  |
| (LOSS) INCOME BEFORE INCOME TAXES AND EQUITY                                    |             |             |             |        |
| IN LOSS OF SUBSIDIARIES   | (8,672)     | 7,727       | (37,603)    |        |
| Income tax (benefit)<br>Expense   | (2,846)     | 936         | (11,267)    |        |
| Equity in (loss) income of<br>subsidiaries                                      | (18,922)    | (26,336)    | --          | 45,    |
|   | -----       | -----       | -----       | -----  |
| NET LOSS  | \$ (24,748) | \$ (19,545) | \$ (26,336) | \$ 45, |
|   | =====       | =====       | =====       | =====  |

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METRIS COMPANIES INC.  
SUPPLEMENTAL CONSOLIDATING STATEMENTS OF INCOME  
THREE MONTHS ENDED JUNE 30, 2002  
(DOLLARS IN THOUSANDS)  
UNAUDITED (AS RESTATED)

|                           | METRIS<br>COMPANIES<br>INC. | GUARANTOR<br>SUBSIDIARIES | NON-GUARANTOR<br>SUBSIDIARIES |
|---------------------------|-----------------------------|---------------------------|-------------------------------|
|                           | -----                       | -----                     | -----                         |
| NET INTEREST (EXPENSE)    |                             |                           |                               |
| INCOME                    | \$ (3,018)                  | \$ (60)                   | \$ 44,915                     |
| Provision for loan losses | (798)                       | --                        | 91,399                        |

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|   |             |             |             |
|---|-------------|-------------|-------------|
| NET INTEREST EXPENSE AFTER PROVISION FOR<br>LOAN LOSSES                         | (2,220)     | (60)        | (46,484)    |
| OTHER OPERATING INCOME:   |             |             |             |
| Securitization income   | (1,777)     | --          | 44,523      |
| Servicing income on<br>securitized / sold<br>receivables                        | --          | --          | 47,528      |
| Credit card fees,<br>interchange and other<br>credit card income                | 189         | 5,796       | 39,253      |
| Enhancement services<br>revenues  | --          | 2,663       | 34,081      |
| Intercompany allocations  | 41          | 72,193      | 15,127      |
|   | (1,547)     | 80,652      | 180,512     |
| OTHER OPERATING EXPENSE:  |             |             |             |
| Credit card account and<br>other product solicitation<br>and marketing expenses | --          | 13,974      | 31,704      |
| Employee compensation   | (1,505)     | 45,753      | 10,117      |
| Data processing services and<br>communications                                  | 13          | (23,809)    | 43,018      |
| Credit protection claims<br>expense   | --          | --          | 13,632      |
| Occupancy and equipment   | --          | --          | 12,291      |
| Purchased portfolio premium<br>amortization                                     | --          | --          | 8,568       |
| MasterCard/Visa assessment<br>and fees  | --          | --          | 3,583       |
| Credit card fraud losses  | 135         | --          | 2,818       |
| Asset impairments, lease<br>write-offs and severance                            | --          | --          | 9,523       |
| Other   | (154)       | 48,690      | (13,862)    |
| Intercompany allocations  | 555         | 23,510      | 63,296      |
|   | (956)       | 108,118     | 184,688     |
| (LOSS) BEFORE INCOME TAXES AND EQUITY IN<br>LOSS OF SUBSIDIARIES                | (2,811)     | (27,526)    | (50,660)    |
| Income tax (benefit)<br>expense   | (747)       | (13,066)    | (16,446)    |
| Equity in loss of<br>subsidiaries   | (48,058)    | (34,214)    | --          |
| NET LOSS  | \$ (50,122) | \$ (48,674) | \$ (34,214) |

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|   | METRIS<br>COMPANIES<br>INC. | GUARANTOR<br>SUBSIDIARIES | NON-GUARANTOR<br>SUBSIDIARIES | ELIMIN |
|---|-----------------------------|---------------------------|-------------------------------|--------|
|   | -----                       | -----                     | -----                         | -----  |
| NET INTEREST INCOME   |                             |                           |                               |        |
| (EXPENSE)   | (17,388)                    | 98                        | 42,826                        |        |
| Provision for loan losses   | 1,387                       | --                        | 73,534                        |        |
|   | -----                       | -----                     | -----                         | -----  |
| NET INTEREST INCOME   |                             |                           |                               |        |
| (EXPENSE) AFTER PROVISION FOR LOAN LOSSES                                       | (18,775)                    | 98                        | (30,708)                      |        |
|   | -----                       | -----                     | -----                         | -----  |
| OTHER OPERATING INCOME:   |                             |                           |                               |        |
| Securitization income   | (10,454)                    | --                        | (7,770)                       | (      |
| Servicing income on<br>securitized / sold<br>receivables                        | --                          | --                        | 93,148                        |        |
| Credit card fees,<br>interchange and other<br>credit card income                | 1,091                       | 31,547                    | 47,926                        | (3     |
| Enhancement services<br>revenues  | --                          | 16,278                    | 72,939                        | (      |
| Intercompany allocations  | 5,340                       | 139,332                   | 18,237                        | (16    |
|   | -----                       | -----                     | -----                         | -----  |
|   | (4,023)                     | 187,157                   | 224,480                       | (20    |
|   | -----                       | -----                     | -----                         | -----  |
| OTHER OPERATING EXPENSE:  |                             |                           |                               |        |
| Credit card account and<br>other product solicitation<br>and marketing expenses | --                          | 30,430                    | 66,489                        | (3     |
| Employee compensation   | --                          | 93,071                    | 6,031                         |        |
| Data processing services and<br>communications                                  | 4                           | (41,704)                  | 83,713                        | (      |
| Credit protection claims<br>expense   | --                          | --                        | 19,952                        |        |
| Occupancy and equipment   | --                          | --                        | 18,537                        |        |
| Purchased portfolio premium<br>amortization                                     | 21                          | --                        | 15,318                        | (      |
| MasterCard/Visa assessment<br>and fees  | --                          | --                        | 4,646                         |        |
| Credit card fraud losses  | 11                          | --                        | 1,998                         |        |
| Asset impairments,<br>lease write-offs and severance                            | --                          | --                        | 22,788                        |        |
| Other   | 5,342                       | 64,454                    | (30,130)                      |        |
| Intercompany allocations  | 35                          | 53,047                    | 109,827                       | (16    |
|   | -----                       | -----                     | -----                         | -----  |
|   | 5,413                       | 199,298                   | 319,169                       | (20    |
|   | -----                       | -----                     | -----                         | -----  |
| LOSS BEFORE INCOME TAXES AND EQUITY IN LOSS<br>OF SUBSIDIARIES                  | (28,211)                    | (12,043)                  | (125,397)                     |        |
| Income tax benefit  | (4,285)                     | (7,184)                   | (46,202)                      |        |
| Equity in loss of subsidiaries  | (83,652)                    | (79,195)                  | --                            | 16     |
|   | -----                       | -----                     | -----                         | -----  |
| NET LOSS  | \$ (107,578)                | \$ (84,054)               | \$ (79,195)                   | \$ 16  |
|   | =====                       | =====                     | =====                         | =====  |

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METRIS COMPANIES INC.  
 SUPPLEMENTAL CONSOLIDATING STATEMENTS OF INCOME  
 SIX MONTHS ENDED JUNE 30, 2002  
 (DOLLARS IN THOUSANDS)  
 UNAUDITED (AS RESTATED)

|   | METRIS<br>COMPANIES<br>INC. | GUARANTOR<br>SUBSIDIARIES | NON-GUARANTOR<br>SUBSIDIARIES | ELIMINATIONS |
|---|-----------------------------|---------------------------|-------------------------------|--------------|
|   | -----                       | -----                     | -----                         | -----        |
| NET INTEREST (EXPENSE)  |                             |                           |                               |              |
| INCOME  | \$ (8,498)                  | \$ (1,456)                | \$ 109,470                    | \$           |
| Provision for loan losses   | (732)                       | --                        | 153,209                       |              |
|   | -----                       | -----                     | -----                         | -----        |
| NET INTEREST EXPENSE AFTER PROVISION FOR<br>LOAN LOSSES                         | (7,766)                     | (1,456)                   | (43,739)                      |              |
|   | -----                       | -----                     | -----                         | -----        |
| OTHER OPERATING INCOME:   |                             |                           |                               |              |
| Securitization income   | (1,742)                     | --                        | 146,934                       |              |
| Servicing income on securitized / sold<br>receivables                           | --                          | --                        | 92,567                        |              |
| Credit card fees,<br>interchange and other credit card income                   | 452                         | 13,719                    | 113,160                       | (            |
| Enhancement services<br>revenues  | --                          | 18,825                    | 52,193                        |              |
| Intercompany allocations  | 71                          | 125,267                   | 24,787                        | (1           |
|   | -----                       | -----                     | -----                         | -----        |
|   | (1,219)                     | 157,811                   | 429,641                       | (1           |
|   | -----                       | -----                     | -----                         | -----        |
| OTHER OPERATING EXPENSE:  |                             |                           |                               |              |
| Credit card account and<br>other product solicitation and marketing<br>expenses | --                          | 16,634                    | 76,297                        |              |
| Employee compensation   | (1,101)                     | 94,921                    | 17,093                        |              |
| Data processing services and communications                                     | 36                          | (43,371)                  | 88,230                        |              |
| Credit protection claims expense  | --                          | --                        | 22,811                        |              |
| Occupancy and equipment   | --                          | --                        | 25,088                        |              |
| Purchased portfolio premium<br>amortization                                     | --                          | --                        | 17,930                        |              |
| MasterCard/Visa assessment and fees   | --                          | --                        | 7,417                         |              |
| Credit card fraud losses  | 127                         | --                        | 5,054                         |              |
| Asset impairments, lease write-offs and<br>severance                            | --                          | --                        | 9,523                         |              |
| Other   | (110)                       | 75,054                    | (19,821)                      |              |
| Intercompany allocations  | 46                          | 41,588                    | 108,491                       | (1           |
|   | -----                       | -----                     | -----                         | -----        |
|   | (1,002)                     | 184,826                   | 358,113                       | (1           |
|   | -----                       | -----                     | -----                         | -----        |
| (LOSS) INCOME BEFORE INCOME TAXES AND EQUITY                                    |                             |                           |                               |              |
| IN (LOSS) INCOME OF SUBSIDIARIES  | (7,983)                     | (28,471)                  | 27,789                        |              |
| Income tax (benefit)<br>expense   | (2,736)                     | (14,497)                  | 14,825                        |              |
| Equity in income of subsidiaries  | (595)                       | 12,964                    | --                            | (            |
|   | -----                       | -----                     | -----                         | -----        |
| NET INCOME  | \$ (5,842)                  | \$ (1,010)                | \$ 12,964                     | \$ (         |
|   | =====                       | =====                     | =====                         | =====        |

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METRIS COMPANIES INC.  
 SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS  
 SIX MONTHS ENDED JUNE 30, 2003  
 (DOLLARS IN THOUSANDS)  
 UNAUDITED (AS RESTATED)

|   | METRIS<br>COMPANIES<br>INC. | GUARANTOR<br>SUBSIDIARIES | NON-GUARANTOR<br>SUBSIDIARIES | ELIM |
|---|-----------------------------|---------------------------|-------------------------------|------|
| OPERATING ACTIVITIES:   |                             |                           |                               |      |
| Net cash (used in) provided by operating activities                           | \$ (141,049)                | \$ (84,492)               | \$ (156,892)                  | \$ 1 |
| INVESTING ACTIVITIES:   |                             |                           |                               |      |
| Proceeds from transfers of portfolios to the Metris Master Trust              | --                          | --                        | 315,065                       |      |
| Net cash from loan originations and principal collections on loans receivable | (41,582)                    | --                        | (43,157)                      |      |
| Additions to (disposals of) property and equipment                            | --                          | (1,259)                   | 19,784                        |      |
| Investment in subsidiaries  | 158,658                     | 240,640                   | 477,513                       | (8   |
| Net cash provided by investing activities                                     | 117,076                     | 239,381                   | 769,205                       | (8   |
| FINANCING ACTIVITIES:   |                             |                           |                               |      |
| Net increase (decrease) in debt   | 25,349                      | (207)                     | --                            |      |
| Net decrease in deposits  | --                          | --                        | (250,820)                     |      |
| Proceeds from issuance of common stock  | 2,370                       | --                        | --                            |      |
| Capital contributions   | --                          | (161,557)                 | (552,005)                     | 7    |
| Net cash (used in) provided by financing activities                           | 27,719                      | (161,764)                 | (802,825)                     | 7    |
| Net (decrease) increase in cash and cash equivalents                          | 3,746                       | (6,875)                   | (190,512)                     |      |
| Cash and cash equivalents at beginning of period                              | (3,795)                     | 8,109                     | 575,918                       |      |
| Cash and cash equivalents at end of period                                    | \$ (49)                     | \$ 1,234                  | \$ 385,406                    | \$   |

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METRIS COMPANIES INC.  
 SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS  
 SIX MONTHS ENDED JUNE 30, 2002  
 (DOLLARS IN THOUSANDS)  
 UNAUDITED (AS RESTATED)

METRIS  
COMPANIES

GUARANTOR

NON-GUARANTOR



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|   | INC.<br>-----       | SUBSIDIARIES<br>----- | SUBSIDIARIES<br>----- |
|---|---------------------|-----------------------|-----------------------|
| OPERATING ACTIVITIES:   |                     |                       |                       |
| Net cash provided by operating activities                                     | \$ 123,696          | \$ 428                | \$ 249,370            |
| INVESTING ACTIVITIES:   |                     |                       |                       |
| Proceeds from transfers of portfolios to the Metris Master Trust              | --                  | --                    | 1,486,993             |
| Net cash from loan originations and principal collections on loans receivable | 120                 |                       | (370,313)             |
| Additions to (disposals of) property and equipment                            | --                  | (4,776)               | 1,238                 |
| Investment in subsidiaries  | 47,949              | (16,588)              | (88,845)              |
| Net cash (used in) provided by investing activities                           | 48,069              | (21,364)              | 1,029,073             |
| FINANCING ACTIVITIES:   |                     |                       |                       |
| Increase (decrease) in debt   | 446                 | (293)                 | (292,000)             |
| Decrease in deposits  | --                  | --                    | (736,147)             |
| Cash dividends paid   | (1,892)             | --                    | --                    |
| Proceeds from issuance of common stock  | 2,257               | --                    | --                    |
| Repurchase of common stock  | (32,951)            | --                    | --                    |
| Capital contributions   | --                  | 21,702                | 23,828                |
| Net cash (used in) provided by financing activities                           | (32,140)            | 21,409                | (1,004,319)           |
| Net increase in cash and cash equivalents                                     | 139,625             | 473                   | 274,124               |
| Cash and cash equivalents at beginning of period                              | 17,614              | 1,505                 | 362,520               |
| Cash and cash equivalents at end of period                                    | \$ 157,239<br>===== | \$ 1,978<br>=====     | \$ 636,644<br>=====   |

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ITEM 2.

METRIS COMPANIES INC. AND SUBSIDIARIES  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis provides information management believes to be relevant to understanding the financial condition and results of operations of Metris Companies Inc. ("MCI") and its subsidiaries. MCI's principal subsidiaries are Direct Merchants Credit Card Bank, National Association ("Direct Merchants Bank" or "DMCCB" or the "Bank"), Metris Direct, Inc. and Metris Receivables, Inc. MCI and its subsidiaries, as applicable, may be referred to as "we," "us," "our" or the "Company." You should read this discussion along with the following documents for a full understanding of our financial condition and results of operations: Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed concurrently with this Quarterly Report on Form 10-Q/A; and our Proxy Statement for the 2003 Annual Meeting of Stockholders. In addition, you should read this discussion along with our condensed consolidated financial statements and related notes

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thereto for the period ended June 30, 2003.

### RESTATEMENTS

The consolidated statements of income as presented for the three and six-month periods ended June 30, 2003 and 2002 and the consolidated balance sheets as of June 30, 2003 and December 31, 2002 have been restated to reflect the following:

- The valuation model and related collateral assumptions used to estimate the fair value of the Company's "Retained interests in loans securitized" did not properly reflect the structure of the Metris Master Trust and related series supplements. All periods presented have been restated to reflect the changes in the valuation model and the related collateral assumptions. These restatements impact "Retained interests in loans securitized," "Other receivables due from credit card securitizations, net" and "Securitization income."
  - The Company's policy for recognizing transaction costs related to the securitization of receivables through the Metris Master Trust or a conduit was not in accordance with GAAP. Historically, these costs had been capitalized and amortized over the estimated life of the new debt securities. These costs are now allocated and recognized over the initial and reinvestment periods of the respective debt securities or Metris Master Trust financing unless the transaction results in a loss, in which case the costs are expensed as incurred. All periods presented have been restated to reflect the revised policy. These restatements impact "Other assets" and "Securitization income."
  - The Company's policy for recognizing expenses related to credit card solicitation costs was not in accordance with GAAP. Historically, the Company had capitalized and expensed these costs over the estimated period over which the new credit card accounts were established, approximately three months. These costs are now expensed as incurred. All periods presented have been restated to reflect the revised policy. This restatement impacts "Other assets" and "Credit card account and other product solicitation and marketing expenses."
  - The Company corrected its accounting for interest rate caps purchased in May of 2002 and forward to comply with SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," as amended, on January 1, 2001. These costs had been deferred and amortized over the estimated life of the new debt securities. These instruments are now recorded at fair value. All periods presented have been restated to reflect this correction. This restatement impacts "Retained interests in loans securitized," "Other assets" and "Securitization income."
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- The Company historically recognized revenue in the month following completion of the cancellation period, generally one month. Cash flows related to debt waiver are now included in the valuation of the interest-only strip receivable. All periods presented have been restated to reflect the revised policy. This restatement impacts "Retained interests in loans

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securitized," "Deferred revenue," "Enhancement services revenue," and "Securitization income."

- At December 31, 2001 we had \$50 million of "Allowance for loan losses" classified as valuation reserve in our "Retained interests in loans securitized." The valuation reserve was transferred to "Allowance for loan losses" through "Provision for loans losses" during the first quarter of 2002. We have restated the December 31, 2001 balance sheet and 2001 income statement and June 30, 2002 income statement to reflect this transfer occurring during the fourth quarter of 2001. This restatement impacts "Allowance for loan losses," "Retained interests in loans securitized," "Provision for loan losses" and "Securitization income."

In addition, we have restated certain prior-period amounts to conform with the current period's presentation.

- In prior periods, we classified interest income, provision for loan losses, and related credit card loan fees generated from retained interests in loans securitized on the income statement as "Interest income-credit card loans and retained interests in loans securitized," "Provision for loan losses" and "Credit card fees, interchange and other credit card income." For all periods presented, these amounts are now included in the estimation of the fair value of the interest-only strip receivable and "Securitization income."
- In prior periods we classified spread accounts receivable in "Other receivables due from credit card securitizations, net." For all periods presented, we have reclassified our spread accounts receivable from "Other receivables due from credit card securitizations, net" to "Retained interests in loans securitized."
- In prior periods, we classified servicing income in "Net securitization and credit card servicing income." For all periods presented, we have reclassified these amounts to "Servicing income."
- In prior periods, income from our debt waiver product sold to customers of Direct Merchants Bank with receivables held by Direct Merchants Bank was included in "Enhancement services revenue." For all periods presented we have reclassified this income to "Credit card fees, interchange and other credit card income."
- In prior periods, we classified the liquidity reserve deposit and other restricted cash deposits maintained at Direct Merchants Bank as "Short-term investments." We have reclassified these items to "Liquidity reserve deposit" for all periods presented.
- Revenue related to our membership club and warranty business for current and prior periods is classified as "Enhancement services revenue." Claims expense related to this business has been reclassified as "Other" expenses for all periods presented.
- In addition to the tax effects of the pre-tax restatement amounts, the restated presentation also reflects revised probable amounts of future taxable and deductible temporary

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differences, resulting in a reclassification of certain deferred income taxes to current income taxes.

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### RESULTS OF OPERATIONS

Net loss for the three months ended June 30, 2003 was \$24.7 million, compared to a net loss of \$50.1 million for the second quarter of 2002. Diluted loss per share for the three months ended June 30, 2003 was (\$0.60) compared to a diluted loss per share of (\$0.97) for the second quarter of 2002. The decrease in net loss is primarily due to a \$60.6 million decrease in the provision for loan losses and a \$52.5 million reduction in operating expense, partially offset by a \$29.1 million decrease in net interest income and a \$41.4 million decrease in other operating income. The provision for loan losses decreased 66.9% to \$30.0 million for the second quarter of 2003 from \$90.6 million for the same period in 2002. The decrease is primarily due to a \$684 million decline in owned credit card receivables and lower delinquency levels, partially offset by higher charge-off rates. Total other operating expenses decreased to \$146.5 million in the second quarter of 2003 from \$198.9 million for the same period in 2002. During the second quarter of 2003, credit card account and other product solicitation and marketing expenses decreased \$13.6 million, largely due to a decrease in credit card marketing expenditures and decreased enhancement services marketing. Employee compensation decreased \$8.6 million for the three months ended June 30, 2003, due to lower staffing requirements. Credit protection claims expense decreased \$6.0 million for the three months ended June 30, 2003, due to a decrease in covered receivable balances on our debt waiver products.

These improvements are partially offset by a decline in "Net interest income" of \$29.1 million and "Credit card fees, interchange and other credit card income" of \$17.1 million primarily due to a decrease in average interest-earning assets of \$1.1 billion. The decrease of \$25.0 million in net securitization revenue is primarily driven by a loss of \$57.8 million on securitization of receivables as compared to a gain of \$18.4 million for the same period last year. The increase in loss on replenishment for the three months ended June 30, 2003 over the same period in the prior year is driven by the prior year benefit of receivables purchased from the Bank at a net discount of \$91.7 million for the three months ended June 30, 2002 compared to \$1.8 million for the three months ended June 30, 2003. Interest only revenue of \$32.2 million for the three-months ended June 30, 2003 declined by \$64.7 million from \$96.9 million for the three-months ended June 30, 2002 due to an increased principal default rate offset by lower cost of funds. These negative variances were partially offset by improvement in the magnitude of the market value write-downs. Market-value write-downs were \$20.3 million for the three-months ended June 30, 2003 compared to \$134.3 million for the three-months ended June 30, 2002. Market value write-downs decreased from \$83.6 million for the three-months ended March 31, 2003 to \$20.3 million for the three-months ended June 30, 2003.

Net loss for the six months ended June 30, 2003 was \$107.6 million, up from a net loss of \$5.8 million for the first six months of 2002. Diluted loss per share for the six months ended June 30, 2003 was (\$2.22) compared to diluted loss per share of (\$0.39) for the six months ended June 30, 2002. The \$101.8 million increase in net loss primarily relates to a \$165.5 million change in securitization income, a decrease of \$74.0 million in net interest income and a \$66.4 million decrease in credit card fees, interchange and other credit card income. These changes are partially offset by a \$77.7 million decrease in provision for loan losses and a \$58.4 million decrease in operating expenses.

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### Net Interest Income

Net interest income consists primarily of interest earned on our credit card loans, less interest expense on borrowings to fund loans. Table 1 provides an analysis of interest income and expense, net interest spread, net interest margin and average balance sheet data for the three- and six-month periods ended June 30, 2003 and 2002.

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TABLE 1: ANALYSIS OF AVERAGE BALANCES, INTEREST AND AVERAGE YIELDS AND RATES  
(Dollars in thousands)

|   | 2003               |           |                | THREE MONTHS ENDED JUNE 30, |
|---|--------------------|-----------|----------------|-----------------------------|
|   | AVERAGE<br>BALANCE | INTEREST  | YIELD/<br>RATE | AVERAGE<br>BALANCE          |
| <b>ASSETS:</b>                              |                    |           |                |                             |
| Interest-earning assets:                    |                    |           |                |                             |
| Federal funds sold                          | \$ 53,441          | \$ 164    | 1.2%           | \$ 28,221                   |
| Short-term investments                      | 364,826            | 1,337     | 1.5%           | 477,642                     |
| Liquidity Reserve Deposit                   | 83,786             | 218       | 1.0%           | --                          |
| Credit card loans                           | 690,903            | 29,713    | 17.3%          | 1,742,833                   |
| Total interest-earning assets               | \$ 1,192,956       | \$ 31,432 | 10.6%          | \$ 2,248,696                |
| Other assets                                | 1,370,203          |           |                | 1,484,939                   |
| Allowances for loan losses                  | (130,106)          |           |                | (309,827)                   |
| Total assets                                | \$ 2,433,053       |           |                | \$ 3,423,808                |
| <b>LIABILITIES AND EQUITY:</b>              |                    |           |                |                             |
| Interest-bearing liabilities:               |                    |           |                |                             |
| Deposits                                    | \$ 729,021         | \$ 9,597  | 5.3%           | \$ 1,518,104                |
| Debt  | 359,378            | 9,119     | 10.2%          | 356,692                     |
| Total interest-bearing liabilities          | \$ 1,088,399       | \$ 18,716 | 6.9%           | \$ 1,874,796                |
| Other liabilities                           | 238,500            |           |                | 419,222                     |
| Total liabilities                           | 1,326,899          |           |                | 2,294,018                   |
| Stockholders' equity                        | 1,106,154          |           |                | 1,129,790                   |
| Total liabilities and equity                | \$ 2,433,053       |           |                | \$ 3,423,808                |
| Net interest income and interest margin (1) |                    | \$ 12,716 | 4.3%           |                             |
| Net interest rate spread (2)                |                    |           | 3.7%           |                             |

(1) We compute "net interest margin" by dividing annualized net interest income by average total interest-earning assets.

(2) The "net interest rate spread" is the annualized yield on average interest-earning assets minus the annualized funding rate on average interest-bearing liabilities.

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Net interest income decreased from \$41.8 million for the three months ended June 30, 2002 to \$12.7 million for the three months ended June 30, 2003. The decrease is primarily due to a decrease in average interest-earning assets of \$1.1 billion and a 170 basis point reduction in net interest margin. The decrease in average interest-earning assets is primarily due to the transfer of \$1.0 billion of receivables to the Master Trust since June 30, 2002. The decrease in margin is primarily due to a \$1.0 billion reduction in average credit card loans, which has resulted in short-term, lower yielding investments increasing to 42% of average interest-earning assets, versus 23% in the second quarter of 2002. In addition, we have experienced a 110 basis point increase in our funding costs versus the second quarter of 2002.

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TABLE 1: ANALYSIS OF AVERAGE BALANCES, INTEREST AND AVERAGE YIELDS AND RATES  
(CONT'D)  
(Dollars in thousands)

|   | 2003               |           |                | SIX MONTHS ENDED JUNE 30, |
|---|--------------------|-----------|----------------|---------------------------|
|   | AVERAGE<br>BALANCE | INTEREST  | YIELD/<br>RATE |                           |
| <b>ASSETS:</b>                              |                    |           |                |                           |
| Interest-earning assets:                    |                    |           |                |                           |
| Federal funds sold                          | \$ 85,370          | \$ 523    | 1.2%           | \$ 28,                    |
| Short-term investments                      | 422,407            | 3,059     | 1.5%           | 375,                      |
| Liquidity Reserve Deposit                   | 71,316             | 391       | 1.1%           |                           |
| Credit card loans                           | 721,121            | 59,620    | 16.7%          | 2,115,                    |
| Total interest-earning assets               | \$ 1,300,214       | \$ 63,593 | 9.9%           | \$ 2,519,                 |
| Other assets                                | 1,392,723          |           |                | 1,551,                    |
| Allowances for loan losses                  | (118,572)          |           |                | (358,                     |
| Total assets                                | \$ 2,574,365       |           |                | \$ 3,712,                 |
| <b>LIABILITIES AND EQUITY:</b>              |                    |           |                |                           |
| Interest-bearing liabilities:               |                    |           |                |                           |
| Deposits                                    | \$ 783,951         | \$ 20,505 | 5.3%           | \$ 1,722,                 |
| Debt  | 374,425            | 17,552    | 9.5%           | 403,                      |
| Total interest-bearing liabilities          | \$ 1,158,376       | \$ 38,057 | 6.6%           | \$ 2,126,                 |
| Other liabilities                           | 354,643            |           |                | 429,                      |
| Total liabilities                           | 1,513,019          |           |                | 2,555,                    |
| Stockholders' equity                        | 1,061,346          |           |                | 1,156,                    |
| Total liabilities and equity                | \$ 2,574,365       |           |                | \$ 3,712,                 |
| Net interest income and interest margin (1) |                    | \$ 25,536 | 4.0%           |                           |
| Net interest rate spread (2)                |                    |           | 3.2%           |                           |

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- (1) We compute "net interest margin" by dividing annualized net interest income by average total interest-earning assets.
- (2) The "net interest rate spread" is the annualized yield on average interest-earning assets minus the annualized funding rate on average interest-bearing liabilities.

Net interest income decreased from \$99.5 million for the six months ended June 30, 2002 to \$25.5 million for the six months ended June 30, 2003. The decrease is primarily due to a decrease in average interest-earning assets of \$1.2 billion and a 280 basis point reduction in net interest margin. The decrease in average interest-earning assets is primarily due to the transfer of \$1.0 billion of receivables to the Master Trust since June 30, 2002. The decrease in margin is primarily due to a \$1.4 billion reduction in average credit card loans, which has resulted in short-term, lower yielding investments increasing to 45% of average interest-earning assets, versus 16% for the six months ended June 30, 2002. In addition, we have experienced a 100 basis point increase in our funding costs versus the same period in 2002.

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### OTHER OPERATING INCOME

Other operating income decreased \$41.4 million and \$219.1 million for the three- and six-month periods ended June 30, 2003 compared to the same periods in 2002. For the three-month period ended June 30, 2003, securitization income decreased \$25.0 million. As detailed below, the change was primarily due to a \$64.7 million decrease in interest-only revenue due to lower excess spreads on securitized receivables caused by an increased default rate and attrition in the Master Trust. In addition, loss on securitization was \$57.8 million for the period ended June 30, 2003 compared to gains of \$18.4 million during the same period last year. These changes were offset by a \$114.0 million reduction in the market value write-downs of \$20.3 million for the three months ended June 30, 2003 compared to \$134.3 million for the three months ended June 30, 2002. Credit card receivables attrition in the Master Trust has caused a decrease in servicing income of \$2.2 million. For the six-month period ended June 30, 2003, securitization income (expense) decreased \$165.5 million primarily due to losses on replenishment of receivables to the Metris Master Trust. Additionally, interest-only revenue was negatively impacted by \$141.3 million due to lower excess spreads caused by increased default rates and attrition of securitized receivables. These impacts were partially offset by a \$38.4 million decrease in loss on new securitization and a \$79.3 million decrease in downward fair value adjustments.

The following summarizes "Securitization (expense) income" for the three and six-month periods ended June 30, 2003 and 2002.

TABLE 2: ANALYSIS OF SECURITIZATION (EXPENSE) INCOME  
(DOLLARS IN THOUSANDS)

|  | THREE-MONTHS ENDED<br>JUNE 30, |         |
|--|--------------------------------|---------|
|  | 2003                           | 2002    |
|  | ----                           | ----    |
| Loss on new securitization of receivables to the Metris Master Trust | \$ (12,244)                    | \$ (45, |

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|  |           |        |
|--|-----------|--------|
| (Loss) gain on replenishment of receivables to the Metris Master Trust | (45,529)  | 63,    |
| Discount accretion   | 78,812    | 73,    |
| Change in fair value   | (20,289)  | (134,  |
| Interest-only revenue  | 32,243    | 96,    |
| Transaction and other costs  | (15,286)  | (11,   |
|  | -----     | -----  |
| Securitization (expense) income  | \$ 17,707 | \$ 42, |
|  | =====     | =====  |

Credit card fees, interchange and other credit card income decreased \$17.1 million and \$66.4 million for the three- and six-month periods ended June 30, 2003 compared to the same periods in 2002. The decrease in credit card fees, interchange and other credit card income, for both the three- and six-month periods, is primarily due to a decrease in average owned credit card receivables of \$1.0 billion and \$1.4 billion for the respective three- and six-month periods. Partially offsetting this decline was an amendment to the core transaction documents of the Master Trust agreement, effective June 2002, resulting in interchange income earned on receivables held by the Master Trust being recorded as contribution to the excess spread earned.

Enhancement services revenues increased by \$2.9 million and \$12.2 million for the three- and six-months ended June 30, 2003. This increase was primarily due to increased enrollments in existing membership products and enrollments from new membership products.

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TABLE 3: ENHANCEMENT SERVICES REVENUES AND ACTIVE MEMBERSHIPS (In thousands)

| REVENUES                    | THREE MONTHS ENDED<br>JUNE 30,<br>----- |           | 2002 | 2003  |
|-----------------------------|---|-----------|------|-------|
|                             | 2003                                    | 2002      |      |       |
|                             | -----                                   | -----     |      | ----- |
| Membership Program Products | 28,609                                  | 21,108    |      |       |
| Warranty / Other            | 11,081                                  | 15,636    |      |       |
|                             | -----                                   | -----     |      | ----- |
| Total                       | \$ 39,690                               | \$ 36,744 | \$   | \$    |
|                             | =====                                   | =====     |      | ===== |

  

| ACTIVE MEMBERSHIPS          | JUNE 30,<br>----- | DECEMBER 31,<br>----- |
|-----------------------------|-------------------|-----------------------|
|                             | 2003              | 2002                  |
|                             | -----             | -----                 |
| Credit Protection Products  | 773               | 905                   |
| Membership Program Products | 2,823             | 3,248                 |
| Warranty / Other            | 686               | 941                   |
|                             | -----             | -----                 |
| Total                       | 4,282             | 5,094                 |
|                             | =====             | =====                 |



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### OTHER OPERATING EXPENSE

Total other operating expenses for the three- and six-month periods ended June 30, 2003, decreased \$52.5 million and \$58.4 million over the comparable periods in 2002. Credit card account and other product solicitation and marketing expenses decreased \$13.6 million and \$27.2 million over the comparable periods in 2002, largely due to fewer new credit card accounts and decreased enhancement services marketing expenses. Employee compensation decreased \$8.6 million and \$11.8 million over comparable periods in 2002, due to lower staffing requirements. Data processing services and communications decreased \$3.8 million and \$6.9 million for the three- and six-month periods ended June 30, 2003, primarily due to the reduction in our credit card portfolio. Credit protection claims expense decreased \$6.0 million and \$2.9 million for the three- and six-month periods ended June 30, 2003, primarily due to a decrease in receivable balances covered by our debt waiver products. Occupancy and Equipment expenses decreased \$3.4 million and \$6.6 million over comparable periods in 2002 due to decreased space requirements. Asset impairments, lease write-offs and severance decreased \$3.5 million and increased \$13.3 million for the three- and six-month periods ended June 30, 2003 to \$6.0 million and \$22.8 million from \$9.5 million and \$9.5 million for the same periods in 2002. During the first quarter of 2003, we recorded approximately \$12.0 million of write-downs of excess property, equipment, and operating leases and a \$4.8 million charge for a workforce reduction. In the second quarter of 2003, we recorded an additional \$0.9 million for a workforce reduction and wrote off the unamortized portion of the commitment fee of \$5.1 million related to a backup financing facility entered into in March of 2003 with Thomas H. Lee Equity Fund IV, L.P. The commitment was replaced in June 2003. In the second quarter of 2002, a write-down of \$10 million was taken for portfolios of charged-off loans purchased in 2001 and 2000. Other expenses decreased \$9.1 million and \$7.3 million for the three- and six-month periods ended June 30, 2003, compared to comparable periods in 2002. The decreases were primarily due to reductions in professional fees of \$5.3 million and \$1.5 million and travel and entertainment of \$1.2 million and \$2.2 million for the three- and six-month periods ended June 30, 2003, respectively.

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### ASSET QUALITY

Our delinquency and net loan charge-off rates at any point in time reflect, among other factors, the credit risk of loans, the average age of our various credit card account portfolios, the success of our collection and recovery efforts, and general economic conditions. The average age of our credit card portfolio affects the stability of delinquency and loss rates. In order to minimize losses, we continue to focus our resources on refining our credit underwriting standards for new accounts, and on collections and post charge-off recovery efforts. At June 30, 2003, 47% of our outstanding receivables balance were from credit card accounts that have been with us in excess of two years, and 22% of outstanding receivables were with us in excess of four years.

We use credit line analyses, account management and customer transaction authorization procedures to minimize loan losses. Our risk models determine initial credit lines at the time of underwriting. We manage credit lines on an ongoing basis and adjust them based on customer usage and payment patterns. We continually monitor customer accounts and initiate appropriate collection activities when an account is delinquent or over-limit.

### Delinquencies

It is our policy to accrue interest and fee income on all credit card accounts, except in limited circumstances, until we charge-off the account. In

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November 2002, we stopped billing late fees once an account became 120 days contractually delinquent and in March 2003, we stopped billing overlmit fees once an account became 120 days contractually delinquent. Past due accounts are re-aged to current status only after we receive at least three minimum payments or the equivalent cumulative amount. Accounts can only be re-aged to current status once every twelve months and two times every five years. Accounts entering long-term fixed payment forbearance programs may receive a workout re-age upon entering the debt management program ("workout re-age"). Workout re-ages can only occur after receipt of at least three consecutive minimum monthly payments, or the equivalent cumulative amount, as defined by the debt management program. Workout re-ages can only occur once in five years. This is in accordance with FFIEC guidance. Table 3 presents the delinquency trends of our credit card loan portfolio.

TABLE 4: LOAN DELINQUENCY  
(Dollars in thousands)

|                                 | JUNE 30,<br>2003<br>---- | % OF<br>TOTAL<br>----- | DECEMBER 31,<br>2002<br>---- | % OF<br>TOTAL<br>----- |
|---------------------------------|--------------------------|------------------------|------------------------------|------------------------|
| Loans outstanding               | \$ 632,913               | 100%                   | \$ 846,417                   | 100%                   |
| Loans contractually delinquent: |                          |                        |                              |                        |
| 30 to 59 days                   | 19,699                   | 3.1%                   | 1,673                        | 0.2%                   |
| 60 to 89 days                   | 17,668                   | 2.8%                   | 2,121                        | 0.2%                   |
| 90 or more days                 | 10,899                   | 1.7%                   | 4,082                        | 0.5%                   |
|                                 | -----                    | ---                    | -----                        | ---                    |
| Total                           | \$ 48,266                | 7.6%                   | \$ 7,876                     | 0.9%                   |
|                                 | =====                    | ===                    | =====                        | ===                    |

The decrease in the delinquency rates as of June 30, 2003 and December 31, 2002 compared to June 30, 2002, primarily reflects the sale of approximately \$120 million delinquent receivables during September and December 2002 and an additional sale of \$29.1 million of delinquent receivables in July 2003. These receivables were accounted for as held-for-sale as of June 30, 2003 and are recorded at fair value in other assets.

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### Net Charge-Offs

Net charge-offs are the principal amount of losses from cardholders unwilling or unable to make minimum payments, bankrupt cardholders and deceased cardholders, less current period recoveries. Net charge-offs exclude accrued finance charges and fees, which are charged-off against the applicable revenue line item at the time of charge-off. We charge-off and take accounts as a loss either 60 days after formal notification of bankruptcy, at the end of the month during which most unsecured accounts become contractually 180 days past due, at the end of the month during which unsecured accounts that have entered into a credit counseling or other similar program and later become contractually 120 days past due, or at the end of the month during which secured accounts become contractually 120 days past due after first reducing the loss by the secured deposit.

Charge-offs due to bankruptcies were \$6.8 million, representing 15.1% of total gross charge-offs for the three-month period ended June 30, 2003 and \$16.6 million, representing 18.1% of total gross charge-offs for the three-month

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period ended June 30, 2002. Charge-offs due to bankruptcies were \$12.3 million, representing 23.4% of total gross charge-offs for the six-month period ended June 30, 2003 and \$41.9 million, representing 23.2% of total gross charge-offs for the six-month period ended June 30, 2002. We charge-off accounts that are identified as fraud losses no later than 90 days after the last activity. We enter into forward flow agreements with third parties for the sale of a majority of charged-off credit card receivables. We also refer charged-off accounts to our recovery unit for coordination of collection efforts to recover the amounts owed. When appropriate, we place accounts with external collection agencies or attorneys.

TABLE 5: NET CHARGE-OFFS  
(Dollars in thousands)

|                           | THREE MONTHS ENDED |              | SIX MONTHS |
|---------------------------|--------------------|--------------|------------|
|                           | JUNE 30,           |              | JUN        |
|                           | 2003               | 2002         | 2003       |
|                           | ----               | ----         | ----       |
| Average credit card loans | \$ 690,903         | \$ 1,742,833 | \$ 721,121 |
| Net charge-offs           | 43,702             | 85,099       | 51,991     |
| Net charge-off ratio      | 25.4%              | 19.6%        | 14.5%      |
|                           | =====              | =====        | =====      |

The increase in the net charge-off ratio for the three months ended June 30, 2003 is primarily due to a \$27.0 million charge-off related to the sale of approximately \$29.1 million of delinquent receivables in July 2003, which were accounted for as held-for-sale as of June 30, 2003. The decrease in the charge-off ratio for the six-month period ended June 30, 2003 is primarily due to the sale of approximately \$120.0 million of delinquent receivables in September and December of 2002 which reduced the charge-offs required in the first six months of 2003, offset by charge-offs related to the \$29.1 million of delinquent assets held-for-sale at June 30, 2003.

### Provision and Allowance for Loan Losses

We record provisions for loan losses in amounts necessary to maintain the allowance at a level sufficient to absorb anticipated probable loan losses inherent in the existing loan portfolio as of the balance sheet date.

In order to mitigate credit losses, we have expanded our collections strategies to aggressively address any potential delinquency increases. We also leverage forbearance programs and credit counseling services for qualifying cardholders that are experiencing payment difficulties. These programs include reduced interest rates, reduced or suspended fees and other incentives to induce the customer to continue making payments. The amount of customer receivables in debt forbearance programs was \$33.8 million or 5% of total credit card loans as of June 30, 2003, compared to \$34.7 million or 4% of total credit card loans as of December 31, 2002. All delinquent receivables in debt forbearance programs are included in Table 3.

The provision for loan losses was \$30.0 million and \$74.8 million for the three- and six-month periods ended June 30, 2003, compared to a provision of \$90.6 million and \$152.5 million for the same periods in 2002. The decrease in the provision for loan losses in 2003 compared to 2002 is primarily due to lower credit card loans. The allowance for loan losses was \$109.2 million as of June

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30, 2003, versus \$90.3 million as of December 31, 2002. Our roll-rate models, including management contingency, indicated our required allowance for loan losses was in the range of \$99 million to \$109.2 million as of June 30, 2003, versus \$75 million to \$90.3 million as of December 31, 2002. The ratio of allowance for loan losses to period-end credit card loans was 17.2% at June 30, 2003, compared to 10.7% at December 31, 2002. The allowance for loan losses as a percentage of 30-day plus receivables was 226.2% at June 30, 2003, compared to 1146.7% at December 31, 2002.

We believe the allowance for loan losses is adequate to cover probable future losses inherent in the loan portfolio under current conditions. However, we cannot give assurance as to future credit losses that may be incurred in connection with our loan portfolio, nor can we provide assurance that the established allowance for loan losses will be sufficient to absorb future losses.

### Valuation of Retained Interests in Loans Securitized

Our credit card receivables are primarily funded through asset securitizations. Upon securitization, the Company removes the applicable credit card loans from the balance sheet and recognizes the retained interests in loans securitized at their allocated carrying value in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125" ("SFAS No. 140"). Assets are sold to the Metris Master Trust at the inception of a securitization series. We also sell receivables to the Metris Master Trust on a daily basis to replenish receivable balances that have decreased due to payments and charge-offs. The difference between the allocated carrying value and the proceeds from the assets sold is recorded as a gain or loss on sale and is included in "Securitization (expense) income." At the same time, the Company recognizes the "Retained interests in loans securitized." The "Retained interests in loans securitized" are financial assets measured at fair value consistent with trading securities in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and includes the contractual retained interests, an interest-only strip receivable, excess transferor's interests and spread accounts receivable. The contractual retained interests consist of non-interest bearing securities held by the Company. The interest-only strip receivable represents the present value of the excess of the estimated future interest and fee collections expected to be generated by the securitized loans over the period the securitized loans are projected to be outstanding above the interest paid on investor certificates, credit losses, contractual servicing fees, and other expenses. The excess transferor's interests represent principal receivables held in the Metris Master Trust over the contractual retained interests. Spread accounts receivable represents restricted cash reserve accounts held by the Metris Master Trust that can be used to fund payments due to securitization investors and credit enhancers if cash flows are insufficient. Cash held in spread accounts is released to us if certain conditions are met or a securitization series terminates with amounts remaining in the spread accounts. The fair value of the "Retained interests in loans securitized" is determined through estimated cash flows discounted at rates that reflect the level of subordination, the projected repayment term, and the credit risk of the securitized loans.

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The following summarizes our "Retained interests in loans securitized" as of March 31, 2003 and December 31, 2002.

TABLE 6: RETAINED INTERESTS IN LOANS SECURITIZED

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| (In thousands):                         | JUNE 30,<br>2003<br>---- | DECEMBER 31,<br>2002<br>---- |
|---|--------------------------|------------------------------|
| Contractual retained interests          | \$ 620,943               | \$ 620,943                   |
| Excess transferor's interests           | 54,850                   | 54,850                       |
| Interest-only strip receivable          | 766                      | 766                          |
| Spread accounts receivable              | 175,656                  | 175,656                      |
|   | -----                    | -----                        |
| Retained interests in loans securitized | \$ 852,215<br>=====      | \$ 852,215<br>=====          |

"Retained interests in loans securitized" increased by \$44.2 million between December 31, 2002, and June 30, 2003, to \$852.2 million. The increase is primarily due to a \$124.2 million increase in spread accounts receivable offset by a \$64.2 million decrease in contractual retained interests and a \$13.1 million reduction in the interest-only strip receivable.

The interest-only strip receivable decreased to \$0.8 million as of June 30, 2003, from \$13.9 million as of December 31, 2002, due to lower projected excess spreads from the receivables held in the Metris Master Trust. The projected excess spreads have decreased primarily due to expected decreases in yield and by expected increases in the principal default rates. Spread accounts receivable increased over December 31, 2002, as all excess spread earned on receivables held in the Metris Master Trust is being restricted from release to the Company due to the performance of the receivables. For more information on restricted cash see the Liquidity, Funding and Capital Resources section of the Management Discussion and Analysis on pages 31 through 55.

At least quarterly, the Company adjusts the valuation of the "Retained interests in loans securitized" to reflect changes in the amount and expected timing of future cash flows. The significant factors that affect the timing and amount of cash flows relate to the collateral assumptions, which include payment rate, default rate, gross yield and discount rate. These values can, and will, vary as a result of changes in the amount and timing of the cash flows and the underlying economic assumptions. The components of retained interests are recorded at their fair value. (See Critical Accounting Policies on page 43 for more information on the valuation of the retained interests). The significant assumptions used for estimating the fair value of the "Retained interests in loans securitized" are as follows:

TABLE 7: SIGNIFICANT ASSUMPTIONS USED FOR ESTIMATING THE FAIR VALUE OF RETAINED INTERESTS

|  | JUNE 30,<br>2003<br>---- | DECEMBER 31,<br>2002<br>---- |
|--|--------------------------|------------------------------|
| Monthly payment rate                       | 6.7%                     | 6.7%                         |
| Gross yield (1)                            | 25.6%                    | 26.0%                        |
| Annual interest expense and servicing fees | 3.8%                     | 4.0%                         |
| Annual gross principal default rate        | 22.6%                    | 21.7%                        |
| Discount rate:                             |                          |                              |
| Contractual retained interests             | 16.0%                    | 16.0%                        |
| Excess transferor's interests              | 16.0%                    | 16.0%                        |
| Interest-only strip receivable             | 30.0%                    | 30.0%                        |
| Spread accounts receivable (2)             | 15.0%                    | 16.0%                        |

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(1) Includes expected cash flows from finance charges, late and overlimit fees, debt waiver premiums and bad debt recoveries, net of finance charge and fee charge-offs. Gross yield for purposes of estimating fair value does not include interchange income, or cash advance fees.

(2) Beginning on March 31, 2003 the discount rate on spread account balances has been reduced by interest income expected to be earned.

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### BALANCE SHEET ANALYSIS

#### Cash and Cash Equivalents

Cash and cash equivalents decreased \$193.6 million to \$386.6 million as of June 30, 2003, compared to \$580.2 million as of December 31, 2002. The decrease is primarily due to the reduction in deposits of \$250.9 million and the establishment of a \$80.6 million liquidity reserve required by the Company's Operating Agreement with the OCC as described on page 52 offset by sales of receivables from Direct Merchants Bank to the Master Trust.

#### Credit Card Loans

Credit card loans were \$632.9 million as of June 30, 2003, compared to \$846.4 million as of December 31, 2002. The \$213.5 million decrease is primarily a result of the transfer of \$319.6 million of receivables from Direct Merchants Bank to the Master Trust.

#### Property and equipment

Property and equipment decreased to \$51.5 million at June 30, 2003, mainly due to the sale of our Arizona facility on May 1, 2003 for cash proceeds of \$19.3 million, which approximated its carrying value.

#### Deposits

Deposits decreased \$250.9 million to \$641.9 million as of June 30, 2003, from \$892.8 million as of December 31, 2002. The decrease relates to a shift in funding from certificates of deposit ("CDs") to off-balance sheet asset-backed securitizations.

#### Deferred Income

Deferred income decreased \$37.0 million to \$106.1 million as of June 30, 2003 compared to \$143.1 million as of December 31, 2002. The decrease primarily relates to declining enhancement services enrollments,, our migration from annual-billed to monthly-billed enhancement service products and the expiration of the ServiceEdge(R) extended warranty contracts.

### CRITICAL ACCOUNTING POLICIES

The Company's most significant accounting policies are our determination of the allowance for loan losses, valuation of retained interests and accounting for deferred acquisition costs and revenue recognition on enhancement services products.

#### Allowance for loan losses

We maintain an allowance for loan losses sufficient to absorb

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anticipated probable loan losses inherent in the credit card loan portfolio as of the balance sheet date. At the time of charge-off, all principal balances are written off against the allowance and all fees and finance charges are netted against the applicable income statement line item. The allowance is based on management's consideration of all relevant factors including management's assessment of applicable economic and seasonal trends.

We segment the loan portfolio into several individual liquidating pools with similar credit risk characteristics, and estimate (based on historical experience for similar pools and existing environmental conditions) the dollar amount of principal, accrued finance charges and fees that will ultimately charge-off. We then aggregate these pools into prime and subprime portfolios based on the prescribed FICO score cuts, credit counseling and various pools of other receivables. We also isolate other potentially higher risk segments such as accounts that are over their credit limit by more than 10%, accounts in suspended status under our debt waiver benefits and other programs as deemed necessary. We separately analyze the reserve requirement on each of these groups or portfolios.

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We continually evaluate the homogenous liquidating risk pools using a roll-rate model which uses historical delinquency levels and pay-down levels (12 months of historical data, with influence given to the last six months' performance to capture current economic and seasonal trends), loan seasoning and other measures of asset quality to estimate charge-offs for both credit losses and bankruptcy losses.

Additionally, in evaluating the adequacy of the loan loss reserves, we consider several subjective factors which may be overlaid into the credit risk roll-rate model in determining the necessary loan loss reserve, including:

- national and economic trends and business conditions, including the condition of various market segments;
- changes in lending policies and procedures, including those for underwriting, collection, charge-off and recovery, as well as in the experience, ability and depth of lending management and staff;
- trends in volume and the product pricing of accounts, including any concentrations of credit; and
- impacts from external factors - such as changes in competition, and legal and regulatory requirements - on the level of estimated credit losses in the current portfolio.

Significant changes in these factors could impact our financial projections and thereby affect the adequacy of our allowance for loan losses.

### Valuation of Retained Interests in Loans Securitized

The "Retained interests in loans securitized" on our balance sheet associated with our securitization transactions includes contractual retained interests, transferor's interests, interest-only strip receivable, and spread accounts receivable. We determine the fair value of each component of the "Retained interests in loans securitized" at the time a securitization transaction or replenishment sale is completed using a discounted cash flow valuation model and on a quarterly basis thereafter. Any change in the fair value is recorded in "Securitization income."

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The discounted cash flow valuation is limited to the receivables that exist and have been sold to the Metris Master Trust. Therefore, the model assumes current principal receivable balances amortize with no new sales, interchange fees or cash advances. The future cash flows are modeled in accordance with the debt series' legal documents and are applied to all series on a pro-rata basis. Excess fee income, finance charge and recovery cash flows above contractual expense payments are first applied to meet spread accounts receivable requirements then returned to us as part of the interest-only strip receivable. We determine upper and lower valuation limits of the "Retained interests in loans securitized" based on historical and forecasted excess spreads. We then determine the best estimate within the range based on historical trends (weighted heavily toward the low end of the range), adjusted when appropriate, for portfolio forecast information.

The contractual retained interests represent the subordinated securities held by us. There is no stated interest/coupon rate associated with these securities and they are not rated. They are subordinate to all other securities, except for the interest-only strip receivable we own and accordingly, are repaid last. Their fair value is determined by discounting the expected future cash flows using a discount rate commensurate with the risks of the underlying assets and the expected timing based on the scheduled maturity date for the underlying securitization. If these securities are recoverable based on the Metris Master Trust forecasts, cash flows related to the entire subordinated principal balance are used in determining their fair value.

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Transferor's interests represent undivided interests in receivables that are not pledged to support a specific security series or class and represent our interest in the excess principal receivables held in the Metris Master Trust. The fair value is determined in the same manner as the contractual retained interests and is discounted based on twelve months to maturity. We have subordinated our rights to the excess cash flows on the principal receivables underlying the transferor's interest, thus they are included in the value of the interest-only strip receivable. Spread accounts receivable balances represent cash held by the Metris Master Trust trustee due to Trust performance and requisite reserves required by certain security series. These balances earn interest and the change in fair value is determined in the same manner as the contractual retained interests.

The interest-only strip receivable represents the contractual right to receive from the Metris Master Trust interest and other fee revenue less certain costs over the estimated life of the underlying debt securities. The fair value is determined by discounting the expected future cash flows using a discount rate commensurate with the risks of the underlying assets and the expected timing of the amortization inherent in the retained interests valuation model. We believe our discount rates are consistent with what other market place participants would use to determine the fair value of these assets. The valuation model assumes that we repurchase the outstanding principal receivables at face value according to the clean up call provisions contained in the respective security series' legal documents.

We use certain assumptions and estimates in determining the fair values of "Retained interests in loans securitized." These assumptions and estimates include estimated principal payments, credit losses, gross yield, interest expense, fees, the timing of cash receipts, and discount rates commensurate with the risks of the underlying assets. On a quarterly basis, we review and adjust as appropriate the assumptions and estimates used in our model based on a variety of internal and external factors, including national and economic trends and business conditions, current lending policies, procedures and strategies, historical trends and assumptions about future trends, competition and legal and



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regulatory requirements. Significant estimates are required in determining these factors and different judgments concerning these factors can result in a material impact on our balance sheet and income statement. The accompanying unaudited consolidated financial statements do not include an adjustment to the fair value of retained interest that might result from the inability to finance future receivables.

### Revenue Recognition on Enhancement Services Products

#### Debt Waiver Products

Direct Merchants Bank offers various debt waiver products on receivables it owns as well as securitized receivables. The Company's policy for recognizing debt waiver revenue on receivables sold to the Metris Master Trust was not in accordance with GAAP. Historically, the Company recognized revenue in the month following completion of the cancellation period, generally one month. Cash flows related to debt waiver are now included in the valuation of the interest-only strip receivable. All periods presented have been restated to reflect the revised policy. Direct Merchants Bank incurs the related claims and marketing expenses. A reserve is maintained for future death and finance charge claims based on Direct Merchants Bank's historical experience with settlement of such claims. Reserves for pending claims and incurred but not reported claims are recorded in the consolidated balance sheets in "Accrued expenses and other liabilities." Reserves for pending and incurred but not reported claims were \$7.8 million as of June 30, 2003, compared to \$8.2 million as of December 31, 2002.

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#### Membership Program Products

We bill membership fees for enhancement services products through financial institutions, including Direct Merchants Bank, and other cardholder-based institutions. We record these fees as deferred membership income upon acceptance of membership and amortize them on a straight-line basis for all annually billed products, and on an accelerated amortization method for all monthly billed products over the membership period beginning after the contractual cancellation period is complete. A liability is established and netted against the related receivable in the consolidated balance sheets in "Other assets" from inception of the membership through the end of the cancellation period that reflects our historical cancellation experience with these products. Gross receivables as of June 30, 2003 on the membership program products were \$13.3 million compared to \$22.0 million as of December 31, 2002. Cancellation reserves were \$11.3 million and \$19.5 million as of June 30, 2003 and December 31, 2002, respectively. Revenues recorded for membership products are included in the consolidated statements of income under "Enhancement services revenues" and were \$28.6 million and \$21.1 million for the three months ended June 30, 2003 and 2002, respectively. Revenues for membership products were \$59.2 million and \$38.3 million for the six months ended June 30, 2003 and 2002, respectively. Unearned revenues on membership program products are recorded in the consolidated balance sheets in "Deferred income." Unearned revenues as of June 30, 2003 were \$85.3 million compared to \$114.2 million as of December 31, 2002.

#### Warranty Products

We coordinate the marketing activities for Direct Merchants Bank and third-party sales of extended service plans. We perform administrative services and retain the claims risk for all extended service plans sold. As a result, we defer and recognize extended service plan revenues and the incremental direct acquisition costs on an accelerated amortization method over the life of the

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related extended service plan contracts beginning after the expiration of any manufacturer's warranty coverage. A liability is established and netted against the related receivable in the consolidated balance sheets in "Other assets" from inception of the extended service plan through the end of the cancellation period that reflects our historical cancellation experience with these products. Gross receivables as of June 30, 2003 on the warranty products were \$3.3 million compared to \$3.8 million as of December 31, 2002. Cancellation reserves were \$3.0 million and \$5.3 million as of June 30, 2003 and December 31, 2002, respectively. Revenues recorded for warranty products are included in the consolidated statements of income under "Enhancement services revenues" and were \$8.4 million and \$12.0 million for the three months ended June 30, 2003 and 2002, respectively. Revenues for warranty were \$18.4 million and \$25.0 million for the six months ended June 30, 2003 and 2002, respectively. Unearned revenues on warranty products are recorded in the consolidated balance sheets in "Deferred income." Unearned revenues as of June 30, 2003 were \$10.4 million compared to \$17.6 million as of December 31, 2002. Reserves for pending and incurred but not reported claims, included in "Accrued expenses and other liabilities," were \$0.4 and \$0.7 million as of June 30, 2003 and December 31, 2002, respectively.

### Deferred Acquisition Costs on Enhancement Services Products

We defer qualifying acquisition costs associated with our enhancement services products. These costs, which relate directly to membership solicitations (direct response advertising costs), principally include postage, printing, mailing, telemarketing costs, and commissions paid to third parties. The total amount of enhancement services deferred costs as of June 30, 2003 and December 31, 2002 were \$46.9 million and \$73.2 million, respectively. If deferred acquisition costs were to exceed forecasted future cash flows, we would make an appropriate adjustment for impairment. The most significant assumption used by the Company in determining the realizability of these deferred costs is future revenues from our enhancement services products. A significant reduction in revenues could have a material impact on the values of these balances.

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### Debt Waiver Products

Qualifying membership acquisition costs are deferred and charged to expense as debt waiver product fees are recognized. We amortize these costs using an accelerated methodology, which approximates our historical cancellation experience for debt waiver products. Amortization of debt waiver acquisition costs was \$1.3 million and \$2.7 million for the three- and six-month periods ended June 30, 2003. All other debt waiver acquisition costs are expensed as incurred. Deferred debt waiver acquisition costs were \$2.3 million and \$2.6 million as of June 30, 2003 and December 31, 2002, respectively, and were classified as "Other assets" on the consolidated balance sheets.

### Membership Program Products

Qualifying membership acquisition costs are deferred and charged to expense as membership fees are recognized. We amortize all deferred costs on a straight-line basis for all annually billed products, and on an accelerated method for all monthly billed products, which approximates our historical cancellation experience for membership program products. Amortization of membership deferred costs was \$13.3 million and \$11.9 million for the three months ended June 30, 2003 and 2002, respectively. Amortization of membership deferred costs was \$33.9 million and \$19.7 million for the six months ended June 30, 2003 and 2002, respectively. All other membership acquisition costs are expensed as incurred. Deferred membership acquisition costs were \$42.8 million and \$66.9 million as of June 30, 2003 and December 31, 2002, respectively, and

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were classified as "Other assets" on the consolidated balance sheets.

Warranty Products

Qualifying warranty acquisition costs are deferred and charged to expense as warranty product fees are recognized. Those direct acquisition costs that cannot be associated with a successful contract, are charged to expense as incurred. A successful effort conversion percentage is applied to these incremental direct acquisition costs, which approximates our historical successful effort rate percentage in selling warranty products. We amortize these deferred costs using an accelerated amortization methodology, which approximates our historical cancellation experience following the expiration of the manufacturer's contractual cancellation period for the warranty products. Amortization of warranty acquisition costs were \$0.8 million and \$3.0 million for the three months ended June 30, 2003 and 2002, respectively. Amortization of warranty acquisition costs were \$2.8 million and \$6.1 million for the six months ended June 30, 2003 and 2002, respectively. All other warranty acquisition costs are expensed as incurred. Deferred warranty acquisition costs amount to \$1.4 million and \$3.0 million as of June 30, 2003 and December 31, 2002, respectively, and were classified as "Other assets" on the consolidated balance sheets.

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LIQUIDITY, FUNDING AND CAPITAL RESOURCES

One of our primary financial goals is to maintain an adequate level of liquidity through active management of assets and liabilities. Liquidity management is a dynamic process, affected by changes in the characteristics of our assets and liabilities and short- and long-term interest rates. We use a variety of financing sources to manage liquidity, funding, and interest rate risks. Table 5 summarizes our funding and liquidity as of June 30, 2003 and December 31, 2002:

TABLE 8: LIQUIDITY, FUNDING AND CAPITAL RESOURCES

|                                 | JUNE 30, 2003 |           |              |            |
|---------------------------------|---------------|-----------|--------------|------------|
|                                 | DMCCB         | OTHER     | CONSOLIDATED | DMCCB      |
| Cash and due from banks         | \$ 85,412     | \$ 1,106  | \$ 86,518    | \$ 58,399  |
| Federal funds sold              | 33,700        | --        | 33,700       | 88,000     |
| Short-term investments          | 209,157       | 57,216    | 266,373      | 322,039    |
| Total cash and cash equivalents | \$ 328,269    | \$ 58,322 | \$ 386,591   | \$ 468,438 |

JUNE 30, 2003

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| ON-BALANCE SHEET FUNDING  | OUTSTANDING  | CAPACITY | OUTSTA |
|---|--------------|----------|--------|
|   | -----        | -----    | -----  |
| Revolving credit line - July 2003   | \$ --        | \$ --    | \$     |
| Term loan - June 2003   | --           | N/A      |        |
| 10% senior notes - November 2004  | 100,000      | N/A      |        |
| 10.125% senior notes - July 2006  | 147,270      | N/A      |        |
| Term loan - June 2004   | 125,000      | N/A      |        |
| Other   | 10,967       | N/A      |        |
| Deposits - various maturities through February 2007                         | 641,934      | N/A      |        |
|   | -----        | -----    | -----  |
| Subtotal  | \$ 1,025,171 | \$ --    | \$ 1,  |
| <br>OFF-BALANCE SHEET FUNDING   |              |          |        |
| Master Trust:   |              |          |        |
| Term asset backed securitizations - various maturities through January 2009 | 7,010,000    | --       | 7,     |
| Conduits - maturing March 2004  | 850,000      | --       | 1,     |
| Metris facility - March 2003  | --           | --       |        |
|   | -----        | -----    | -----  |
| Subtotal  | 7,860,000    | --       | 8,     |
|   | -----        | -----    | -----  |
| Total   | \$ 8,885,171 | \$ --    | \$ 10, |
|   | =====        | =====    | =====  |

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Our contractual cash obligations during the next twelve months as of June 30, 2003 are as follows:

|                  |            |
|------------------|------------|
| Long-term debt   | \$ 126,167 |
| Operating leases | 13,019     |
| Deposits         | 182,705    |
|                  | -----      |
| Total            | \$ 321,891 |
|                  | =====      |

In addition to the contractual cash obligations, open-to-buy on credit card accounts as of June 30, 2003 was \$10.1 billion.

As of June 30, 2003, \$2.0 billion of off-balance sheet funding in the Master Trust is scheduled to amortize over the next twelve months. We base the amortization amounts on estimated amortization periods, which are subject to change based on the Master Trust performance.

The following table shows the annualized yields, defaults, costs and excess spreads for the Master Trust on a cash basis:

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| (In thousands)                             | THREE MONTHS ENDED JUNE 30, |        |        |
|--|-----------------------------|--------|--------|
|  | 2003                        |        |        |
|  | -----                       |        |        |
| Gross yield (1)                            | \$ 608,762                  | 26.86% | \$ 616 |
| Annual principal defaults                  | 477,392                     | 21.06% | 373    |
|  | -----                       | -----  | -----  |
| Net portfolio yield                        | 131,370                     | 5.80%  | 242    |
| Annual interest expense and servicing fees | 83,575                      | 3.86%  | 100    |
|  | -----                       | -----  | -----  |
| Net excess spread                          | \$ 47,795                   | 1.94%  | \$ 142 |
|  | =====                       | =====  | =====  |

| (In thousands)                             | SIX MONTHS ENDED JUNE 30, |        |          |
|--|---------------------------|--------|----------|
|  | 2003                      |        |          |
|  | -----                     |        |          |
| Gross yield (1)                            | \$ 1,266,543              | 27.29% | \$ 1,202 |
| Annual principal defaults                  | 985,592                   | 21.23% | 687      |
|  | -----                     | -----  | -----    |
| Net portfolio yield                        | 280,951                   | 6.06%  | 515      |
| Annual interest expense and servicing fees | 171,744                   | 3.90%  | 206      |
|  | -----                     | -----  | -----    |
| Net excess spread                          | \$ 109,207                | 2.16%  | \$ 308   |
|  | =====                     | =====  | =====    |

- (1) Includes cash flows from finance charges, late, overlimit and cash advance fees, bad debt recoveries, interchange income and debt waiver fees, less finance charge and fee charge-offs.

The Master Trust and the associated off-balance sheet debt provide for early amortization if certain events occur. These events are described in the applicable series supplement of each securitization transaction. The significant events are (i) three-month average excess spreads below levels between 0.0% and 1.0%, (ii) negative transferor's interest within the Master Trust or (iii) failure to obtain funding during an accumulation period for a maturing term asset-backed securitization. In addition, there are various triggers within our securitization agreements that, if broken, would restrict the release of cash to us from the Master Trust. This restricted cash provides additional security to the investors in the Master Trust. We reflect cash restricted from release in the Master Trust as "Other receivables due from credit card securitizations, net" in the consolidated balance sheet. The restricted cash is discounted to reflect the present value of the future cash release. The triggers are primarily related to the performance of the Master Trust, in particular the average of net excess spread over a one to three-month period.

The cash restricted from release is limited to the amount of excess spread generated in the Master Trust on a cash basis. During periods of lower excess spreads, the required amount of cash to be restricted in the Master Trust may not be achieved. During those periods, all excess cash normally released to Metris Receivables, Inc. ("MRI") will be restricted from release. Once the maximum required amount of cash is restricted from release or excess spreads improve, cash can again be released to us. Based on the performance of our Master Trust, the amount of cash required to be restricted was \$463 million at June 30, 2003 and \$304 million at December 31, 2002. As of June 30, 2003, \$177.1

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million has been restricted from release in the Master Trust due to performance, \$21.4 million has been restricted from release in the Master Trust due to corporate

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debt ratings at the inception of the securitization transactions and \$15.9 million has been restricted from release in the Master Trust for maturity reserves. As of December 31, 2002, \$29.1 million had been restricted from release in the Master Trust due to performance and \$21.4 million had been restricted from release in the Master Trust due to corporate debt ratings at the inception of the securitization transactions. The \$148.0 million increase in this restricted cash is a result of approximately \$109.2 million of net excess cash generated by the Master Trust being restricted within the Master Trust and approximately \$38.8 million that was funded as additional enhancements. We expect all cash basis excess spread to be restricted from release to us until at least 2004.

On March 17, 2003 we obtained a \$425 million extension through March 2004 of an \$850 million conduit which was scheduled to mature in June of 2003. We also secured a \$425 million conduit through March 2004, which replaced conduits and warehouse facilities that matured during March through May 2003. Furthermore, these conduits provided for the financing of a term asset-backed securitization that matured in July 2003. The continued availability of funding under these facilities is subject to various conditions, including a minimum three-month average excess spread of 1% and a commitment, no later than September 30, 2003, for funding of a \$610 million term asset backed securitization that matures in January and February 2004. On June 26, 2003, we paid approximately \$4.3 million of prepaid interest and related fees to reduce the interest rate on one of these financing facilities.

On March 31, 2003, Thomas H. Lee Equity Fund IV, L.P. ("THL Fund IV") committed to provide a term loan to the Company in an aggregate amount of \$125 million as a backup financing facility, secured by assets of the Company. On June 27, 2003 the term loan commitment was terminated and replaced with a \$125 million senior secured loan funded by a consortium of lenders. With the termination of the THL Fund IV commitment, we wrote off \$5.1 million of capitalized commitment fees.

The \$125 million term loan was issued pursuant to an Amended and Restated Senior Secured Credit Agreement dated as of June 18, 2003 (the "Credit Agreement"). The loan matures June 27, 2004 and carries a fixed interest rate of 12% plus a monthly performance interest payment, which is indexed to the monthly excess spread in the Master Trust. The funds were used to pay off a \$100 million term loan that matured in June of 2003. The terms of the Credit Agreement, under which the loan was issued, require mandatory prepayment of a portion of the principal if the Company receives funds due to the sale of certain Company assets. We were therefore required to make a \$22.5 million principal repayment from the proceeds of the sale of our membership and warranty business. We are bound by certain covenants under the Credit Agreement as filed July 11, 2003 on Form 8-K. As of June 30, 2003, we were in compliance with all covenants under the Credit Agreement. In addition, under the agreement, Direct Merchants Bank dividends paid to MCI are limited to Bank earnings not to exceed \$20 million per quarter.

The Internal Revenue Service ("IRS") has recently completed its examination of the Company's tax returns through December 31, 1998. The IRS has proposed adjustments to increase the Company's federal income tax by \$42.9 million, plus interest of more than \$15 million, pertaining to the Company's treatment of certain credit card fees as original issue discount ("OID"). Although these fees are primarily reported as income when billed for financial

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reporting purposes, we believe the fees constitute OID and must be deferred and amortized over the life of the underlying credit card loans for tax purposes. Cumulatively through the year ended June 30, 2003, the Company has deferred approximately \$213.9 million in federal income tax under the OID rules. Any assessment similar to what has been proposed by the IRS may ultimately require the Company to pay the federal tax, state tax and related interest.

The Company believes its treatment of the fees is appropriate and continues to work with the IRS to resolve the proposed adjustments. The Company's position on the treatment of credit card fees is consistent with that of many other U.S. credit card issuers. We do not expect any additional tax to be paid or settlement to be reached over the next twelve months. However, both the timing and amount of the final resolution of this matter is uncertain.

In July of 2003, the OCC requested and Direct Merchants Bank agreed to eliminate federally insured deposits at the Bank, or the risk thereof to the FDIC, by September 30, 2003. The Bank estimates that it will have approximately \$565 million of insured deposits at September 30, 2003. The Bank also estimates it will have approximately \$375 million of unencumbered cash and

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approximately \$500 million of available gross receivables at September 30, 2003 to meet this obligation. We have received preliminary proposals from financing sources, and we are working with our financial advisors on a variety of options to achieve this goal. These options may include additional conduit financing or the sale of credit card receivables to third parties.

During the next twelve months we have contractual cash obligations of \$322 million and off-balance sheet funding scheduled to amortize of \$2.0 billion, which includes funding for a \$610 million term asset-backed securitization maturing in January and February 2004. In addition, we require funding for approximately \$565 million of deposits to be paid-off or defeased by September 30, 2003. We have historically utilized a variety of funding vehicles, as well as ongoing cash generated from operations, to finance credit card receivables, maturing debt obligations and general operating needs. During the next twelve months we intend to reduce outstanding credit card receivables in the Master Trust through lower credit card account acquisitions, attrition in the portfolio and third party sales as necessary. This reduction in the size of the portfolio will significantly reduce our need for additional bank conduits or the issuance of new asset-backed securities. We believe that we will be able to obtain the requisite funding that will provide us with adequate liquidity to meet anticipated cash needs, although no assurance can be given to that effect.

### CAPITAL ADEQUACY

In the normal course of business, Direct Merchants Bank enters into agreements, or is subject to regulatory requirements, that result in cash, debt and dividend or other capital restrictions.

The Federal Reserve Act imposes various legal limitations on the extent to which banks can finance or otherwise supply funds to their affiliates. In particular, Direct Merchants Bank is subject to certain restrictions on any extensions of credit to or other covered transactions, such as certain purchases of assets, with MCI and its affiliates. Such restrictions limit Direct Merchants Bank's ability to lend to MCI and its affiliates. Additionally, Direct Merchants Bank is limited in its ability to declare dividends to MCI in accordance with the national bank dividend provisions.

Direct Merchants Bank is subject to certain capital adequacy guidelines adopted by the OCC. At June 30, 2003 and December 31, 2002, Direct Merchants

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Bank's Tier 1 risk-based capital ratio, risk-based total capital ratio and Tier 1 leverage ratio exceeded the minimum required capital levels, as illustrated in the following table.

Additionally, the Bank must maintain minimum capital in the aggregate amount of (i) liquid assets deposited pursuant to the Liquidity Reserve Deposit Agreement discussed below; (ii) the capital required as a result of the 200% risk-weight applied to on-book subprime credit card receivables; and (iii) the minimum capital required under Federal law for a "well capitalized" institution for all remaining assets owned by the Bank. Under these more stringent guidelines, Direct Merchants Bank's total capital ratio as of June 30, 2003 was 17.2% and Direct Merchants Bank was considered a "well-capitalized" depository institution under regulations of the OCC (including FFIEC subprime guidelines).

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Direct Merchants Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Direct Merchants Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require Direct Merchants Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 leverage capital (as defined) to average assets (as defined). Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material adverse effect on our financial statements.

Additional information about Direct Merchants Bank's actual capital amounts and ratios are presented in the following table:

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| AS OF JUNE 30, 2003                         | ACTUAL     |       | TO BE ADEQUATELY CAPITALIZED |       |
|---|------------|-------|------------------------------|-------|
|   | AMOUNT     | RATIO | AMOUNT                       | RATIO |
| Total Capital<br>(to risk-weighted assets)  | \$ 259,364 | 39.4% | \$ 52,614                    | 8.0%  |
| Tier 1 Capital<br>(to risk-weighted assets) | 249,917    | 38.0% | 26,307                       | 4.0%  |
| Tier 1 Capital<br>(to average assets)       | 249,917    | 21.8% | 45,841                       | 4.0%  |

TO BE ADEQUATELY



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| AS OF DECEMBER 31, 2002                        | ACTUAL     |       | CAPITALIZED |       | A   |
|--|------------|-------|-------------|-------|-----|
|  | AMOUNT     | RATIO | AMOUNT      | RATIO |     |
| Total Capital<br>(to risk-weighted<br>assets)  | \$ 402,721 | 30.8% | \$104,516   | 8.0%  | \$1 |
| Tier 1 Capital<br>(to risk-weighted<br>assets) | 385,480    | 29.5% | 52,258      | 4.0%  |     |
| Tier 1 Capital<br>(to average assets)          | 385,480    | 24.7% | 62,381      | 4.0%  |     |

REGULATORY MATTERS

On March 18, 2003, we entered into an operating agreement with the OCC designed to ensure that Direct Merchants Bank continues to operate in a safe and sound manner.

The operating agreement requires, among other things, the following:

- The Bank must reduce its on-balance-sheet credit card receivables to no more than \$550 million by December 31, 2003 and to zero by December 31, 2004. During the time the Bank is reducing these receivables, the mix of subprime receivables may not exceed 60% of all credit card receivables. As of June 30, 2003, 56.2% of the Bank's credit card receivables were subprime. The Bank will continue to sell credit card receivables on a daily basis to MCI under the purchase agreement currently in effect between MCI and the Bank.
- The Bank must maintain minimum capital in the aggregate amount of (i) liquid assets deposited pursuant to the Liquidity Reserve Deposit Agreement discussed below; (ii) the capital required as a result of the 200% risk-weight applied to on-book subprime credit card receivables; and (iii) the minimum capital required under Federal law for a "well capitalized" institution for all remaining assets owned by the Bank.
- The Bank must meet certain liquidity requirements, including maintaining, on a daily basis, liquid assets of not less than 100% of the deposits and other liabilities coming due within the next 30 days, maintaining marketable assets in an amount equal to or in excess of the Bank's insured deposits, maintaining cash and cash equivalents

in excess of 46% of outstanding CDs, and entering into the Liquidity Reserve Deposit Agreement discussed below to support the Bank's credit card receivables funding needs.

- The Bank is working with the OCC to develop a written strategic plan establishing objectives for the Bank's overall risk profile, earning performance, growth, balance sheet mix, off-balance sheet activities, liability structure, capital

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adequacy, product line development and marketing segments.

The terms of the operating agreement required Direct Merchants Bank and MCI to enter into a Capital Assurance and Liquidity Maintenance Agreement ("CALMA") which also was executed on March 18, 2003. The effect of the CALMA is to potentially require MCI to make such capital infusions or provide Direct Merchants Bank with financial assistance so as to permit Direct Merchants Bank to meet its liquidity requirements.

As required by the operating agreement, Direct Merchants Bank, a third-party depository bank and the OCC executed a Liquidity Reserve Deposit Agreement ("LRDA").

If the OCC were to conclude that the Bank failed to implement any provision of the agreement, the OCC could pursue various enforcement options.

Upon signing these agreements Direct Merchants Bank declared and paid a \$155 million dividend to us. An additional dividend of \$15.8 million was declared and paid during the second quarter of 2003.

In July of 2003, the OCC requested and Direct Merchants Bank agreed to eliminate federally insured deposits at the Bank, or the risk thereof to the FDIC, by September 30, 2003. The Bank estimates that it will have approximately \$565 million of insured deposits at September 30, 2003. The Bank also estimates it will have approximately \$375 million of unencumbered cash and approximately \$500 million of available gross receivables at September 30, 2003 to meet this obligation. We have received preliminary proposals from financing sources, and we are working with our financial advisors on a variety of options to achieve this goal. These options may include additional conduit financing or the sale of credit card receivables to third parties. If we do not eliminate federally insured deposits, or the risk thereof, by September 30, 2003, the OCC could pursue various enforcement options.

On August 5, 2003, we received notification from the Securities and Exchange Commission that we are the subject of a formal, nonpublic investigation. We believe that this investigation relates primarily to the Company's treatment of loan loss allowances in 2001 and subsequent years, the Company's 2001 credit line increase program and other related matters.

The SEC specifically advised us that this is a fact-finding inquiry and that it has not reached any conclusions related to this matter. We are responding fully to the SEC in its investigation.

### 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 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," "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

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that could cause actual results to differ materially from those in the forward-looking statements.

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These risks and uncertainties include, but are not limited to, our high liquidity requirement; our higher delinquency rate, credit loss rates and charge-off rates of our "Credit card loans;" the higher charge-off and bankruptcy rates of the Company's target market of moderate-income consumers; the success and impact of our existing or modified strategic initiatives; the effect of the restatement of the Company's financial statements discussed herein, risks associated with Direct Merchants Bank's ability to comply with its agreement with regulators regarding the safety and soundness of its operations; interest rate risks; risks associated with acquired portfolios; dependence on the securitization markets and other funding sources to fund our business, including the refinancing of existing indebtedness; the effects of the previously announced SEC investigation, government policy and regulation, whether of general applicability or specific to us, including restrictions and/or limitations relating to our minimum capital requirements, reserving methodologies, dividend policies and payments, growth, and/or underwriting criteria; reduced funding availability and increased funding costs; privacy laws that could result in lower revenue generated from fewer marketing campaigns and/or penalties for non-compliance; and general economic conditions that can have a negative impact on the performance of loans and marketing of credit protection and other enhancement services.

These and other risks and uncertainties are discussed herein and in the Original 10-Q in "Legal Proceedings" (page 48 of the Original 10-Q), "Management's Discussion and Analysis of Financial Condition and Results of Operations" (pages 32-56 hereof) and "Quantitative and Qualitative Disclosures About Market Risk" (pages 46-47 of the Original 10-Q). 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.

### SELECTED OPERATING DATA - MANAGED BASIS

In addition to analyzing the Company's performance on an owned basis, we analyze the Company's financial performance on a managed loan portfolio basis. On a managed basis, the balance sheets and income statements include other investors' interests in securitized loans that are not assets of the Company, thereby reversing the effects of sale accounting under SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." We believe this information is meaningful to the reader of the financial statements. We service the receivables that have been securitized and sold and own the right to the cash flows from those receivables sold in excess of amounts owed to security holders.

The following information is not in conformity with accounting principles generally accepted in the United States of America, however, we believe the information is relevant to understanding the overall financial condition and results of operations of the Company.

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TABLE 9: MANAGED LOAN PORTFOLIO  
(Dollars in thousands)

|  | JUNE 30,<br>2003<br>----- | % OF<br>TOTAL<br>----- | DECEMBER 31,<br>2002<br>---- | % OF<br>TOTAL<br>----- |
|--|---------------------------|------------------------|------------------------------|------------------------|
| PERIOD-END BALANCES:                           |                           |                        |                              |                        |
| Credit card loans                              | \$ 632,913                |                        | \$ 846,417                   |                        |
| Receivables held in the Metris<br>Master Trust | 9,483,652                 |                        | 10,573,769                   |                        |
|  | -----                     |                        | -----                        |                        |
| Managed  | \$ 10,116,565             |                        | \$ 11,420,186                |                        |
|  | =====                     |                        | =====                        |                        |
| Loans contractually delinquent:                |                           |                        |                              |                        |
| Credit card loans                              | 48,266                    | 7.6%                   | 7,876                        | 0.                     |
| Receivables held in the Metris<br>Master Trust | 1,084,241                 | 11.4%                  | 1,252,073                    | 11.                    |
|  | -----                     |                        | -----                        |                        |
| Managed  | \$ 1,132,507              | 11.2%                  | \$ 1,259,949                 | 11.                    |
|  | =====                     |                        | =====                        |                        |
| THREE MONTHS ENDED<br>JUNE 30,<br>-----        |                           |                        |                              |                        |
|  | 2003<br>----              |                        | 2002<br>----                 | 2003<br>----           |
| AVERAGE BALANCES:                              |                           |                        |                              |                        |
| Credit card loans                              | \$ 690,903                |                        | \$ 1,737,626                 | \$ 721,121             |
| Receivables held in the<br>Metris Master Trust | 9,771,210                 |                        | 10,163,087                   | 10,086,551             |
|  | -----                     |                        | -----                        | -----                  |
| Managed  | \$ 10,462,113             |                        | \$ 11,900,713                | \$ 10,807,672          |
|  | =====                     |                        | =====                        | =====                  |
| NET CHARGE-OFFS:                               |                           |                        |                              |                        |
| Credit card loans                              | \$ 43,702                 | 25.4%                  | \$ 85,099                    | 19.6%                  |
| Receivables held in the<br>Metris Master Trust | 454,914                   | 18.7%                  | 356,688                      | 14.1%                  |
|  | -----                     |                        | -----                        | -----                  |
| Managed  | \$ 498,616                | 19.1%                  | \$ 441,787                   | 14.9%                  |
|  | =====                     |                        | =====                        | =====                  |

The increase in the managed delinquency rates as of June 30, 2003 over December 31, 2002 and June 30, 2002 reflects various factors, including declining receivable balances, a deterioration in the economy and the impact of our 2001 credit line increase program. The credit line increase program added pressure to our customers due to increased average outstanding balances, which require higher monthly payments. This, along with a deteriorating economy, has made our collections efforts more difficult, resulting in higher delinquencies.

Total managed loans decreased \$1.3 billion to \$10.1 billion as of June 30, 2003, compared to \$11.4 billion as of December 31, 2002. This was primarily due to a reduction in credit lines, tighter underwriting standards implemented in 2002 and lower new accounts. The amount of credit card receivables in debt forbearance programs was \$856.0 million or 8.5% of total managed loans as of June 30, 2003, compared with \$860.1 million or 7.5% of managed loans as of

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December 31, 2002. All delinquent receivables in debt forbearance programs are included in Table 6.

Managed net charge-offs increased \$56.8 million and \$168.0 million for the three- and six-month periods ended June 30, 2003 compared to the same periods in 2002 primarily due to the impact of the 2001 credit line increase program and deterioration in the economy.

We charge-off bankrupt accounts 60 days following formal notification. Charge-offs due to bankruptcies were \$181.2 million, representing 34.5% of total managed gross charge-offs for the three months ended June 30, 2003 and \$133.2 million, representing 25.3% of total managed gross charge-offs for the three months ended June 30, 2002. Charge-offs due to bankruptcies were \$367.2 million, representing 35.1% of total managed gross charge-offs for the six months ended June 30, 2003 and \$285.8 million, representing 32.8% of total managed gross charge-offs for the six months ended June 30, 2002. In addition to those bankrupt accounts that were charged-off, we received formal notification of \$89.7 million and \$103.3 million of managed bankrupt accounts as of June 30, 2003 and 2002, respectively.

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### Net Interest Income

TABLE 10: ANALYSIS OF AVERAGE BALANCES, INTEREST AND AVERAGE YIELDS AND RATES

|  | THREE MONTHS ENDED |               |       |
|--|--------------------|---------------|-------|
|  | JUNE 30,           |               |       |
|  | 2003               | 2002          |       |
|  | ----               | ----          |       |
| (Dollars in thousands)   |                    |               |       |
| Average interest-earning assets:                                 |                    |               |       |
| Owned  | \$ 1,192,956       | \$ 2,243,490  | \$    |
| Receivables held in the Metris Master Trust                      | 9,771,210          | 10,163,201    | 1     |
|  | -----              | -----         | ----- |
| Managed  | \$ 10,964,166      | \$ 12,406,691 | \$ 1  |
|  | =====              | =====         | ===== |
| Net interest income:   |                    |               |       |
| Owned  | \$ 12,717          | \$ 41,838     | \$    |
| Receivables held in the Metris Master Trust                      | 378,324            | 387,036       |       |
|  | -----              | -----         | ----- |
| Managed  | \$ 391,041         | \$ 428,874    | \$    |
|  | =====              | =====         | ===== |
| Net interest margin (1):   |                    |               |       |
| Owned  | 4.3%               | 7.5%          |       |
| Retained interests and investors' interests in loans securitized | 15.5%              | 15.3%         |       |
| Managed  | 14.3%              | 13.9%         |       |

(1) We compute net interest margin by dividing annualized net interest income by average total interest-earning assets.

Managed net interest income decreased \$37.8 million and \$54.9 million for the three- and six-month periods ended June 30, 2003, compared to the same

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periods in 2002. Net interest income consists primarily of interest earned on our credit card loans less interest expense on borrowing to fund the loans. The decrease is primarily due to a \$1.4 billion and \$989.0 million decrease in managed average interest-earning assets, for the three- and six-month periods ended June 30, 2003, compared to the same periods in 2003.

### ITEM 4 CONTROLS AND PROCEDURES

Under the supervision and with the participation of the Company's management, including the Chairman and Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), we evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-14(c) or 15d-14(c) under the Exchange Act). Based on that evaluation, the Company's management, including the CEO and CFO, have concluded that our disclosure controls and procedures, as of June 30, 2003, were not effective in ensuring that information required to be disclosed in the reports we file under the Securities Exchange Act of 1934, as amended ("Exchange Act") are recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

On November 17, 2003, our external auditors, KPMG LLP, issued a material weakness report noting a material weakness in our policies and procedures for estimating the fair value of our "Retained interests in loans securitized" and associated revenue recognition. During the past several months we have taken steps to revise our valuation model and related policies, procedures and assumptions to address the issues in the material weakness report. During the period, the Company also identified and changed its accounting policies to conform with accounting principles generally accepted in the United States of America associated with the accounting for securitization transaction costs, credit card solicitation costs, and debt waiver revenue associated with receivables sold to the Metris Master Trust (See Note 2 of the unaudited consolidated financial statements on page 9 for further discussion).

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The Company, as of February 24, 2004, has re-evaluated the effectiveness of the design of the Company's disclosure controls and procedures (as defined in Rule 13a-14(c) or 15d-14(c) under the Exchange Act). Based on that evaluation, the Company's management, including the CEO and CFO, has concluded that the design of our disclosure controls and procedures is effective in ensuring that information required to be disclosed in the reports we file under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms. The Company has not yet evaluated (tested) the operating effectiveness of such controls.

### PART II. OTHER INFORMATION

#### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

##### (a) Exhibits:

- 10.1 Amended and Restated Senior Secured Credit Agreement, dated as of June 18, 2003, among Metris Companies Inc., the Lenders from time to time parties thereto, Goldman Sachs Credit Partners L.P. as Administrative Agent, and Deutsche Bank Trust Companies America as Collateral Agent (Incorporated by reference to Exhibit 10 to MCI's Current Report on Form 8-K dated July 11, 2003 (File No. [1-12351])).

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- 10.2 First Amendment to the Amended and Restated Senior Secured Credit Agreement and to credit Agreement Reserve Securities Account Control Agreement, dated as of July 29, 2003 among Metris Companies Inc., the Lenders from time to time parties to the Senior Secured Credit Agreement, Goldman Sachs Credit Partners L.P. as Administrative Agent, and Deutsche Bank Trust Companies America As Collateral Agent. (Previously filed as an exhibit to the Original 10-Q, which was filed with the Securities and Exchange Commission on July 15, 2003).
- 10.3 Asset Purchase Agreement Dated July 29, 2003 by and among Metris Companies Inc., Metris Direct, Inc., Metris Direct Services, Inc., Metris Travel Services Inc., Metris Club Services, Inc., Metris Warranty Services, Inc., and Metris Warranty Services of Florida, Inc., CPP Holdings Limited and CPP US Operations Group, LLC. (Previously filed as an exhibit to the Original 10-Q, which was filed with the Securities and Exchange Commission on July 15, 2003).
- 10.4 Transition Services Agreement dated July 29, 2003 by and among CPP Holdings Limited and CPP US Operations Group, LLC and Metris Companies Inc. and MES Insurance Agency, LLC. (Previously filed as an exhibit to the Original 10-Q, which was filed with the Securities and Exchange Commission on July 15, 2003).
- 10.5 Employee Leasing Agreement dated July 29, 2003, by and between CPP Holdings Limited and CPP US Operations Group, LLC and Metris Companies Inc. (Previously filed as an exhibit to the Original 10-Q, which was filed with the Securities and Exchange Commission on July 15, 2003).
- 11. Computation of Earnings Per Share
  - 31.1 Certification of Principal Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a).
  - 31.2 Certification of Principal Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a).
  - 32.1 Certification of Principal Executive Officer Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code.
  - 32.2 Certification of Principal Financial Officer Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code.

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### (b) Reports on Form 8-K:

On April 16, 2003, we filed a Current Report on Form 8-K to report the submission of unaudited financial statements in a press release dated April 16, 2003.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

METRIS COMPANIES INC.  
(Registrant)

Date: April 9, 2004

By: /s/John A. Witham  
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John A. Witham  
Executive Vice President and Chief Financial Officer  
(Principal Financial Officer and Authorized  
Officer of Registrant)