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

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

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# FORM 10-K/A

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

| For the fiscal year ended DECEMBER 31, 2002 | 001-12351 Commission file number |
|---|---|

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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)

Securities registered pursuant to Section 12(b) of the Act:

| Common Stock, $.01 Par Value | New York Stock Exchange, Inc. |
|---|---|
| Title of Each Class | Name of Each Exchange On Which Registered |

Securities registered pursuant to Section 12(g) of the Act: None

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 and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes [X] No [ ]

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of June 28, 2002 was approximately $493,557,434 based upon the closing price of $8.31 on the New York Stock Exchange on that date.

As of March 14, 2003, 57,657,924 shares of the Registrant's Common Stock were outstanding and the aggregate market value of common stock held by

non-affiliates of the Registrant on that date was approximately $76,887,744 based upon the closing price of $1.37 on the New York Stock Exchange on March 14, 2003.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the Proxy Statement for the Annual Meeting of Stockholders of Metris Companies Inc. held on May 6, 2003, were filed with the Securities and Exchange Commission ("SEC") within 120 days after December 31, 2002, and are incorporated by reference in Part III.

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EXPLANATORY NOTE

As previously disclosed, Metris Companies Inc. (the "Company") has restated its financial results for 1998 through 2002 and for the first three quarters of 2003. The determination was made to restate these financial statements 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 Annual Report on Form 10-K for the year ended December 31, 2002, initially filed with the Securities and Exchange Commission ("SEC") on March 31, 2003 (the "Original 10-K"), is being filed to reflect restatements of the following financial statements: (a) consolidated balance sheets as of December 31, 2002 and December 31, 2001; (b) consolidated statements of income for the years ended December 31, 2002, 2001 and 2000; and (c) consolidated statements of cash flows for years ended December 31, 2002, 2001 and 2000. 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 audited consolidated financial statements and "Restatements" in Management's Discussion and Analysis of Financial Condition and Results of Operations contained in this Annual Report on Form 10-K.

This Amendment No. 1 amends and restates Items 6, 7 and 8 of Part II, Item 14 of Part III and Item 15 of Part IV of the Original 10-K and no other information in the Original 10-K 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-K or to modify or update those disclosures affected by subsequent events. Such matters have been or will be addressed in the amended Quarterly Reports on Form 10-Q/A for the quarters ended March 31, 2003 and June 30, 2003, filed concurrently here with, 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 amended Quarterly Reports on Form 10-Q/A for the quarters ended March 31, 2003, June 30, 2003, and 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 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

ITEM 6. TABLE 1: SELECTED FINANCIAL DATA (AS RESTATED)

| | | | | YEAR ENDED DECEMBER 31 |
|---|---|---|---|---|
| (in thousands, except EPS, dividends and stock prices) | 2002 | 2001 | 2000 | 1999 |
| INCOME STATEMENT DATA: | | | | |
| Net interest income | $ 125,886 | $ 202,861 | $ (12,608) | $ 27, |
| Provision for loan losses | 219,804 | 461,106 | 164,800 | 122, |
| Other operating income | 835,421 | 1,273,444 | 1,080,270 | 794, |
| Other operating expense | 741,220 | 727,284 | 599,139 | 437, |
| Tax rate (1) | 659.7% | 39.5% | 38.6% | 4 |
| Net income (loss) | $ (1,584) | $ 160,029 | $ 185,902 | $ 109, |
| PER COMMON SHARE STATISTICS: | | | | |
| Earnings (Loss) per share - diluted | $ (0.66) | $ 1.61 | $ 2.01 | $ 1 |
| Stock price | 2.47 | 25.71 | 26.31 | 23 |
| Dividends paid | 0.040 | 0.040 | 0.033 | 0. |
| Book value per common share equivalent(2) | 11.53 | 12.00 | 9.68 | 7 |
| Shares outstanding (year-end) | 57,168 | 63,419 | 62,243 | 57, |
| Shares used to compute earnings (loss) per share (diluted) | 59,782 | 99,366 | 92,582 | 76, |
| SELECTED OPERATING DATA: | | | | |
| Year-end credit card loans | $ 846,417 | $ 2,756,763 | $ 1,184,269 | $ 150, |
| Year-end assets | 2,590,392 | 4,165,975 | 3,738,307 | 2,041, |
| Average credit card loans | 1,305,127 | 1,709,989 | 614,991 | 78, |
| Average interest-earning assets | 1,889,768 | 2,060,191 | 838,468 | 1,485, |
| Average assets | 3,334,850 | 3,903,846 | 2,826,653 | 193, |
| Average total equity | 1,116,578 | 1,011,573 | 759,653 | 564, |
| Year-end deposits | 892,754 | 2,058,008 | 2,106,199 | 775, |
| Year-end debt | 357,649 | 647,904 | 356,066 | 345, |
| Year-end preferred stock | 430,642 | 393,970 | 360,421 | 329, |
| Return on average assets | N/A | 4.1% | 6.6% | 5 |
| Return on average total equity | N/A | 15.8% | 24.5% | 1 |
| Net interest margin | 6.7% | 9.8% | (1.5)% | |
| Allowance for loan losses | $ 90,315 | $ 460,159 | $ 123,123 | $ 12, |
| Allowance for loan losses as a percent of 30-day plus delinquent receivables | 1,146.7% | 165.7% | 138.1% | 35 |
| Delinquency ratio (3) | 0.9% | 10.1% | 7.5% | |
| Allowance for loan losses as a percent of credit card loans | 10.7% | 16.7% | 10.4% | |
| Net charge-off ratio (4) | 24.9% | 12.3% | 9.7% | 5 |

TABLE 1: SELECTED FINANCIAL DATA (CONTINUED)

| | YEAR ENDED DECEMBER 31, | | | | |
|---|---|---|---|---|---|
| | 2002 | 2001 | 2000 | 1999 | 1998 |
| SELECTED ENHANCEMENT SERVICES DATA: | | | | | |
| Revenue: | | | | | |
| Membership products | $ 92,919 | $ 57,186 | $ 75,981 | $ 31,858 | $ 13, |
| Warranty/other | 60,597 | 84,736 | 45,578 | 33,494 | 17, |
| Total revenue | $ 153,516 | $ 141,922 | $ 121,559 | $ 65,352 | $ 30, |
| Deferred Revenue: | | | | | |
| Membership products | 114,184 | 130,922 | 159,481 | 89,812 | 44, |
| Warranty/other | 18,377 | 38,211 | 28,999 | 32,206 | 24, |
| Year-end deferred revenue | $ 132,561 | $ 169,133 | $ 188,480 | $ 122,018 | $ 68, |
| Year-end deferred acquisition costs | $ 48,647 | $ 42,091 | $ 37,149 | $ 24,482 | $ 21, |
| Total enrollments | 3,292 | 3,475 | 4,809 | 3,294 | 2, |
| Third-party enrollments | 1,825 | 1,398 | 1,675 | 1,336 | 1, |
| Active members | 5,094 | 5,775 | 6,067 | 4,902 | 3, |

(1) 1999 results include a permanent nondeductible tax difference of $50.8 million due to the extinguishment of the Series B Preferred Stock and 12% Senior Notes, and the cancellation of warrants in June 1999 with the issuance of its Series C Preferred Stock.

(2) "Book value" is calculated assuming conversion of preferred stock.

(3) "Delinquency ratio" represents credit card loans that were at least 30 days contractually past due at year-end as a percentage of year-end owned credit card loans. The decrease in delinquencies as of December 31, 2002 versus December 31, 2001 primarily reflects the sale of approximately $120 million delinquent receivables during September and December 2002.

(4) "Net charge-off ratio" reflects actual principal amounts charged-off, less recoveries, as a percentage of average credit card loans. The net charge-off ratio also includes a $101.5 million charge-off of loans transferred to "held for sale."

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The consolidated statements of income for the years ended December 31, 2002, 2001 and 2000 and the consolidated balance sheets as of December 31, 2002 and 2001 have been restated. See Note 2 - restatements on page XX for further discussion.

YEAR ENDED DECEMBER 31, 2002 COMPARED TO YEAR ENDED DECEMBER 31, 2001

Net loss applicable to common stockholders for the year ended December 31, 2002 was $39.6 million, or ($.66) per diluted share, down from net income applicable to common stockholders of $125.3 million, or $1.61 per diluted share in 2001. The decrease in net income is primarily due to a $326.9 million reduction in securitization income from 2001, caused by a 205 basis point reduction in excess spread due to higher default rates in the Metris Master Trust (Metris Master Trust or Master Trust). The annual principal default rate in the Master Trust during 2002 was 16.4% compared to 13.2% in 2001.

Net interest income decreased from $202.9 million for the year ended December 31, 2001 to $125.9 million for year ended December 31, 2002. The decrease is due to a decrease in average interest-earning assets of $170.4 million and a 310 basis point reduction in net interest margin. The decrease in margin is primarily due to a 390 basis point decrease in yield on credit card loans resulting from a $404.9 million reduction in average credit card loans and a 50 basis point reduction in the prime rate during the past year. Additionally, there was a shift in the mix of assets from higher yielding credit card loans to lower yielding investments. For the year ended December 31, 2002, 69.1% of our average interest-earning assets were in credit card loans, compared to 83.0% for the year ended December 31, 2001.

The provision for loan losses was $219.8 million in 2002 compared to $461.1 million in 2001. The decrease relates to the estimated required balance in the allowance for loan losses to cover probable losses inherent in our loan portfolio under current conditions. The size of the credit card loan portfolio, net principal charge-offs, recent delinquency and collection trends, and current economic conditions were factors considered by management in determining the necessary balance in the allowance for loan losses. Average credit card loans decreased to $1.3 billion in 2002 from $1.7 billion in 2001. The net principal charge-off rate was 24.9% in 2002 compared to 12.3% in 2001. The increase in the net principal charge-off rate is partially due to the sale of approximately $120 million of delinquent receivables in 2002. The sale resulted in a charge-off of $101.5 million. The weak economic environment and the effects of the Company's 2001 credit line increase program on the severity of credit losses also adversely affected the net charge-off rate.

Other operating income decreased $438.0 million, or 34%, to $835.4 million for the year ended December 31, 2002. This decrease was primarily due to a $326.9 million decrease in securitization income to $323.5 million in 2002. The decrease in securitization income was primarily due to an unfavorable change in the market value adjustment of $370.1 million and a reduction of $58.5 million in interest-only revenue based on the performance of the underlying assets. These changes were partially offset by an increase of $63.4 million in gains on asset replenishment and an $83.7 million increase in discount accretion income. Servicing income on securitized/sold receivables of $195.2 million increased $36.1 million over 2001. The increase in servicing income was due to the increase in securitized credit card receivables due to the transfer of approximately $2.3 billion of receivables from Direct Merchants Bank to the Master Trust. Credit card fees, interchange and other credit card income decreased to $163.2 million in 2002, compared to $322.0 million in 2001. The decrease in credit card fees, interchange and other credit card income is due to the reduction of our owned credit

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card portfolio. In addition, we also amended the Master Trust core transaction documents, which resulted in interchange income earned on receivables held by the Master Trust to be recorded as contribution to the excess spread earned, effective May 2002. In 2002, $44.3 million of interchange income was earned by the Master Trust. Enhancement services revenue increased 8.2% to $153.5 million

due primarily to increased active enrollments in various membership products. These increases were partially offset by a decrease in ServiceEdge(R) revenue due to the run-off of the ServiceEdge(R) portfolio and a decrease in PurchaseShield(R) revenue due to decreased enrollments.

Other operating expenses increased to $741.2 million in 2002, compared to $727.3 million in 2001. This increase was primarily due to $27.7 million of asset impairments and lease write-offs and a $14.1 million increase in credit protection claims expense, partially offset by $14.6 million in lower employee compensation expenses. During 2002, we recorded approximately $17.1 million of write-downs of excess property, equipment, operating leases, and the pending sale of our Arizona building, approximately $7 million of marketing and origination costs on our retail note program and a $10.6 million write-down of portfolios of charged-off loans purchased in 2001 and 2000.

CRITICAL ACCOUNTING POLICIES

The Company's accounting policies are identified on pages 55-63 of this Report, the most significant of which are our determination of the allowance for loan losses, valuation of retained interests in loans securitized, and accounting for deferred acquisition costs and deferred revenue on enhancement services products.

Allowance for loan losses

We maintain an allowance for loan losses sufficient to absorb 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 and time since solicitation (vintage pools), and estimate (based on historical experience and existing economic conditions) the dollar amount of principal, accrued finance charges and fees in each 30-day delinquency bucket that will not be collected and, therefore, "roll" into the next 30-day bucket and ultimately charge-off. We then aggregate these pools into prime and subprime portfolios based on the prescribed FICO score cuts, and into several other groups such as credit counseling and payment alternative receivables. We also isolate individual pools subsequent to solicitation when the credit risk associated with the pools includes higher risk segments, such as our secured card program, accounts that are over their credit limit by more than 10% and other programs as deemed necessary. We separately analyze the reserve requirement on each of these groups or portfolios. The impact on the allowance for loan losses for accounts in suspended status under our debt waiver benefits is included in the vintage pool roll-rate analysis.

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 loss and bankruptcy losses.

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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 changes 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."

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.

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 interest 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 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.

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 December 31, 2002 and 2001 were $73.2 million and $79.4 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.

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 $3.7 million for the year ended December 31, 2002. All other debt waiver acquisition costs are expensed as incurred. Deferred debt waiver acquisition costs were $2.6 million as of December 31, 2002.

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 $55.4 million, $28.0 million and $19.8 million for the years ended December 31, 2002, 2001 and 2000, respectively. All other membership acquisition costs are expensed as incurred. Deferred membership acquisition costs were $66.9 million and $66.7 million as of December 31, 2002 and 2001, respectively.

Warranty Products

Qualifying warranty acquisition costs are deferred and charged to expense as warranty product fees are recognized. Those incremental direct acquisition costs, which are a result of a contract that is not consummated, 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 negotiating 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 $12.8 million, $15.9 million, and $10.4 million for the years ended December 31, 2002, 2001, and 2000, respectively. All other warranty acquisition costs are expensed as incurred. Deferred warranty acquisition costs amount to $3.0 million and $12.7 million as of December 31, 2002 and 2001, respectively.

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. Direct Merchants Bank records deferred revenue when the debt waiver customer is billed. For customers whose accounts are funded on balance sheet, revenue is recognized in the month following the completion of the of the cancellation period, which is one month. Cash flows related to debt waiver on receivables sold to the Metris Master Trust are included in the valuation of the interest-only strip receivable. 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 $8.2 million as of December 31, 2002, compared to $5.2 million as of December 31, 2001.

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 December 31, 2002 on the membership program products were $22.0 million compared to $38.7 million as of December 31, 2001. Cancellation reserves were $19.5 million and $29.6 million for the years ended December 31, 2002 and 2001, respectively. Revenues recorded for membership products are included in the statements of income under "enhancement services revenues" and were $92.9 million, $57.2 million and $76.0 million for the years ended December 31, 2002, 2001 and 2000, respectively. Unearned revenues on membership program products are recorded in the consolidated balance sheets in "deferred income." Unearned revenues as of December 31, 2002 were $114.2 million compared to $130.9 million as of December 31, 2001. Reserves for pending and incurred but not reported claims, included in "accrued expenses and other liabilities," were $0.1 million as of December 31, 2002, compared to $0.2 million as of December 31, 2001.

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 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 December 31, 2002 on the warranty products were $3.8 million compared to $7.0 million as of December 31, 2001. Cancellation reserves were $5.3 million and $6.2 million for the years ended December 31, 2002 and 2001, respectively. Unearned revenues on warranty products are recorded in the consolidated balance sheets in "deferred income. " Unearned revenues as of December 31, 2002 were $17.6 million compared to $33.8 million as of December 31, 2001. Reserves for pending and incurred but reported claims, included in "accrued expenses and other liabilities," were $0.7 million as of December 31, 2002, compared to $0.5 million as of December 31, 2001.



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 2 provides an analysis of interest income and expense, net interest spread, net interest margin and average balance sheet data for the years ended December 31, 2002, 2001 and 2000.

TABLE 2: ANALYSIS OF AVERAGE BALANCES, INTEREST AND AVERAGE YIELDS AND RATES

| | YEAR ENDED DECEMBER 31, | | | |
|---|---|---|---|---|
| | 2002 | | | 2001 |
| (Dollars in thousands) | Average | | Yield/ | Average |

| | Balance | Interest | Rate | Balance | Inte |
|---|---|---|---|---|---|
| ASSETS: | | | | | |
| Interest-earning assets: | | | | | |
| Federal funds sold | $ 23,750 | $ 403 | 1.7% | $ 63,981 | $ |
| Short-term investments | 560,891 | 10,121 | 1.8% | 286,221 | 1 |
| Credit card loans | 1,305,127 | 218,878 | 16.8% | 1,709,989 | 35 |
| Total interest-earning assets | $ 1,889,768 | $ 229,402 | 12.1% | $ 2,060,191 | $ 36 |
| Other assets | 1,696,174 | -- | -- | 2,089,242 | |
| Allowance for loan losses | (251,092) | -- | -- | (245,587) | |
| Total assets | $ 3,334,850 | -- | -- | $ 3,903,846 | |
| LIABILITIES AND EQUITY: | | | | | |
| Interest-bearing liabilities: | | | | | |
| Deposits | $ 1,406,022 | $ 68,740 | 4.9% | $ 2,110,967 | $ 12 |
| Debt | 380,728 | 34,776 | 9.1% | 379,159 | 3 |
| Total interest-bearing liabilities | $ 1,786,750 | $ 103,516 | 5.8% | $ 2,490,126 | $ 16 |
| Other liabilities | 431,522 | -- | -- | 402,147 | |
| Total liabilities | 2,218,272 | -- | -- | 2,892,273 | |
| Stockholders' equity | 1,116,578 | -- | -- | 1,011,573 | |
| Total liabilities and equity | $ 3,334,850 | -- | -- | $ 3,903,846 | |
| Net interest income and interest margin (1) | -- | $ 125,886 | 6.7% | -- | $20 |
| Net interest rate spread (2) | -- | -- | 6.3% | -- | |
| Return on average assets | | | N/A | | |
| Return on average total equity | | | N/A | | |

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

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



TABLE 2: ANALYSIS OF AVERAGE BALANCES, INTEREST AND AVERAGE YIELDS AND RATES (CONTINUED)

| Table changes (Dollars in thousands) | YEAR ENDED DECEMBER 31, 2000 | | |
|---|---|---|---|
| | Average Balance | Interest | Yield/ Rate |
| ASSETS: | | | |
| Interest-earning assets: | | | |
| Federal funds sold | $ 144,780 | $ 9,139 | 6.3% |

| | | | |
|---|---|---|---|
| Short-term investments | 78,697 | 4,710 | 6.0% |
| Credit card loans | 614,991 | 106,549 | 17.3% |
| Total interest-earning assets | $ 838,468 | $ 120,398 | 14.4% |
| Other assets | 2,068,537 | -- | -- |
| Allowance for loan losses | (80,352) | -- | -- |
| Total assets | $ 2,826,653 | -- | -- |
| LIABILITIES AND EQUITY: | | | |
| Interest-bearing liabilities: | | | |
| Deposits | $ 1,317,718 | $ 89,560 | 6.8% |
| Debt | 354,204 | 43,446 | 12.3% |
| Total interest-bearing liabilities | $ 1,671,922 | $ 133,006 | 8.0% |
| Other liabilities | 395,078 | -- | -- |
| Total liabilities | 2,067,000 | -- | -- |
| Stockholders' equity | 759,653 | -- | -- |
| Total liabilities and equity | $ 2,826,653 | -- | -- |
| Net interest income and interest margin (1) | -- | $ (12,608) | (1.5)% |
| Net interest rate spread (2) | -- | -- | 6.4% |
| Return on average assets | | | 6.6% |
| Return on average total equity | | | 24.5% |

Net interest income decreased from $202.9 million for the year ended December 31, 2001 to $125.9 million for year ended December 31, 2002. The decrease is due to a decrease in average interest-earning assets of $170.4 million and a 310 basis point reduction in net interest margin. The decrease in margin is primarily due to a 390-basis-point decrease in yield on credit card loans resulting from a $404.9 million reduction in average credit card loans and retained interests in securitized loans, and a 50-basis-point reduction in the Prime rate during the past year. As of December 31, 2002, 69.1% of our interest-earning assets were in credit card loans compared to 83.0% as of December 31, 2001.

Risk-Based Pricing

Net interest income is affected by changes in the average interest rate earned on interest-earning assets and the average interest rate paid on interest-bearing liabilities, in addition to changes in the volume of interest-earning assets and interest-bearing liabilities. Table 3 presents the effects of changes in average volume and interest rates on individual financial statement line items on an owned basis.

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TABLE 3: CHANGES IN NET INTEREST INCOME

| Update table | YEAR ENDED DECEMBER 31, 2002 VS. 2001 | | | YEAR ENDED DECEMBER 31, 2001 VS. 2000 | | |
|---|---|---|---|---|---|---|
| | INCREASE | CHANGE DUE TO | | INCREASE | CHANGE DUE TO | |
| (Dollars in thousands) | (DECREASE) | VOLUME | RATE | (DECREASE) | VOLUME | RATE |

| | | | | | | |
|---|---|---|---|---|---|---|
| INTEREST INCOME: | | | | | | |
| Federal funds sold | $ (2,712) | $ (1,959) | $ (753) | $ (6,024) | $ (5,100) | $ (9 |
| Short-term investments | (2,252) | 11,874 | (14,126) | 7,663 | 12,420 | (4,7 |
| Credit card loans | (134,772) | (83,731) | (51,041) | 247,101 | 189,712 | 57,3 |
| Total interest income | (139,736) | (73,816) | (65,920) | 248,740 | 197,032 | 51,7 |
| Deposit interest expense | (59,176) | (42,717) | (16,459) | 38,356 | 53,914 | (15,5 |
| Other interest expense | (3,585) | 159 | (3,744) | (5,085) | 3,061 | (8,1 |
| Total interest expense | (62,761) | (42,558) | (20,203) | 33,271 | 56,975 | (23,7 |
| Net interest income | $ (76,975) | $ (31,258) | $ (45,717) | $ 215,469 | $ 140,057 | $ 75,4 |

CREDIT CARD RECEIVABLES

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 December 31, 2002, 49.5% of our outstanding receivables balance was from accounts that have been with us in excess of two years, and 22.0% 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 overlimit.

Delinquencies

Delinquencies not only have the potential to affect earnings in the form of net loan losses, but they also are costly in terms of the personnel and other resources dedicated to their resolution. It is our policy to continue to accrue interest and fee income on all credit card accounts, except in limited circumstances, until we charge-off the account. Beginning in November 2002, we stopped billing late 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 ("workout re-age") may receive a workout re-age upon entering the Debt Management Program. 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. Table 4 presents the delinquency trends of our credit card loan portfolio.



TABLE 4: LOAN DELINQUENCY

| (Dollars in thousands) | DECEMBER 31, 2002 | % OF TOTAL | DECEMBER 31, 2001 | % OF TOTAL | DECEMBER 31, 2000 | % OF TOTAL |
|---|---|---|---|---|---|---|
| Loan portfolio | $ 846,417 | 100% | $2,756,763 | 100% | $1,184,269 | 1 |
| Loans contractually delinquent: | | | | | | |
| 30 to 59 days | 1,673 | 0.2% | 87,603 | 3.2% | 27,837 | 2 |
| 60 to 89 days | 2,121 | 0.2% | 66,647 | 2.4% | 22,074 | 1 |
| 90 or more days | 4,082 | 0.5% | 123,528 | 4.5% | 39,257 | 3 |
| Total | $ 7,876 | 0.9% | $ 277,778 | 10.1% | $ 89,168 | 7 |

The decrease in delinquencies as of December 31, 2002 versus December 31, 2001 primarily reflects the sale of approximately $120 million delinquent receivables during September and December 2002.

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 income statement line item at the time of charge-off. We charge-off and take accounts as a loss either within 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 $61.5 million, representing 17.8% of total gross charge-offs as of December 31, 2002 and $76.3 million, representing 27.8% of total gross charge-offs as of December 31, 2001. 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 accounts. 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 presents our net charge-offs for the periods indicated as reported in the consolidated financial statements:

TABLE 5: NET CHARGE-OFFS

| | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| (Dollars in thousands) | | | |

| | | | |
|---|---|---|---|
| Average credit card loans outstanding | $1,305,127 | $1,709,989 | $ 614,991 |
| Net charge-offs | 325,351 | 209,779 | 59,679 |
| Net charge-off ratio | 24.9% | 12.3% | 9.7% |

Net charge-offs for the year ended December 31, 2002 increased $115.6 million over the year ended December 31, 2001. The increase is due to a $101.5 million charge-



off for receivables that were sold during the year. The net charge-off ratio increased from 12.3% to 24.9% due to the sale of the delinquent receivables, the weak economic environment and the impact of the Company's 2001 credit line increase program on the severity of credit losses.

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.

The economy has exhibited a significant slowdown over the last two years. Some of the actions we are taking to mitigate this slowdown include expanding our collections strategies to aggressively address any potential delinquency increases and utilizing our recovery staff to work on precharge-off receivables. 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 Management Programs was $34.7 million or 4.1% of total credit card loans as of December 31, 2002, compared to $129.9 million or 5% of total credit card loans as of December 31, 2001.

The provision for loan losses for the year ended December 31, 2002, totaled $219.8 million compared to a provision of $461.1 million in 2001. The decrease in the provision for loan losses in 2002 compared to 2001 reflects the decrease in credit card loans due to the transfer of approximately $2.3 billion of receivables from Direct Merchants Bank to the Master Trust.

The allowance for loan losses was $90.3 million as of December 31, 2002, compared to $460.2 million as of December 31, 2001. In our previously filed 2002 Form 10-K, our "Allowance for Loan Losses" was $410.2 million at December 31, 2001 since 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 to reflect this transfer occurring during the fourth quarter of 2001.

Our roll-rate models, including management contingency, indicated our required allowance for loan losses was in the range of $75 million to $90 million as of December 31, 2002, compared to $410 million to $460 million as of December 31, 2001. The ratio of allowance for loan losses to period-end credit card loans was 10.7% at December 31, 2002, compared to 16.7% at December 31, 2001. The allowance for loan losses as a percentage of 30-day plus receivables was 1,146.7% at December 31, 2002, compared to 165.7% at December 31, 2001. The increase in the allowance as a percentage of credit card loans and the increase in allowance as a percentage of 30-day plus receivables is primarily due to the

sale of approximately $120 million of delinquent receivables during 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"). Credit card receivables 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.

The following summarizes our "Retained interests in loans securitized" as of December 31, 2002 and December 31, 2001.

TABLE 6: RETAINED INTERESTS IN LOANS SECURITIZED

| (In thousands): | DECEMBER 31, 2002 | DECEMBER 31, 2001 |
| --- | --- | --- |

| | | |
|---|---|---|
| Contractual retained interests | $ 685,197 | $ 571,715 |
| Excess transferor's interests | 57,447 | 30,836 |
| Interest-only strip receivable | 13,882 | 214,707 |
| Spread accounts receivable | 51,500 | 42,301 |
| Retained interests in loans securitized | $ 808,026 | $ 859,559 |

"Retained interests in loans securitized" decreased by $51.5 million between December 31, 2001, and December 31, 2002, to $808.0 million. The decrease is primarily due to a decrease of $200.8 million in interest-only strip receivable offset by a $113.5 million increase in contractual retained interests, a $26.6 million increase in excess transferor's interests, and a $9.2 million increase in spread accounts receivable.

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The increase in the contractual retained interests is primarily due to a $1.3 billion increase in securitized receivables from December 31, 2001 to December 31, 2002. The interest-only strip receivable decreased to $13.9 million as of December 31, 2002, from $214.7 million as of December 31, 2001, due to lower projected excess spreads from the receivables held in the Metris Master Trust. The projected excess spreads have decreased primarily due to higher expected principal default rates partially offset by lower cost of funds. Spread accounts receivable increased over December 31, 2001, as 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 22 through 29.

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. The significant assumptions used for estimating the fair value of the retained interests in loans securitized are as follows:

| | DECEMBER 31, 2002 | DECEMBER 31, 2001 |
|---|---|---|
| Monthly payment rate | 6.7% | 6.3% |
| Gross yield (1) | 26.0% | 25.4% |
| Annual interest expense and servicing fees | 4.0% | 5.5% |
| Annual gross principal default rate | 21.7% | 16.6% |
| Discount rate (2): | | |
| Contractual retained interests | 16.0% | 12.0% |
| Excess transferor's interests | 16.0% | 12.0% |
| Interest-only strip receivable | 30.0% | 25.0% |
| Spread accounts receivable | 16.0% | 12.0% |

(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) The discount rates used in the retained interest valuation take into consideration the uncertainty inherent in the portfolio. The deterioration in credit quality and overall performance of the Metris Master Trust in 2002 create a higher risk to future cash flows. Based on the increased risk in the portfolio, the discount rates were increased during 2002.

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At December 31, 2002, 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 VALUE | |
|---|---|---|
| | 10% ADVERSE CHANGE | 20% ADVERSE CHANGE |
| Annual discount rate | $ 24.3 | $ 47.4 |
| Monthly payment rate | 183.7 | 425.5 |
| Gross yield | 172.1 | 362.1 |
| Annual interest expense and servicing fees | 26.0 | 59.6 |
| Annual gross principal default rate | 135.6 | 278.5 |

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.

OTHER OPERATING INCOME

Other operating income contributed 87% and 86% of total revenues for both of the years ended December 31, 2002 and 2001, respectively. Other operating income decreased $438.0 million for the year ended December 31, 2002 over 2001.

Securitization income decreased $326.9 million to $323.5 million in 2002. The decrease was primarily due to a decrease in fair value adjustments of $370.1 million and a decrease in interest-only revenue of $58.5 million, both of which are primarily due to deteriorating performance in the Metris Master Trust and the increase in discount rates noted on page 20. In addition, transaction and other costs increased by $35.2 million during the year. These changes were partially offset by decreases in net losses on securitization of $53.4 million and an $83.7 million increase in accretion income due to the change in discount rates. The following summarizes "Securitization income" for the years ended December 31, 2002, December 31, 2001 and December 31, 2000.

| | DECEMBER 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| Loss on new securitization of receivables to the Metris Master Trust | $ (70,578) | $ (60,574) | $ (52,406) |
| (Loss) gain on replenishment of receivables to | | | |

| | | | |
|---|---|---|---|
| the Metris Master Trust | 28,706 | (34,672) | (24,816) |
| Discount accretion | 305,327 | 221,670 | 279,500 |
| Change in fair value | (342,080) | 28,069 | (97,946) |
| Interest-only revenue | 452,268 | 510,806 | 566,690 |
| Transaction and other costs | (50,126) | (14,899) | (26,565) |
| Securitization income | $ 323,517 | $ 650,400 | $ 644,457 |

Credit card fees, interchange and other credit card income was $163.2 million in 2002, a decrease of $158.8 million from 2001. The decrease is primarily due to the reduction in average credit card receivables due to the transfer of approximately $2.3 billion of receivables to the Master Trust during 2002. In addition, we amended the Master Trust core transaction documents, which resulted in interchange income earned on



receivables held by the Master Trust to be recorded as securitization income, effective May 2002. In 2002, $44.3 million of interchange income was earned by the Master Trust.

Enhancement services revenues increased by $11.6 million for the year ended December 31, 2002. The increase was primarily due to increased active enrollments in various membership products. These increases were partially offset by a decrease in ServiceEdge(R) revenue due to the run-off of the ServiceEdge(R) portfolio, and a decrease in PurchaseShield(R) revenue due to decreased enrollments. Table 7 presents the breakdown of revenues and active memberships for our enhancement services products.

TABLE 7: ENHANCEMENT SERVICES REVENUES AND ACTIVE MEMBERSHIPS (Dollars in thousands)

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| Revenues | | | |
| Membership Program Products | $ 92,919 | $ 57,186 | $ 75,981 |
| Warranty / Other | 60,597 | 84,736 | 45,578 |
| Total | $153,516 | $141,922 | $121,559 |

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| Active Memberships | | | |
| Membership Program Products | 3,248 | 2,856 | 3,335 |
| Warranty / Other | 1,846 | 2,919 | 2,732 |
| Total | 5,094 | 5,775 | 6,067 |

====== ====== ======

OTHER OPERATING EXPENSE

Total other operating expenses for the year ended December 31, 2002 increased $13.9 million over 2001. Credit card account and other product solicitation and marketing expenses decreased $14.7 million over 2001. Credit protection claims expense increased $14.1 million, reflecting higher claims paid on debt waiver death benefits and interest forgiven, as well as an increase in our estimate of unreported claims as of the balance sheet date. As of December 31, 2002, we had a debt waiver total covered balance of $2.4 billion, compared to $2.8 billion as of December 31, 2001. Employee compensation decreased $14.6 million for the year ended December 31, 2002, due to decreased staffing needs and fringe benefits. Other expenses increased $10.5 million.

During 2002, we recorded approximately $17.1 million of write-downs of excess property, equipment, operating leases, and the pending sale of our Arizona building. In addition, we recorded a $10.6 million write-down on portfolios of charged-off loans purchased in 2001 and 2000. The book value of these portfolios was $3.4 million as of December 31, 2002, compared to $20.1 million as of December 31, 2001.

DERIVATIVE ACTIVITIES

We use derivative financial instruments for the purpose of managing our exposure to interest rate risks.

MRI enters into interest rate cap transactions related to each asset-backed securitization transaction. MRI assigns all of its right, title, and interest under the interest rate cap agreement to the Trustee of the Metris Master Trust for the benefit of the holders of securities issued by the Metris Master Trust. The purpose of the interest rate cap is to effectively limit the interest exposure of the Metris Master Trust for each individual series to a maximum based upon the LIBOR rate.



The interest rate caps do not meet the criteria for hedge accounting treatment. The change in the fair value of the caps is included in the consolidated income statement under "Securitization Income." For the year ended December 31, 2002 we recognized expense of $22.6 million from the mark-to-market adjustments on the interest rate caps. For the year ended December 31, 2001, excluding the cumulative effect of accounting change, we recognized income of $10.1 million from the mark-to-market adjustments on interest rate caps.

We entered into interest rate swap transactions through Direct Merchants Bank. The swaps were used to convert a portion of the fixed rate certificates of deposit ("CDs") to variable rate CDs, and thus hedge the fair market value of the CDs. The CDs expose us to variability in the fair value in rising or declining interest rate environments. By converting the fixed payment to a variable payment, the interest rate swaps reduce the variability of the fair market value of the CDs. As of December 31, 2002, there were no interest rate swaps outstanding. As of December 31, 2001, there was one swap outstanding with a fair value of $3.3 million.

As of the adoption of SFAS No. 133 or their inception, all swaps were designated as fair value hedges. Changes in the value of the swaps are recognized in income, in the period in which the change in value occurred. In addition, changes in the value of the CDs, to the extent they are attributable to the risk being hedged, are simultaneously recognized in income. Any

difference between the fair value change in the swaps versus the fair value change in the related hedged CDs was considered to be the "ineffective" portion of the hedge. The ineffective portion of the swap is recorded as an increase or decrease in income.

During 2002 and 2001, all swaps were sold. At the date of sale, the swap and the related CDs were valued, and a gain or loss was recognized for the difference between the change in fair value of the swap and the change in fair value of the CDs. The cumulative amount recorded as an adjustment to the value of the CDs is being amortized over the life of the CDs as an adjustment to interest expense. Additionally, $3.5 million was recognized as income in 2001 related to the ineffective portion of the swaps.

The adoption of SFAS No. 133, resulted in a one-time, non-cash, after-tax charge to earnings of $14.2 million, reflected as a "Cumulative effect of accounting change" in the consolidated statements of income for the year ended December 31, 2001.

## BALANCE SHEET ANALYSIS

### Cash and Cash Equivalents

Cash and cash equivalents increased $198.6 million to $580.2 million as of December 31, 2002, compared to $381.6 million as of December 31, 2001. The increase is due to the transfer of assets from Direct Merchants Bank to the Master Trust, which created excess cash at Direct Merchants Bank.

### Credit Card Loans

Credit card loans were $846.4 million as of December 31, 2002 compared to $2.76 billion as of December 31, 2001. The $1.9 billion decrease is primarily a result of the transfer of $2.3 billion of receivables from Direct Merchants Bank to the Master Trust.



### Deposits

Deposits decreased $1.2 billion to $892.8 million as of December 31, 2002, from $2.1 billion as of December 31, 2001. The decrease relates to a shift in funding from CDs to off-balance sheet asset-backed securitizations.

Under the OCC operating agreement, the Company has agreed to reduce receivables at Direct Merchants Bank to no more than $550 million by December 31, 2003, and to zero by December 31, 2004. As a result, we do not anticipate issuing certificates of deposit in the foreseeable future.

### Debt

Debt decreased from $647.9 million in 2001 to $357.6 million in 2002 due to the paydown of a warehouse financing arrangement entered into by Direct Merchants Bank in June 2001 that was accounted for as a collateralized financing.

### Deferred Income

Deferred income decreased to $143.1 million as of December 31, 2002, compared to $188.7 million as of December 31, 2001. The decrease primarily relates to a shift from annual-billed to monthly-billed enhancement services products and the run-off of deferred revenues associated with our ServiceEdge(R) product.

Stockholders' Equity

Stockholders' equity was $1.1 billion as of December 31, 2002, a decrease of $50.7 million from December 31, 2001. The decrease primarily results from a net loss of $39.6 million, cash dividends of $3.7 million and $45.3 million of stock repurchases under our stock repurchase program, partially offset by an increase of $36.7 million in convertible preferred stock, $3.0 million of stock issuances under employee benefit plans, and the forfeiture of $4.8 million of restricted stock.

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 9 summarizes our funding and liquidity as of December 31, 2002 and 2001:

TABLE 9: LIQUIDITY, FUNDING AND CAPITAL RESOURCES

| | DECEMBER 31, 2002 | | | DECEMBER 31, 2001 | | |
|---|---|---|---|---|---|---|
| | DMCCB | OTHER | CONSOLIDATED | DMCCB | OTHER | CONSOLID |
| Cash and due from banks | $ 58,399 | $ 4,414 | $ 62,813 | $ 106,479 | $ 3,333 | $ 109, |
| Federal funds sold | 88,000 | -- | 88,000 | 243,772 | -- | 243, |
| Short-term investments | 322,039 | 107,380 | 429,419 | 50 | 28,005 | 28, |
| Total cash and cash equivalents | $ 468,438 | $ 111,794 | $ 580,232 | $ 350,301 | $ 31,338 | $ 381, |



| | DECEMBER 31, 2002 | | DECEMBER 31, 200 | |
|---|---|---|---|---|
| ON-BALANCE SHEET FUNDING | OUTSTANDING | UNUSED CAPACITY | OUTSTANDING | UNUS CAPAC |
| Bank conduit - June 2003 | $ -- | $ -- | $ 292,000 | $ 10 |
| Revolving credit line -July 2003 | -- | 162,696 | -- | 16 |
| Term loan - June 2003 | 100,000 | N/A | 100,000 | |
| 10% senior notes - November 2004 | 100,000 | N/A | 100,000 | |
| 10.125% senior notes - July 2006 | 146,824 | N/A | 145,924 | |
| Other | 10,825 | N/A | 9,980 | |
| Deposits - various maturities through February 2007 | 892,754 | N/A | 2,058,008 | |
| Subtotal | 1,250,403 | 162,696 | 2,705,912 | 27 |

| | | | | |
|---|---|---|---|---|
| OFF-BALANCE SHEET FUNDING | | | | |
| Metris Master Trust: | | | | |
| Term asset back securitizations - various maturities through January 2009 | 7,610,000 | -- | 7,459,250 | |
| Bank conduits - various maturities through June 2003 | 1,177,957 | 422,043 | 421,093 | 32 |
| Metris facility-March 2003 | 48,900 | 26,100 | 15,500 | 5 |
| Subtotal | 8,836,857 | 448,143 | 7,895,843 | 38 |
| Total | $10,087,260 | $ 610,839 | $10,601,755 | $ 66 |

During 2002 and 2001, we had net proceeds of approximately $0.9 billion and $1.8 billion, respectively, from sales of credit card loans to the Master Trust and the Metris facility referred to in the above table. We used cash generated from these transactions to reduce borrowings and to fund the credit card loan portfolio.

As of December 31, 2002 and 2001, we had $7.3 million and $5.3 million, respectively, of letters of credit issued under our revolving line of credit. Under our credit agreement, we need to maintain, among other items, minimum equity plus reserves to managed assets of 10%, minimum three-month average excess spread (on each individual series of securities issued under the Master Trust) of 1%, minimum equity of $685 million at December 31, 2002 and a ratio of equity plus allowance for loan losses and valuation allowance to managed 90-day plus delinquencies of 2.25. Furthermore, the Company has pledged certain assets as collateral on the credit agreement. As of December 31, 2002, and 2001 we were in compliance with all financial covenants under our credit agreement.



Our contractual cash obligations as of December 31, 2002 were as follows:

| | LESS THAN ONE YEAR | ONE TO THREE YEARS | FOUR TO FIVE YEARS | OVER FIVE YEARS | TOTAL |
|---|---|---|---|---|---|
| Long-term debt | $ 101,031 | $ 109,530 | $ 146,921 | $ 167 | $ 357,649 |
| Operating leases | 14,851 | 20,634 | 15,656 | 26,998 | 78,139 |
| Deposits | 388,965 | 256,277 | 247,512 | -- | 892,754 |
| Open-to-buy on credit card accounts | -- | -- | -- | -- | 12,009,893 |
| Total | $ 504,847 | $ 386,441 | $ 410,089 | $ 27,165 | $13,338,435 |

The following table presents the amounts, as of December 31, 2002, of off-balance sheet funding in the Master Trust and the Metris facility scheduled to amortize in future years. We base the amortization amounts on estimated amortization periods, which are subject to change based on the Master Trust and Metris facility performance:

| (In thousands) | |
|---|---|
| 2003 | $ 1,826,857 |
| 2004 | 2,260,000 |
| 2005 | 2,300,000 |
| 2006 | 1,250,000 |
| 2007 | 600,000 |
| Thereafter | 600,000 |
| Total | $ 8,836,857 |

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

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| (In thousands) | 2002 | | 2001 | | 200 |
| Gross yield (1) | $2,564,009 | 26.46% | $2,035,113 | 27.58% | $1,528,056 |
| Annual principal defaults | 1,587,095 | 16.38% | 972,348 | 13.18% | 632,763 |
| Net portfolio yield | 976,914 | 10.08% | 1,062,765 | 14.40% | 895,293 |
| Annual interest expense and servicing fees | 406,826 | 4.35% | 451,061 | 6.62% | 470,634 |
| Net excess spread (2) | $ 570,088 | 5.73% | $ 611,704 | 7.78% | $ 424,659 |

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

(2) The net excess spread on a cash basis for the Master Trust was 2.24% for the month ended February 28, 2003. The three-month average net excess spread on a cash basis was 1.91% as of February 28, 2003.

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 prospectus of each securitization transaction. The significant events are (i) one-month and three-month average excess spreads below certain levels, (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 triggers are related to

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the performance of the Master Trust, specifically the average of net excess

spread over a one to three-month period.

The following table illustrates the maximum amount of cash (as a percentage of outstanding securitized principal receivables) that could be held by the Master Trust as additional collateral if the one-month and three-month average excess spread of the Master Trust was within various ranges:

| Cash Basis Net Excess Spread | Maximum Restricted |
|---|---|
| Greater than 5.5% | -- |
| 5.1% - 5.5% | 0.5% - 1.0% |
| 4.6% - 5.0% | 0.5% - 1.5% |
| 4.1% - 4.5% | 2.0% - 2.5% |
| 3.6% - 4.0% | 2.5% - 3.0% |
| 3.1% - 3.5% | 2.5% - 4.0% |
| Less than 3.0% | 4.0% - 5.0% |

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 excess spread to be restricted in the Master Trust may not be achieved. During those periods, all excess spread normally released to 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 from the spread accounts. Based on the performance of our Master Trust, the amount of cash required to be restricted was $304 million at December 31, 2002 and $455 million at February 28, 2003. As of December 31, 2002, $29.1 million has been restricted from release in the Master Trust due to performance and $21.4 million has been restricted from release in the Master Trust due to corporate debt ratings. As of February 28, 2003, $62.1 million has been restricted from release in the Master Trust due to performance and $21.4 million has been restricted from release in the Master Trust due to corporate debt ratings (see page 27 for discussion of corporate debt ratings). We expect all cash basis excess spread to be restricted from release to us until 2004.

In the past, Direct Merchants Bank has issued jumbo CDs of $100,000 or more. As of December 31, 2002 and 2001, $0.9 billion and $2.1 billion of CDs were outstanding with original maturities ranging from six months to five years. These CDs pay fixed interest rates ranging from 1.1% to 7.6% and 2.4% to 7.6% at December 31, 2002 and 2001, respectively. Under the OCC operating agreement, the Company has agreed to reduce receivables at Direct Merchants Bank to no more than $550 million by December 31, 2003, and to zero by December 31, 2004. As a result, we do not anticipate issuing jumbo CDs in the foreseeable future.

The weighted-average interest rate on outstanding funding as of December 31, 2002 and 2001 was as follows:

| | DECEMBER 31, 2002 | DECEMBER 31, 2001 |
|---|---|---|
| Bank conduit-2003 | -- | 2.4% |
| Term loan-2003 | 4.7% | 5.4% |
| Senior notes-2004 | 10.0% | 10.0% |
| Senior notes-2006 | 11.4% | 11.5% |
| Other | 8.7% | 8.9% |
| Deposits | 5.1% | 5.1% |

| | | |
|---|---|---|
| Master Trust | 2.1% | 3.0% |
| Metris facility | 1.9% | 2.3% |



The 70 basis point decrease in the weighted-average interest rate on the term loan and the 90 basis point decrease in the weighted-average interest rate on the Master Trust were primarily due to the decrease in LIBOR, which is the base rate for these funding vehicles, and the maturity of the 1997-1 asset-backed securitization, which had fixed rate funding at 6.9%, in April 2002. As the base rate, LIBOR decreased from 1.9% as of December 31, 2001, to 1.4% as of December 31, 2002.

The Company has $430.6 million of Series C Perpetual Convertible Preferred Stock outstanding which is held by affiliates of Thomas H. Lee Partners, L.P. (formerly, Thomas H. Lee Company) ("THL Partners"), a private equity firm, and is convertible into common shares at a conversion price of $12.42 per common share subject to adjustment in certain circumstances. The Series C Preferred Stock has a 9% dividend payable in additional shares of Series C Preferred Stock and will also receive any cash dividends paid on the Company's common stock on a converted basis. One share of Series C Preferred Stock is convertible into 30 shares of common stock, plus a premium amount designed to guarantee a portion of seven years' worth of dividends at a 9% annual rate. For conversions in 2002, the premium amount would be equal to approximately 54.4% of those future dividends. Assuming conversion of the Series C Preferred Stock into common stock, THL Partners would own approximately 40.5% of the Company on a diluted basis at December 31, 2002. So long as affiliates of THL Partners own at least 25% of the originally issued Series C Preferred Stock (or any shares of Common Stock issued upon conversion thereof), the holders of a majority of the then-outstanding shares of the Series C Preferred Stock are entitled to elect four members to MCI's Board of Directors. The Series C Preferred Stock may be redeemed by us in certain circumstances by paying 103% of the redemption price of $372.50 and all accrued dividends at the time of redemption. We also have the option to redeem the Series C Preferred Stock after December 9, 2008, without restriction by paying the redemption price of $372.50 and all accrued dividends at the time of redemption.

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 $14 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 receivables for tax purposes. Cumulatively through the year ended December 31, 2002, the Company has deferred more than $212 million in federal income tax under the OID rules.

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.

The Federal Reserve Act imposes various legal limitations on the extent to which banks that are members of the Federal Reserve System can finance or otherwise supply funds to certain of their affiliates. In particular, Direct Merchants Bank is subject to certain restrictions on any extensions of credit to MCI or its subsidiaries. Additionally, Direct Merchants Bank is limited in its

ability to declare dividends to MCI or its subsidiaries. Therefore, Direct Merchants Bank's investments in federal funds sold are generally not available for the general liquidity needs of the Company or its subsidiaries.

Since the later part of 2002, our corporate debt ratings, the Master Trust ratings and the ratings of Direct Merchants Bank have been downgraded. These



downgrades reflect the losses we experienced in 2002, as well as deteriorating performance in the Master Trust. These downgrades and any future downgrades will have a negative effect on our ability to obtain funding. In addition, access to funding may be at a higher cost and on terms less favorable to us than those previously available as a result of the deterioration in our financial performance and asset quality.

Our deposits and secured/unsecured debt are rated by Moody's Investor Services ("Moody's"), Standard & Poor's Rating Services ("S&P") and Fitch, Inc. ("Fitch"). Factors affecting the various ratings include the overall health of the global/national economy, specific economic conditions impacting the subprime consumer finance industry, and the overall financial performance of the Company, including earnings, credit losses, delinquencies, excess spreads in the Master Trust and our overall liquidity. Furthermore, certain of our term asset-backed securitizations require the restriction of cash if our corporate debt ratings go below certain levels. The table below illustrates the current debt ratings of MCI and Direct Merchants Bank:

| | MOODY'S | STANDARD & POOR'S | FITCH |
|---|---|---|---|
| METRIS COMPANIES INC. | | | |
| Senior unsecured debt | B3 | CCC+ | CCC |
| Credit facility | B2 | B- | CCC |
| DIRECT MERCHANTS BANK | Ba2 | | |
| Short-term deposits | | | B |
| Long-term deposits | Ba1 | | B |

Moody's, S&P and Fitch have a "negative outlook" for us and our debt ratings. The rating agencies cited concerns about our funding and liquidity challenges, earnings and asset quality.

During the first quarter of 2003, we continue to experience pressure on our liquidity position. As part of our commitment to meet the goals under our strategic plan, management is implementing measures to maintain strong levels of liquidity.

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 will replace conduits and warehouse facilities scheduled to mature during March through May 2003. Furthermore, these conduits will provide for the financing of a term asset-backed securitization that is scheduled to mature in July 2003. The availability of funding under these facilities is subject to various conditions, including a net reduction of receivables in the Master Trust and a minimum three-month average excess spread of 1%. In connection with the transactions, we also terminated our $170 million revolving line of credit.

On March 18, 2003 the Company and Direct Merchants Bank entered into an operating agreement with the OCC. 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 December 31, 2002, 52.9% of the Bank's credit card portfolio was 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 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 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.

- The operating agreement requires Direct Merchants Bank, a third-party depository bank and the OCC to execute a Liquidity Reserve Deposit Agreement ("LRDA") within 30 days of the effective date of the operating agreement.

Upon entering into the operating agreement, Direct Merchants Bank declared and paid a dividend of $155 million to us on March 19, 2003. Furthermore, the agreement allows Direct Merchants Bank to declare and pay future dividends, provided such dividends are in compliance with OCC regulations.

During the past fiscal year, we had in place a $270 million term loan and revolving credit facility. In connection with the conduit transactions discussed above, all availability under the $170 million revolving portion of this facility was terminated as of March 18, 2003, with the exception of the $7.3 million of outstanding letters of credit. Term loans of $100 million remain outstanding under the facility and mature on June 30, 2003. In order to

refinance the facility in part, on March 31, 2003, 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. The backup facility carries an interest rate of 12% per annum plus an option to earn an additional meaningful economic return based on the performance of the Company's managed receivables through December 31, 2004. The backup facility would be repayable in full on March 1, 2004. THL Fund IV's obligation to loan funds to the Company is subject to a number of conditions, including the requirement that the Company receive an opinion or opinions satisfactory to THL Fund IV that the new credit facility is fair, from a financial point of view to the Company and to the holders of the Company's outstanding notes. There can be no assurance that these conditions will be met.

As previously noted, during 2003 we have contractual cash obligations of $505 million, off-balance sheet funding scheduled to amortize of $1.8 billion and will require funding for a $610 million term asset-backed securitization maturing in January 2004. In addition, we will need cash to fund new receivables, for the reduction of credit card loans at Direct Merchants Bank to no more than $550 million at December 31, 2003 (required under our operating agreement) and for general operating needs. We have historically utilized a variety of funding vehicles, as well as ongoing cash generated from operations, to finance credit card receivable growth, maturing debt obligations and general operating needs. During the next year we intend to shrink the size of the



credit receivables in the Master Trust by approximately $2.1 billion 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 we have adequate liquidity for meeting 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, 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 pay dividends to us in accordance with the national bank dividend provisions.

Direct Merchants Bank is subject to certain capital adequacy guidelines adopted by the OCC. At December 31, 2002 and 2001, Direct Merchants Bank's Tier 1 risk-based capital ratio, risk-based total capital ratio and Tier 1 leverage ratio exceeded the minimum required capital levels, and Direct Merchants Bank was considered a "well- capitalized" depository institution under regulations of the OCC, as illustrated in the table below.

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.

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

| | ACTUAL | | TO BE ADEQUATELY CAPITALIZED | | TO BE WELL CAPITALIZED | |
|---|---|---|---|---|---|---|
| As of December 31, 2002 | AMOUNT | RATIO | AMOUNT | RATIO | AMOUNT | RATI |
| Total capital (to risk-weighted assets) | $ 402,721 | 30.8% | $ 104,516 | 8.0% | $ 130,645 | 10. |
| Tier 1 capital (to risk-weighted assets) | 385,480 | 29.5% | 52,258 | 4.0% | 78,387 | 6. |
| Tier 1 capital (to average assets) | 385,480 | 24.7% | 62,381 | 4.0% | 77,977 | 5. |

| | ACTUAL | | TO BE ADEQUATELY CAPITALIZED | | TO BE WELL CAPITALIZED | |
|---|---|---|---|---|---|---|
| As of December 31, 2001 | AMOUNT | RATIO | AMOUNT | RATIO | AMOUNT | RATI |
| Total capital (to risk-weighted assets) | $ 334,468 | 13.1% | $ 204,533 | 8.0% | $ 255,666 | 10. |
| Tier 1 capital (to risk-weighted assets) | 297,167 | 11.6% | 102,266 | 4.0% | 153,400 | 6. |
| Tier 1 capital (to average assets) | 297,167 | 10.8% | 109,921 | 4.0% | 137,401 | 5. |

FFIEC guidelines indicate that an institution with a concentration in subprime lending should hold one and one-half to three times the normal minimum capital required. The OCC has regulatory authority to evaluate the safety and

soundness of Direct Merchants Bank under these more stringent guidelines. The OCC has required Direct Merchants Bank, to maintain two times the normal minimum capital on those credit card loans that qualify as subprime loans (FICO score of 660 and below) and maintain a minimum capital ratio of 10%. Under these guidelines, Direct Merchants Bank's total capital ratio as of December 31, 2002 was 22.8%.

NEWLY ISSUED PRONOUNCEMENTS

On January 1, 2002, we adopted SFAS No. 142, "Goodwill and Other Intangible Assets," which establishes accounting and reporting standards for goodwill and other intangible assets. It requires enterprises to test these assets for impairment upon the adoption of SFAS No. 142, as well as on an annual basis, and reduce the carrying amount of these assets if they are found to be impaired. Goodwill and other intangible assets with an indefinite useful life will no longer be amortized. Other intangible assets with an estimable useful life will continue to be amortized over their useful



lives. The adoption of the standard did not have a material impact on our financial statements.

On January 1, 2002, we adopted SFAS No. 144, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," which supersedes FASB Statement No. 121, and provides a single accounting model for long-lived assets to be disposed of. The adoption of the standard did not have a material impact on our financial statements.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 62, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145 will require gains and losses on extinguishments of debt to be classified as income or loss from continuing operations rather than as extraordinary items as previously required under SFAS No. 4. SFAS No. 145 also amends SFAS No. 13 to require that certain modifications to capital leases be treated as a sale-leaseback and modifies the accounting for sub-leases when the original lessee remains a secondary obligor or guarantor. Accordingly, most gains or losses from extinguishments of debt for fiscal years beginning after May 15, 2002 shall not be reported as extraordinary. Upon adoption, any gain or loss on extinguishment of debt previously classified as an extraordinary item in prior periods presented must be reclassified to conform with the provisions of SFAS No. 145. SFAS No. 145's amendment and technical correction to SFAS No. 13 is effective for all transactions occurring after May 15, 2002. There was not a material impact on our financial statements upon adoption of SFAS No. 145.

In July 2002, FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." The statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when a liability is incurred. Under Issue No. 94-3, a liability for an exit cost as generally defined in Issue No. 94-3 was recognized at the date of an entity's commitment to an exit plan. The provisions of SFAS No. 146 are effective for exit or disposal activities that are initiated after December 31, 2002. We do not expect a material impact on our financial statements upon adoption of SFAS No. 146.

In November 2002, FASB issued Interpretation No. 45, "Guarantors

Accounting for Guarantees". The Interpretation requires certain guarantees to be recognized and initially measured at fair value. The interpretation applies to contracts or indemnification agreements that contingently require the guarantor to make payments to the guaranteed party based on changes in an underlying that is related to an asset, liability, or an equity security of the guaranteed party. The requirements of Interpretation No. 45 are effective for financial statements ending after December 15, 2002. The initial recognition and initial measurement provisions of the Interpretation are applied, on a prospective basis only, to guarantees issued after December 31, 2002, irrespective of the guarantor's fiscal year-end. There was not a material impact on our financial statements upon adoption of Interpretation No. 45.

In December 2002, 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 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. 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 December 2002, the FFIEC issued guidance on the accounting treatment of Accrued Interest Receivables ("AIR") related to credit card securitizations. AIR typically consists of a seller's retained interest in the investor's portion of the accrued and billed fees and finance charges and the right to finance charges accrued but not yet billed. The guidance requires AIR to be recorded on the balance sheet as a retained beneficial interest. Accordingly, we reclassified accrued but unbilled finance charges on our balance sheet from "other receivables due from securitizations, net" and "other assets" to "retained interests in loans securitized".

In January 2003, FASB issued SFAS No. 148 "Accounting for Stock-Based Compensation-Transition and Disclosure", which amends FASB Statement 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. There was not a material impact on our financial statements upon adoption of SFAS No. 148.

In January 2003, the FFIEC issued guidance with respect to account management, risk management, and loss allowance practices for institutions engaged in credit card lending. The guidance provides requirements for certain

operational and accounting policies which are designed to bring consistency in practice between institutions. At this time we are reviewing the impact of the guidance and there can be no assurance that adoption of the guidance will not have a material adverse effect on our financial condition.

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K/A 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 limitations: 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 no historical fact. Forward-looking statements may be identified by the use or terminology such as "may," "will," "believes," "does not believe," no reason to believe," expects," "plans," "intends," "estimates," "anticipated," or "anticipates" and similar expressions, as they relate to the Company or our management. Forward-looking statements are based on certain assumptions by management and are subject to risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements.



These risks and uncertainties include, but are not limited to, 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 payment, 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 described herein and in the original 10-K, including under the heading "Risk Factors" (pages 26-34 of the original 10-K), and are also discussed in other parts of this Report, including "Legal Proceedings" (page 35 of the original 10-K) and "Management's Discussion and Analysis of Financial Condition and Results of Operations" (pages 6-39 hereof). Although we have attempted to list comprehensively the major risks and uncertainties, other factors may in the future prove to be important in causing actual results to differ materially from those contained in any forward-looking statement. Readers are cautioned not to place undue reliance on any forward-looking statement, which speaks only as of the date thereof. We

undertake no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.

YEAR ENDED DECEMBER 31, 2001 COMPARED TO YEAR ENDED DECEMBER 31, 2000

Net income applicable to common stockholders for the year ended December 31, 2001 was $125.3 million, or $1.61 per diluted share, down from net income applicable to common stockholders of $154.3 million, or $2.01 per diluted share in 2000. The decrease in net income results from increases in provision for loan losses and other operating expense partially offset by increases in net interest income and other operating income.

The provision for loan losses was $461.1 million in 2001 compared to $164.8 million in 2000. The increase relates to the estimated required balance in the allowance for loan losses to cover probable inherent in our loan portfolio under current conditions. Increased credit card loans, increased net principal charge-offs, recent delinquency and collection trends, and current economic conditions were factors considered by management in determining the necessary balance in the allowance for loan losses. The net principal charge-off rate was 12.3% in 2001 compared to 9.7% in 2000. The delinquency ratio was 10.1% in 2001 compared to 7.5% in 2000.

Other operating income increased $193.2 million, or 18%, to $1.3 billion for the year ended December 31, 2001. This increase was comprised of an increase in credit card fees, interchange and other credit card income of $136.6 million, an increase in servicing income of $30.3 million, an increase in enhancement services revenues of $20.4 million, and an increase in securitization income of $5.9 million. The servicing income increase was caused by an increase of approximately $1.2 billion in average securitized receivables. The remaining increases were primarily due to the growth in total credit card accounts, an increase in outstanding receivables in the securitized



credit card loan portfolio, development of new third-party relationships and the creation of new products.

Other operating expenses increased to $727.3 million in 2001, compared to $599.1 million in 2000. This increase was primarily due to continued investments in our infrastructure in order to service the growth in our credit card loan portfolio, an increase in overall marketing expenditures and increased amortization on purchased portfolio premiums.

On January 1, 2001, we adopted Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," which establishes accounting and reporting standards for derivative instruments. SFAS 133 requires enterprises to recognize all derivatives as either assets or liabilities in the statement of financial position and to measure those instruments at fair value. Prior to SFAS No. 133, we amortized the costs of interest rate contracts on a straight-line basis over the expected life of the contract. The adoption of SFAS No. 133 resulted in a one-time, non-cash, after-tax charge to earnings of $14.2 million reflected as a "Cumulative effect of accounting change" in the consolidated statements of income for the year ended December 31, 2001.

During the quarter ended March 31, 2000 we adopted Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements," for our debt waiver products. This change resulted in a one-time, non-cash net charge to earnings of $0.5 million, which is reflected as a "Cumulative effect of accounting change" in the consolidated statements of income for the year ended

December 31, 2000. Because we have applied the provisions of this SAB to our membership programs since 1998, before the SEC formalized its guidance, we did not have to adjust our enhancement services revenues.



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.

TABLE 10: SELECTED OPERATING DATA - MANAGED BASIS

| | YEAR ENDED DECEMBER 31, | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | 2002 | 2001 | 2000 | 1999 | |
| SELECTED OPERATING DATA: | | | | | |
| Total credit card accounts | 3,929 | 4,929 | 4,464 | 3,680 | |
| Year-end loans | $ 11,420,186 | $ 11,991,784 | $ 9,345,631 | $ 7,343,272 | $ 5 |
| Year-end assets | 11,431,203 | 12,124,528 | 9,806,249 | 7,563,394 | 5 |
| Average loans | 11,850,927 | 10,419,280 | 8,081,638 | 6,053,811 | 4 |
| Average interest-earning assets | 12,435,568 | 10,769,482 | 8,305,115 | 6,190,267 | 4 |
| Average assets | 11,972,958 | 10,656,156 | 8,332,500 | 6,269,760 | 4 |
| Return on average assets | N/A | 2.3% | 2.3% | 1.0% | |
| Equity to managed assets | 9.3% | 9.4% | 9.0% | 8.2% | |
| Net interest margin (1) | 14.3% | 13.9% | 12.9% | 13.4% | |
| Delinquency ratio (2) | 11.0% | 9.4% | 8.2% | 7.6% | |
| Net charge-off ratio (3) | 15.5% | 10.9% | 9.6% | 9.0% | |

(1) Includes MCI's actual cost of funds plus all costs associated with asset securitizations, including the interest expense paid to certificate holders and amortization of the discount and fees.

(2) Delinquency ratio represents credit card loans that were at least 30 days contractually past due at year-end as a percentage of year-end managed loans.

(3) Net charge-off ratio reflects actual principal amounts charged-off, less recoveries, as a percentage of average managed credit card loans.

TABLE 11: MANAGED LOAN PORTFOLIO

| (Dollars in thousands) | DECEMBER 31, | | | |
|---|---|---|---|---|
| | 2002 | % OF TOTAL | 2001 | % OF TOTAL |
| Credit card loans | $ 846,417 | | $ 2,756,763 | |
| Receivables held in the Metris Master Trust | 10,573,769 | | 9,235,021 | |
| Total managed loan portfolio | $ 11,420,186 | | $ 11,991,784 | |
| Loans contractually Delinquent: | | | | |
| 30 to 59 days | 359,223 | 3.1% | 375,887 | 3.1 |
| 60 to 89 days | 285,448 | 2.5% | 274,278 | 2.3 |
| 90 or more days | 615,278 | 5.4% | 473,003 | 4.0 |
| Total | $ 1,259,949 | 11.0% | $ 1,123,168 | 9.4 |
| AVERAGE BALANCES: | | | | |
| Credit card loans | $ 1,305,127 | | $ 1,709,989 | |
| Receivables held in the Metris Master Trust | 10,545,800 | | 8,709,291 | |
| Total managed loan portfolio | $ 11,850,927 | | $ 10,419,280 | |
| Net charge-offs | $ 1,840,786 | 15.5% | $ 1,140,151 | 10.9 |

The 160-basis-point increase during 2002 in the managed delinquency rates over 2001 primarily reflects declining receivables, a deterioration in the economy and the impact of our 2001 credit line increase program. The credit line increase program added pressure to our cardholders due to increased average outstanding balances, which require higher monthly payments. This, along with a deteriorating economy, has made collection efforts more difficult, resulting in higher delinquencies.

Managed net charge-offs increased $700.6 million in 2002 primarily due to the impact of the 2001 credit line increase program and deterioration in the economy.

We charge-off bankrupt accounts within 60 days of formal notification. Charge-offs due to bankruptcies were $654.5 million, representing 33.7% of total managed gross charge-offs as of December 31, 2002 and $455.0 million, representing 36.0% of total managed gross charge-offs as of December 31, 2001. In addition to those bankrupt accounts that were charged-off, we received formal notification of $106.3 million and $58.7 million of managed bankrupt accounts as of December 31, 2002 and 2001, respectively.

Total managed loans decreased $571.6 million to $11.4 billion as of December 31, 2002, compared to $12.0 billion as of December 31, 2001. This was primarily due to a reduction in credit lines and tighter underwriting standards

implemented in 2002. The amount of credit card receivables in debt forbearance programs was $860.1 million or 7.5% of total managed loans as of December 31, 2002, compared with $837.2 million or 7.0% of managed loans as of December 31, 2001. All delinquent receivables in debt forbearance programs are included in Table 11.



TABLE 12: ANALYSIS OF AVERAGE BALANCES, INTEREST AND AVERAGE YIELDS AND RATES

| | YEAR ENDED DECEMBER 31, | | | | |
|---|---|---|---|---|---|
| | 2002 | | | | |
| (Dollars in thousands) | Average Balance | Interest | Yield/ Rate | Average Balance | In |
| MANAGED BASIS | | | | | |
| Credit card loans | $ 11,850,927 | $ 2,089,070 | 17.6% | $ 10,419,280 | $ 1 |
| Total interest-earning assets | 12,435,568 | 2,099,595 | 16.9% | 10,769,482 | 1 |
| Total interest-bearing liabilities | 10,420,532 | 321,981 | 3.1% | 9,234,217 | |
| Net interest income and interest margin (1) | -- | 1,777,614 | 14.3% | -- | 1 |
| Net interest rate spread (2) | -- | -- | 13.8% | -- | |

| | YEAR ENDED DECEMBER 31, | |
|---|---|---|
| | 2000 | |
| (Dollars in thousands) | Average Balance | Interest |
| MANAGED BASIS | | |
| Credit card loans | $ 8,081,638 | $ 1,582,503 |
| Total interest-earnings assets | 8,305,115 | 1,596,352 |
| Total interest-bearing liabilities | 7,209,068 | 521,477 |
| Net interest income and interest margin (1) | -- | 1,074,875 |
| Net interest rate spread (2) | -- | -- |

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

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

Managed net interest income for the year ended December 31, 2002 was $1.8 billion, compared to $1.5 billion for the same period in 2001. Net interest income consists primarily of interest earned on our credit card loans less interest expense on borrowing to fund the loans. The increase is due to a $1.7 billion increase in average interest-earning assets and a 40-basis-point

increase in net interest margin.



ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

METRIS COMPANIES INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(DOLLARS IN THOUSANDS, EXCEPT PER-SHARE DATA)

| | D |
|---|---|
| | 2002 (AS RESTATED) |
| ASSETS: | |
| Cash and due from banks | $ 62,8 |
| Federal funds sold | 88,0 |
| Short-term investments | 429,4 |
| Cash and cash equivalents | 580,2 |
| Credit card loans | 846,4 |
| Less: Allowance for loan losses | 90,3 |
| Net credit card loans | 756,1 |
| Retained interests in loans securitized | 808,0 |
| Property and equipment, net | 83,8 |
| Purchased portfolio premium, net | 64,5 |
| Other receivables due from credit card securitizations, net | 110,4 |
| Other assets | 187,1 |
| TOTAL ASSETS | $ 2,590,3 |
| LIABILITIES: | |
| Deposits | $ 892,7 |
| Debt | 357,6 |
| Accounts payable | 53,5 |
| Deferred income | 143,1 |
| Accrued expenses and other liabilities | 88,5 |
| TOTAL LIABILITIES | 1,535,7 |
| STOCKHOLDERS' EQUITY: | |
| Convertible preferred stock - Series C, par value $.01 per share; 10,000,000 shares authorized, 1,156,086 and 1,057,638 shares issued and outstanding | 430,6 |
| Common stock, par value $.01 per share; 300,000,000 shares authorized, 64,223,231 and 64,224,878 shares issued | 6 |
| Paid-in capital | 227,3 |
| Unearned compensation | |
| Treasury stock - 7,055,300 and 806,300 shares | (58,3 |
| Retained earnings | 454,3 |
| TOTAL STOCKHOLDERS' EQUITY | 1,054,6 |

| | |
|---|---|
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 2,590,3 |

See accompanying Notes to Consolidated Financial Statements.

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METRIS COMPANIES INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(DOLLARS IN THOUSANDS, EXCEPT PER-SHARE DATA)

| | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 2002 (AS RESTATED) | 2001 (AS RESTATED) | ( |
| INTEREST INCOME: | | | |
| Finance charge income | $ 218,878 | $ 353,650 | $ |
| Federal funds sold | 403 | 3,115 | |
| Other | 10,121 | 12,373 | |
| Total interest income | 229,402 | 369,138 | |
| Deposit interest expense | 68,740 | 127,916 | |
| Other interest expense | 34,776 | 38,361 | |
| Total interest expense | 103,516 | 166,277 | |
| NET INTEREST INCOME (EXPENSE) | 125,886 | 202,861 | |
| Provision for loan losses | 219,804 | 461,106 | |
| NET INTEREST EXPENSE AFTER PROVISION FOR LOAN LOSSES | (93,918) | (258,245) | |
| OTHER OPERATING INCOME: | | | |
| Securitization income | 323,517 | 650,400 | |
| Servicing income on securitized / sold receivables | 195,214 | 159,074 | |
| Credit card fees, interchange and other credit card income | 163,174 | 322,048 | |
| Enhancement services revenues | 153,516 | 141,922 | |
| | 835,421 | 1,273,444 | |
| OTHER OPERATING EXPENSE: | | | |
| Credit card account and other product solicitation and marketing expenses | 173,269 | 188,009 | |
| Employee compensation | 210,826 | 225,463 | |
| Data processing services and communications | 83,874 | 90,222 | |
| Credit protection claims expense | 44,550 | 30,457 | |
| Credit card fraud losses | 8,647 | 9,068 | |
| Purchased portfolio premium amortization | 30,220 | 30,277 | |
| Occupancy and equipment | 48,013 | 47,572 | |
| Mastercard/Visa assessment and fees | 13,869 | 16,522 | |

| | | |
|---|---|---|
| Asset impairments and lease write-offs | 27,736 | -- |
| Other | 100,216 | 89,694 |
| | 741,220 | 727,284 |
| INCOME BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF ACCOUNTING CHANGES | 283 | 287,915 |
| Income tax expense | 1,867 | 113,660 |
| (LOSS) INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGES | (1,584) | 174,255 |
| Cumulative effect of accounting changes (net of income taxes of $9,273 and $320) | -- | 14,226 |
| NET (LOSS) INCOME | (1,584) | 160,029 |
| Convertible preferred stock dividends | 38,009 | 34,771 |
| NET (LOSS) INCOME APPLICABLE TO COMMON STOCKHOLDERS | $ (39,593) | $ 125,258 |

See accompanying Notes to Consolidated Financial Statements.

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| | YEAR ENDED DECEMBER 31 | |
|---|---|---|
| | 2002 AS RESTATED | 2001 AS RESTATED |
| EARNINGS (LOSS) PER SHARE: | | |
| Basic - income (loss) before cumulative effect of accounting changes | $ (0.66) | $ 1.79 |
| Basic - cumulative effect of accounting changes | -- | (0.15) |
| Basic-net income (loss) | (0.66) | 1.64 |
| Diluted - income (loss) before cumulative effect of accounting changes | (0.66) | 1.75 |
| Diluted-cumulative effect of accounting changes | -- | (0.14) |
| Diluted-net income(loss) | (0.66) | 1.61 |
| SHARES USED TO COMPUTE EARNINGS (LOSS) PER SHARE: | | |
| Basic | 59,782 | 97,641 |
| Diluted | 59,782 | 99,366 |

| | | | |
|---|---|---|---|
| DIVIDENDS DECLARED AND PAID PER COMMON SHARE | $ 0.040 | $ 0.040 | $ |

See accompanying Notes to Consolidated Financial Statements.



METRIS COMPANIES INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(DOLLARS AND SHARES IN THOUSANDS)

| | NUMBER OF SHARES OUTSTANDING | | PREFERRED | COMMON | PAID-IN | UNEARNED | |
|---|---|---|---|---|---|---|---|
| | PREFERRED | COMMON | STOCK | STOCK | CAPITAL | COMPENSATION | |
| BALANCE AT DECEMBER 31, 1999 AS PREVIOUSLY REPORTED | 885 | 57,919 | $329,729 | $386 | $130,772 | $ -- | $ |
| Cumulative restatements to prior periods, see Note 2 | -- | -- | -- | -- | -- | -- | |
| BALANCE AT DECEMBER 31, 1999, AS RESTATED | 885 | 57,919 | $329,729 | $386 | $130,772 | $ -- | $ |
| Net income (as restated) | -- | -- | -- | -- | -- | -- | |
| Cash dividends | -- | -- | -- | -- | -- | -- | |
| June 2000 three-for-two stock split | -- | -- | -- | 201 | (201) | -- | |
| Preferred dividends in kind | 83 | -- | 30,692 | -- | -- | -- | |
| Issuance of common stock under employee benefit plans | -- | 4,324 | -- | 35 | 67,506 | -- | |
| BALANCE, DECEMBER 31, 2000 AS RESTATED | 968 | 62,243 | $360,421 | $622 | $198,077 | $ -- | $ |
| Net income (as restated) | -- | -- | -- | -- | -- | -- | |
| Cash dividends | -- | -- | -- | -- | -- | -- | |
| Common stock repurchased | -- | (806) | -- | -- | -- | -- | |
| Preferred dividends in kind | 90 | -- | 33,549 | -- | -- | -- | |
| Issuance of common stock under employee benefit plans | -- | 1,518 | -- | 15 | 27,927 | -- | |
| Deferred compensation | -- | 464 | -- | 5 | 6,409 | (8,108) | |
| Amortization of restricted stock | -- | -- | -- | -- | -- | 3,128 | |
| BALANCE, DECEMBER 31, 2001 AS RESTATED | 1,058 | 63,419 | $393,970 | $642 | $232,413 | $(4,980) | $ |
| Net loss (as restated) | -- | -- | -- | -- | -- | -- | |
| Cash dividends | -- | -- | -- | -- | -- | -- | |
| Common stock repurchased | -- | (6,249) | -- | -- | -- | -- | |
| Preferred dividends in kind | 98 | -- | 36,672 | -- | -- | -- | |
| Issuance of common stock under employee | | | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| benefit plans | -- | 462 | -- | 4 | 2,975 | -- | |
| Deferred compensation | -- | 76 | -- | 1 | 967 | (968) | |
| Amortization of restricted stock | -- | -- | -- | -- | -- | 1,808 | |
| Forfeiture of restricted stock | -- | (540) | -- | (5) | (8,979) | 4,140 | |
| BALANCE, DECEMBER 31, 2002 AS RESTATED | 1,156 | 57,168 | $430,642 | $642 | $227,376 | $ -- | $ |

See accompanying Notes to Consolidated Financial Statements.

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METRIS COMPANIES INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLARS IN THOUSANDS)

| | YEAR ENDED DECEM | |
|---|---|---|
| | 2002 AS RESTATED | 2001 AS RESTATE |
| OPERATING ACTIVITIES: | | |
| Net income (loss) | $ (1,584) | $ 160,02 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Cumulative effect of accounting changes | -- | 14,22 |
| Depreciation, amortization and accretion | (175,314) | (125,09 |
| Provision for loan losses | 219,804 | 461,10 |
| (Gain) loss from credit card securitization | (41,872) | 95,24 |
| Asset impairments, lease write-offs, and severance | 27,736 | - |
| Market loss (gain) on derivative financial instruments | 22,562 | (10,12 |
| Changes in operating assets and liabilities, net: | | |
| Fair value of retained interests in loans securitized | 342,080 | (28,06 |
| Spread accounts receivable | (39,785) | 6,57 |
| Other receivables due from credit card securitizations | 29,362 | (132,17 |
| Accounts payable and accrued expenses | (27,163) | 32,37 |
| Deferred income | (45,587) | (23,30 |
| Other | (1,728) | 26,99 |
| Net cash provided by operating activities | 308,511 | 477,76 |
| INVESTING ACTIVITIES: | | |
| Proceeds from transfers of portfolios to the Metris Master Trust | 2,087,097 | 553,18 |
| Net cash from loan originations and principal collections on loans receivable | (704,614) | (1,127,38 |
| Proceeds from sales of credit card portfolios to third parties | 16,278 | - |
| Credit card portfolio acquisitions | -- | (290,77 |
| Additions to premises and equipment | (6,159) | (5,70 |
| Net cash provided by (used in) investing | | |

| | | |
|---|---|---|
| activities | 1,392,602 | (870,69 |
| FINANCING ACTIVITIES: | | |
| Proceeds from issuance of debt | 51,745 | 387,00 |
| Repayment of debt | (342,000) | (95,16 |
| Net (decrease) increase in deposits | (1,165,254) | (48,19 |
| Cash dividends paid | (3,728) | (3,75 |
| Increase in common equity | 2,011 | 26,24 |
| Repurchase of common stock | (45,294) | (13,01 |
| Net cash provided by (used in) financing activities | (1,502,520) | 253,12 |
| Net increase (decrease) in cash and cash equivalents | 198,593 | (139,80 |
| Cash and cash equivalents at beginning of year | 381,639 | 521,44 |
| Cash and cash equivalents at end of year | $ 580,232 | $ 381,63 |

See accompanying Notes to Consolidated Financial Statements.



| | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 200 |
| SUPPLEMENTAL DISCLOSURES AND CASH FLOW INFORMATION: | | | |
| Cash paid (received) during the year for: | | | |
| Interest | $106,394 | $165,241 | $81,7 |
| Income taxes | (32,996) | 25,718 | 75,3 |
| Tax benefit from employee stock option exercises | 174 | 8,989 | 31,1 |

See accompanying Notes to Consolidated Financial Statements.



METRIS COMPANIES INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(DOLLARS IN THOUSANDS, EXCEPT AS NOTED)

## 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, primarily to moderate-income consumers. We issue credit cards through our wholly owned subsidiary, Direct Merchants Bank, the 11th largest bankcard issuer in the United States. We also offer consumer products through our enhancement services business unit, including credit protection, third-party insurance, warranty products, and membership program products, and list syndication products.

All dollar amounts are presented as pre-tax amounts unless otherwise noted. We have eliminated all significant intercompany balances and transactions in consolidation. We have reclassified certain prior-year amounts to conform with the current year's presentation.

PERVASIVENESS OF ESTIMATES

We have prepared the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("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 are our determination of the adequacy of the allowance for loan losses, which is discussed under Note 3, and our determination of the fair value of retained interests in loans securitized, which is discussed under note 4. The significant factors susceptible to future change that have an impact on these estimates include default rates, net interest spreads, payment rates, liquidity and the ability to finance future receivables activity, and overall economic conditions. As a result, the actual losses in our loan portfolio and the fair value of our retained interests as of December 31, 2002 and 2001 could materially differ from these estimates.

NOTE 2 - RESTATEMENTS

The consolidated statements of income as presented for the periods ended December 31, 2002, 2001 and 2000 and the consolidated balance sheets as of December 31, 2002 and December 31, 2001 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, 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."

- 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."

- 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 March 31, 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.

The cumulative impact of the above restatements as of December 31, 1999 is a $58.4 million increase to retained earnings and consists of the following adjustments:

| | |
|---|---|
| Retained interests in loans securitized | $ 79.4 |
| Transaction costs | 12.2 |
| Tax | (33.2) |
| Total | $ 58.4 |

- 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."

- Revenue related to the membership club and warranty business for current and prior periods is classified as "Enhancement services revenue." Claims expense related to the sold 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. The effects of the reclass for each of the years ended December 31, 2000 through 2002 amounted to a reduction (addition) to deferred income taxes of $23.8 million, $1.0 million, and ($16.5) million, respectively. Such reclasses did not result in any adjustment to net income.

See Notes 3,4,5,6,7,14,19,20 and 21, 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.

| | DECEMBER 31, 2002 | |
|---|---|---|
| | AS PREVIOUSLY REPORTED | AS RESTATED |
| BALANCE SHEETS: | | |
| ASSETS: | | |
| Retained interests in loans securitized | $1,736,912 | $ -- |
| Less: Valuation allowance | 986,517 | -- |
| Net retained interests in loans securitized | 750,395 | 808,026 |
| Other receivables due from credit card securitizations, net | 184,220 | 110,471 |
| Other assets | 174,987 | 187,151 |
| LIABILITIES: | | |
| Deferred income | $ 159,267 | $ 143,148 |
| Accrued expenses and other liabilities | 72,062 | 88,579 |
| STOCKHOLDERS' EQUITY | | |
| Retained earnings | $ 458,673 | $ 454,321 |

| | DECEMBER 31, 2001 | |
|---|---|---|
| | AS PREVIOUSLY REPORTED | AS RESTATED |
| BALANCE SHEETS: | | |
| ASSETS: | | |
| Short-term investments | $ 134,502 | $ 28,055 |
| Cash and cash equivalents | 488,086 | 381,639 |
| Allowance for credit card loan losses | (410,159) | (460,159) |
| Retained interests in loans securitized | 1,339,178 | -- |
| Less: Valuation allowance | 537,499 | -- |
| Net retained interests in loans securitized | 801,679 | 859,559 |
| Other receivables due from credit card securitizations, net | 114,456 | 139,833 |
| Other assets | 268,155 | 278,634 |
| LIABILITIES: | | |
| Deferred income | $ 215,031 | $ 188,735 |
| Accrued expenses and other liabilities | 82,313 | 82,517 |
| STOCKHOLDERS' EQUITY | | |
| Retained earnings | $ 532,924 | $ 496,305 |

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| | DECEMBER 31, 2002 | |
|---|---|---|
| | AS PREVIOUSLY REPORTED | AS RESTATED |
| STATEMENTS OF INCOME: | | |
| Provision for loan losses | $ 573,478 | $ 219,804 |
| Net interest expense after provision for loan losses | (149,635) | (93,918) |
| Other operating income: | | |
| Securitization income | -- | 323,517 |
| Servicing income on securitized/sold receivables | -- | 195,214 |
| Net securitization and credit card servicing income | 271,348 | -- |
| Credit card fees, interchange and other credit card income | 202,664 | 163,174 |
| Enhancement services revenue | 392,827 | 153,516 |
| Other operating expenses: | | |
| Credit card account and other product solicitation and marketing expenses | 190,259 | 173,269 |
| Enhancement services claims expenses | 51,542 | -- |
| Credit protection claims expense | -- | 44,550 |

| | | |
|---|---|---|
| Other | 93,221 | 100,216 |
| (Loss) Income Before Income Taxes | (49,781) | 283 |
| Income tax (benefit) expense | (15,930) | 1,867 |
| Net (loss) | (33,851) | (1,584) |
| Loss per share | (1.20) | (0.66) |
| Diluted loss per share | (1.20) | (0.66) |



| STATEMENTS OF INCOME: | DECEMBER 31, 2001 AS PREVIOUSLY REPORTED | DECEMBER 31, 2001 AS RESTATED | DECEMBER 31, AS PREVIOUSLY REPORTED |
|---|---|---|---|
| Finance charge income | $ -- | $353,650 | $ -- |
| Credit card loans and retained interests in loans securitized | 681,503 | -- | 490,929 |
| Net interest income (expense) | 549,145 | 202,861 | 388,234 |
| Provision for loan losses | 549,145 | 461,106 | 388,234 |
| Other operating income: | | | |
| Net securitization and credit card servicing income | 517,399 | -- | 444,254 |
| Securitization income | -- | 650,400 | -- |
| Servicing income on securitized / sold receivables | -- | 159,074 | -- |
| Credit card fees, interchange and other credit card income | 296,926 | 322,048 | 223,333 |
| Enhancement services revenue | 340,132 | 141,922 | 266,200 |
| Other operating expenses: | | | |
| Credit card account and other product solicitation and marketing expenses | 174,883 | 188,009 | 144,481 |
| Credit protection claims expense | -- | 30,457 | -- |
| Enhancement services claims expense | 35,628 | -- | 26,431 |
| Other | 84,519 | 89,694 | 80,308 |
| Income before income taxes | 412,868 | 287,915 | 322,911 |
| Income tax expense | 161,577 | 113,660 | 124,320 |
| Net income | 245,792 | 160,029 | 195,153 |
| Earnings per share | 2.52 | 1.64 | 2.19 |
| Diluted earnings per share | 2.47 | 1.61 | 2.11 |

| STATEMENTS OF CASH FLOWS: | DECEMBER 31, 2002 AS PREVIOUSLY REPORTED | DECEMBER 31, 2002 AS RESTATED |
|---|---|---|
| Net loss | $ (33,851) | $ (1,584) |
| Depreciation, amortization and accretion | 130,013 | (175,314) |
| (Gain) loss from credit card securitizations | -- | (41,873) |
| Retained interests valuation income | (118,953) | -- |
| Market loss on derivative financial instruments | -- | 22,562 |
| Changes in operating assets and liabilities, net: | | |
| Fair value of retained interests in loans securitized | -- | 342,080 |
| Spread accounts receivable | -- | (39,785) |
| Other receivables due from credit card securitizations, net | (23,680) | 29,362 |
| Accounts payable and accrued expenses | (43,476) | (27,163) |
| Deferred income | (55,764) | (45,487) |
| Other | 43,871 | (1,727) |
| Net cash provided by operating activities | 499,374 | 308,511 |
| Net use of cash from sales and repayments of securitized loans | (1,145,947) | -- |
| Net cash collected from loan originations and principal collections on loans receivable | -- | (704,614) |
| Net loans collected | 211,458 | -- |
| Net cash provided by investing activities | 1,162,727 | 1,392,602 |

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| STATEMENTS OF CASH FLOWS: | DECEMBER 31, 2001 AS PREVIOUSLY REPORTED | DECEMBER 31, 2001 AS RESTATED |
|---|---|---|
| Net income | $ 245,792 | $ 160,029 |
| Cumulative effect of accounting changes | 14,499 | 14,226 |
| Depreciation, amortization and accretion | 106,703 | (125,096) |
| Provision for loan losses | 549,145 | 461,106 |
| (Gain) loss from credit card securitizations | -- | 95,246 |
| Retained interests valuation income | (131,992) | -- |
| Market gain on derivative financial instruments | -- | (10,128) |
| Changes in operating assets and liabilities, net: | | |
| Fair value of retained interests in loans securitized | -- | (28,069) |
| Spread accounts receivable | -- | 6,570 |
| Other receivables due from credit card securitizations, net | (5,583) | (132,177) |
| Accounts payable and accrued expenses | 6,446 | 32,370 |
| Deferred income | (20,476) | (23,306) |
| Other | 45,878 | 26,990 |
| Net cash provided by operating activities | 810,412 | 477,761 |
| Net use of cash from sales and repayments of securitized loans | 1,272,438 | -- |
| Net loans collected | (2,617,045) | -- |

| | | |
|---|---|---|
| Net cash from loan originations and principal collections on loans receivable | -- | (1,127,389) |
| Additions to property and equipment | (5,706) | (5,708) |
| Net cash (used in) provided by investing activities | (1,087,907) | (870,691) |
| Proceeds from issuance of common stock | 17,260 | 26,248 |
| Net cash used in financing activities | 244,141 | 253,129 |



| | DECEMBER 31, 2000 | |
|---|---|---|
| STATEMENTS OF CASH FLOWS: | AS PREVIOUSLY REPORTED | AS RESTATED |
| Net income | $ 195,153 | $ 185,902 |
| Depreciation, amortization and accretion | 76,256 | (203,244) |
| Provision for loan losses | 388,234 | 164,800 |
| Retained interests valuation income | (104,710) | -- |
| (Gain) loss from credit card securitizations | -- | 77,222 |
| Changes in operating assets and liabilities, net: | | |
| Fair value of retained interests in loans securitized | -- | 97,946 |
| Spread accounts receivable | -- | 79,964 |
| Other receivables due from credit card securitizations, net | 55,240 | (14,995) |
| Accounts payable and accrued expenses | 45,877 | 37,623 |
| Deferred income | 60,403 | 61,367 |
| Other | (53,058) | 116,529 |
| Net cash provided by operating activities | 666,833 | 603,630 |
| Net cash from loan originations and principal collections on loans receivable | (1,976,341) | (1,361,227) |
| Net cash (used in) investing activities | (1,705,034) | (1,641,831) |

In addition, the restatements will have the following impact on the previously reported annual information for the year ended December 31:

| | NET (LOSS) INCOME | | BASIC (LOSS) EARNINGS PER SHARE | | DILUTED (LOSS) EARN PER SHARE | |
|---|---|---|---|---|---|---|
| | AS PREVIOUSLY REPORTED | AS RESTATED | AS PREVIOUSLY REPORTED | AS RESTATED | AS PREVIOUSLY REPORTED | RE |
| 2002 | (33,851) | (1,584) | (1.20) | (0.66) | (1.20) | ( |
| 2001 | 245,792 | 160,029 | 2.52 | 1.64 | 2.47 | |
| 2000 | 195,152 | 185,902 | 2.19 | 2.08 | 2.11 | |
| 1999 | 64,555 | 109,555 | (1.07) | 1.50 | (1.07) | |
| 1998 | 57,348 | 66,691 | 0.97 | 1.14 | 0.94 | |

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of the significant accounting and reporting policies used in preparing the consolidated financial statements.

FEDERAL FUNDS SOLD AND SHORT-TERM INVESTMENTS

Federal funds sold are short-term loans made to banks through the Federal Reserve System. It is our policy to make such loans only to banks that are considered to be in compliance with their regulatory capital requirements. Short-term investments are investments in money market mutual funds, Treasuries, other Government Agency Obligations, and commercial paper with maturities less than three months. We invest in certain certificates of deposit and Housing Bonds in order to meet our obligations under the Community Reinvestment Act, and fulfill the credit needs of our local community.

CREDIT CARD LOANS

Credit card loans presented on our consolidated balance sheet are receivables from cardholders that we have not sold via securitizations or third-party conduit warehousing arrangements, and are recorded at the amount outstanding plus related deferred acquisition costs and net of related deferred revenue. Interest income on credit card loans is earned and accrued based on the amount of the loans outstanding. Accrued interest and fees which have been billed to the cardholder but not yet received are classified on the consolidated balance sheet with the related credit card loans. Accrued interest which has not yet been billed to the cardholder is estimated and classified on the consolidated balance sheet in "Other assets." Interest income and fees are generally recognized until a loan is charged-off. Upon charge-off, any unpaid principal is applied to the allowance for loan losses and any unpaid finance charges and fees are netted against the applicable income statement line items. Beginning in November 2002, we stopped late fee billings after an account becomes 120 days contractually delinquent.

When we decide to sell a portion of our credit card loans, the loans are specifically identified and transferred to the held-for-sale account. The loans are transferred into the account at the lower of cost or fair value at the date the decision to sell is made. Any reduction in the loans' value is reflected as a charge-off of the recorded investment in the loan with a corresponding reduction in the allowance for loan losses. All deferred costs and fees are written off upon the decision to sell. At the time of sale we record the difference between the carrying value and sales price as an increase or decrease in the provision for loan losses. Any portfolio premium would also be written off unless we retain ownership of the cardholder account. To the extent that the loans' carrying value at the time of transfer does not reflect fair value, an additional provision for loan losses is recorded. Any loans in the held-for-sale account are revalued to the lower of cost or fair value at each subsequent reporting date. We had no loans in the held-for-sale account as of December 31, 2002 and 2001.



ALLOWANCE FOR LOAN LOSSES

We maintain an allowance for loan losses sufficient to absorb anticipated probable loan losses inherent in the credit card loan portfolio, including accrued finance charges and fees, as of the balance sheet date. The allowance is based on management's consideration of all relevant factors including management's assessment of applicable economic and seasonal trends. In

addition, we have incorporated updated regulatory guidance regarding analysis and documentation for the allowance for loan losses.

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.

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 loss 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.

Various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses maintained at Direct Merchants Bank. Such agencies may require that we recognize additions to the allowance based on their judgment on information available to them at the time of their examination. In our opinion, the allowance for loan losses is adequate to cover probable losses inherent in the loan portfolio under current conditions.

We charge-off unsecured credit card accounts at the end of the month during which the loan becomes contractually 180 days past due except as follows. We charge-off all secured credit card accounts and accounts which enter into credit



counseling or other similar programs and later become delinquent at the end of the month during which the loan becomes contractually 120 days past due after

first reducing the loss by the security deposit. Bankrupt accounts are charged-off within 60 days of formal notification of bankruptcy. Accounts of deceased accountholders without a surviving, contractually liable individual, or an estate large enough to pay the debt in full are charged-off immediately upon notification.

SECURITIZATION, RETAINED INTERESTS IN LOANS SECURITIZED, AND SECURITIZATION INCOME

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"). 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 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 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 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 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 income."

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

SERVICING INCOME

During 2003, 2002, and 2001, we sold credit card loan receivables in securitization transactions. In those securitizations, we retained servicing responsibilities and subordinated interests. We receive annual servicing fees of two percent of the outstanding principal balance. Revenue from these servicing responsibilities is recognized when earned and recorded in the consolidated income statements as "Servicing income on securitized/sold receivables."

CREDIT CARD FEES AND ORIGINATION COSTS

Credit card fees include annual membership, late payment, overlimit, returned check, cash advance transaction and other miscellaneous fees. We assess these fees according to the terms of the related cardholder agreements and, except for annual membership fees, we recognize the fees as revenue when charged to the cardholder's account.

We defer direct credit card origination costs associated with successful credit card solicitations that we incur in transactions with independent third parties, and certain other costs that we incur in connection with loan underwriting and the preparation and processing of loan documents. These deferred credit card origination costs and cardholders annual membership fees are netted and amortized to interest income on a straight-line basis over the cardholder's privilege period, generally 12 months. These net deferred fees are included in credit card loans. If deferred direct credit card acquisition costs were to exceed forecasted future cash flows, we would make an appropriate adjustment for impairment. All other costs of credit card solicitation are expensed as incurred.

CREDIT CARD FRAUD LOSSES

We experience credit card fraud losses from the unauthorized use of credit cards. We expense these fraudulent transactions when identified, through the establishment of a reserve for the transactions. We charge-off these amounts no later than 90 days from discovery, after all attempts to recover the amounts from these transactions, including charge backs to merchants and claims against cardholders, are exhausted.

DEBT ISSUANCE COSTS

Debt issuance costs (upfront fees) are the costs related to issuing new

debt securities. We capitalize these costs and amortize them to expense over the term of the new debt security.

PROPERTY AND EQUIPMENT

We record property and equipment at cost and depreciate them on a straight-line basis over their estimated economic useful lives, which range from one to 25 years. We capitalize software developed for internal use that represents major enhancements or replacements of operating and management information systems. We begin amortization of such capitalized software when the systems are fully developed and ready for implementation. We expense repair and maintenance costs as incurred. We review property and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of



an asset may not be recoverable. Any impairment is recorded as other operating expenses. Upon the decision to sell property and equipment, we adjust the carrying value to the lower of cost or market and transfer the assets to a held for sale account. No depreciation is recognized on held for sale assets.

PURCHASED PORTFOLIO PREMIUM

The purchased portfolio premium represents the excess of amounts paid for portfolio acquisitions over the related credit card loan balances net of reserves and discounts. The premium is amortized over the estimated account life, generally seven years, based on the expected account attrition. The recoverability of the premium is evaluated quarterly. Such evaluation is based on undiscounted cash flow projections.

ENHANCEMENT SERVICES

Debt Waiver Products

Direct Merchants Bank offers various debt waiver products on receivables it owns as well as securitized receivables. Direct Merchants Banks records deferred revenue when the debt waiver customer is billed. For customers whose accounts are funded on balance sheet, revenue is recognized in the month following the completion of the of the cancellation period, which is one month. Cash flows related to debt waiver on receivables sold to the Metris Master Trust are included in the valuation of the interest-only strip receivable. 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 $8.2 million as of December 31, 2002, compared to $5.2 million as of December 31, 2001.

During the quarter ended March 31, 2000, we adopted Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements," for our debt waiver products. This change resulted in a one-time, non-cash net charge to earnings of $3.4 million, which is reflected as a "Cumulative effect of accounting change" in the consolidated statements of income for the year ended December 31, 2000.

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 the debt waiver products. Amortization of debt waiver acquisition costs was $3.7 million for the year ended December 31, 2002. All other debt

waiver acquisition costs are expensed as incurred. Deferred debt waiver acquisition costs were $2.6 million as of December 31, 2002.

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



December 31, 2002 on the membership program products were $22.0 million compared to $38.7 million as of December 31, 2001. Cancellation reserves were $19.5 million and $29.6 million for the years ended December 31, 2002 and 2001, respectively. Revenues recorded for membership products are included in the statements of income under "enhancement services revenues" and were $92.9 million, $57.2 million and $76.0 million for the years ended December 31, 2002, 2001 and 2000, respectively. Unearned revenues on membership program products are recorded in the consolidated balance sheets in "deferred income." Unearned revenues as of December 31, 2002 were $114.2 million compared to $130.9 million as of December 31, 2001. Reserves for pending and incurred but not reported claims, included in "accrued expenses and other liabilities," were $0.1 million as of December 31, 2002, compared to $0.2 million as of December 31, 2001.

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 the membership program products. Amortization of membership deferred costs was $55.4 million, $28.0 million and $19.8 million for the years ended December 31, 2002, 2001 and 2000, respectively. All other membership acquisition costs are expensed as incurred. Deferred membership acquisition costs were $66.9 million and $66.7 million as of December 31, 2002 and 2001, respectively.

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 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 December 31, 2002 on the warranty products were $3.8 million compared to $7.0 million as of December 31, 2001. Cancellation reserves were $5.3 million and $6.2 million for the years ended December 31, 2002 and 2001, respectively. Unearned revenues on warranty products are recorded in the consolidated balance sheets in "deferred income". Unearned revenues as of December 31, 2002 were $17.6 million compared to $33.8 million as of December

31, 2001. Reserves for pending and incurred but not reported claims, included in "accrued expenses and other liabilities," were $0.7 million as of December 31, 2002, compared to $0.5 million as of December 31, 2001.

Qualifying warranty acquisition costs are deferred and charged to expense as warranty product fees are recognized. Those incremental direct acquisition costs, which are a result of a contract that is not consummated, 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 negotiating 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 amount to $12.8 million, $15.9 million, and $10.4 million for the years ended December 31, 2002, 2001, and 2000, respectively. All other warranty acquisition costs are expensed as



incurred. Deferred warranty acquisition costs amount to $3.0 million and $12.7 million as of December 31, 2002 and 2001, respectively.

We discontinue the billing of enhancement services products to Direct Merchants Bank customers that are more than 60 days past due (except for debt waiver which bills customers until 120 days past due) or over their credit limit. The impact of uncollectible fees associated with enhancement service products is included in determining the adequacy of the allowance for loan losses.

INTEREST RATE RISK MANAGEMENT CONTRACTS

We enter into a variety of interest rate risk management contracts such as interest rate swap, floor and cap agreements with highly rated counterparties in order to hedge our interest rate exposure on securitized loans and deposits. We account for these contracts in accordance with SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS 138. We recognize all derivatives as either assets or liabilities on the balance sheet and measure those instruments at fair value. The change in fair value of the derivatives is recognized currently in earnings unless specific hedge accounting criteria are met. If the derivative qualifies as a hedge, the accounting treatment for the change in fair value varies based on the type of risk being hedged. The monthly interest rate differential to be paid or received on these contracts is accrued and included in "Net securitization and credit card servicing income" or "Deposit interest expense," as appropriate, on the consolidated statements of income. Interest payable or receivable under these contracts is classified under "Other receivables due from credit card securitization, net" or "Other assets," as appropriate on the consolidated balance sheets.

INCOME TAXES

Deferred taxes are based on the temporary differences between the financial statement and the tax bases of assets and liabilities that will result in future taxable or deductible amounts. The deferred taxes are based on the enacted rate that is expected to apply when the temporary differences reverse. A valuation allowance is recognized if it is more likely than not that all or some portion of the deferred tax asset will not be realized.

EARNINGS PER SHARE

The following table presents the computation of basic and diluted weighted-average shares used in the per-share calculations:

| (In thousands) | YEAR ENDED DECEMBER 31, 2002 | 2001 | |
|---|---|---|---|
| Income (loss) before cumulative effect of accounting changes | $ (1,584) | $ 174,255 | $ |
| Preferred dividends | 38,009 | 34,771 | |
| Net income (loss) applicable to common stockholders before cumulative effect of accounting changes | (39,593) | 139,484 | |
| Cumulative effect of accounting changes, net | -- | 14,226 | |
| Net income (loss) applicable to common stockholders | $ (39,593) | $ 125,258 | $ |
| Weighted average common shares outstanding | 59,782 | 62,962 | |
| Adjustment for: | | | |
| Assumed conversion of convertible preferred stock(1) | -- | 34,679 | |
| Basic common shares | 59,782 | 97,641 | |
| Assumed exercise of outstanding stock options(1) | -- | 1,725 | |
| Diluted common shares | 59,782 | 99,366 | |

(1) The earnings per share calculation for the year ended December 31, 2002 excludes the assumed conversion of the convertible preferred stock and the outstanding stock options, as they are anti-dilutive.

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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.

Pro forma information regarding net income and 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. Our net earnings and earnings per share would have been reduced to the pro forma amounts indicated below:

| YEAR ENDED DECEMBER 31, 2002 | 2001 | |
|---|---|---|

| | | |
|---|---|---|
| Net income (loss), as reported | $ (1,584) | $ 160,029 |
| Deduct: Annual stock-based compensation expense based on the fair value for all awards, net of related tax effects | 18,141 | 16,847 |
| Pro forma net income (loss) | (19,725) | 143,182 |
| Earnings (loss) per share: | | |
| Basic-as reported | (0.66) | 1.64 |
| Basic-pro forma | (0.97) | 1.47 |
| Diluted-as reported | (0.66) | 1.61 |
| Diluted-pro forma | (0.97) | 1.44 |
| Weighted-average assumptions in option valuation: | | |
| Risk-free interest rates | 3.7% | 4.9% |
| Dividend yields | 1.6% | 0.2% |
| Stock volatility factor | 92.9% | 52.2% |
| Expected life of options (in years) | 6.0 | 6.0 |

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

COMPREHENSIVE INCOME

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

NOTE 4 - 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 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.

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The following table shows the fair value of the components of the "Retained interests in loans securitized" as of December 31, 2002 and December 31, 2001:

| | DECEMBER 31, 2002 | DECEMBER 31, 2001 |
|---|---|---|

| | | |
|---|---|---|
| Contractual retained interests | $685,197 | $571,715 |
| Excess transferor's interests | 57,447 | 30,836 |
| Interest-only strip receivable | 13,882 | 214,707 |
| Spread accounts receivable | 51,500 | 42,301 |
| Retained interests in loans securitized | $808,026 | $859,559 |

The following table illustrates the significant assumptions used for estimating the fair value of retained interests as of December 31, 2002 and December 31, 2001:

| | DECEMBER 31 2002 | DECEMBER 31, 2001 |
|---|---|---|
| Monthly payment rate | 6.7% | 6.3% |
| Gross yield (1) | 26.0% | 25.4% |
| Annual interest expense and servicing fees | 4.0% | 5.5% |
| Annual gross principal default rate | 21.7% | 16.6% |
| Discount rate (2): | | |
| Contractual retained interests | 16.0% | 12.0% |
| Excess transferor's interests | 16.0% | 12.0% |
| Interest-only strip receivable | 30.0% | 25.0% |
| Spread accounts receivable | 16.0% | 12.0% |

(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) The discount rates used in the retained interest valuation take into consideration the uncertainty inherent in the portfolio. The deterioratin in credit quality and overall performance of the Metris Master Trust in 2002 create a higher risk to future cash flows. Based on the increased risk in the portfolio, the discount rates were increased over 2002.

At December 31, 2002, 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 VALUE | |
|---|---|---|
| | 10% ADVERSE CHANGE | 20% ADVERSE CHANGE |
| Annual discount rate | $ 24.3 | $ 47.4 |
| Monthly payment rate | 183.7 | 425.5 |
| Gross yield | 172.1 | 362.1 |
| Annual interest expense and servicing fees | 26.0 | 59.6 |
| Annual gross principal default rate | 135.6 | 278.5 |

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.



The actual rates for loans securitized are as follows:

| | DECEMBER 31, 2002 | DECEMBER 31, 2001 |
|---|---|---|
| Annual gross principal default rate | 16.4% | 13.2% |
| Monthly payment rate | 6.6% | 6.6% |
| Gross yield (1) | 26.5% | 27.6% |

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

NOTE 5 - SECURITIZATION INCOME

The following summarizes "Securitization income" for the years ended December 31, 2002, December 31, 2001 and December 31, 2000.

| | DECEMBER 31, 2002 | 2001 | 2000 |
|---|---|---|---|
| Loss on new securitization of receivables to the Metris Master Trust | $ (70,578) | $ (60,574) | $ (52,406) |
| (Loss) gain on replenishment of receivables to the Metris Master Trust | 28,706 | (34,672) | (24,816) |
| Discount accretion | 305,327 | 221,670 | 279,500 |
| Change in fair value | (342,080) | 28,069 | (97,946) |
| Interest-only revenue | 452,268 | 510,806 | 566,690 |
| Transaction and other costs | (50,126) | (14,899) | (26,565) |
| Securitization income | $ 323,517 | $ 650,400 | $ 644,457 |



NOTE 6 - SECURITIZATION ACTIVITY

During 2002 and 2001, we sold credit card loan receivables in securitization transactions. In those securitizations, we retained servicing responsibilities and subordinated interests. We receive annual servicing fees of two percent of the outstanding principal balance. Our subordinated interests give us rights to future cash flows arising in the Master Trust after the investors in the Master Trust have received their invested amount and interest thereon. The investors and related securitization trusts have no recourse to our assets. Because our retained interests are subordinate to investors' interests, their value is subject to credit and interest rate risk associated with the transferred financial assets.

Securitization activity for the years ended December 31, 2002 and 2001, is as follows:

| | 2002 | 2001 |
|---|---|---|
| Credit card loans | $ 846,417 | $ 2,756,763 |
| Receivables held in the Metris Master Trust | 10,573,769 | 9,235,021 |
| Total managed loans | $ 11,420,186 | $ 11,991,784 |
| Managed loans more than 30-days contractually delinquent | $ 1,259,949 | $ 1,123,168 |
| Managed loans charged-off, net of recoveries | 1,840,786 | 1,140,151 |

| | YEAR ENDED DECEMBER 31, 2002 | 2001 |
|---|---|---|
| Cash flow to/from the Company: | | |
| Proceeds from transfers of portfolios to the Master Trust | $ 2,087,097 | $ 553,180 |
| Net proceeds from sales and repayments of securitized loans | (1,145,947) | 1,272,438 |
| Proceeds from principal receivables collections reinvested in revolving credit card securitizations | 5,490,499 | 4,181,887 |
| Servicing fees received | 192,325 | 147,518 |
| Cash flows received from net excess spread | 570,088 | 611,704 |
| Total | $ 7,194,062 | $ 6,766,727 |

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NOTE 7 - ALLOWANCE FOR LOAN LOSSES

Activity in the allowance for loan losses is as follows:

| | YEAR ENDED DECEMBER 31 | | |
|---|---|---|---|
| | 2002 | 2001 | |
| Balance at beginning of year | $ 460,159 | $ 123,123 | $ |
| Allowance related to assets acquired | -- | 14,106 | |
| Allowance related to assets transferred to/from the Master Trust | (264,297) | 71,603 | |
| Provision for loan losses | 219,804 | 461,106 | |
| Principal receivables charged-off (1) | (345,785) | (235,197) | |
| Recoveries | 20,434 | 25,418 | |
| Net loans charged-off | (325,351) | (209,779) | |
| Balance at end of year | $ 90,315 | $ 460,159 | $ |

(1) Principal receivables charged-off for the year ended December 31, 2002 include a $101.5 million charge-off related to the sales of delinquent receivables in September and December 2002.

Credit card loans greater than 30 days contractually past due for the years ended December 31, 2002, 2001 and 2000 were $7.9 million, $277.8 million, and $89.2 million, respectively.

NOTE 8 - PROPERTY AND EQUIPMENT

The carrying value of property and equipment is as follows:

| | AT DECEMBER 31, | |
|---|---|---|
| | 2002 | 2001 |
| Furniture and equipment | $ 40,870 | $ 48,707 |
| Computer software and equipment | 71,640 | 65,407 |
| Buildings and land | 24,143 | 28,031 |
| Leasehold improvements | 16,389 | 18,561 |
| Total | $153,042 | $160,706 |
| Less: Accumulated depreciation and amortization | 69,211 | 45,793 |
| Balance at end of year | $ 83,831 | $114,913 |

Depreciation and amortization expense for the years ended December 31, 2002, 2001 and 2000, was $25.6 million, $24.7 million and $16.0 million, respectively.

In 2002, furniture and equipment was written down by $5.1 million due to excess capacity. Subsequent to year-end we entered into a letter of intent to sell our interest in an Arizona facility, as well as related furniture and equipment. The transaction is expected to result in a loss of approximately $5.7 million, which reflects the write-down of the building and furniture and equipment to the sales price. Accordingly, we have classified the land, building, improvements and equipment as held for sale and halted applicable depreciation.

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NOTE 9 - PURCHASED PORTFOLIO PREMIUM

The carrying value of the purchased portfolio premium was $64.6 million and $94.8 million as of December 31, 2002 and 2001, net of accumulated amortization of $124.2 million and $94.0 million, respectively. Amortization expense for the years ended December 31, 2002, 2001 and 2000, was $30.2 million, $30.3 million, and $19.3 million, respectively. The purchased portfolio premium is analyzed for impairment using the undiscounted cash flow method. As of December 31, 2002 and 2001 the purchased portfolio premium was not impaired.

NOTE 10 - PORTFOLIO ACQUISITIONS AND SALES

In 2001, Direct Merchants Bank purchased two credit card portfolios that consisted of approximately 170,000 active accounts and approximately $290

million in receivables. There were no portfolio acquisitions during 2002.

During 2002, we sold two portfolios of delinquent accounts approximating $120 million in receivables. Upon the decision to sell, $101.5 million of receivables were charged-off.

NOTE 11 - CONVERTIBLE PREFERRED STOCK

Affiliates of Thomas H. Lee Partners, L.P. ("THL Partners"), a Boston-based investment firm, and its predecessor, Thomas H. Lee Company, hold 100% of the outstanding shares of our Series C Perpetual Convertible Preferred Stock. The Series C Preferred Stock has a 9% dividend payable in additional shares of Series C Preferred Stock and also receives any cash dividends paid on our common stock based on the number of shares of common stock into which the Preferred Stock would convert on the record date of the dividend. Each share of Series C Preferred Stock is convertible into 30 shares of common stock plus - if converted at the option of the holder before January 1, 2004 - a premium amount designed to guarantee a portion of seven years worth of dividends at the 9% annual rate. The premium amount would have been equal to 41.0% of those future dividends for conversions in 2001 and would be 54.4% of those dividends in 2002.

The Series C Preferred Stock is normally fully convertible into common stock. This would mean that upon conversion of their Preferred Stock, our Preferred Stockholders could have received 38,977,613 shares, or approximately 40.5%, outstanding common stock on a diluted basis as of December 31, 2002. However, the indenture that governs our 10% Senior Notes due 2004 requires us to offer to purchase those notes in the event that such a conversion would result in a shareholder or group (within the meaning of Rules 13d-3 and 13d-5 of the Securities Exchange Act of 1934) obtaining 35% or more of our outstanding voting stock. Therefore, we included a provision in the terms of our Series C Preferred Stock that sets the maximum percentage of outstanding voting stock that any shareholder or group, such as the affiliates of THL Partners, could obtain while any of our 10% Notes remain outstanding at 34.9%. Accordingly, as of December 31, 2002, the Series C Preferred Stock could have been converted into 30,647,631 shares, or 34.9%, of our common stock on a diluted basis, with the excess Series C Preferred Stock converting into 8,329,982 shares of nonvoting Series D Preferred Stock. The Series D Preferred Stock automatically converts into common stock on a share-for-share basis at the time that the conversion will not exceed the ownership limitations described above. The terms of our Series D Preferred Stock are essentially the same as the terms of our common stock, except that

- the Series D Preferred Stock has a liquidation preference of $.01 per share, and



- is non-voting, except as required by law to preserve the powers, preferences or other rights of that class of stock.

So long as they or their affiliates own at least 25% of the originally issued Series C Preferred Stock (or any shares of common stock issued upon conversion thereof), the holders of a majority of the shares of Series C Preferred Stock are entitled to elect four of 11 directors of the Board. So long as they or their affiliates: (a) own any shares of Series C Preferred Stock (or any shares of common stock issued upon conversion thereof); and (b) are entitled to elect four directors, the Thomas H. Lee Equity Fund IV, L.P., which owns approximately 85% of our outstanding Series C Preferred Stock, has the right to appoint one of the four directors. So long as they or their affiliates own at least 10% but less than 25% of the originally issued Series C Preferred Stock (or any shares of common stock issued upon conversion thereof), the holders of a majority of the shares of Series C Preferred Stock are entitled to elect one

director. The four directors who have been elected by the holders of our Series C Preferred Stock are all affiliates of THL Partners and, through such affiliation as well as actual ownership of Series C Preferred Stock, may be deemed to be the beneficial owners of approximately 97% of the common stock that would be issued upon conversion of our Series C and D Preferred Stock, both individually and in the aggregate.

The Series C Preferred Stock may be redeemed by us in certain circumstances by paying 103% of the redemption price of $372.50 and any accrued dividends at the time of redemption. We also have the option to redeem the Series C Preferred Stock after December 9, 2008, without restriction by paying the redemption price of $372.50 and any accrued dividends at the time of redemption.

NOTE 12 - STOCK OPTIONS

We offer the Metris Companies Inc. Long-Term Incentive and Stock Option Plan, which permits a variety of stock-based grants and awards and gives us flexibility in tailoring our long-term compensation programs. In 2002, the Board of Directors recommended, and the shareholders approved, an increase in the number of shares reserved for issuance under the plan to 19.0 million shares of common stock for awards of stock options or other stock-based awards, subject to adjustment in certain circumstances. As of December 31, 2002, 2.3 million shares were available for grant. We do not provide loans to employees for the purchase of stock or the exercise of stock options.

The MCI Compensation Committee has the authority to determine the exercise prices, vesting dates or conditions, expiration dates and other material conditions upon which options or awards may be exercised, except that the option price for Incentive Stock Options ("ISOs") may not be less than 100% of the fair market value of the common stock on the date of grant (and not less than 110% of the fair market value in the case of an ISO granted to any employee owning more than 10% of the common stock) and the terms of nonqualified stock options may not exceed 15 years from the date of grant (not more than ten years for ISOs and five years for ISOs granted to any employee owning more than 10% of the common stock). Full- or part-time employees, consultants or independent contractors are eligible to receive nonqualified options and awards. Only full- or part-time employees are eligible to receive ISOs. Our stock options expire ten years from the date of grant and vest over periods ranging from one to six years with some options vesting at 25% to 33.3% per year.

During 2002, 2001 and 2000, we granted 2.1 million, 2.7 million and 4.2 million options, respectively, to officers and employees.

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We also issue restricted stock grants under the stock option plan to our executive officers. As of December 31, 2002, no shares had been granted to any executive officer except our former Chairman and Chief Executive Officer. The restricted stock has a five-year cliff vesting period. A total of 76,041 shares were issued in 2002 and 72,558 shares of restricted stock were granted in 2001, with an approximate aggregate market value in 2002 and 2001 of $1.0 million and $1.8 million respectively, at the time of the grants. Restricted stock vests on the fifth anniversary of the date of grant provided the employee remains employed though that DATE. As of the date restricted stock is granted, deferred compensation is recorded as a reduction of equity for the fair value of the shares granted. The deferred compensation is amortized to compensation expense on a straight-line basis over the vesting period.

Upon our termination of our former Chairman and Chief Executive Officer in December 2002, he forfeited all the restricted stock previously granted to

him. All previously recognized expense was reversed and the related deferred compensation was added back to stockholders' equity. The amount of compensation reversed in 2002 that had been recognized in previous years was $3.0 million.

We also offer the Metris Companies Inc. Non-Employee Director Stock Option Plan which provides up to 750,000 shares of common stock for awards of options, subject to adjustments in certain circumstances. During 2002, 2001 and 2000, we granted 100,000, 89,000 and 82,500 options, respectively. At December 31, 2002, 186,000 shares were available for grant.

Information regarding our stock option plans for 2002, 2001 and 2000, is as follows:

| | YEAR ENDED DECEMBER 31, | | | | |
|---|---|---|---|---|---|
| | 2002 | | 2001 | | 2 |
| | SHARES | WEIGHTED-AVERAGE EXERCISE PRICE | SHARES | WEIGHTED-AVERAGE EXERCISE PRICE | SHARES |
| Options outstanding, beginning of year | 10,604,136 | $19.73 | 9,907,062 | $ 17.67 | 10,129,61 |
| Options exercised | 49,899 | 13.67 | 1,383,358 | 11.81 | 4,212,53 |
| Options granted | 2,180,885 | 12.09 | 2,832,838 | 25.01 | 4,348,68 |
| Options canceled/ forfeited | 1,005,678 | 11.45 | 752,406 | 27.06 | 358,70 |
| Options outstanding, end of year | 11,729,444 | 19.05 | 10,604,136 | 19.73 | 9,907,06 |
| Weighted-average fair value of options granted during the year | -- | 8.19 | -- | $ 13.57 | - |

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The following table summarizes information about stock options outstanding at December 31, 2002:

| | OPTIONS OUTSTANDING | | | OPTIONS EXERCISABLE | |
|---|---|---|---|---|---|
| EXERCISE PRICE | NUMBER OUTSTANDING AT 12/31/02 | WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE | WEIGHTED-AVERAGE EXERCISE PRICE | NUMBER EXERCISABLE AT 12/31/02 | WEIGHTED-AVERAGE EXERCISE PRICE |
| $ 2.25-$16.77 | 5,116,908 | 7.1 | $12.29 | 2,718,261 | $12.14 |
| $17.10-$24.42 | 3,900,000 | 7.3 | 22.06 | 2,134,845 | 21.89 |
| $24.67-$38.88 | 2,712,536 | 7.9 | 27.47 | 514,534 | 29.37 |
| | 11,729,444 | 7.4 | $19.05 | 5,367,640 | $17.67 |

EMPLOYEE STOCK PURCHASE PLAN

We offer the Metris Companies Inc. Employee Stock Purchase Plan ("ESPP"), whereby eligible employees may authorize payroll deductions of the lesser of up to 15% of their salary or $25,000 to purchase shares of our common stock. Under the plan, shares of our common stock may be purchased at the end of each monthly offering period at 85% of the lower of the fair market value on the first or last day of the monthly offering period. Employees contributed $1.8 million and $2.2 million to purchase 374,166 and 111,967 shares of common stock under the ESPP for 2002 and 2001, respectively. We are authorized to issue up to 2.5 million shares of common stock to employees under the plan, and as of December 31, 2002, there were approximately 1.9 million shares available for future issuance.

We offer certain employees the Non-Qualified Employees Stock Purchase Plan ("NQ ESPP"). Eligible employees may purchase shares of our common stock at 100% of the fair market value of common shares on the last day of the monthly offering period. Employees contributed $0.1 million and $0.2 million to purchase 27,946 and 9,886 shares of common stock under the NQ ESPP for 2002 and 2001, respectively. We are authorized to issue up to 0.5 million shares of common stock to employees under the plan, and as of December 31, 2002, there were approximately 0.5 million shares available for future issuance.

MANAGEMENT STOCK PURCHASE PLANS

We provide a management stock purchase plan, whereby any employee who is a Senior Vice President or higher, excluding corporate officers designated by the Board of Directors, who participates in the Metris Management Incentive Bonus Plan is eligible to participate. Participants may elect to defer up to 50% of their bonus received under the Management Bonus Plan, which is credited to a stock purchase account as restricted stock units. We will make a match of $1 for every $3 contributed by the participant. The participant's contributions are vested immediately and our matching contributions vest after three years. No contributions were made to the plan in 2002. Employees contributed approximately $1.0 million to purchase 73,722 restricted stock units under the plans for 2001. The restricted stock units convert to common stock when distributed from the plans. We are authorized to issue up to 450,000 shares of common stock to employees under the plans, and as of December 31, 2002, approximately 243,578 of the authorized shares were available for future issuance.

We provide an additional management stock purchase plan, whereby officers designated by the board of directors, who participate in the Metris Annual



Incentive Bonus Plan for Designated Corporate Officers are eligible to participate. Participants may elect to defer up to 50% of their bonus received under the Management Bonus Plan, which is credited to a stock purchase account as restricted stock units. We will make a match of $1 for every $3 contributed by the participant. The participant's contributions are vested immediately and our matching contributions vest after three years. No contributions were made to the plan in 2002. Employees contributed approximately $0.3 million to purchase 22,498 restricted stock units under the plans for 2001. The restricted stock units convert to common stock when distributed from the plans. We are authorized to issue up to 450,000 shares of common stock to employees under the plans, and as of December 31, 2002, approximately 372,669 of the authorized shares were available for future issuance.

NOTE 13 - EMPLOYEE BENEFIT PLANS

We offer a defined contribution plan that is intended to qualify under section 401(k) of the Internal Revenue Code. The 401(k) Plan provides retirement benefits for eligible employees. Eligible employees may elect to contribute to the 401(k) Plan, and we match a portion of employee contributions and make discretionary contributions based upon our financial performance. For the years ended December 31, 2002, 2001 and 2000 we contributed $2.6 million, $2.0 million and $1.4 million to the 401(k) Plan, respectively.

The Company also offered a Non-Qualified Deferred Compensation Plan for a select group of management or highly compensated employees. The plan provides saving and investment opportunities to those individuals who elect to defer a portion of their salary. The Company matched a portion of the employee contribution and made discretionary contributions based on the Company's financial performance. We contributed $0.4 million and $0.3 million to the plan for the years ended December 31, 2002 and 2001, respectively.

Subsequent to year-end, the Non-Qualified Deferred Compensation Plan was discontinued and all vested balances were distributed to participants.

SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN

Our Supplemental Executive Retirement Plan ("SERP") provides officers and other members of senior management with supplemental retirement benefits in excess of limits imposed on qualified plans by federal tax law. The SERP is an account balance plan to which we will make annual contributions targeted to provide 40%-60% of the average of the participant's final three years of salary and bonus with us. These benefits will be paid in 15 annual installments beginning the year after they become eligible to receive benefits. Participants are eligible to receive benefits upon leaving our employment if they are at least 65 years of age or at least age 55 with five years of plan participation, if a change of control occurs or in the event of death. We recognized $0.9 million and $0.7 million of expense in 2002 and 2001, respectively, related to the SERP. Our liability was $3.8 million and $3.1 million at December 31, 2002 and 2001, respectively, for future payments under this plan. We calculate this expense and liability based on actuarial assumptions regarding years of participation, future investment returns and participants continuing in the SERP until age 65.

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NOTE 14 - INCOME TAXES

The components of the provision for income taxes consisted of the following:

| | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| Current: | | | |
| Federal | $ (28,893) | $ 63,865 | $ 93,334 |
| State | 138 | 6,381 | 7,085 |
| | (28,755) | 70,246 | 100,419 |
| Deferred | | | |

| | | | |
|---|---|---|---|
| Federal | 29,840 | 41,445 | 11,072 |
| State | 782 | 1,969 | 5,814 |
| | 30,622 | 43,414 | 16,886 |
| Total | $ 1,867 | $ 113,660 | $ 117,305 |

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

| | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| Statutory federal income tax rate | 35.0% | 35.0% | 35.0% |
| State income taxes, net of federal benefit | 211.3 | 1.9 | 2.7 |
| Other, net | 413.4 | 2.6 | 0.9 |
| Effective income tax rate | 659.7% | 39.5% | 38.6% |

The 2002 effective income tax rate is high relative to statutory rates primarily due to the effect of nondeductible expenses, minimum state income taxes and low pretax income.

Our deferred tax assets and liabilities are as follows:

| | AT DECEMBER 31, | |
|---|---|---|
| | 2002 | 2001 |
| Deferred income tax assets resulting from future deductible and taxable temporary differences: | | |
| Allowance for loan losses and retained interests fair value adjustments | $ 172,299 | $221,405 |
| Deferred revenues | 59,042 | 72,944 |
| Other | 68,143 | 45,867 |
| Total deferred tax assets | 299,484 | 340,216 |
| Deferred income tax liabilities resulting from future taxable and deductible temporary differences: | | |
| Accrued interest on credit card loans | 207,984 | 226,060 |
| Deferred marketing costs | 35,689 | 37,524 |
| Other | 34,986 | 25,185 |
| Total deferred tax liabilities | 278,659 | 288,769 |
| Net deferred tax assets | $ 20,825 | $ 51,447 |

We believe, based on our operating earnings in prior years, expected reversal of taxable temporary differences, and to a lesser degree reliance on expectations for operating earnings in future years, the deferred tax assets are fully realizable.



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 each of the years ended December 31, 1998 through 2002 amounted to a reduction (addition) to deferred income taxes of $15.1 million, $40.3 million, $23.8 million, $1.0 million, and ($16.5 million), respectively. Such reclasses did not result in any adjustment to net income.

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 $14 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 December 31, 2002, the Company has deferred more than $212 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 15 - RELATED PARTY TRANSACTIONS

In the ordinary course of business, our executive officers may have credit card loans issued by us. Pursuant to our policy, such loans are issued on the same terms as those prevailing at the time for comparable loans with unrelated persons and do not involve more than the normal risk of collectibility.

On May 7, 1999 we entered into a loan agreement with our former Chairman and Chief Executive Officer, Ronald N. Zebeck. The loan's original and current principal balance is $5 million. The loan is unsecured and bears interest at a rate of 6.25%. Mr. Zebeck was terminated effective December 15, 2002. The terms of the loan agreement provide that if he remained employed by us until May 17, 2004, or if his employment by us is terminated before that date due to (a) his death or disability, or (b) for any reason other than for cause, we will pay him a bonus equal to (1) the amount of interest accrued on the loan, plus (2) the gross-up amount of taxes relating to his receipt of the interest amount. At the time of Mr. Zebeck's termination, we reserved the right to treat his termination as for cause. Accordingly, whether Mr. Zebeck is entitled to the bonus described in this paragraph will depend on the resolution of the basis for his termination.

NOTE 16 - COMMITMENTS AND CONTINGENCIES

Commitments to extend credit to consumers represent the unused credit limits on open credit card accounts. These commitments were $12.0 billion and

$15.7 billion as of December 31, 2002 and 2001, respectively. While these amounts represent the total lines of credit available to our customers, we have not experienced and do not anticipate that all of our customers will exercise their entire available line at any given point in time. We also have the right to



increase, reduce, cancel, alter or amend the terms of these available lines of credit at any time.

We lease certain office facilities and equipment under various cancelable and non-cancelable operating lease agreements that provide for the payment of a proportionate share of property taxes, insurance and other maintenance expenses. These leases also may include scheduled rent increases and renewal options. Rental expense for these operating leases for the years ended December 31, 2002, 2001, and 2000, was $23.8 million, $21.8 million and $18.1 million, respectively. In 2002, we recognized $6.4 million of expense due to excess capacity related to certain operating leases.

Future minimum lease commitments at December 31, 2002, under cancelable and non-cancelable operating leases are as follows:

| | |
|---|---|
| 2003 | 14,851 |
| 2004 | 11,382 |
| 2005 | 9,252 |
| 2006 | 7,850 |
| 2007 | 7,806 |
| Thereafter | 26,998 |
| Total minimum lease payments | $ 78,139 |

We are a party to various legal proceedings resulting from the ordinary business activities relating to our operations. In July 2000 an Amended Complaint was filed in Hennepin County District Court in Minneapolis, Minnesota against MCI and its subsidiaries, Metris Direct Inc. and Direct Merchants Bank. The complaint sought damages in unascertained amounts and purported to be a class action complaint on behalf of all cardholders who were issued a credit card by Direct Merchants Bank and were allegedly assessed fees or charges that the cardholder did not authorize. Specifically, the complaint alleged violations of the Minnesota Prevention of Consumer Fraud Act, the Minnesota Deceptive Trade Practices Act and breach of contract. A class action settlement was signed by the Judge on May 30, 2002 and entered on June 4, 2002, whereby we will pay approximately $5.6 million for attorneys' fees and costs incurred by attorneys for the plaintiffs in separate lawsuits filed in Arizona, California and Minnesota in 2000 and 2001. We recorded a $5.6 million accrual during 2001 to reflect the proposed settlement. Under the terms of the settlement, we denied any wrongdoing or liability. A final order approving the settlement was signed by the judge on May 30, 2002, and entered on June 4, 2002. No appeal was filed. We implemented the terms of settlement beginning September 4, 2002.

In September and October 2002, three shareholder lawsuits were filed in the United States District Court for the District of Minnesota, naming MCI, Ronald N. Zebeck and David Wesselink as defendants. Two of the lawsuits have been dismissed. The plaintiff in the remaining lawsuit seeks to represent a class of purchasers of MCI common stock between November 5, 2001 and July 17, 2002. The lawsuit seeks damages in an unspecified amount. The complaint alleges

that defendants violated the federal securities laws when MCI failed to disclose the existence of the OCC Report of Examination ("ROE") until April 17, 2002. Metris believes that the lawsuit is without merit and has moved for its dismissal.

Our activities as a credit card lender are subject to regular review and examination by federal regulators to assess compliance with various federal consumer protection laws. Regulators are authorized to impose penalties for violations of these laws and, in certain cases, to order us to pay restitution to injured cardholders.



On May 3, 2001, Direct Merchants Bank entered into a consent order with the OCC. The consent order required us to pay approximately $3.2 million in restitution to approximately 62,000 credit card customers who applied for and received a credit card in connection with a series of limited test marketing campaigns from March 1999 to June 2000. Under the terms of the consent order, we made no admission or agreement on the merits of the OCC's assertions. The restitution as required by the OCC consent order was paid and is reflected in our December 31, 2001 financial statements. In October 2002, the OCC advised that Direct Merchants Bank is in full compliance with the consent order.

In May 2001, the OCC also indicated that it was considering whether or not to pursue an assessment of civil money penalties and gave us the opportunity to provide information to the OCC bearing on whether imposing a penalty would be appropriate and the severity of any penalty. The statutory provisions pursuant to which a civil money penalty could be assessed give the OCC broad discretion in determining whether or not a penalty will be assessed and, if so, the amount of the penalty. In October 2002, the OCC made a determination not to assess civil money penalties.

On April 16, 2002, Direct Merchants Bank entered into an agreement with the OCC intended to strengthen the safety and soundness of Direct Merchants Bank's operations. The agreement formalized recommendations made and requirements imposed by the OCC following an examination of Direct Merchants Bank that resulted in a Report of Examination issued on April 4, 2002. On March 18, 2003, the OCC terminated the agreement.

NOTE 17 - CAPITAL REQUIREMENTS AND RESTRICTED PAYMENTS

In the normal course of business, we enter into agreements, or are 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 us and our affiliates. Such restrictions limit Direct Merchants Bank's ability to lend to us and our affiliates. Additionally, Direct Merchants Bank is limited in its ability to declare dividends to us and our affiliates in accordance with the national bank dividend rules and the Formal Agreement.

Direct Merchants Bank is subject to certain capital adequacy guidelines adopted by the OCC. At December 31, 2002 and 2001, Direct Merchants Bank's Tier 1 risk-based capital ratio, risk-based total capital ratio and Tier 1 leverage ratio exceeded the minimum required capital levels, and Direct Merchants Bank was considered a "well-capitalized" depository institution under regulations of the OCC.

We are also bound by restrictions set forth in the indentures related to the Senior Notes dated November 7, 1997, and July 15, 1999. Pursuant to those indentures, we may not make dividend payments in the event of a default or if all such restricted payments would exceed 25% of our aggregate cumulative net income.

NOTE 18 - CONCENTRATIONS OF CREDIT RISK

A concentration of credit risk is defined as significant credit exposure with an individual or group engaged in similar activities or affected similarly by economic conditions. We are active in originating credit card loans throughout

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the United States, and no individual or group had a significant concentration of credit risk at December 31, 2002 or 2001.

We target our consumer lending products primarily to moderate-income consumers. Primary risks associated with lending to this market are that they may be more sensitive to future economic downturn, which may make them more likely to default on their obligations.

The banking regulators have issued guidelines to further segregate a credit card issuer's loan portfolio between subprime loans (loans to consumers who have a FICO credit score of 660 or less) and prime loans (loans to consumers with FICO scores in excess of 660). The banking regulators deem subprime loans to have higher credit risk. Subprime receivables were $447.3, million or 52.9% of the credit card portfolio as of December 31, 2002, compared to $1.6 billion or 59.2% of the credit card portfolio as of December 31, 2001.

NOTE 19 - FAIR VALUE OF FINANCIAL INSTRUMENTS

We have estimated the fair value of our financial instruments in accordance with SFAS No. 107, "Disclosures About Fair Value of Financial Instruments." Financial instruments include both assets and liabilities, whether or not recognized in our consolidated balance sheets, for which it is practicable to estimate fair value. The fair value of an asset is the amount at which the asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Additionally, certain intangible assets recorded on the consolidated balance sheets, such as purchased credit card relationships, and other intangible assets not recorded on the consolidated balance sheets (such as the value of the credit card relationships for originated loans and the franchise values of our various lines of business) are not considered financial instruments and, accordingly, are not valued for purposes of this disclosure. Accordingly, the aggregate estimated fair value amounts presented do not represent the entire underlying value of the Company.

Quoted market prices generally are not available for all of our financial instruments. Accordingly, in cases where quoted market prices are not available, fair values were estimated using present value and other valuation techniques that are significantly affected by the assumptions used, including the discount rate and estimated future cash flows. These assumptions are based on historical experience and assessments regarding the ultimate collectibility of assets and related interest, and estimates of product lives and repricing characteristics used in our asset/liability management process. These assumptions involve uncertainties and matters of judgment, and therefore, cannot be determined with precision. Thus, changes in these assumptions could significantly affect the fair-value estimates.

A description of the methods and assumptions used to estimate the fair value of each class of our financial instruments is as follows:

Cash and cash equivalents

The carrying amounts approximate fair value due to the short-term nature of these instruments.

Net credit card loans

Credit card loans are originated with variable rates of interest that adjust with changing market interest rates. Thus, the carrying value of the credit card loans, less the allowance for loan losses, approximates fair value. This valuation does not include the value that relates to estimated cash flows

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generated from new loans from existing cardholders over the life of the cardholder relationship. Accordingly, the aggregate fair value of the credit card loans does not represent the underlying value of the established cardholder relationships.

Retained interests and other securitization related assets

The fair value of the retained interests and other securitization related assets are estimated by discounting the expected future cash flows from the Master Trust and each of the conduits at rates which we believe to be consistent with those that would be used by an independent third party. However, because there is no active market for the retained interests, the fair values presented may not be indicative of the value negotiated in an actual sale. The future cash flows used to estimate fair value are limited to the securitized receivables that exist at year end and do not reflect the value associated with future receivables generated by accountholder activity.

Interest rate caps

We enter into interest rate cap transactions related to each series of securities issued from the Metris Master Trust. We report these assets on the consolidated balance sheets at market value.

Debt

We make short-term borrowings with variable rates of interest that adjust with changing market interest rates. Thus, carrying value approximates fair value.

We obtain the fair value of long-term debt from quoted market yields, when available.

Deposits

The fair values for fixed rate certificates of deposit are estimated based on quoted market prices of comparable instruments.

The estimated fair values of our financial instruments are summarized as follows:

AT DECEMBER 31,

| | 2002 | | 2001 | |
|---|---|---|---|---|
| | CARRYING AMOUNT | ESTIMATED FAIR VALUE | CARRYING AMOUNT | ESTIMATED FAIR VALUE |
| Cash and cash equivalents | $580,232 | $ 580,232 | $ 381,639 | $ 381,639 |
| Credit card loans, net | 756,102 | 756,102 | 2,296,604 | 2,296,604 |
| Retained interests in loans securitized | 808,026 | 808,026 | 859,559 | 859,559 |
| Other receivables due from credit card securitizations, net | 110,471 | 110,471 | 139,833 | 139,833 |
| Interest rate caps | 12,711 | 12,711 | 27,321 | 27,321 |
| Interest rate swap agreements | -- | -- | 3,293 | 3,293 |
| Debt | 357,649 | 341,580 | 647,904 | 633,005 |
| Deposits | 892,754 | 911,141 | 2,058,008 | 2,067,697 |

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NOTE 20 - DERIVATIVE FINANCIAL INSTRUMENTS

We use derivative financial instruments for the purpose of managing our exposure to interest rate risks.

MRI enters into interest rate cap transactions related to each asset-backed securitization transaction. MRI assigns all of its right, title, and interest under the interest rate cap agreement to the Trustee of the Metris Master Trust for the benefit of the holders of securities issued by the Metris Master Trust. The purpose of the interest rate cap is to effectively limit the interest exposure of the Metris Master Trust for each individual series to a maximum based upon the LIBOR rate.

The interest rate caps do not meet the criteria for hedge accounting treatment. The change in the fair value of the caps is included in the consolidated income statement under "Securitization Income." For the year ended December 31, 2002 we recognized expense of $22.6 million from the mark-to-market adjustments on the interest rate caps. For the year ended December 31, 2001, excluding the cumulative effect of accounting change, we recognized income of $10.1 million from the mark-to-market adjustments on interest rate caps.

We entered into interest rate swap transactions through Direct Merchants Bank. The swaps were used to convert a portion of the fixed rate certificates of deposit ("CDs") to variable rate CDs, and thus hedge the fair market value of the CDs. The CDs expose us to variability in the fair value in rising or declining interest rate environments. By converting the fixed payment to a variable payment, the interest rate swaps reduce the variability of the fair market value of the CDs. As of December 31, 2002, there were no interest rate swaps outstanding. As of December 31, 2001, there was one swap outstanding with a fair value of $3.3 million.

As of the adoption of SFAS No. 133 or their inception, all swaps were designated as fair value hedges. Changes in the value of the swaps are recognized in income, in the period in which the change in value occurred. In addition, changes in the value of the CDs, to the extent they are attributable to the risk being hedged, are simultaneously recognized in income. Any difference between the fair value change in the swaps versus the fair value change in the related hedged CDs was considered to be the "ineffective" portion of the hedge. The ineffective portion of the swap is recorded as an increase or decrease in income.

During 2002 and 2001, all swaps were sold. At the date of sale, the swap and the related CDs were valued, and a gain or loss was recognized for the

difference between the change in fair value of the swap and the change in fair value of the CDs. The cumulative amount recorded as an adjustment to the value of the CDs is being amortized over the life of the CDs as an adjustment to interest expense. Additionally, $3.5 million was recognized as income in 2001 related to the ineffective portion of the swaps.

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Prior to SFAS No. 133, we amortized the costs of interest rate contracts on a straight-line basis over the expected life of the contract. The adoption of SFAS No. 133 resulted in a one-time, non-cash, after-tax charge to earnings of $14.2 million, reflected as a "Cumulative effect of accounting change" in the consolidated statements of income for the year ended December 31, 2001.

NOTE 21 - 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 consumers for whom general credit bureau information is available.

We market our enhancement services products, including (1) debt waiver protection for unemployment, disabilities, 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 currently issue and administer our extended service plans sold through a third-party retailer, and the customer pays the retailer directly.

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 elimination column in the segment table includes adjustments to present the information on an owned basis as reported in the financial statements of this Annual Report on Form 10-K/A.

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, extraordinary loss and cumulative effect of accounting changes 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 operating assets located outside of the United States for the periods presented.

Our enhancement services operating segment pays a fee to the consumer lending products segment for successful marketing efforts to cardholders at a rate similar to those paid to other third parties. Our enhancement services segment reports interest income and the consumer lending 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.

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| | 2002 | | | | |
|---|---|---|---|---|---|
| | CONSUMER LENDING PRODUCTS | ENHANCEMENT SERVICES | SECURITIZATION ADJUSTMENTS (a) | OTHER ADJUSTMENTS(b) | CONSOLIDATED |
| Interest income | $ 2,099,595 | $ 2,521 | $ (1,870,193) | $ (2,521) | $ 229,402 |
| Interest expense | 321,982 | -- | (215,945) | (2,521) | 103,516 |
| Net interest income | 1,777,613 | 2,521 | (1,654,248) | -- | 125,886 |
| Other operating income | 517,266 | 384,050 | (65,895) | -- | 835,421 |
| Total revenue | 2,294,879 | 386,571 | (1,720,143) | -- | 961,307 |
| Income (loss) before income taxes and cumulative effect of accounting change | 267,336(c) | 240,709(c) | -- | (507,762) | 283 |
| Total assets | $10,671,740 | $ 74,829 | $ (8,836,857) | $ 680,680(d) | $ 2,590,392 |

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| | 2001 | | | | |
|---|---|---|---|---|---|
| | CONSUMER LENDING PRODUCTS | ENHANCEMENT SERVICES | SECURITIZATION ADJUSTMENTS (a) | OTHER ADJUSTMENTS(b) | CONSOLIDATED |
| Interest income | $ 1,973,401 | $ 12,308 | $ (1,604,263) | $ (12,308) | $ 369,138 |
| Interest expense | 480,463 | -- | (301,878) | (12,308) | 166,277 |
| Net interest income | 1,492,938 | 12,308 | (1,302,385) | -- | 202,861 |
| Other operating income | 608,322 | 340,133 | 324,989 | -- | 1,273,444 |
| Total revenue | 2,101,260 | 352,441 | (977,396) | -- | 1,476,305 |
| Income before income taxes and cumulative effect of accounting change | 550,658(c) | 231,837(c) | -- | (494,580) | 287,915 |
| Total assets | $11,369,799 | $ 111,114 | $ (7,895,843) | $ 580,905(d) | $ 4,165,975 |

| | 2000 | | | | |
|---|---|---|---|---|---|
| | CONSUMER LENDING PRODUCTS | ENHANCEMENT SERVICES | SECURITIZATION ADJUSTMENTS (a) | OTHER ADJUSTMENTS(b) | CONSOLIDATED |
| Interest income | $ 1,596,353 | $ 11,848 | $ (1,475,955) | $ (11,848) | $ 120,398 |
| Interest expense | 521,477 | -- | (376,623) | (11,848) | 133,006 |
| Net interest income | 1,074,876 | 11,848 | (1,099,332) | -- | (12,608 |
| Other operating income | 492,864 | 266,201 | 321,205 | -- | 1,080,270 |
| Total revenue | 1,567,740 | 278,049 | (778,127) | -- | 1,067,662 |
| Income before income taxes and cumulative effect of accounting change | 539,914(c) | 183,208(c) | -- | (419,399) | 303,723 |
| Total assets | $ 9,050,108 | $ 120,735 | $ (6,070,224) | $ 637,688(d) | $ 3,738,307 |

(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 adjustments column includes: intercompany eliminations and amounts not allocated to segments.

(c) Income before income taxes and cumulative effect of accounting changes, includes intercompany commissions paid by the enhancement services segment to the consumer lending products segment for successful marketing efforts to

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cardholders of $2.4 million, $12.4 million and $18.3 million for 2002, 2001 and 2000, respectively.

(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.

NOTE 22 - STOCKHOLDERS' EQUITY

On February 6, 2001, the Company's Board of Directors authorized a share repurchase program of up to $200 million of its outstanding common stock over a period ending December 31, 2002. The amount of shares the Company can repurchase in a calendar year is limited under its various debt agreements. In 2002, the Company was limited to repurchasing approximately $98.3 million of shares. As of December 31, 2002, 7.1 million shares had been repurchased under the program for $58.3 million.

During the years ended December 31, 2002 and December 31, 2001, we paid cash dividends of $3.7 million. Under our credit facility agreement we can not make dividend payments in an aggregate amount in any fiscal year that exceed 40% of consolidated net income for the prior fiscal year.

Upon our termination of our former Chairman and Chief Executive Officer in December 2002, he forfeited 540,029 shares of restricted stock. As a result, $4.8 million of deferred compensation and common stock was added back to stockholders' equity.

NOTE 23 - DEBT AND DEPOSITS

We have a warehouse financing facilities accounted for as collateralized financings under SFAS No. 140 which is included in "Debt" on the consolidated balance sheet. The financing conduits had a capacity of $100 million and $400 million as of December 31, 2002 and 2001, respectively, and a variable interest rate based on LIBOR. As of December 31, 2002 and 2001, there was zero and $292 million, respectively outstanding on the conduit. Subsequent to year-end, all financing conduits were terminated.

Our credit facility consists of a $170 million revolving credit facility which matures in July 2003, and a $100 million term loan which matures in June 2003. At December 31, 2002 and 2001, we had outstanding borrowings of $100 million under the term loan facility with weighted-average interest rates of 4.7% and 5.4% respectively, and outstanding letters of credit of $7.3 million and $5.3 million, respectively. At December 31, 2002, we were in compliance with all financial covenants under these agreements.

As of December 31, 2002, we had $150 million of 10.125% Senior Notes due 2006 outstanding. The carrying value of theses Senior Notes is $146.8 million as of December 31, 2002. These Senior Notes were issued at a discount of $6.3 million to yield an effective interest rate of 11%. The Senior Notes due 2006 and credit facility are unconditionally guaranteed on a senior basis, jointly and severally, by Metris Direct, Inc., magnUS Services, Inc. (formerly Metris Recovery Services, Inc.), Metris Card Services, LLC and Metris Credit Card Services, Inc. (the "Guarantors"). Any subsidiaries we form in the future will provide a guarantee of this indebtedness. The guarantee is an unsecured obligation of the Guarantors and ranks equally with all existing and future unsubordinated indebtedness. We also have $100 million of 10% Senior Notes due 2004 outstanding with terms and conditions substantially similar to the Senior Notes due 2006. We also have a $10.0 million 9.19% term loan due 2005 used to

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fund Company equipment. As of December 31, 2002 and 2001 we were in compliance with all financial covenants under our credit agreements.

Our debt outstanding as of December 31, 2002, matures as follows:

| | |
|---|---|
| 2003 | $ 101,031 |
| 2004 | 100,979 |
| 2005 | 8,551 |
| 2006 | 146,841 |
| 2007 | 80 |
| Thereafter | 167 |
| Total debt outstanding | $ 357,649 |

Direct Merchants Bank has issued certificates of deposit of $100,000 or more from 1999 to 2002. As of December 31, 2002 and 2001, $0.9 billion and $2.1 billion of CDs were outstanding with original maturities ranging from six months

to five years. These CDs pay fixed interest rates ranging from 1.1% to 7.6% and 2.4% to 7.6% at December 31, 2002 and 2001, respectively.

Our deposits outstanding as of December 31, 2002 and 2001, mature as follows:

| | 2002 | WEIGHTED-AVERAGE INTEREST RATE | 2001 | WEIGHTED-AVERAGE INTEREST RATE |
|---|---|---|---|---|
| Three months or less | $ 97,822 | 4.9% | $ 404,955 | 5.8% |
| Over three months through twelve months | 291,143 | 4.8% | 811,802 | 5.3% |
| Over one year through three years | 256,277 | 5.1% | 567,897 | 5.2% |
| Over three years | 247,512 | 5.3% | 273,354 | 5.9% |
| Total deposits | $ 892,754 | 5.1% | $2,058,008 | 5.4% |

The Company, at the request of the OCC, has agreed to reduce receivables at Direct Merchants Bank to no more than $550 million at December 31, 2003 and zero at December 31, 2004. As a result, we do not anticipate issuing jumbo CDs in the foreseeable future.

We have various indirect subsidiaries which 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 the non-guaranteeing subsidiaries are not presented because we have determined that the subsidiaries financial information would not be material to investors.



NOTE 24 - SUBSEQUENT EVENTS

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. This operating agreement formally terminates our April 16, 2002 agreement with the OCC, which is discussed in Footnote 14.

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 December 31, 2002, 52.9% of the Bank's credit card portfolio was 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 required, within 60 days from the date of the operating agreement, to submit to the OCC 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 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 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.

The operating agreement requires Direct Merchants Bank, a third-party depository bank and the OCC to execute a Liquidity Reserve Deposit Agreement ("LRDA") within 30 days of the effective date of the operating agreement.

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 this agreement Direct Merchants Bank declared and paid a $155 million dividend to us.

On March 17, 2003 we secured 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 will replace conduits and warehouse facilities scheduled to mature during March through May 2003. The availability of funding under these facilities is subject to various conditions, including a net reduction of receivables in the Master Trust. Maturities of the conduits can accelerate in certain instances, including if net excess spreads in the Master Trust fall below certain levels. We also terminated our $170 million revolving line of credit.

On March 31, 2003, 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. The backup facility carries an interest rate of 12% per annum plus an option to earn an additional meaningful economic return based on the performance of the Company's managed receivables through December 31, 2004. The backup facility would be repayable in full on March 1, 2004. During the past fiscal year we had in place a $270 million term loan and revolving credit facility. In connection with the conduit transactions discussed

above, all availability under the $170 million revolving portion of this facility was terminated as of March 18, 2003, with the exception of $7.3 million of outstanding letters of credit. Term loans of $100 million remain outstanding under the facility and mature on June 30, 2003. We may refinance these loans with the backup facility provided by THL Fund IV. THL Fund IV's obligation to provide this facility is subject to a number of conditions.



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

| | METRIS COMPANIES INC. | GUARANTOR SUBSIDIARIES | NON-GUARANTOR SUBSIDIARIES | ELIMINATIONS | CONSOLI |
|---|---|---|---|---|---|
| ASSETS: | | | | | |
| Cash and cash equivalents | $ (3,795) | $ 8,109 | $ 575,918 | $ -- | $ 58 |
| Net retained interests in loans securitized | -- | -- | 808,026 | -- | 80 |
| Net credit card loans | 3,813 | -- | 752,289 | -- | 75 |
| Property and equipment, net | -- | 63,395 | 20,436 | -- | 8 |
| Purchased portfolio premium | 128 | -- | 64,451 | -- | 6 |
| Other receivables due from credit card securitizations, net | 13 | -- | 110,458 | -- | 11 |
| Other assets | 10,160 | 44,252 | 180,591 | (47,852) | 18 |
| Investment in subsidiaries | 1,594,352 | 1,549,307 | -- | (3,143,659) | |
| TOTAL ASSETS | $ 1,604,671 | $ 1,665,063 | $ 2,512,169 | $ (3,191,511) | $ 2,59 |
| LIABILITIES: | | | | | |
| Deposits | $ (1,000) | $ -- | $ 893,754 | $ -- | $ 89 |
| Debt | 391,228 | 9,421 | -- | (43,000) | 35 |
| Accounts payable | 71 | 20,683 | 38,949 | (6,114) | 5 |
| Deferred income | -- | 16,681 | 129,978 | (3,511) | 14 |
| Accrued expenses and other liabilities | 159,699 | 23,926 | (99,819) | 4,773 | 8 |
| TOTAL LIABILITIES | 549,998 | 70,711 | 962,862 | (47,852) | 1,53 |
| TOTAL STOCKHOLDERS' EQUITY | 1,054,673 | 1,594,352 | 1,549,307 | (3,143,659) | 1,05 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 1,604,671 | $ 1,665,063 | $ 2,512,169 | $ (3,191,511) | $ 2,59 |

METRIS COMPANIES INC.
SUPPLEMENTAL CONSOLIDATING BALANCE SHEETS
DECEMBER 31, 2001
(DOLLARS IN THOUSANDS)

| | METRIS COMPANIES INC. | GUARANTOR SUBSIDIARIES | NON-GUARANTOR SUBSIDIARIES | ELIMINATIONS | CONSOLI |
|---|---|---|---|---|---|
| ASSETS: | | | | | |
| Cash and cash equivalents | $ 17,614 | $ 1,505 | $ 362,520 | $ -- | $ 38 |
| Net retained interests in loans securitized | -- | -- | 859,559 | -- | 85 |
| Net credit card loans | 1,656 | -- | 2,294,948 | -- | 2,29 |
| Property and equipment, net | -- | 89,101 | 25,812 | -- | 11 |
| Purchased portfolio premium | 248 | -- | 94,545 | -- | 9 |
| Other receivables due from credit card securitizations, net | 34 | 644 | 139,155 | -- | 13 |
| Other assets | (3,521) | 54,243 | 237,351 | (9,439) | 27 |
| Investment in subsidiaries | 1,845,622 | 1,694,115 | -- | (3,539,737) | |
| TOTAL ASSETS | $ 1,861,653 | $ 1,839,608 | $ 4,013,890 | $ (3,549,176) | $ 4,16 |
| LIABILITIES: | | | | | |
| Deposits | $ (1,000) | $ -- | $ 2,059,008 | $ -- | $ 2,05 |
| Debt | 345,924 | 9,980 | 292,000 | -- | 64 |
| Accounts payable | 3,070 | 15,461 | 68,073 | (3,129) | 8 |
| Deferred income | 3,270 | 30,615 | 157,979 | (3,129) | 18 |
| Accrued expenses and other liabilities | (51,404) | 60,061 | 77,041 | (3,181) | 8 |
| Intercompany allocations | 456,457 | (122,131) | (334,326) | -- | |
| TOTAL LIABILITIES | 756,317 | (6,014) | 2,319,775 | (9,439) | 3,06 |
| TOTAL STOCKHOLDERS' EQUITY | 1,105,336 | 1,845,622 | 1,694,115 | (3,539,737) | 1,10 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 1,861,653 | $ 1,839,608 | $ 4,013,890 | $ (3,549,176) | $ 4,16 |



METRIS COMPANIES INC.
SUPPLEMENTAL CONSOLIDATING STATEMENTS OF INCOME
YEAR ENDED DECEMBER 31, 2002
(DOLLARS IN THOUSANDS)

| | METRIS COMPANIES | GUARANTOR | NON-GUARANTOR |
|---|---|---|---|

| | INC. | SUBSIDIARIES | SUBSIDIARIES | ELIMINATIONS | CONSOLI |
|---|---|---|---|---|---|
| NET INTEREST INCOME (EXPENSE) | $ (30,584) | $ (389) | $ 156,859 | $ -- | $ 12 |
| Provision for loan losses | (603) | -- | 220,305 | 102 | 21 |
| NET INTEREST INCOME (EXPENSE) AFTER PROVISION FOR LOAN LOSSES | (29,981) | (389) | (63,446) | (102) | (9 |
| OTHER OPERATING INCOME: | | | | | |
| Securitization income | 3,168 | -- | 324,872 | (4,523) | 32 |
| Servicing income on securitized / sold receivables | -- | -- | 195,214 | -- | 19 |
| Credit card fees, interchange and other credit card income | 1,748 | 94,941 | 166,747 | (100,262) | 16 |
| Enhancement services revenues | -- | 58,664 | 154,519 | (59,667) | 15 |
| Intercompany allocations | 166 | 266,604 | 45,742 | (312,512) | |
| | 5,082 | 420,209 | 887,094 | (476,964) | 83 |
| OTHER OPERATING EXPENSE: | | | | | |
| Credit card account and other product solicitation and marketing expenses | 16 | 112,249 | 181,196 | (120,192) | 17 |
| Employee compensation | (1,101) | 183,701 | 28,226 | -- | 21 |
| Data processing services and communications | 52 | (92,080) | 184,702 | (8,800) | 8 |
| Credit protection claims expense | -- | 1,334 | 43,216 | -- | 4 |
| Credit card fraud losses | 177 | -- | 8,470 | -- | |
| Purchased portfolio premium amortization | 119 | -- | 33,727 | (3,626) | 3 |



| | INC. | SUBSIDIARIES | SUBSIDIARIES | ELIMINATIONS | CONSOLI |
|---|---|---|---|---|---|
| Occupancy and equipment | -- | -- | 48,013 | -- | 4 |
| Mastercard/Visa assessment and fees | -- | -- | 13,869 | -- | 1 |
| Asset impairments and lease write-offs | -- | -- | 27,736 | -- | 2 |
| Other | 7,037 | 143,488 | (40,918) | (9,391) | 10 |
| Intercompany allocations | 80 | 92,814 | 219,618 | (312,512) | |
| | 6,380 | 441,506 | 747,855 | (454,521) | 74 |
| INCOME (LOSS) BEFORE INCOME TAXES, EQUITY IN INCOME OF SUBSIDIARIES AND | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| CUMULATIVE EFFECT OF ACCOUNTING CHANGE | (31,279) | (21,686) | 75,793 | (22,545) | |
| Income taxes | (9,377) | (20,107) | 38,110 | (6,759) | |
| Equity in income of subsidiaries | 20,318 | 37,683 | -- | (58,001) | |
| NET INCOME (LOSS) | $ (1,584) | $ 36,104 | $ 37,683 | $ (73,787) | $ ( |



METRIS COMPANIES INC.
SUPPLEMENTAL CONSOLIDATING STATEMENTS OF INCOME
YEAR ENDED DECEMBER 31, 2001
(DOLLARS IN THOUSANDS)

| | METRIS COMPANIES INC. | GUARANTOR SUBSIDIARIES | NON-GUARANTOR SUBSIDIARIES | ELIMINATIONS | CONSOLI |
|---|---|---|---|---|---|
| NET INTEREST INCOME (EXPENSE) | $ 8,579 | $ (8,437) | $ 202,719 | $ -- | $ 20 |
| Provision for loan losses | 1,393 | -- | 459,713 | -- | 46 |
| NET INTEREST INCOME (EXPENSE) AFTER PROVISION FOR LOAN LOSSES | 7,186 | (8,437) | (256,994) | -- | (25 |
| OTHER OPERATING INCOME: | | | | | |
| Securitization income | 67 | -- | 650,333 | -- | 65 |
| Servicing income on securitized / sold receivables | -- | -- | 159,074 | -- | 15 |
| Credit card fees, interchange and other credit card income | 2,890 | 31,507 | 318,718 | (31,067) | 32 |
| Enhancement services revenues | -- | 57,836 | 84,086 | -- | 14 |
| Intercompany allocations | 152 | 229,643 | 34,807 | (264,602) | |
| | 3,109 | 318,986 | 1,247,018 | (295,669) | 1,27 |
| OTHER OPERATING EXPENSE: | | | | | |
| Credit card account and other product solicitation and marketing expenses | -- | 12,869 | 175,140 | -- | 18 |
| Employee compensation | 1,101 | 197,646 | 26,716 | -- | 22 |
| Data processing services and communications | 3 | (90,538) | 198,876 | (18,119) | 9 |
| Enhancement services claims expense | -- | 877 | 29,580 | -- | 3 |
| Credit card fraud losses | 1 | 5 | 9,062 | -- | |

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| | | | | | |
|---|---|---|---|---|---|
| Purchased portfolio premium amortization | -- | -- | 32,116 | (1,839) | 3 |
| Occupancy and equipment | -- | -- | 47,572 | -- | 4 |
| Mastercard/Visa assessment and fees | -- | -- | 16,522 | -- | 1 |
| Intercompany allocations | 127 | 57,355 | 207,120 | (264,602) | |
| Other | (392) | 127,304 | (34,366) | (2,852) | 8 |
| | 840 | 305,518 | 708,338 | (287,412) | 72 |
| INCOME BEFORE INCOME TAXES, EQUITY IN INCOME OF SUBSIDIARIES AND CUMULATIVE EFFECT OF ACCOUNTING CHANGE | 9,455 | 5,031 | 281,686 | (8,257) | 28 |
| Income taxes | 3,646 | 1,168 | 111,875 | (3,029) | 11 |
| Equity in income of subsidiaries | 154,220 | 155,585 | -- | (309,805) | |
| INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE | 160,029 | 159,448 | 169,811 | (315,033) | 17 |
| Cumulative effect of accounting change, net | -- | -- | 14,226 | -- | 1 |
| NET INCOME | $ 160,029 | $ 159,448 | $ 155,585 | $ (315,033) | $ 16 |

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METRIS COMPANIES INC.
SUPPLEMENTAL CONSOLIDATING STATEMENTS OF INCOME
YEAR ENDED DECEMBER 31, 2000
(DOLLARS IN THOUSANDS)

| | METRIS COMPANIES INC. | GUARANTOR SUBSIDIARIES | NON-GUARANTOR SUBSIDIARIES | ELIMINATIONS | CONSOLI |
|---|---|---|---|---|---|
| NET INTEREST (EXPENSE) INCOME | $ (76,200) | $ (5,102) | $ 68,694 | $ -- | $ (1 |
| Provision for loan losses | (12) | -- | 164,812 | -- | 16 |
| NET INTEREST (EXPENSE) INCOME AFTER PROVISION FOR LOAN LOSSES | (76,188) | (5,102) | (96,118) | -- | (17 |
| OTHER OPERATING INCOME: | | | | | |
| Securitization income | 3,536 | -- | 640,921 | -- | 64 |
| Servicing income on securitized / sold | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| receivables | -- | -- | 128,823 | -- | 12 |
| Credit card fees, interchange and other credit card income | 504 | 633 | 184,294 | -- | 18 |
| Enhancement services revenues | -- | 54,747 | 66,812 | -- | 12 |
| | 4,040 | 55,380 | 1,020,850 | -- | 1,08 |
| OTHER OPERATING EXPENSE: | | | | | |
| Credit card account and other product solicitation and marketing expenses | -- | 21,690 | 127,515 | -- | 14 |
| Employee compensation | -- | 147,567 | 31,025 | -- | 17 |
| Data processing services and communications | -- | (82,228) | 168,394 | -- | 8 |
| Credit protection claims expense | -- | 1,354 | 19,457 | -- | 2 |
| Credit card fraud losses | 5 | -- | 8,881 | -- | |



| | | | | | |
|---|---|---|---|---|---|
| Purchased portfolio premium amortization | -- | -- | 19,275 | -- | 1 |
| Occupancy and equipment | -- | -- | 35,563 | -- | 3 |
| Mastercard/Visa assessment and fees | -- | -- | 14,712 | -- | 1 |
| Other | (119) | 57,267 | 28,781 | -- | 8 |
| | (114) | 145,650 | 453,603 | -- | 59 |
| INCOME (LOSS) BEFORE INCOME TAXES, EQUITY IN INCOME OF SUBSIDIARIES AND CUMULATIVE EFFECT OF ACCOUNTING CHANGE | (72,034) | (95,372) | 471,129 | -- | 30 |
| Income taxes | (27,767) | (38,424) | 183,496 | -- | 11 |
| Equity in income of subsidiaries | 230,169 | 287,117 | -- | (517,286) | |
| INCOME (LOSS) BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE | 185,902 | 230,169 | 287,633 | (517,286) | 18 |
| Cumulative effect of accounting change, net | -- | -- | 516 | -- | |
| NET INCOME (LOSS) | $ 185,902 | $ 230,169 | $ 287,117 | $ (517,286) | $ 18 |



METRIS COMPANIES INC.
SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2002

(DOLLARS IN THOUSANDS)

| | METRIS COMPANIES INC. | GUARANTOR SUBSIDIARIES | NON-GUARANTOR SUBSIDIARIES | ELIMINATIONS | CONSOLI |
|---|---|---|---|---|---|
| OPERATING ACTIVITIES: | | | | | |
| Net cash provided by operating activities | $ 78,331 | $ 51,110 | $ 209,857 | $ (30,787) | $ 30 |
| INVESTING ACTIVITIES: | | | | | |
| Net proceeds from transfers of portfolios to the Metris Master Trust | -- | -- | 2,087,097 | -- | 2,08 |
| Net cash from loan originations and principal collections on loans receivable | (1,554) | -- | (703,060) | -- | (70 |
| Proceeds from sales of credit card portfolios to third parties | -- | -- | 16,278 | -- | 1 |
| Additions to property and equipment | -- | (5,161) | (998) | -- | ( |
| Investment in subsidiaries | (96,479) | 248,588 | 243,969 | (396,078) | |
| Net cash provided by (used in) investing activities | (98,033) | 243,427 | 1,643,286 | (396,078) | 1,39 |
| FINANCING ACTIVITIES: | | | | | |
| Net proceeds from issuance (repayment) of debt | 45,304 | (559) | (292,000) | (43,000) | (29 |
| Net (decrease) increase in deposits | -- | -- | (1,165,254) | -- | (1,16 |
| Cash dividends paid | (3,728) | -- | -- | -- | ( |
| Net (decrease) increase in common equity | 2,011 | -- | -- | -- | |
| Repurchase of common stock | (45,294) | -- | -- | -- | (4 |
| Capital contributions | -- | (287,374) | (182,491) | 469,865 | |



| | METRIS COMPANIES INC. | GUARANTOR SUBSIDIARIES | NON-GUARANTOR SUBSIDIARIES | ELIMINATIONS | CONSOLI |
|---|---|---|---|---|---|
| Net cash (used in) provided by financing activities | (1,707) | (287,933) | (1,639,745) | 426,865 | (1,50 |
| Net (decrease) increase in cash and cash equivalents | (21,409) | 6,604 | 213,398 | -- | 19 |
| Cash and cash equivalents at beginning of year | 17,614 | 1,505 | 362,520 | -- | 38 |
| Cash and cash equivalents | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| at end of year | $ (3,795) | $ 8,109 | $ 575,918 | $ -- | $ 58 |



METRIS COMPANIES INC.
SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
YEAR ENDED DECEMBER 31,2001
(DOLLARS IN THOUSANDS)

| | METRIS COMPANIES INC. | GUARANTOR SUBSIDIARIES | NON-GUARANTOR SUBSIDIARIES | ELIMINATIONS | CONSOLI |
|---|---|---|---|---|---|
| OPERATING ACTIVITIES: | | | | | |
| Net cash provided by operating activities | $ 161,612 | $ 132,930 | $ 498,252 | $ (315,033) | $ 47 |
| INVESTING ACTIVITIES: | | | | | |
| Net proceeds from transfers of portfolios to the Metris Master Trust | -- | -- | 553,180 | -- | 55 |
| Net cash flow from loan originations and principal collections on loans receivable | (503) | -- | (1,126,886) | -- | (1,12 |
| Credit card portfolio acquisitions | -- | -- | (290,774) | -- | (29 |
| Additions to property and equipment | -- | (18,257) | 12,549 | -- | ( |
| Investment in subsidiaries | (218,746) | (170,922) | 2,238 | 387,430 | |
| Net cash provided by (used in) investing activities | (219,249) | (189,179) | (849,693) | 387,430 | (87 |
| FINANCING ACTIVITIES: | | | | | |
| Net proceeds from issuance (repayment) of debt | 900 | (1,062) | 292,000 | -- | 29 |
| Net (decrease) increase in deposits | -- | -- | (48,191) | -- | (4 |
| Cash dividends paid | (3,752) | -- | -- | -- | ( |
| Net (decrease) increase in common equity | 26,248 | -- | -- | -- | 2 |
| Repurchase of common stock | (13,014) | -- | -- | -- | (1 |
| Capital contributions | -- | 48,156 | 24,241 | (72,397) | |
| Net cash (used in) provided by financing activities | 10,382 | 47,094 | 268,050 | (72,397) | 25 |

| | | | | | |
|---|---|---|---|---|---|
| Net (decrease) increase in cash and cash equivalents | (47,255) | (9,155) | (83,391) | -- | (13 |
| Cash and cash equivalents at beginning of year | 64,869 | 10,660 | 445,911 | -- | 52 |
| Cash and cash equivalents at end of year | $ 17,614 | $ 1,505 | $ 362,520 | $ -- | $ 38 |

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METRIS COMPANIES INC.
SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2000
(DOLLARS IN THOUSANDS)

| | METRIS COMPANIES INC. | GUARANTOR SUBSIDIARIES | NON-GUARANTOR SUBSIDIARIES | ELIMINATIONS | CONSOLI |
|---|---|---|---|---|---|
| OPERATING ACTIVITIES: | | | | | |
| Net cash provided by operating activities | $ 160,614 | $ 283,108 | $ 696,061 | $ (536,153) | $ 60 |
| INVESTING ACTIVITIES: | | | | | |
| Net cash from loan originations and principal collections on loans receivable | (417) | -- | (1,360,810) | -- | (1,36 |
| Proceeds from sales of credit card portfolios to third parties | -- | -- | -- | -- | |
| Credit card portfolio acquisitions | -- | -- | (195,597) | -- | (19 |
| Additions to property and equipment | -- | (54,552) | (30,455) | -- | (8 |
| Investment in subsidiaries | (336,303) | (404,912) | -- | 741,215 | |
| Net cash provided by (used in) investing activities | (336,720) | (459,464) | (1,586,862) | 741,215 | (1,64 |
| FINANCING ACTIVITIES: | | | | | |
| Net proceeds from issuance (repayment) of debt | 242,667 | (47,376) | (184,237) | -- | 1 |
| Net (decrease) increase in deposits | -- | -- | 1,330,818 | -- | 1,33 |
| Cash dividends paid | (2,942) | -- | -- | -- | ( |
| Net (decrease) increase in common equity | (42,369) | 234,081 | 39,628 | (205,062) | 2 |
| Net cash (used in) | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| provided by financing activities | 197,356 | 186,705 | 1,186,209 | (205,062) | 1,36 |
| Net (decrease) increase in cash and cash equivalents | 21,250 | 10,349 | 295,408 | -- | 32 |

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| | | | | | |
|---|---|---|---|---|---|
| Cash and cash equivalents at beginning of year | 43,619 | 309 | 150,505 | -- | 19 |
| Cash and cash equivalents at end of period | $ 64,869 | $ 10,658 | $ 445,913 | $ -- | $ 52 |

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METRIS COMPANIES INC. AND SUBSIDIARIES
SUMMARY OF CONSOLIDATED QUARTERLY FINANCIAL INFORMATION AND STOCK DATA
(Dollars in thousands, except per-share data) (unaudited)

| | 2002 | | |
|---|---|---|---|
| | FOURTH QUARTER | THIRD QUARTER | SEC QUAR |
| SUMMARY OF OPERATIONS: | | | |
| Interest income | $ 39,350 | $ 31,416 | $ 68 |
| Interest expense | 21,144 | 23,252 | 26 |
| Net Interest Income | 18,206 | 8,164 | 41 |
| Provision for loan losses | 40,987 | 26,340 | 90 |
| Other Operating Income | 147,480 | 262,967 | 167 |
| Other Operating Expense(1) | 186,636 | 174,540 | 198 |
| Income (Loss) Before Income taxes | (61,937) | 70,251 | (80 |
| Income taxes | (21,145) | 25,201 | (30 |
| Net Income (Loss) | (40,792) | 45,050 | (50 |
| Preferred Stock Dividends | 9,822 | 9,605 | 9 |
| Net Income (Loss) Applicable to Common Stockholders | $ (50,614) | $ 35,445 | $ (59 |
| PER COMMON SHARE: | | | |
| Earnings (Loss) per Share: | | | |
| Basic | $ (0.88) | $ 0.50 | $ ( |
| Diluted | (0.88) | 0.50 | ( |
| Shares used to Compute EPS (000's): | | | |

| | | | |
|---|---|---|---|
| Basic | 57,199 | 89,574 | 61 |
| Diluted | 57,199 | 89,579 | 61 |
| Cash Dividends: | $ 0.010 | $ 0.010 | $ 0 |
| Market Prices: | | | |
| High | $ 4.70 | $ 8.40 | $ 2 |
| Low | 1.45 | 1.61 | |
| Close | 2.47 | 2.31 | |

(1) Fourth quarter 2002, included approximately $17.1 million write-down of excess property, equipment, operating leases, and pending sale of our Arizona building and approximately $7 million of marketing and origination costs on our retail note program. In addition, we recorded a $1.1 million write-down of portfolios of charged-off loans purchased in 2001 and 2000.

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METRIS COMPANIES INC. AND SUBSIDIARIES
SUMMARY OF CONSOLIDATED QUARTERLY FINANCIAL INFORMATION AND STOCK DATA
(Dollars in thousands, except per-share data) (unaudited)

| | | 2001 | |
|---|---|---|---|
| | FOURTH QUARTER | THIRD QUARTER | SECOND QUARTER |
| SUMMARY OF OPERATIONS: | | | |
| Interest income | $120,165 | $114,330 | $ 76,20 |
| Interest expense | 31,983 | 42,147 | 44,31 |
| Net Interest Income | 88,182 | 72,183 | 31,89 |
| Provision for loan losses | 252,011 | 78,514 | 89,71 |
| Other Operating Income | 358,520 | 317,938 | 305,41 |
| Other Operating Expense | 166,915 | 197,764 | 187,86 |
| Income Before Income Taxes and Cumulative Effect of Accounting Change | 27,776 | 113,843 | 59,72 |
| Income taxes | 17,611 | 45,613 | 22,74 |
| Income Before Cumulative Effect of Accounting Change | 10,165 | 68,230 | 36,98 |
| Cumulative Effect of Accounting Change (Net of Income Taxes of $8,727) | -- | -- | - |
| Net Income | 10,165 | 68,230 | 36,98 |
| Preferred Stock Dividends | 8,986 | 8,789 | 8,59 |
| Net Income Applicable to Common Stockholders | $ 1,179 | $ 59,441 | $ 28,39 |
| PER COMMON SHARE: | | | |
| Earnings per Share: | | | |

| | | | |
|---|---|---|---|
| Basic (1) | $ 0.02 | $ 0.70 | $ 0.3 |
| Diluted (1) | 0.02 | 0.68 | 0.3 |
| Shares used to Compute EPS (000's): | | | |
| Basic | 63,154 | 97,731 | 97,63 |
| Diluted | 64,271 | 99,911 | 99,84 |
| Cash Dividends: | $ 0.010 | $ 0.010 | $ 0.01 |
| Market Prices: | | | |
| High | $ 28.10 | $ 38.65 | $ 33.7 |
| Low | 15.10 | 20.00 | 20.1 |
| Close | 25.71 | 24.75 | 33.7 |

(1) Earnings per share for the first quarter reflects the $14.2 million one-time, non-cash accounting impact from the adoption of SFAS 133.

STOCK DATA

Our common stock, which is traded under the symbol "MXT," has been listed on the New York Stock Exchange since May 7, 1999. Prior to its listing on the New York Stock Exchange, our common stock traded under the symbol "MTRS" on the Nasdaq Stock Market since its initial public offering on October 25, 1996. As of March 14, 2003, there were approximately 746 holders of record and approximately 18,650 beneficial holders of our common stock.

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MANAGEMENT'S REPORT ON CONSOLIDATED FINANCIAL STATEMENTS AND INTERNAL CONTROL

The accompanying consolidated financial statements, related financial data, and other information in this annual report were prepared by the management of Metris Companies Inc. Management is responsible for the integrity and objectivity of the data presented, including amounts that must necessarily be based on judgments and estimates. The consolidated financial statements were prepared in conformity with accounting principles generally accepted in the United States of America.

Management of Metris Companies Inc. depends on its accounting systems and internal control structures in meeting its responsibilities for reliable consolidated financial statements. In management's opinion, these systems and structures provide reasonable assurance that assets are safeguarded and that transactions are properly recorded and executed in accordance with management's authorizations. As an integral part of these systems and structures, the Company employs a professional staff of internal auditors who conduct operational and special audits and coordinate audit coverage with Company management and the independent auditors.

The consolidated financial statements have been audited by the Company's independent auditors, KPMG LLP, whose opinion appears separately. Their opinion on the consolidated financial statements is based on auditing procedures that include performing selected tests of transactions and records as they deem appropriate. These auditing procedures are designed to provide reasonable assurance that the consolidated financial statements are free of material misstatement.

The Audit Committee of the Company's Board of Directors, composed solely of outside directors, meets quarterly with the internal auditors, the independent auditors and management to review the work of each and ensure that each is properly discharging its responsibilities. The internal and independent auditors have free access to the Audit Committee to discuss the results of their

audit work and their findings.

| /s/ David D. Wesselink | /s/ John A. Witham |
|---|---|
| David D. Wesselink<br>Chairman and<br>Chief Executive Officer | John A. Witham<br>Executive Vice President and<br>Chief Financial Officer |

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INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders
Metris Companies Inc.:

We have audited the accompanying consolidated balance sheets of Metris Companies Inc. and subsidiaries as of December 31, 2002 and 2001, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Metris Companies Inc. and subsidiaries as of December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, the Company has restated its consolidated financial statements;

As discussed in Note 20 to the consolidated financial statements, the Company changed its method of accounting for derivative financial instruments in 2001. As discussed in Note 3 to the consolidated financial statements, the Company changed its method of recognizing revenue for its debt waiver products in 2000.

----------------------
KPMG LLP
Minneapolis, Minnesota
March 31, 2003, except for Note 2, which is dated April 9, 2004.

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14. 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 December 31, 2002, 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 XX for further discussion).

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 IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) The following documents are made part of this Report:

1. Consolidated Financial Statements - See Item 8 above.

2. Financial Statement Schedules

All schedules to the consolidated financial statements normally required by Form 10-K are omitted since they are either not applicable or the required information is shown in the financial statements or the notes thereto.

(b) Reports on Form 8-K: During the three months ended December 31, 2002, through the date of this Report, the Company filed the following six Current Reports on Form 8-K:



Form 8-K filed October 18, 2002, relating to the Company's third quarter 2002 financial results.

Form 8-K filed October 26, 2002, relating to the Company's Renewable Unsecured Subordinated Notes.

Form 8-K filed December 18, 2002, relating to the termination of the Company's former chairman and chief executive officer.

Form 8-K filed January 23, 2003, relating to the Company's workforce reduction.

Form 8-K filed February 28, 2003, correcting the Company's prior announcement regarding payment of a dividend.

Form 8-K filed March 19, 2003, relating to the Company's funding agreements and operating agreement with the Office of the Comptroller of the Currency.

(c) Exhibits: See Exhibit Index on page 109 of this Report.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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 on the 9th day of April, 2004.

METRIS COMPANIES INC.

(Registrant)

By /s/ David D. Wesselink

David D. Wesselink
Chairman and
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of Metris Companies Inc., the Registrant, and in the capacities and on the dates indicated.

| Signature | Title | Date |
| --- | --- | --- |
| Principal executive officer: | Chairman of the Board, Chief Executive Officer | April 9 |
| /s/ David D. Wesselink<br>David D. Wesselink | | |
| Principal financial officer: | Executive Vice President, Chief Financial Officer | April 9 |
| /s/ John A. Witham<br>John A. Witham | | |
| Principal accounting officer: | Senior Vice President, Controller | April 9 |

/s/ Mark P. Wagener
----------------------------------------
Mark P. Wagener



DIRECTORS:

| | | |
|---|---|---|
| /s/ Lee R. Anderson, Sr.<br>Lee R. Anderson, Sr. | Director | April 9 |
| /s/ C. Hunter Boll<br>C. Hunter Boll | Director | April 9 |
| /s/ John A. Cleary<br>John A. Cleary | Director | April 9 |
| /s/ Thomas M. Hagerty<br>Thomas M. Hagerty | Director | April 9 |
| /s/ David V. Harkins<br>David V. Harkins | Director | April 9 |
| /s/ Walter M. Hoff<br>Walter M. Hoff | Director | April 9 |
| /s/ Thomas H. Lee<br>Thomas H. Lee | Director | April 9 |
| /s/ Edward B. Speno<br>Edward B. Speno | Director | April 9 |
| /s/ Frank D. Trestman<br>Frank D. Trestman | Director | April 9 |



EXHIBIT INDEX

| Exhibit Number | Description of Exhibit |
|---|---|
| Charter Documents: | |
| 3.1 | Amended and Restated Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form 8-A (File No. 1-12351)). |

3.2 Amended and Restated Bylaws of the Company (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 1999 (File No. 1-12351)).

Instruments Defining Rights:

4.1 Indenture, dated as of November 7, 1997, among MCI, Metris Direct, Inc., as Guarantor, and the First National Bank of Chicago, as Trustee, including form of 10% Senior Note due 2004 and form of Guarantee by Metris Direct, Inc. (incorporated by reference to Exhibit 4.a to MCI's Registration Statement on Form S-4 (File No. 333-43771)).

(a) First Supplemental Indenture, dated as of June 25, 1999, among MCI, the Guarantors named therein and the First National Bank of Chicago (incorporated by reference to Exhibit 4.4 to MCI's Registration Statement on Form S-4 (File No. 333-86695)).

(b) Second Supplemental Indenture, dated as of February 28, 2000, among MCI, the Guarantors named therein and Bank One Trust Company, N.A., as Trustee, successor in interest to the First National Bank of Chicago (incorporated by reference to Exhibit 4.2 to MCI's Quarterly Report on Form 10-Q for the period ended March 31, 2000 (File No. 1-12351)).

(c) Third Supplemental Indenture, dated as of January 2, 2001, among MCI, the guarantors named therein and Bank One Trust Company, N.A. (incorporated by reference to Exhibit 4.1(c) to MCI's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-12351)).

(d) Agreement of Resignation, Appointment and Acceptance, dated as of November 14, 2001, among MCI, Bank One Trust Company, N.A., as Prior Trustee, and US Bank National Association, as Successor Trustee (incorporated by reference to Exhibit 4.1(d) to MCI's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-12351)).

4.2 Certificate of Designation of Series B Perpetual Preferred Stock (incorporated by reference to Exhibit 4.1 of MCI's Current Report on Form 8-K dated December 22, 1998 (File No. 1-12351)).

4.3 Certificate of Designation of Series C Perpetual Preferred Stock (incorporated by reference to Exhibit 4.2 of MCI's Current Report on Form 8-K dated December 22, 1998 (File No. 1-12351)).

(a) Amended Certificate of Designation of Series C Perpetual Convertible Preferred Stock (incorporated by reference to Exhibit 3.3 to MCI's Registration Statement on Form S-3 (File No. 333-82007)).



4.4 Certificate of Designation of Series D Junior Participating Convertible Preferred Stock (incorporated by reference to Exhibit 4.3 of MCI's Current Report on Form 8-K dated December 22, 1998 (File No. 1-12351)).

4.5 Registration Rights Agreement, dated as of December 9, 1998, between MCI and the Investors named therein (incorporated by reference to Exhibit 10.3 to MCI's Current Report on Form 8-K

dated December 22, 1998 (File No. 1-12351)).

4.6 Form of common stock certificate of MCI (incorporated by reference to Exhibit 4.3 to MCI's Registration Statement on Form S-8 (File No. 333-91917)).

4.7 Indenture, dated as of July 13, 1999, by and among MCI, Metris Direct, Inc. and The Bank of New York, including Form of 10 1/8% Senior Notes due 2006 and Form of Guarantee (incorporated by reference to Exhibit 4.1 to MCI's Registration Statement on Form S-4 (File No. 333-86695)).

(a) First Supplemental Indenture, dated as of February 28, 2000, among MCI, the Guarantors named therein and The Bank of New York, (incorporated by reference to Exhibit 4.1 to MCI's Quarterly Report on Form 10-Q for the period ended March 31, 2000 (File No. 1-12351)).

(b) Second Supplemental Indenture, dated as of February 2, 2001, among MCI, the Guarantors named therein and The Bank of New York (incorporated by reference to Exhibit 4.7(b) to MCI's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-12351)).

(c) Agreement of Resignation, Appointment and Acceptance, dated as of February 20, 2002, among MCI, The Bank of New York, as Prior Trustee, and US Bank National Association, as Successor Trustee (incorporated by reference to Exhibit 4.7(c) to MCI's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 1-12351)).

4.8 Exchange and Registration Rights Agreement, dated as of July 13, 1999, by and among MCI, Bear, Stearns & Co. Inc., Chase Securities Inc., Salomon Smith Barney Inc. and Barclays Capital Inc., relating to the new notes (incorporated by reference to Exhibit 4.2 to MCI's Registration Statement on Form S-4 (File No. 333-86695)).

4.9 Base Indenture, dated as of October 25, 2002, between MCI and U.S. Bank National Association, as Trustee (incorporated by reference to Exhibit 4.1 to MCI's Current Report on Form 8-K dated October 28, 2002 (File No. 1-12351

(a) First Supplemental Indenture, dated as of October 25, 2002 between MCI and U.S. Bank National Association, as Trustee (incorporated by reference to Exhibit 4.2 to MCI's Current Report on Form 8-K dated October 28, 2002 (File No. 1-12351)).

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Material Contracts

10.1 Second Amended and Restated Pooling and Servicing Agreement, dated as of January 22, 2002, among Metris Receivables, Inc. ("MRI"), as Transferor, Direct Merchants Credit Card Bank, National Association ("Direct Merchants Bank"), as Servicer, and U.S. Bank National Association, as Trustee (incorporated by reference to Exhibit 4.3 to MRI's Current Report on Form 8-K dated January 24, 2002 (File No. 0-23961)).

(a) Amendment No. 1 to the Second Amended and Restated Bank Receivables Purchase Agreement, dated as of June 14, 2002, between Metris Companies Inc., as Buyer, and Direct Merchants Credit Card Bank, National Association, as Seller (incorporated by reference to Exhibit 4.1 to MRI's Current Report on Form 8-K dated June 18, 2002 (File No. 0-23961).

10.2 Second Amended and Restated Bank Receivables Purchase Agreement, dated as of January 22, 2002, between Direct Merchants Bank and MCI (incorporated by reference to Exhibit 4.1 to MRI's Current Report on Form 8-K dated January 24, 2002 (File No. 0-23961)).

(a) Amendment No. 1 to the Second Amended and Restated Purchase Agreement, dated as of June 14, 2002, between Metris Receivables, Inc., as Buyer, and Metris Companies Inc., as Seller (incorporated by reference to Exhibit 4.2 to MRI's Current Report on Form 8-K dated June 18, 2002 (File No. 0-23961).

10.3 Second Amended and Restated Bank Receivables Purchase Agreement, dated as of January 22, 2002, between MCI and MRI (incorporated by reference to Exhibit 4.2 to MRI's Current Report on Form 8-K dated January 24, 2002 (File No. 0-23961)).

(a) Amendment No. 1 to the Metris Master Trust Second Amended and Restated Pooling and Servicing Agreement, dated as of June 14, 2002, among Metris Receivables, Inc., as Transferor, Direct Merchants Credit Card Bank, National Association, as Servicer, and U.S. Bank National Association, as Trustee (incorporated by reference to Exhibit 4.3 to MRI's Current Report on Form 8-K dated June 18, 2002 (File No. 0-23961).

10.4* Change of Control Severance Agreement, dated as of May 15, 1998, by and between MCI and Ronald N. Zebeck and a schedule of executive officers of the Company also having such an agreement with MCI, indicating the differences from the version of agreement filed (as permitted by Instruction 2 to Item 601 of Regulation S-K) (incorporated by reference to Exhibit 10.2 to MCI's Quarterly Report on Form 10-Q for the quarter ended September 30, 1998 (File No. 1-12351)).

(a) Amendment to Ronald N. Zebeck's Change of Control Severance Agreement, dated as of December 9, 1998 (incorporated by reference to Exhibit 10.7(i) to MCI's Annual Report on Form 10-K for the year ended December 31, 1998 (File No. 1-12351)).

(b) Amended Schedule of Executive Officers with Change of Control Severance Agreements (incorporated by reference to Exhibit 10.4(b) to MCI's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-12351)).



10.5* Retention Agreement, dated May 17, 1999, between Ronald N. Zebeck and MCI (incorporated by reference to Exhibit 10.2 to MCI's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999 (File No. 1-12351)).

10.6 Amended and Restated Credit Agreement, dated as of July 21, 2000, among MCI; the Lenders from time to time parties thereto; The Chase Manhattan Bank, as Administrative Agent; Bank of America, N.A., as Syndicate

Agent; Deutsche Bank AG, New York Branch, as Co-Documentation Agent; U.S. Bank National Association, as Co-Documentation Agent; and Barclays Bank PLC, as Co-Agent (incorporated by reference to MCI's Quarterly Report on Form 10-Q for the quarter ended June 30, 2000 (File No. 1-12351)).

(a) Amendment No. 1, dated as of July 10, 2001, to the Amended and Restated Credit Agreement, among MCI; the Lenders from time to time parties thereto; The Chase Manhattan Bank, as Administrative Agent; Bank of America, N.A., as Syndication Agent; Deutsche Bank AG, New York Branch, as Co-Documentation Agent; U.S. Bank National Association, as Co-Documentation Agent; and Barclays Bank PLC, as Co-Agent (incorporated by reference to Exhibit 10.6(a) to MCI's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-12351)).

(b) Amendment No. 2, dated as of March 17, 2003, to the Amended and Restated Credit Agreement, among MCI; the Lenders from time to time parties thereto; The Chase Manhattan Bank, as Administrative Agent; Bank of America, N.A., as Syndication Agent; Deutsche Bank AG, New York Branch, as Co-Documentation Agent; U.S. Bank National Association, as Co-Documentation Agent; and Barclays Bank PLC, as Co-Agent (incorporated by reference to Exhibit 10.6 (b) to MCI's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 1-12351)).

10.7* MCI Non-Employee Director Stock Option Plan (incorporated by reference to Exhibit 10.3 to MCI's Registration Statement on Form S-4/A (File No. 333-86695)).

10.8* MCI Management Stock Purchase Plan (incorporated by reference to Exhibit 10.4 to MCI's Registration Statement on Form S-4/A (File No. 333-86695)).

10.9* MCI Amended and Restated Annual Incentive Bonus Plan for Designated Corporate Officers (incorporated by reference to Exhibit 10.5 to MCI's Registration Statement on Form S-4/A (File No. 333-86695)).

10.10* MCI Amended and Restated Long-Term Incentive and Stock Option Plan (incorporated by reference to Exhibit 10.6 to MCI's Registration Statement on Form S-4/A (File No. 333-86695)).

(a) Form of Non-Qualified Stock Option Agreement (incorporated by reference to Exhibit 10.8 to MCI's Annual Report on Form 10-K for the year ended December 31, 1998 (File No. 1-12351)).

(b) Form of Non-Qualified Performance Accelerated Stock Option Agreement (incorporated by reference to Exhibit 10.10(b) to MCI's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-12351)).



(c) Form of Restricted Stock Award Agreement (incorporated by reference to Exhibit 10.10(c) to MCI's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-12351)).

10.11 Formal Agreement, dated as of April 16, 2002, between Direct Merchants Bank and the Office of the Comptroller of the Currency (Incorporated by reference to Exhibit 99.1 to MCI's Current Report on Form 8-K dated April 17, 2002 (File No. 1-12351)).

10.12 Operating Agreement, dated as of March 18, 2003, between MCI, Direct Merchants Bank and the Office of the Comptroller of the Currency (Incorporated by reference to Exhibit 99.2 to MCI's Current Report on Form 8-K dated March 19, 2003 (File No. 1-12351)).

10.13 Capital Assurance and Liquidity Maintenance Agreement, dated as of March 18, 2003, between Direct Merchants Bank and MCI (Incorporated by reference to Exhibit 99.3 to MCI's Current Report on Form 8-K dated March 19, 2003 (File No. 1-12351)).

10.14 Liquidity Reserve Deposit Agreement, dated as of March 18, 2003, among Direct Merchants Bank, JPMorgan Chase Bank, and the Office of the Comptroller of the Currency (Incorporated by reference to Exhibit 99.4 to MCI's Current Report on Form 8-K dated March 19, 2003 (File No. 1-12351)).

10.15 Metris Companies Inc. Term Loan Commitment Letter dated March 31, 2003 between Thomas H. Lee Partners, L.P. and Metris Companies Inc. (incorporated by reference to Exhibit 10.15 to MCI's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 1-12351)).

Other Exhibits

11 Computation of Earnings Per Share.

12(a) Computation of Ratio of Earnings to Fixed Charges.

12(b) Computation of Ratio of Earnings to Fixed Charges and Preferred Dividends.

21 Subsidiaries of MCI. (Previously filed on March 31, 2003 as an exhibit to the original Form 10-K.)

23 Independent Auditors' Consent.

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.

* Management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 14(c) of Form 10-K.