METRIS COMPANIES INC
Form 10-Q
August 14, 2003

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

FORM 10-Q

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2003

or

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from __________ to __________

Commission file number: 001-12351

METRIS COMPANIES INC.
(Exact name of registrant as specified in its charter)

Delaware	41-1849591
(State of Incorporation)	(I.R.S. Employer Identification No.)

10900 Wayzata Boulevard, Minnetonka, Minnesota 55305-1534
(Address of principal executive offices)

(952) 525-5020
(Registrant's telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No _____

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

Yes X No _____

As of July 31, 2003, 57,798,577 shares of the registrant's common stock, par value $.01 per share, were outstanding.

METRIS COMPANIES INC.

FORM 10-Q

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June 30, 2003

Part I. Financial Information

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

METRIS COMPANIES INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(Dollars in thousands) (Unaudited)

	June 30, 2003	December 31, 2002
Assets:		
Cash and due from banks	$ 86,518	$ 62,813
Federal funds sold	33,700	88,000
Short-term investments	346,963	429,419
Cash and cash equivalents	467,181	580,232
Retained interests in loans securitized	1,623,652	1,736,912
Less: Valuation allowance	858,605	986,517
Net retained interests in loans securitized	765,047	750,395
Credit card loans	632,913	846,417
Less: Allowance for loan losses	109,162	90,315
Net credit card loans	523,751	756,102
Property and equipment, net	51,510	83,831
Purchased portfolio premium, net	51,584	64,579
Other receivables due from credit card securitizations, net	281,233	184,220
Other assets	167,783	174,987
Total assets	$ 2,308,089	$ 2,594,346
Liabilities:		
Deposits	$ 641,934	$ 892,754
Debt	383,237	357,649
Accounts payable	49,996	53,589
Deferred income	119,807	159,267
Accrued expenses and other liabilities	92,173	72,062
Total liabilities	1,287,147	1,535,321
Stockholders' Equity:		
Convertible preferred stock - Series C, par value $.01 per share; 10,000,000 shares authorized, 1,208,695 and 1,156,086 shares issued and outstanding, respectively	450,239	430,642
Common stock, par value $.01 per share; 300,000,000 shares authorized, 64,853,877 and		

64,223,231 shares issued, respectively	648	642
Paid-in capital	230,241	227,376
Unearned compensation	(292)	--
Treasury stock - 7,055,300 shares	(58,308)	(58,308)
Retained earnings	398,414	458,673
Total stockholders' equity	1,020,942	1,059,025
Total liabilities and stockholders' equity	$ 2,308,089	$ 2,594,346

See accompanying Notes to Consolidated Financial Statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Interest Income:				
Credit card loans	$ 29,713	$ 66,324	$ 59,620	$ 154,850
Federal funds sold	165	110	524	224
Other	1,556	2,359	3,451	3,563
Total interest income	31,434	68,793	63,595	158,637
Deposit interest expense	9,597	18,335	20,505	41,988
Other interest expense	9,120	8,620	17,553	17,132
Total interest expense	18,717	26,955	38,058	59,120
Net Interest Income	12,717	41,838	25,537	99,517
Provision for loan losses	30,033	90,601	74,819	202,477
Net Interest Expense After Provision for Loan Losses	(17,316)	(48,763)	(49,282)	(102,960)
Other Operating Income:				
Net securitization and credit card servicing income	31,110	71,223	87,506	228,642
Credit card fees, interchange and other credit card income...................	20,146	32,759	41,903	93,759
Enhancement services revenue	84,954	95,649	178,638	190,645
	136,210	199,631	308,047	513,046
Other Operating Expense:				
Credit card account and other product solicitation and marketing expenses...	28,138	56,193	64,192	96,745
Employee compensation	45,721	54,365	99,102	110,913
Data processing services and communications	17,034	20,795	36,212	43,101

Enhancement services claims expense	8,087	15,917	21,109	27,124
Occupancy and equipment	8,924	12,291	18,537	25,088
Purchased portfolio premium amortization ..	6,499	7,743	12,995	16,198
MasterCard/Visa assessment and fees	2,231	3,583	4,646	7,417
Credit card fraud losses	1,069	2,953	2,009	5,181
Asset impairments, lease write-offs and severance............................	6,011	9,523	22,788	9,523
Other	18,866	26,161	38,505	42,622
	142,580	209,524	320,095	383,912
(Loss) Income Before Income Taxes	(23,686)	(58,656)	(61,330)	26,174
Income tax (benefit) expense	(7,982)	(22,282)	(20,668)	10,208
Net (Loss) Income	(15,704)	(36,374)	(40,662)	15,966
Convertible preferred stock dividends	9,908	9,394	19,597	18,582
Net Loss Applicable to Common Stockholders	$ (25,612)	$ (45,768)	$ (60,259)	$ (2,616)
Loss per share:				
Basic	$ (0.44)	$ (0.74)	$ (1.05)	$ (0.04)
Diluted	$ (0.44)	$ (0.74)	$ (1.05)	$ (0.04)
Shares used to compute loss per share:				
Basic	57,462	61,503	57,360	61,844
Diluted	57,462	61,503	57,360	61,844
Dividends declared per common share	--	$ 0.01	--	$ 0.02

See accompanying Notes to Consolidated Financial Statements.

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METRIS COMPANIES INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity
(In thousands) (Unaudited)

	Number of Shares Preferred	Number of Shares Common	Preferred Stock	Common Stock	Paid-in Capital	Unearned Compensation
BALANCE AT DECEMBER 31, 2001	1,058	63,419	$ 393,970	$ 642	$ 232,413	$ (4,980)
Net income	--	--	--	--	--	--
Cash dividends	--	--	--	--	--	--
Common stock repurchased	--	(2,720)	--	--	--	--
Preferred dividends in kind .	48	--	17,928	--	--	--
Issuance of common stock under employee benefit plans	--	161	--	2	2,255	--
Deferred compensation obligations	--	76	--	1	967	(968)
Amortization of restricted stock	--	--	--	--	--	911
BALANCE AT JUNE 30, 2002	1,106	60,936	$ 411,898	$ 645	$ 235,635	$ (5,037)

BALANCE AT DECEMBER 31, 2002	1,156	57,168	$ 430,642	$ 642	$ 227,376	$ --
Net loss	--	--	--	--	--	--
Preferred dividends in kind .	53	--	19,597	--	--	--
Issuance of common stock under employee benefit plans	--	352	--	3	2,367	--
Deferred compensation obligations	--	303	--	3	546	(549)
Restricted stock forfeitures	--	(24)	--	--	(48)	46
Amortization of restricted stock	--	--	--	--	--	211
BALANCE AT JUNE 30, 2003	1,209	57,799	$ 450,239	$ 648	$ 230,241	$ (292)

See accompanying Notes to Consolidated Financial Statements.

METRIS COMPANIES INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(Dollars in thousands) (Unaudited)

	Six Months Ended June 30, 2003	2002
Operating Activities:		
Net (loss) income	$ (40,662)	$ 15,966
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	67,518	52,374
Provision for loan losses	74,819	202,477
Retained interests valuation (income) expense	(131,893)	38,126
Asset impairments, lease write-offs, and severance	22,788	9,523
Changes in operating assets and liabilities, net:		
Other receivables due from credit card securitizations	(104,500)	54,024
Accounts payable and accrued expenses	(2,111)	43,770
Deferred income	(39,460)	(17,045)
Other	(29,477)	36,398
Net cash provided by (used in) operating activities ...	(182,978)	435,613
Investing Activities:		

Proceeds from transfers of portfolios to the Metris Master Trust	315,065	1,486,993
Net proceeds from sales and repayments of securitized loans	(773,955)	(785,856)
Net loans collected	733,600	337,903
Disposal of premises	19,252	--
Additions to premises and equipment	(727)	(3,538)
Net cash provided by investing activities	293,235	1,035,502
Financing Activities:		
Proceeds from issuance of debt	125,348	153
Repayment of debt	(100,206)	(292,000)
Net decrease in deposits	(250,820)	(736,147)
Cash dividends paid	--	(1,892)
Proceeds from issuance of common stock	2,370	2,257
Repurchase of common stock	--	(32,951)
Net cash used in financing activities	(223,308)	(1,060,580)
Net increase (decrease) in cash and cash equivalents	(113,051)	410,535
Cash and cash equivalents at beginning of period	580,232	488,086
Cash and cash equivalents at end of period	$ 467,181	$ 898,621
Supplemental disclosures and cash flow information:		
Cash paid (received) during the period for:		
Interest	$ 21,019	$ 61,345
Income taxes	(31,846)	(16,488)
Tax benefit from employee stock option exercises	1	174

See accompanying Notes to Consolidated Financial Statements.

METRIS COMPANIES INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
(Dollars in thousands, except as noted) (Unaudited)

NOTE 1 - ORGANIZATION AND BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Metris Companies Inc. ("MCI") and its subsidiaries, including Direct Merchants Credit Card Bank, National Association ("Direct Merchants Bank" or "DMCCB" or the "Bank"), which 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.

We have eliminated all significant intercompany balances and transactions in consolidation. We have reclassified certain prior-period amounts to conform with the current period's presentation. In prior periods, we classified interest income, provision for loan losses, and related credit card loan fees generated from retained interests in loans securitized on the income statement as "Interest income-credit card loans and retained interests in loans securitized," "Provision for loan losses" and "Credit card fees, interchange and other credit card income." We have reclassified these amounts to "Net securitization and credit card servicing income." In the second quarter of 2003, certain subsidiaries were designated as guarantors which had previously been classified as non-guarantors. The supplemental consolidating financial statements have been reclassified for all periods presented.

Interim Financial Statements

We have prepared the unaudited interim consolidated financial statements and related unaudited financial information in the footnotes in accordance with accounting principles generally accepted in the United States of America and the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial statements. These interim financial statements reflect all adjustments consisting of normal recurring accruals which, in the opinion of management, are necessary to present fairly our consolidated financial position and the results of our operations and our cash flows for the interim periods. You should read these consolidated financial statements in conjunction with the financial statements and the notes thereto contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2002. The nature of our business is such that the results of any interim period may not be indicative of the results to be expected for the entire year.

Pervasiveness of Estimates

We have prepared the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, which require us to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. The most significant and subjective of these estimates is our determination of the adequacy of the allowance for loan losses and our determination of the fair value of retained interests from assets securitized including the fair value of cash restricted in the Metris Master Trust. The significant factors susceptible to future change that have an impact on these estimates include default rates, net interest spreads, liquidity and overall economic conditions. As a result, the actual losses in our loan portfolio and the fair value of our retained interests as of June 30, 2003 and December 31, 2002 could materially differ from these estimates.

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Comprehensive Income

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

NOTE 2 - EARNINGS PER SHARE

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

NOTE 3 - Stock-Based Compensation Plans

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

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

	Three Months Ended June 30, 2003	Three Months Ended June 30, 2002	Six Months End[ed] June 30, 2003	Six Months End[ed] June 30, 20[02]
Net (loss) income, as reported	$ (15,704)	$ (36,374)	$ (40,662)	$ 1
Deduct: Annual stock-based employee compensation expense (benefit) determined based on the fair value for all awards, net of related tax effects.......................	3,003	8,631	(4,894)	1
Pro forma net (loss) income	$ (18,707)	$ (45,005)	$ (35,768)	$
Loss per share:				
Basic-as reported	(0.44)	(0.74)	(1.05)	
Basic-pro forma	(0.50)	(0.88)	(0.97)	
Diluted-as reported	(0.44)	(0.74)	(1.05)	
Diluted-pro forma	(0.50)	(0.88)	(0.97)	
Weighted-average assumptions in option valuation:				
Risk-free interest rates	1.5%	3.7%	1.5%	
Dividend yields	--	1.6%	--	
Stock volatility factor	124.2%	92.9%	110.1%	
Expected life of options (in years)	2.7	6.0	4.2	

The above pro forma amounts may not be representative of the effects on reported net (loss) earnings for future periods.

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NOTE 4 - ACCOUNTING CHANGES

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 adoption of SFAS 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 new 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 which are to be disposed. The adoption of the new standard did not have a material impact on our financial statements.

In July 2002, the Financial Accounting Standards Board ("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 EITF 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. The adoption of this standard did not have a material impact on our financial statements.

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

In January 2003, the Federal Financial Institutions Examination Council ("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.

In January 2003, FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" in an effort to expand upon and strengthen existing accounting guidance that addresses when a company should include in its financial statements the assets, liabilities and activities of another entity. FASB Interpretation No. 46 requires a variable interest entity to be consolidated by a company, if that company is subject to a majority of the risk of loss from the variable interest entity activities or entitled to receive a majority of the entity's residual returns or both. The

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

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

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

NOTE 5 - ALLOWANCE FOR LOAN LOSSES

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Balance at beginning of period	$ 125,357	$ 416,914	$ 90,315	$ 410,159
Allowance related to assets transferred to the Metris Master Trust.........	(2,526)	(147,137)	(3,981)	(168,580)
Provision for loan losses	30,033	90,601	74,819	202,477
Principal receivables charged-off	(44,789)	(91,595)	(53,470)	(180,486)
Recoveries	1,087	6,496	1,479	11,709
Net principal receivables charged-off .	(43,702)	(85,099)	(51,991)	(168,777)
Balance at end of period	$ 109,162	$ 275,279	$ 109,162	$ 275,279

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

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NOTE 6 - RETAINED INTERESTS IN LOANS SECURITIZED

Activity in retained interests is as follows:

	June 30,		December 31,
	2003	Change	2002

Contractual retained interests...	$ 920,908	$ (70,145)	$ 991,053
Excess transferor's interests....	76,140	29,680	46,460
Finance charge receivables	626,604	(72,795)	699,399
Gross retained interests	1,623,652	(113,260)	1,736,912
Valuation allowance	(858,605)	127,912	(986,517)
Net retained interests	$ 765,047	$ 14,652	$ 750,395

	June 30, 2002	Change	December 31, 2001
Contractual retained interests...	$ 903,629	$ 126,220	$ 777,409
Excess transferor's interests....	18,807	(21,117)	39,924
Finance charge receivables	630,124	108,279	521,845
Gross retained interests	1,552,560	213,382	1,339,178
Valuation allowance	(744,205)	(206,706)	(537,499)
Net retained interests	$ 808,355	$ 6,676	$ 801,679

Activity in the valuation allowance on retained interests in loans securitized is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Balance at beginning of period	$ 931,052	$ 551,385	$ 986,517	$ 537,499
Transfers related to assets transferred to the Metris Master Trust...........	2,526	147,137	3,981	168,580
Retained interests valuation (income) expense............................	(74,973)	45,683	(131,893)	38,126
Balance at end of period	$ 858,605	$ 744,205	$ 858,605	$ 744,205

NOTE 7 - SEGMENTS

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

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

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

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

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

The enhancement services operating segment has paid fees to our consumer lending products segment for successful marketing efforts to cardholders at a rate similar to those paid to other third parties. The enhancement services segment reports interest income and our consumer lending products segment reports interest expense at our weighted-average borrowing rate for the excess cash flow generated by the enhancement services segment and used by the consumer lending products segment to fund the growth of cardholder balances.

	Three Months Ended June 30, 2003				
	Consumer Lending Products	Enhancement Services	Securitization Adjustments(a)	Other Adjustments(b)	Consolidated
Interest income.	$ 451,205	$ 34	$ (419,771)	$ (34)	$ 31,434
Interest expense	60,198	--	(41,447)	(34)	18,717

Net interest income	391,007	34	(378,324)	--	12,717
Other operating income........	88,293	84,954	(37,037)	--	136,210
Total revenue...	479,300	84,988	(415,361)	--	148,927
Income before income taxes..	22,968 (c)	58,632 (c)	--	(105,286)	(23,686)
Total assets ...	$ 9,502,200	$ 77,614	$(7,860,000)	$ 588,275 (d)	$ 2,308,089

Three Months Ended June 30, 2002

	Consumer Lending Products	Enhancement Services	Securitization Adjustments(a)	Other Adjustments(b)	Consolidated
Interest income.	$ 509,821	$ 58	$ (441,028)	$ (58)	$ 68,793
Interest expense	81,005	--	(53,992)	(58)	26,955
Net interest income	428,816	58	(387,036)	--	41,838
Other operating income........	119,317	95,649	(15,335)	--	199,631
Total revenue ..	548,133	95,707	(402,371)	--	241,469
Income before income taxes..	21,145 (c)	54,660 (c)	--	(134,461)	(58,656)
Total assets ...	$10,985,709	$ 142,705	$(8,924,497)	$ 1,007,792 (d)	$ 3,211,709

Six Months Ended June 30, 2003

	Consumer Lending Products	Enhancement Services	Securitization Adjustments(a)	Other Adjustments(b)	Consolidated
Interest income	$ 936,434	$ 63	$ (872,839)	$ (63)	$ 63,595
Interest expense	124,209	--	(86,088)	(63)	38,058
Net interest income	812,225	63	(786,751)	--	25,537
Other operating income......	187,583	178,638	(58,174)	--	308,047

Total revenue ..	999,808	178,701	(844,925)	--	333,584
Income before income taxes.	61,478 (c)	109,977 (c)	--	(232,785)	(61,330)
Total assets ...	$ 9,502,200	$ 77,614	$(7,860,000)	$ 588,275 (d)	$ 2,308,089

Six Months Ended June 30, 2002

	Consumer Lending Products	Enhancement Services	Securitization Adjustments(a)	Other Adjustments(b)	Consolidated
Interest income.	$ 1,036,499	$ 2,386	$ (877,862)	$ (2,386)	$ 158,637
Interest expense	171,737	--	(110,231)	(2,386)	59,120
Net interest income	864,762	2,386	(767,631)	--	99,517
Other operating income......	250,080	190,645	72,321	--	513,046
Total revenue ..	1,114,842	193,031	(695,310)	--	612,563
Income before income taxes	161,469 (c)	119,567 (c)	--	(254,862)	26,174
Total assets ...	$10,985,709	$ 142,705	$(8,924,497)	$ 1,007,792 (d)	$3,211,709

(a) This column reflects adjustments to the Company's internal financial statements, which are prepared on a managed basis, to eliminate investors' interests in securitized loans.

(b) The other adjustments column includes: intercompany eliminations and amounts not allocated to segments.

(c) Income before income taxes includes intercompany commissions paid by the enhancement services segment to the consumer lending products segment for successful marketing efforts to cardholders of $3.1 million for the three months ended June 30, 2003 and $3.0 million for the three months ended June 30, 2002, $6.1 million for the six months ended June 30, 2003 and $6.3 million for the six months ended June 30, 2002.

(d) Total assets include the assets attributable to corporate functions not allocated to operating segments and the removal of investors' interests in securitized loans to present total assets on an owned basis.

NOTE 8 - SUBSEQUENT EVENTS

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

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

NOTE 9 - SUPPLEMENTAL CONSOLIDATING FINANCIAL STATEMENTS

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

METRIS COMPANIES INC.
Supplemental Consolidating Balance Sheets
June 30, 2003
(Dollars in thousands)
Unaudited

	Metris Companies Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Elimin
Assets:				
Cash and cash equivalents	$ (49)	$ 1,234	$ 465,996	$
Net retained interests in loans securitized......................	31,883	--	733,164	
Net credit card loans	8,393	--	515,358	
Property and equipment, net	--	50,997	513	
Purchased portfolio premium, net..................................	107	--	51,477	
Other receivables due from credit card securitizations, net...................	7	--	281,226	
Other assets	38,277	38,285	130,630	(3
Investment in subsidiaries	1,409,140	1,016,665	--	(2,42
Total assets	$ 1,487,758	$ 1,107,181	$ 2,178,364	$(2,46
Liabilities:				
Deposits	$ (1,000)	$ --	$ 642,934	$
Debt	417,023	9,214	--	(4
Accounts payable	97	22,026	32,230	(
Deferred income	--	10,003	111,879	(
Accrued expenses and other liabilities				

	50,696	(343,202)	374,656	1
Total liabilities	466,816	(301,959)	1,161,699	(3
Total stockholders' equity	1,020,942	1,409,140	1,016,665	(2,42
Total liabilities and stockholders' equity....................	$ 1,487,758	$ 1,107,181	$ 2,178,364	$(2,46

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METRIS COMPANIES INC.
Supplemental Consolidating Balance Sheets
December 31, 2002
(Dollars in thousands)
Unaudited

	Metris Companies Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Elimin
Assets:				
Cash and cash equivalents	$ (3,795)	$ 8,109	575,918	$
Net retained interests in loans securitized......................	--	--	750,395	
Net credit card loans	3,814	--	752,288	
Property and equipment, net	--	63,395	20,436	
Purchased portfolio premium, net...................................	129	--	64,450	
Other receivables due from credit card securitizations, net....................	13	--	184,207	
Other assets	10,098	44,738	181,278	(61
Investment in subsidiaries	1,606,930	1,580,650	--	(3,187
Total assets	$ 1,617,189	$ 1,696,892	$ 2,528,972	$(3,248
Liabilities:				
Deposits	$ (1,000)	$ --	$ 893,754	$
Debt	391,228	9,421	--	(43
Accounts payable	71	20,683	38,949	(6
Deferred income	--	16,681	146,097	(3
Accrued expenses and other liabilities............................	167,865	43,177	(130,478)	(8
Total liabilities	558,164	89,962	948,322	(61
Total stockholders' equity	1,059,025	1,606,930	1,580,650	(3,187
Total liabilities and stockholders' equity....................	$ 1,617,189	$ 1,696,892	$ 2,528,972	$(3,248

METRIS COMPANIES INC.
Supplemental Consolidating Statements of Income
Three Months Ended June 30, 2003
(Dollars in thousands)
Unaudited

	Metris Companies Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Elimin
Net Interest Income (Expense)	$ (8,682)	$ 915	$ 20,484	$
Provision for loan losses	540	--	29,759	(2
Net Interest Expense After Provision for Loan Losses	(9,222)	915	(9,275)	2
Other Operating Income:				
Net securitization and credit card servicing income	(539)	--	33,009	(1,3
Credit card fees, interchange and other credit card income	1,036	19,004	18,162	(18,0
Enhancement services revenues	--	7,100	80,120	(2,2
Intercompany allocations	5,264	73,725	8,247	(87,2
	5,761	99,829	139,538	(108,9
Other Operating Expense:				
Credit card account and other product solicitation and marketing expenses	--	14,315	32,733	(18,9
Employee compensation	--	40,971	4,750	
Data processing services and communications	5	(19,716)	39,061	(2,3
Enhancement services claims expense	--	(97)	8,184	
Occupancy and equipment	--	8,844	80	
Purchased portfolio premium amortization	10	--	7,621	(1,1
MasterCard/Visa assessment and fees	--	--	2,231	
Credit card fraud losses	10	--	1,059	
Asset impairments, lease write-offs and severance	5,128	889	(6)	
Other	130	16,498	2,245	
Intercompany allocations	24	27,420	59,792	(87,2
	5,307	89,124	157,750	(109,6

(Loss) Income Before Income Tax Benefit and Equity in Loss of Subsidiaries....................	(8,768)	11,620	(27,487)	9
Income tax (benefit) expense...............	(2,955)	1,989	(7,337)	3
Equity in loss of subsidiaries............................	(9,891)	(20,150)	--	30,0
Net Loss	$ (15,704)	$ (10,519)	$ (20,150)	$ 30,6

METRIS COMPANIES INC.
Supplemental Consolidating Statements of Income
Three Months Ended June 30, 2002
(Dollars in thousands)
Unaudited

	Metris Companies Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminati
Net Interest (Expense) Income...............	$ (3,017)	$ (60)	$ 44,915	$ -
Provision for loan losses	(797)	--	91,398	-
Net Interest Expense After Provision for Loan Losses	(2,220)	(60)	(46,483)	-
Other Operating Income:				
Net securitization and credit card servicing income....................	(1,777)	--	73,000	-
Credit card fees, interchange and other credit card income..................................	189	5,796	31,474	(4,70
Enhancement services revenues..............	--	2,662	92,987	-
Intercompany allocations	41	72,193	15,127	(87,36
	(1,547)	80,651	212,588	(92,06
Other Operating Expense:				
Credit card account and other product solicitation and marketing expenses.......................	--	4,594	51,653	(5
Employee compensation	(1,505)	45,753	10,117	-
Data processing services and communications...........................	13	(23,809)	43,018	1,57
Enhancement services claims expense.................................	--	444	15,473	-
Occupancy and equipment	--	11,399	892	-
Purchased portfolio premium amortization	--	--	8,568	(82
MasterCard/Visa assessment and fees................................	--	--	3,583	-
Credit card fraud losses	135	--	2,818	-
Asset impairments, lease write-offs and severance	--	9,523	--	-
Other	(153)	27,325	5,218	(6,22

Intercompany allocations	555	23,510	63,296	(87,36
	(955)	98,739	204,636	(92,89
(Loss) Before Income Taxes and Equity in (Loss) Income of Subsidiaries..........................	(2,812)	(18,148)	(38,531)	83
Income tax (benefit) expense...............	(1,134)	12,591	(14,487)	(19,25
Equity in income of subsidiaries............................	(34,696)	(24,044)	--	58,74
Net Loss	$ (36,374)	$ (54,783)	$ (24,044)	$ 78,82

METRIS COMPANIES INC.
Supplemental Consolidating Statements of Income
Six Months Ended June 30, 2003
(Dollars in thousands)
Unaudited

	Metris Companies Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminati
Net Interest Income (Expense)	$ (17,388)	$ 98	$ 42,827	$ -
Provision for loan losses	1,387	--	73,534	(10
Net Interest Expense After Provision for Loan Losses	(18,775)	98	(30,707)	10
Other Operating Income:				
Net securitization and credit card servicing income...................	(2,863)	--	92,408	(2,03
Credit card fees, interchange and other credit card income......................	1,091	31,547	40,050	(30,78
Enhancement services revenues..............	--	16,279	168,377	(6,01
Intercompany allocations	5,340	139,332	18,237	(162,90
	3,568	187,158	319,072	(201,75
Other Operating Expense:				
Credit card account and other product solicitation and marketing expenses......................	--	28,902	66,489	(31,19
Employee compensation	--	88,539	10,563	-
Data processing services and communications..........................	4	(41,704)	83,713	(5,80
Enhancement services claims expense................................	--	12	21,097	-
Occupancy and equipment	--	18,373	164	-
Purchased portfolio premium amortization	21	--	15,318	(2,34
MasterCard/Visa assessment and fees...............................	--	--	4,646	-

Credit card fraud losses	11	--	1,998	-
Asset impairments, lease write-offs and severance	5,129	16,527	1,132	-
Other	213	34,073	4,226	(
Intercompany allocations	35	53,047	109,827	(162,90
	5,413	197,769	319,173	(202,26
Loss Before Income Tax Benefit and Equity in Loss of Subsidiaries.........................	(20,620)	(10,513)	(30,808)	61
Income tax benefit	(6,949)	(6,968)	(6,957)	20
Equity in loss of subsidiaries............................	(26,991)	(23,851)	--	50,84
Net Loss	$ (40,662)	$ (27,396)	$ (23,851)	$ 51,24

METRIS COMPANIES INC.
Supplemental Consolidating Statements of Income
Six Months Ended June 30, 2002
(Dollars in thousands)
Unaudited

	Metris Companies Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminati
Net Interest (Expense) Income	$ (8,499)	$ (1,456)	$ 109,472	$ -
Provision for loan losses	(732)	--	153,209	50,00
Net Interest Expense After Provision for Loan Losses	(7,767)	(1,456)	(43,737)	(50,00
Other Operating Income:				
Net securitization and credit card servicing income	(1,742)	--	230,384	-
Credit card fees, interchange and other credit card income..................................	452	13,719	90,722	(11,13
Enhancement services revenues..............	--	18,826	171,819	-
Intercompany allocations	72	125,266	24,788	(150,12
	(1,218)	157,811	517,713	(161,26
Other Operating Expense:				
Credit card account and other product solicitation and marketing expenses......................	--	7,254	89,545	(5

Employee compensation	(1,101)	94,921	17,093	-
Data processing services and communications...........................	36	(43,371)	88,230	(1,79
Enhancement services claims expense..................................	--	500	26,624	-
Occupancy and equipment	--	23,205	1,883	-
Purchased portfolio premium amortization	--	--	17,930	(1,73
MasterCard/Visa assessment and fees................................	--	--	7,417	-
Credit card fraud losses	127	--	5,054	-
Asset impairments, lease write-offs and severance	--	9,523	--	-
Other	(110)	41,826	9,094	(8,18
Intercompany allocations	46	41,588	108,491	(150,12
	(1,002)	175,446	371,361	(161,89
(Loss) Income Before Income Taxes and Equity in (Loss) Income of Subsidiaries...................	(7,983)	(19,091)	102,615	(49,36
Income tax (benefit) expense................	(3,114)	(8,207)	40,781	(19,25
Equity in income of subsidiaries............................	20,835	61,834	--	(82,66
Net Income	$ 15,966	$ 50,950	$ 61,834	$(112,78

METRIS COMPANIES INC.
Supplemental Condensed Consolidating Statements of Cash Flows
Six Months Ended June 30, 2003
(Dollars in thousands)
Unaudited

	Metris Companies Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminati
Operating Activities:				
Net cash (used in) provided by operating activities	$(201,937)	$ (8,440)	$ 344,956	$(317,55
Investing Activities:				
Net proceeds from sales and repayments of securitized loans	(34,950)	--	(423,940)	-
Net loans (originated) collected	(6,632)	--	740,232	-
Additions to (disposals of) property and equipment	--	(1,259)	19,784	-
Investment in subsidiaries	219,546	173,426	--	(392,97
Net cash provided by investing activities.....................	177,964	172,167	336,076	(392,97

Financing Activities:				
Net increase (decrease) in debt	25,349	(207)	--	-
Net decrease in deposits	--	--	(250,820)	-
Proceeds from issuance of common stock	2,370	--	--	-
Capital contributions	--	(170,395)	(540,134)	710,52
Net cash (used in) provided by financing activities	27,719	(170,602)	(790,954)	710,52
Net (decrease) increase in cash and cash equivalents	3,746	(6,875)	(109,922)	-
Cash and cash equivalents at beginning of period	(3,795)	8,109	575,918	-
Cash and cash equivalents at end of period	$ (49)	$ 1,234	$ 465,996	$ -

METRIS COMPANIES INC.
Supplemental Condensed Consolidating Statements of Cash Flows
Six Months Ended June 30, 2002
(Dollars in thousands)
Unaudited

	Metris Companies Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminati
Operating Activities:				
Net cash provided by operating activities	$ 195,499	$ 67,362	$ 285,536	$ (1
Investing Activities:				
Net proceeds from sales and repayments of securitized loans	--	--	701,137	
Net loans (originated) collected	120	(2)	337,785	
Additions to (disposals of) property and equipment	--	(4,776)	1,238	
Investment in subsidiaries	(23,855)	(34,721)	--	
Net cash (used in) provided by investing activities	(23,735)	(39,499)	1,040,160	
Financing Activities:				
Increase (decrease) in debt	447	(294)	(292,000)	

Decrease in deposits	--	--	(736,147)	
Cash dividends paid	(1,892)	--	--	
Proceeds from issuance of common stock	2,257	--	--	
Repurchase of common stock	(32,951)	--	--	
Capital contributions	--	(27,096)	(27,112)	
Net cash (used in) provided by financing activities	(32,139)	(27,390)	(1,055,259)	
Net increase in cash and cash equivalents	139,625	473	270,437	
Cash and cash equivalents at beginning of period	17,613	1,505	468,968	
Cash and cash equivalents at end of period	$ 157,238	$ 1,978	$ 739,405	$

ITEM 2.

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

The following discussion and analysis provides information management believes to be relevant to understanding the financial condition and results of operations of Metris Companies Inc. ("MCI") and its subsidiaries, including Direct Merchants Credit Card Bank, National Association ("Direct Merchants Bank" or "DMCCB" or the "Bank"), which may be referred to as "we," "us," "our" or the "Company." You should read this discussion along with the following documents for a full understanding of our financial condition and results of operations: Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended December 31, 2002; and our Proxy Statement for the 2003 Annual Meeting of Stockholders. In addition, you should read this discussion along with our Quarterly Report on Form 10-Q for the period ended June 30, 2003, of which this commentary is a part, and the condensed consolidated financial statements and related notes thereto.

Results of Operations

Net loss for the three months ended June 30, 2003 was $15.7 million, down from a net loss of $36.4 million for the second quarter of 2002. Diluted loss per share for the three months ended June 30, 2003 was $0.44 compared to a diluted loss per share of $0.74 for the second quarter of 2002. The decrease in net loss is primarily due to a decrease in the provision for loan losses and reduction in operating expense, partially offset by a decrease in net interest margin and a decrease in net securitization and credit card servicing income. Net margin has declined due to a decrease in average interest-earning assets of $1.0 billion. The decrease of $40.1 million in net securitization revenue is primarily due to decreases in excess spread as a result of an increased default rate and credit card receivables attrition in the Master Trust. In addition, the credit card receivables attrition in the Master Trust caused a decrease in servicing fees. The provision for loan losses decreased 66.9% to $30 million for the second quarter of 2003 from $90.6 million for the same period in 2002. The decrease is primarily due to a $684 million decline in owned credit card receivables and lower delinquency levels, partially offset by higher charge-off rates. Total other operating expenses decreased to $142.6 million in the second quarter of 2003 from $209.5 million for the same period in 2002. During the second quarter of 2003, credit card account and other product solicitation and marketing expenses decreased $28.1 million, largely due to a decrease in credit card marketing expenditures and decreased enhancement services marketing. Employee compensation decreased $8.6 million for the three months ended June 30, 2003, due to lower staffing requirements. Enhancement services claims expense decreased $7.8 million for the three months ended June 30, 2003, primarily due to a decrease in covered receivable balances on our debt waiver products.

Net loss for the six months ended June 30, 2003 was $40.7 million, down from net income of $16.0 million for the first six months of 2002. Diluted loss per share for the six months ended June 30, 2003 was $1.05 compared to diluted loss per share of $0.04 for the six months ended June 30, 2002. The $56.7 million decrease in net income primarily relates to a $141.1 million reduction in net securitization and credit card servicing income, a decrease of $74.0 million in net interest income and a $51.9 million decrease in credit card fees and interchange revenues, offset by a $127.7 million decrease in provision for loan losses and a $63.8 million decrease in operating expenses.

Critical Accounting Policies

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

Allowance for loan losses

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

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

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

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

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

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

Valuation of Retained Interests

We determine the fair value of the net retained interests in loans securitized by calculating the present value of future expected cash flows using management's best estimate of key assumptions including credit losses, gross yield, interest expense, servicing fees, payment rates and a discount rate commensurate with the risks involved. Our fair value analysis considers cash flows associated with the current receivable balances as of the balance sheet date. We assume no new sales or increases in outstanding receivables in conjunction with the accounts in the portfolio. The significant assumptions are applied to the existing receivable balance to determine the expected future cash flows. Our funding costs are primarily variable based on the London Interbank Offered Rate ("LIBOR"), and the income earned on our receivable balance is substantially variable based on Prime. We assume a flat interest rate environment and when interest rates change, we assume our assets and liabilities will reprice in a consistent manner.

Our estimate of the assumptions considers several subjective factors, 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.

Furthermore, we consider the impact of conduit/asset-backed transaction enhancement levels. Significant changes in these factors could impact our financial projections and thereby affect the valuation of the retained interests. At June 30, 2003, $214.4 million of cash was trapped in the Master Trust and is recorded at a discounted value of $179.0 million and classified as "Other due from credit card securitizations, net" on the consolidated balance sheets.

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

	June 30, 2003	December 31, 2002
Annual discount rate	20.0%	20.0%
Monthly payment rate	6.8%	6.8%
Gross yield (1)	21.1%	21.4%
Annual interest expense and servicing fees...	4.1%	4.3%
Annual gross principal default rate	20.6%	19.9%

(1) Includes finance charges, late and overlimit fees and bad debt recoveries, net of finance charge and fee charge-offs. Gross yield for purposes of our valuation does not include interchange income, debt waiver fees, or cash advance fees.

Deferred Acquisition Costs on Enhancement Services Products

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

Debt Waiver Products

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

Membership Program Products

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

June 30, 2003 and December 31, 2002, respectively, and were classified as "Other assets" on the consolidated balance sheets.

Warranty Products

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

expensed as incurred. Deferred warranty acquisition costs amount to $1.4 million and $3.0 million as of June 30, 2003 and December 31, 2002, respectively, and were classified as "Other assets" on the consolidated balance sheets.

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. Revenue is recognized in the month following the completion of the cancellation period, which is one-month. 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. Revenues recorded for debt waiver products are included in the consolidated statements of income under "Enhancement services revenues" and were $45.3 million and $58.9 million for the three months ended June 30, 2003 and 2002, respectively. Revenues were $95.4 million and $119.6 million for the six months ended June 30, 2003 and 2002, respectively. Unearned revenues and reserves for pending claims and incurred but not reported claims are recorded in the consolidated balance sheets in "Deferred income" and "Accrued expenses and other liabilities," respectively. Unearned revenues as of June 30, 2003 were $14.4 million compared to $16.9 million as of December 31, 2002. Reserves for pending and incurred but not reported claims were $7.8 million as of June 30, 2003, compared to $8.2 million as of December 31, 2002.

Membership Program Products

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

Warranty Products

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

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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 June 30, 2003 on the warranty products were $3.3 million compared to $3.8 million as of December 31, 2002. Cancellation reserves were $3.0 million and $5.3 million as of June 30, 2003 and December 31, 2002, respectively. Revenues recorded for warranty products are included in the consolidated statements of income under "Enhancement services revenues" and were $8.4 million and $12.0 million for the three months ended June 30, 2003 and 2002, respectively. Revenues for warranty were $18.4 million and $25.0 million for the six months ended June 30, 2003 and 2002, respectively. Unearned revenues on warranty products are recorded in the consolidated balance sheets in "Deferred income." Unearned revenues as of June 30, 2003 were $10.4 million compared to $17.6 million as of December 31, 2002. Reserves for pending and incurred but not reported claims, included in "Accrued expenses and other liabilities," were $0.4 and $0.7 million as of June 30, 2003 and December 31, 2002, respectively.

Net Interest Income

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

Table 1: Analysis of Average Balances, Interest and Average Yields and Rates
(Dollars in thousands)

	Three Months Ended June 30, 2003			
	Average Balance	Interest	Yield/ Rate	Average Balance

Assets:				
Interest-earning assets:				
Federal funds sold	$ 53,441	$ 165	1.2%	$ 28,222
Short-term investments	448,612	1,556	1.4%	477,642
Credit card loans	690,903	29,713	17.2%	1,737,626
Total interest-earning assets.	$ 1,192,956	$ 31,434	10.6%	$ 2,243,490
Other assets	1,395,501			1,534,543
Allowances for loan losses	(124,485)			(309,827)
Total assets	$ 2,463,972			$ 3,468,206
Liabilities and Equity:				
Interest-bearing liabilities:				
Deposits	$ 729,021	$ 9,597	5.3%	$ 1,518,104
Debt	359,378	9,120	10.2%	356,693
Total interest-bearing liabilities	$ 1,088,399	$ 18,717	6.9%	$ 1,874,797
Other liabilities	269,420			434,407
Total liabilities	1,357,819			2,309,204
Stockholders' equity	1,106,153			1,159,002
Total liabilities and equity..	$ 2,463,972			$ 3,468,206
Net interest income and interest margin (1)		$ 12,717	4.3%	$
Net interest rate spread (2)..			3.7%	

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

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

Net interest income decreased from $41.8 million for the three months ended June 30, 2002 to $12.7 million for the three months ended June 30, 2003. The decrease is primarily due to a decrease in average interest-earning assets of $1.1 billion and a 320 basis point reduction in net interest margin. The decrease in average interest-earning assets is primarily due to the transfer of $1.0 billion of receivables to the Master Trust since June 30, 2002. The decrease in margin is primarily due to a $1.0 billion reduction in average credit card loans, which has resulted in short-term, lower yielding investments increasing to 42% of average interest-earning assets, versus 23% in the second quarter of 2002. In addition, we have experienced a 110 basis point increase in our funding costs versus the second quarter of 2002.

Table 1: Analysis of Average Balances, Interest and Average Yields and Rates (cont'd)
(Dollars in thousands)

Six Months Ended June 30,
2003

	Average Balance	Interest	Yield/ Rate	Average Balance	Int
Assets:					
Interest-earning assets:					
Federal funds sold	$ 85,370	$ 524	1.2%	$ 28,326	$
Short-term investments	493,723	3,451	1.4%	375,204	
Credit card loans	721,121	59,620	16.7%	2,115,683	15
Total interest-earning assets.	$ 1,300,214	$ 63,595	9.9%	$ 2,519,213	$ 15
Other assets	1,383,374			1,551,933	
Allowances for loan losses	(118,572)			(358,577)	
Total assets	$ 2,565,016			$ 3,712,569	
Liabilities and Equity:					
Interest-bearing liabilities:					
Deposits	$ 783,951	$ 20,505	5.3%	$ 1,722,869	$ 4
Debt	374,425	17,553	9.5%	403,824	1
Total interest-bearing liabilities	$ 1,158,376	$ 38,058	6.6%	$ 2,126,693	$ 5
Other liabilities	330,288			429,177	
Total liabilities	1,488,664			2,555,870	
Stockholders' equity	1,076,352			1,156,699	
Total liabilities and equity..	$ 2,565,016			$ 3,712,569	
Net interest income and interest margin (1)		$ 25,537	4.0%		$ 9
Net interest rate spread (2)..			3.3%		

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

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

Net interest income decreased from $99.5 million for the six months ended June 30, 2002 to $25.5 million for the six months ended June 30, 2003. The decrease is primarily due to a decrease in average interest-earning assets of $1.2 billion and a 400 basis point reduction in net interest margin. The decrease in average interest-earning assets is primarily due to the transfer of $1.0 billion of receivables to the Master Trust since June 30, 2002. The decrease in margin is primarily due to a $1.4 billion reduction in average credit card loans, which has resulted in short-term, lower

yielding investments increasing to 45% of average interest-earning assets, versus 16% for the six months ended June 30, 2002. In addition, we have experienced a 100 basis point increase in our funding costs versus the same period in 2002.

Other Operating Income

Other operating income represented 91.5% and 92.3% of revenues for the three- and six-month periods ended June 30, 2003, versus 82.7% and 83.8% for the same periods in 2002, respectively.

Other operating income decreased $63.4 million and $205.0 million for the three- and six-month periods ended June 30, 2003 compared to the same periods in 2002. For the three-month period ended June 30, 2003, net securitization and credit card servicing income decreased $40.1 million primarily due to a decrease in excess spread on securitized receivables caused by an increased default rate and attrition in the Master Trust. In addition, credit card receivables attrition in the Master Trust has caused a decrease in servicing income of $2.2 million. For the six-month period ended June 30, 2003, net securitization and credit card servicing income decreased $141.1 million primarily due to lower excess spreads caused by increased default rates on securitized receivables.

Credit card fees and interchange revenue decreased $12.6 million and $51.9 million for the three- and six-month periods ended June 30, 2003 compared to the same periods in 2002. The decrease in credit card fees, interchange and other credit card income, for both the three- and six-month periods, is primarily due to a decrease in average owned credit card receivables of $1.0 billion and $1.4 billion for the respective three- and six-month periods. Partially offsetting this decline was an amendment to the core transaction documents of the Master Trust agreement, effective June 2002, resulting in interchange income earned on receivables held by the Master Trust being recorded as contribution to the excess spread earned.

Enhancement services revenues decreased by $10.7 million and $12.0 million for the three- and six-months ended June 30, 2003. This decrease was primarily due to a decrease in credit card receivables covered by our debt waiver products due to portfolio attrition, as well as a decrease in ServiceEdge(R) revenue due to the expiration of the ServiceEdge(R) extended warranty contracts.

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Table 2: Enhancement Services Revenues and Active Memberships (In thousands)

Revenues	Three Months Ended June 30, 2003	Three Months Ended June 30, 2002	Six Months Ended June 30, 2003	Six Months Ended June 30, 2002
Credit Protection Products..	$ 46,148	$ 59,859	$ 97,124	$121,542
Membership Program Products.	28,609	21,108	59,163	38,268
Warranty / Other	10,197	14,682	22,351	30,835
Total	$ 84,954	$ 95,649	$178,638	$190,645

Active Memberships	June 30, 2003	December 31, 2002	June 30, 2002
Credit Protection Products..	773	905	1,056
Membership Program Products.	2,823	3,248	3,085
Warranty / Other	686	941	1,346

Total	4,282	5,094	5,487

Other Operating Expense

Total other operating expenses for the three- and six-month periods ended June 30, 2003, decreased $66.9 million and $63.8 million over the comparable periods in 2002. Credit card account and other product solicitation and marketing expenses decreased $28.1 million and $32.6 million over the comparable periods in 2002, largely due to fewer new credit card accounts and decreased enhancement services marketing expenses. Employee compensation decreased $8.6 million and $11.8 million over comparable periods in 2002, due to lower staffing requirements. Data processing services and communications decreased $3.8 million and $6.9 million for the three- and six-month periods ended June 30, 2003, primarily due to the reduction in our credit card portfolio. Enhancement services claims expense decreased $7.8 million and $6.0 million for the three- and six-month periods ended June 30, 2003, primarily due to a decrease in receivable balances covered by our debt waiver products. Occupancy and Equipment expenses decreased $3.4 million and $6.6 million over comparable periods in 2002 due to decreased space requirements. Asset impairments, lease write-offs and severance decreased $3.5 million and increased $13.3 million for the three- and six-month periods ended June 30, 2003 to $6.0 million and $22.8 million from $9.5 million and $9.5 million for the same periods in 2002. During the first quarter of 2003, we recorded approximately $12.0 million of write-downs of excess property, equipment, and operating leases and a $4.8 million charge for a workforce reduction. In the second quarter of 2003, we recorded an additional $0.9 million for a workforce reduction and wrote off the unamortized portion of the commitment fee of $5.1 million related to a backup financing facility entered into in March of 2003 with Thomas H. Lee Equity Fund IV, L.P. The commitment was replaced in June 2003. In the second quarter of 2002, a write-down of $10 million was taken for portfolios of charged-off loans purchased in 2001 and 2000. Other expenses decreased $7.3 million and $4.1 million for the three- and six-month periods ended June 30, 2003, compared to comparable periods in 2002. The decreases were primarily due to reductions in professional fees of $5.3 million and $1.5 million and travel and entertainment of $1.2 million and $2.2 million for the three- and six-month periods ended June 30, 2003, respectively.

Asset Quality

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

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

Delinquencies

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

Table 3: Loan Delinquency
(Dollars in thousands)

	June 30, 2003	% of Total	December 31, 2002	% of Total	June 30, 2002	% of Total
Loans outstanding	$ 632,913	100%	$ 846,417	100%	$1,317,238	100%
Loans contractually delinquent:						
30 to 59 days ...	19,699	3.1%	1,673	0.2%	41,382	3.1%
60 to 89 days ...	17,668	2.8%	2,121	0.2%	35,161	2.7%
90 or more days..	10,899	1.7%	4,082	0.5%	72,360	5.5%
Total	$ 48,266	7.6%	$ 7,876	0.9%	$ 148,903	11.3%

The decrease in the delinquency rates as of June 30, 2003 and December 31, 2002 compared to June 30, 2002, primarily reflects the sale of approximately $120 million delinquent receivables during September and December 2002 and an additional sale of $29.1 million of delinquent receivables in July 2003. These receivables were accounted

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for as held-for-sale as of June 30, 2003 and are recorded at fair value in other assets.

Net Charge-Offs

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

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

million, representing 18.1% of total gross charge-offs for the three-month period ended June 30, 2002. Charge-offs due to bankruptcies were $12.3 million, representing 23.4% of total gross charge-offs for the six-month period ended June 30, 2003 and $41.9 million, representing 23.2% of total gross charge-offs for the six-month period ended June 30, 2002. We charge-off accounts that are identified as fraud losses no later than 90 days after the last activity. We enter into forward flow agreements with third parties for the sale of a majority of charged-off credit card receivables. We also refer charged-off accounts to our recovery unit for coordination of collection efforts to recover the amounts owed. When appropriate, we place accounts with external collection agencies or attorneys.

Table 4: Net Charge-offs

(Dollars in thousands)	Three Months Ended June 30, 2003	Three Months Ended June 30, 2002	Six Months Ended June 30, 2003	Six Months Ended June 30, 2002
Average credit card loans..	$ 690,903	$1,737,626	$ 721,121	$2,115,683
Net charge-offs...........	43,702	85,099	51,991	168,777
Net charge-off ratio.......	25.4%	19.6%	14.5%	16.1%

The increase in the net charge-off ratio for the three months