

## **Metris 3Q 2005 Earnings Conference Call Notes October 25, 2005**

Good morning. I'm Jeff Grosklags, and I want to welcome you to Metris Companies' third quarter 2005 earnings conference call. The participants from Metris on our call today are Dave Wesselink, Chairman and Chief Executive Officer; Bill Houlihan, Chief Financial Officer; Matt Melius, Head of Operations; and Mark Wagener, Corporate Controller.

A recorded version of this conference call will be available for investors by calling 1-800-405-2236. Enter reservation number 11040335 followed by the pound sign. The recording will be available beginning at 2:00 p.m. Eastern time today.

I'd like to read the following "Safe Harbor" statement before we begin:

Investors are cautioned that all statements in this call that are not historical are "forward-looking statements," as defined in the *Private Securities Litigation Reform Act of 1995*. Forward-looking statements include statements regarding intent, belief or current expectations of the Company and its management. They are not guarantees of future performance and involve a number of risks, trends and uncertainties that may cause the Company's actual results to differ materially from those discussed in the forward-looking statements, as a result of various factors, including those set forth under "Risk Factors" and "Management's Discussion and Analysis" in the Company's 2004 Annual Report on Form 10-K and other Quarterly and Current Reports filed with the U.S. Securities and Exchange Commission.

The Company undertakes no obligation to update any forward-looking statement.

Some of the information that will be discussed during this conference call does not conform to accounting principles generally accepted in the United States. However, we believe the information is relevant to understanding the overall financial condition and results of operations of the Company.

I will now turn the call over to Dave Wesselink.

## **Dave Wesselink's Remarks**

Thank you, Jeff, and good morning everyone.

Yesterday, Metris Companies reported third quarter net income of 53.7 million dollars, or 39 cents per diluted common share. This compares with 32.5 million dollars, or 20 cents per diluted common share, for the second quarter of 2005. Year-to-date net income is 113.7 million dollars ... more than triple the full-year 2004 net income of 33.7 million dollars. We are encouraged that our business is continuing to produce improving results.

Improved excess spread continued to drive the earnings during the quarter. The Metris Master Trust average excess spread for the third quarter was 8.49 percent, up 166 basis points from the second quarter. The last time the average excess spread was above 8 percent was the fourth quarter of 2001, almost 4 years ago.

The average portfolio yield reported in the Master Trust in the third quarter was 28.49 percent, up slightly from the second quarter. Part of this increase in yield can be attributed to the increases in the Prime interest rate, which has been reflected in customer rates.

The average charge-off rate in the Master Trust fell to 13.88 percent in the third quarter compared to 15.54 percent in the second quarter. This is a result of the decrease in delinquencies we reported in the last few quarters.

The average payment rate for the quarter was 8.97 percent, up from 8.58 percent last quarter and 7.76 percent from third quarter 2004.

We reported first-stage delinquencies of 4.67 percent at September 30, 2005 compared to 4.30 percent as of June 30, 2005. Two-cycle-plus delinquencies followed a historical seasonal pattern and were up 39 basis points over last quarter. They stood at 8.10 percent at September 30, 2005 and 7.71 percent at June 30, 2005.

Our increased marketing efforts resulted in 249,000 new accounts being booked this quarter, our highest new account total since second quarter of 2002. That represents 84,000 more new accounts than we booked in the second quarter of this year. It also compares favorably to the 118,000 accounts booked in the third quarter of 2004. Year-to-date new account bookings total 577,000, which leaves us only 223,000 accounts from our full-year goal of 800,000 new accounts. We generated 480,000 new accounts in all of 2004.

We announced a new relationship with Discover in September, to complement our long-standing and continuing relationship with MasterCard. Metris has teamed with Discover to issue credit cards on the Discover Network, as well as to become a secondary issuer for Discover-sourced accounts. This exciting new relationship allows us to expand our product offerings. In addition, it provides an opportunity to give potential new customers another option when evaluating card choices. We plan to launch this program by late 2005, and we look forward to leveraging this partnership to help us achieve our growth goals for 2006 and subsequent years.

Gross active accounts ended the third quarter at 2.2 million. Managed credit card receivables for the third quarter were 5.8 billion dollars, down 105 million dollars from second quarter 2005. We continue to believe managed receivables will begin to grow sometime in 2006 based on the success we are having in increasing new accounts.

I would now like to address some topics that arose during the third quarter that have led to many investor questions. One of these is the impact of this fall's Gulf Coast hurricanes. Overall, we believe approximately 2 percent of our receivables may have been affected by Hurricane Katrina. We obviously are unable to predict how quickly people will recover from natural disasters, but we do attempt to mitigate some of the negative impact to our portfolio. We have proactively relaxed fee and interest payments for many affected customers and also allowed for the deferral of payments for customers most affected by Hurricane Katrina. We do not believe these actions will have a material impact on our future results.

The ongoing higher level of energy costs is something that is related to the hurricanes, and we are watching it closely. There have been many third-party reports regarding the impact of higher gas prices on consumers' wallets. We have also seen such trends with our customer base. Our customers' average gasoline purchase increased approximately 6 dollars per transaction over the

last 12 to 15 months. The number of gasoline transactions as a percentage of total transactions on our cards has also increased approximately 20 percent over the last 15 months.

Despite the increase in gasoline costs, our analysis shows that our customers have reduced other spending to manage the impact on their overall debt burden. Customers probably don't have as much cushion as before, but we are pleased with how they have responded so far, resulting in our highest portfolio payment rates ever. We will obviously continue to monitor the impact of higher gas prices on our customers.

Recent bankruptcy legislation has caused industry-wide increases in filings. We saw our third quarter filings increase 12.8 percent over third quarter 2004 compared to the national increase of approximately 35 percent over 2004, as reported by MasterCard. The law became effective on October 17, and we believe bankruptcy filings should now moderate, although there is still a backlog of filings in the court system. The impact of the increased filings we saw recently should cause our excess spread to be lower in the fourth quarter than it was in the third quarter as we write-off these increased bankruptcies within our normal 60-day period.

We continue to work toward full implementation of the customer amortization requirements of the 2003 FFIEC guidelines. We intend to have fully implemented the guidance by year-end 2005, by which time our portfolio will be operating under minimum payment terms that will satisfy the amortization timeframes set forth by our bank regulators.

We do not anticipate any significant impact to 2005 excess spread results, but we believe the impact of the FFIEC guidance will likely moderate anticipated future benefits in excess spread in 2006 and beyond.

I wish to close my prepared remarks by expressing how proud we are of the Metris team and the fine work they have done. We have posted solid results this year and expect to continue to do so. We are excited about the opportunities that lie ahead for both our customers and our employees with the merger of Metris and HSBC.

With that, I'd now like to turn the call over to Bill Houlihan to cover some more of the specifics. Bill ...

## **Bill Houlihan's Remarks**

Thanks, Dave.

I will start by making some remarks on the merger process with HSBC. I will then have some comments on our financing activities and earnings.

### Merger-related Comments

Metris announced its proposed merger with HSBC on August 4, 2005. We have made a lot of progress in the merger process during the two months since then. We continue to believe the merger will close in the fourth quarter of 2005, just as we did when we first announced the transaction in August.

Metris filed its preliminary proxy with the SEC on August 16. The SEC is not reviewing our preliminary proxy statement, but it is reviewing our latest 10K. We are having a regular dialogue with the Corporate Finance Staff at the SEC to resolve the questions they have.

The merger agreement requires us to resolve the Wells Notice matter with the SEC before the merger closes, at a cost that is not substantial. We have had many conversations with the Enforcement Staff of the SEC in this regard since Metris responded to the Wells Notice on August 2. We anticipate that we will resolve this matter on a timely basis, and that the merger will close in the fourth quarter as noted previously.

Both Metris and HSBC have made all the regulatory filings and notices, to the extent necessary by either party, to applicable regulatory agencies. The regulatory review processes are moving forward as expected. Metris has also received all required merger consents from our lenders and landlords.

The management of Metris has been meeting regularly with its counterparts at HSBC to plan the potential integration of the two companies. We are pleased that we have been able to continue to have solid operating results, even while we also allocate time and resources to merger-related matters.

## Financing Activity

Let me now discuss our recent financing activity.

Our ratio of equity-to-managed assets was 17.9 percent at quarter-end. This represents an increase of 130 basis points from June 30, 2005 and 440 basis points from September 30, 2004.

Metris prepaid all of its remaining corporate debt in the third quarter.

Metris also modified its receivables-backed conduit borrowing arrangements with its lenders in the third quarter, and we are now using a paired series structure to fund maturing securitizations in the conduit. This reduced our financing costs and the timing of our collateral requirements.

Our latest two-year maturity securitization closed on October 19, 2005. It was a 500 million dollar transaction, structured with tranches rated Triple A to Triple B. The weighted average spread was LIBOR plus 16 basis points, which was also lower than the weighted average spread on our April transaction by approximately 10 basis points. We retained a class D note of 39.4 million dollars rated Double B, which we intend to hold at this time, along with a retained interest of 66.7 million dollars. The enhancement level under the Triple B securities was 17.5 percent. This represents a 350-basis-point improvement over our last asset-backed transaction issued in April 2005.

## Earnings

Let me now discuss some of the key items in our income statement.

Interest-only revenue was 121.8 million dollars for the quarter due to the performance of our portfolio. IO revenue is more than 25 million dollars higher, or 26 percent higher, than the prior quarter.

Loss on securitization for the quarter was 7.1 million dollars, which was a lower loss than in the previous quarter. This was due to the use of the paired series. It reduces the total accounting loss, and also spreads the loss on new securitizations over a few months when compared to a defeasance.

We recognized a gain on replenishment of 736 thousand dollars, a significant improvement over the 11.1 million dollar loss last quarter. This improvement is driven by higher excess spread assumptions and lower weighted average months to maturity on outstanding securitization transactions.

We incurred a 20 million dollar expense related to the change in fair value of retained interests in the quarter. This reflects the impact of receivables attrition during the quarter on a more highly valued interest-only receivable asset. The change in fair value is somewhat offset by higher excess spread assumptions utilized in performing the quarterly valuation of our interest-only strip receivable.

Interest expense decreased by 4 million dollars compared to the prior quarter, due to the prepayment of the remaining corporate debt in August, as previously mentioned.

Marketing expense for this quarter was slightly above last quarter, and helped us add 84,000 more new accounts this quarter than last quarter. We are positioned to hit our full-year goal of 800,000 new accounts, as Dave stated earlier.

Pretax income for the third quarter was 74 million dollars. This is 24 million dollars above what we reported for the second quarter of 2005.

The effective tax rate for the quarter was 27.7 percent. This was lower than the 35 percent rate we reported in the second quarter. The primary reason for the change in the effective tax rate is the approval of a tax refund during the quarter. This approval resulted in a reduction of 4.7 million dollars in our income tax reserves.

The results we posted this quarter are strong, and truly reflect the improvement in business operations this Metris team has implemented over the last few years.

That concludes our prepared remarks. We will now begin the question-and-answer period.

### **Q&A and Close**

We want to thank everyone for participating in Metris Companies' third quarter 2005 earnings conference call. A recorded version of this call will be available on our website, [www.metriscompanies.com](http://www.metriscompanies.com), or by calling 1-800-405-2236, reservation number 11040335 followed by the pound sign, beginning at 2:00 p.m. Eastern time today.

This concludes our third quarter 2005 conference call. Thank you.