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ETFC.OQ^J20 - Q1 2003 E*TRADE Group, Inc. Earnings Conference Call

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**OVERVIEW:**


ET reported 1Q03 net revenues of $322m and net income of $21m. GAAP EPS was $0.06, and EPS from ongoing operations was $0.10, in line with expectations. ET announced a restructuring plan resulting in pre-tax charges of up to $120m, or $0.20 per share, over the next two quarters. FY03 EPS guidance: $0.45-0.55 from ongoing operations, or $0.30-0.40 on a GAAP basis, prior to restructuring plan charges. Q&A Focus: the co.'s restructuring plan, guidance, and market share.

## CORPORATE PARTICIPANTS

**Mitchell Caplan** *E*TRADE Group, Inc. - CEO, Director*

**Leonard Purkis** *E*TRADE Group, Inc. - CFO*

**Arlen Gelbard** *E*TRADE Group, Inc. - CBO, President E*TRADE Bank*

**R. Jarrett Lilien** *E*TRADE Group, Inc. - President, COO*

## CONFERENCE CALL PARTICIPANTS

**Justin Hughes** *Jeffries*

**Richard Repetto** *Putnam Lovell Securities*

**Michael Vinciquerra** *Raymond James & Associates*

**Glen Manna** *Banc of America Securities#Smith Barney*

**Judd Gorsun** *The Capital*

**Greg McCosco** *Lord Abbott*

## PRESENTATION

**Operator**

Welcome to the first quarter 2003 conference call for E*TRADE Group, Incorporated. At this time all participants have been placed on a listen-only mode. Following the presentation, the floor will be open for questions.

I've been asked to begin this call with E*TRADE Group, Incorporated's Safe Harbor Statement. During this conference call, the company will be sharing with you certain projections or other forward-looking statements regarding future events or its future's performance. E*TRADE Group cautions you that certain factors including risks and uncertainties referred to in the 10-Ks, 10-Qs and other reports periodically filed with the Securities and Exchange Commission could cause the company's actual results to differ materially from those indicated by its projections or forward-looking statements. In this call E*TRADE Group will discuss some non-GAAP measures in talking about its performance and you can find the reconciliation of those measures to the GAAP in the company's press release which can be found on its website.

This call is being recorded. The recording will be available by telephone beginning approximately at 4:00 p.m. Pacific time today through 9:00 p.m. Pacific time April 29th. The call is also being webcast at www.etrades.com. No other tape recordings of this call or copies of the taping are authorized or may be relied upon.

I'll now turn the call over to Mitchell Caplan, Chief Executive Officer of E*TRADE Group. Mr. Caplan the floor is yours.

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**Mitchell Caplan** - *E*TRADE Group, Inc. - CEO, Director*

Thanks, everybody, for joining us this afternoon. A word on process for today in going forward. Our prepared remarks will be brief and we will leave ample time at the end for questions. Over 20 years ago, E*TRADE was founded with this simple principle: Use innovative technology to provide superior financial products and services. Along the way, we have experienced all types of economic conditions, from a rationally exuberant bull markets to exceedingly pessimistic bear markets. We have added new components to our business to better serve our customers.

In 2000, we added a retail bank that had been built on exactly the same principles of value and technological advances. That bank is now the eighth largest savings bank in the country. We have added or built strategically to capitalize on natural cross-sale opportunities and to produce scale and deficiencies, and throughout we have remained committed to our core tenet. We have always and will always aspire to create customer value and competitive advantage by being faster, cheaper, and better than our competition.

And so, while there are a greater number of parts than in the old days, or as compared to a monoline brokerage or bank, our motto remains simple and opportunistic. We offer brokerage, banking and lending products to retail, corporate, and institutional customers, all built around a low-cost technology infrastructure. We manage risk through strong, conservative credit policies. Our diversified model provides downside protection in difficult times. More importantly, the complimentary nature of our businesses provide greater upside through scale, efficiency and cross-sell.

Moving forward, we remain committed to do our principles of value and innovation. We will continue to add businesses in scale as opportunity presents. And when appropriate, we will exit those activities that do not conform to our core tenets. We will be rigorous in delivering results while building long-term value, and we will continue to build on our vision to reinvent and redefine the industry. It is in this context that I'm pleased to announce that in the latest, of what has become a string of very difficult quarters for the economy, we generated reported earnings of 6 cents a share, or 10 cents per share from ongoing operations, a non-GAAP measurement. These results are consistent with street consensus. Len will walk you through the financial details in a few minutes.

Again this quarter, we have demonstrated the value of diversification. While brokerage revenue continued to show the impact of a challenging equities market, interest and fee income from banking activities produced some of the best results our banking segment has experienced to date.

Let me now turn briefly to our brokerage and banking businesses. In Detroit Securities Brokerage business, we are concentrating on increasing market share and creating cost efficiencies. For the third quarter in a row, based on industry numbers released for January and February, showing a decrease of approximately 15% in the industry, we have increased market share demonstrated by our decline in average daily transactions by only 6% for the entire quarter. We have done so by focusing on the active trader segment with our targeted promotion of the Power of Nine value proposition.

In early March, we began the second phase of this campaign, introducing competitive pricing on margin rates and option trades for qualified investors. Since launching this new campaign, margin balances among active traders has increased, and active trader option trading, as a percentage of total active trader trades, has increased 12%.

Our ongoing focus on operating efficiency has given us a lower transactional and fixed cost structure, translating into real operating leverage throughout the business. To this end, we can increase earnings per share by a penny per quarter in a number of ways, including producing an additional 10,000 transactions per day, increasing margin debits by $300 million per quarter or reducing our cost structure by 2%. This focus on lowering fixed costs and eliminating redundancy across complimentary retail, institutional and corporate businesses has created one of the lowest cost operating structures with down side protection and some of the greatest upside leverage in the industry.

At E*TRADE Bank, we are concentrated on widening net interest spreads while carefully managing and limiting credit risk. To achieve our goal of wider spread, we continue to take a balanced approach of asset diversification and liability cost reduction. Each incremental 15 basis points on our bank net interest spread contributes earnings per share of 1 cent per quarter. This quarter, our net interest spread increased to 152 basis points, a 12 basis point improvement over last quarter.

High mortgage prepayments and the limited availability of asset portfolios that met our stringent credit requirements, partially offset the 20 basis point spread gain we saw from our expanded consumer loan portfolio. Carefully managing the credit quality of our assets will always take priority over increasing net interest spread. At the same time, that same low interest rate environment that has driven high prepayment and has held in check our ability to widen interest spread, has been a great benefit in our direct and indirect mortgage origination business. Over the first quarter, we generated a record $2.5 billion in direct retail mortgage originations and over $1.2 billion through our correspondent business in mortgage whole loans. We also are carrying $1.2 billion of direct originated mortgage whole loan product locked in the pipeline into the second quarter.

Our diversified model continues to drive cross-sell success. During the quarter, 41% of our FDIC-insured, deposit products, 26% of our mortgage products and 38% of our home equity products sold came from cross-sell. The value in cross-selling opportunity continues to represent a significant one for us. For example, if we can increase the number of households in our base that purchase our lending products by just 1%, we could generate incremental earnings per share of up to 3 cents per quarter. We are lowering our cost of funding by continually improving the value proposition we offer our customers. This focus has generated growth in transaction deposits, both quarter over quarter and year over year, same quarter.

Transaction deposits grew by $318 million, 58% of net new deposits in this quarter for banking, bringing our total transaction deposits to $4.6 billion, which is over 51% of our total deposit base. We believe that it is extremely rare, if at all possible, to find a unique way to extract consistent and recurring value from loans on the lower end of the credit spectrum. Accordingly, we have chosen to lend to only the higher credit end of the market, and virtually all of our loans are secured by mortgages or consumer assets with conservative loan-to-value ratios. For example, our mortgage product has an average LTV of 67%, while our home equity product has an average LTV of 78%. We maintain adequate reserves, which represent the equivalent of 12 months for expected losses in both our mortgage and consumer loan portfolios. As a result, we have been able to keep our losses well below industry average.

Our chargeoffs for the quarter total 21 basis points on total average assets, well below the OTS fourth quarter industry average of 34 basis points. The credit quality of our asset portfolio remains strong, as demonstrated by the weighted average FICA scores for our mortgage and consumer portfolios, holding solid at 724 and 728, respectively. All told, this past quarter again validated the power of our concept and though it is difficult to get too excited about today's equity markets, it's easy to be confident in our model.

We have a great foundation on which to build, and a 20-year legacy from which to draw. The management team and I are dedicated to improving both short- and long-term value for our customers and shareholders. We are disciplined in driving initiatives that fulfill our vision and in eliminating businesses or products that do not. Over the last 90 days, we have conducted a comprehensive evaluation of our businesses, products, and services. Every business, initiative, and investment was reexamined for consistency with our goals of value and innovation and for adequate profitability. This process has generated opportunities for cost reductions over and above those that we will naturally derive from smart applications of technology.

In the next three months, we will be finalizing a restructuring plan that will be implemented over the next two quarters. The plan better aligns our cost structure with our vision for the company and with current business conditions. At the same time, it also maintains the infrastructure required to achieve the company's full growth potential when general economic conditions improve.

The restructuring plan has two major elements. First, we will be exiting unprofitable locations, including our E*TRADE Financial Center in New York and certain international locations. We will also be consolidating underutilized facilities and reducing square footage in our Menlo park and Rancho Cordova offices while remaining committed to maintaining a presence in these cities. Second, we will be exiting and writing off unprofitable product offerings and initiatives; specifically, stock baskets, E-adviser and personal money management. None of these were making an adequate return to justify continued investment of capital and management time.

We expect this restructuring plan to result in approximately total pretax charges of up to $120 million over the next two quarters, or up to 20 cents per share. These actions will allow us to achieve additional pretax cost savings estimated between $40 million and $50 million, or 7-8 cents annually. The plan is designed to enhance short, intermediate, and long-term profit performance. More importantly, it is designed to ensure that we continue to be an efficient, effective, competitor. The associated savings better position us for continued sluggish economic conditions and create additional operating leverage when the markets return.

As we continue to develop our business, we are maturing our business practices. As Len walks you through the numbers, you will see that we are committed to providing transparency into our model and our results. We are providing a new segment breakout of our fully allocated brokerage and banking segments. We have provided additional metrics in our press release, including transactions per account per quarter, EBITDA, and interest coverage, to name a few. In the second quarter, we intend to break out compensation in benefits expense in our earnings release as a precursor to our transition to a natural accounts, expense-reporting format over the next few quarters.

Last year we heard shareholder concern around corporate governance arising from compensation issues. This troubled us deeply because it drew focus away from the continuing success of our model and from the work of our dedicated employees. We have acted strongly to remedy these concerns. We split the office of Chief Executive Officer and Chairman of the Board, and we recently announced the appointment of four new unaffiliated and independent outside directors to our board. With Bill Ford and Peter Chernen's departure, and upon shareholder approval, our board will consist of nine independent directors and one inside director, well in excess of NYSE, SEC and Calpers guidelines.

Our new directors bring distinct financial services expertise and relevant experience needed to provide outstanding corporate oversight. They also comprise the newly reconstituted compensation committee. The intent of our structure is to ensure that the board remains completely impartial in reviewing, evaluating, and guiding the company's business at arm's-length to better serve our shareholders. In addition, every member of the management team has agreed to a realignment of compensation, including components in metrics with all plans being approved by the entire board.

All of the changes that I have discussed might seem new, but they are, in fact, a rededication to those principles upon which we were founded. We have traditionally been lean and efficient, and we have always aspired to be a customer champion. We are passionate about our business and moving forward, we will ensure that our dedication to corporate excellence matches our dedication to customer and power. Now to Len for the numbers.

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**Leonard Purkis** - *E*TRADE Group, Inc. - CFO*

Thanks, Mitch. This quarter we generated total net revenues of $322 million. That's an 8% decline from last quarter and 3% decline from the same quarter last year. This decline is largely related to reduction in brokerage revenues, partially offset by an increase in banking revenues. Cash and accruements for the quarter totaled $975 million and precash totaled $402 million this quarter, a $35 million increase over the fourth quarter. Precash, as we define it, represents cash held at the parent and excess regulatory capital of bank and brokerage and is a metric use by management in measuring business performance.

Beginning this quarter, we are adding in additional cash flow-related metric, EBITDA to supplement the GAAP cash flow presentation in our 10-Ks and 10-Qs. The definition and reconciliation of EBITDA to GAAP net income is in the metrics section of our earnings release. EBITDA, for the quarter, totaled $79 million. That's a 23% decrease over last quarter and a 12% decrease over the same quarter last year. While lower on a comparative basis as a result of reduced income, it remains strong, generating debt service coverage of nearly seven times.

As you will find detailed in our press release, provision for loan losses totaled $10 million versus net chargeoffs of $9 million. This quarter's provision is up slightly as expected reflecting the different composition of our balance sheet. Our reserve now exceeds $29 million, an increase of more than $1 million over last quarter. For the quarter our total reserves to nonperforming loans equaled 119%. That's up from 104% in the fourth quarter and a 48 percentage point increase from 71% to last year, same quarter.

Now, brokerage revenue for the quarter totaled $177 million, a 17% decline from last quarter and a 21% decline from same quarter last year. This decline is a result of a significant reduction in trading activity during the quarter, impacted both at retail and institutional businesses and lowering commission and transaction revenues.

Now, banking revenue for the first quarter totaled $145 million. That's up 7% over last quarter and up 36% over same quarter last year. This increase is related to a growth in net interest income and an increasing gain on sale of originated loans partially offset by declining gain on sale of loans held for sale and other securities. The increase in net interest income is a result of widening interest spreads and an increase in average bank assets.

The growth and gain on sale of originated loans is a direct result of the continued success of our direct mortgage origination business and the addition of our consumer finance business Ganis. The declining gain on sale of loans held for sale stems from our decision to retain more of our correspondence flow in comparison to the fourth quarter. And while we continue to anticipate a decline in mortgage revenue generation when interest rates rise and refinancing volume's slow, we also expect to offset declining mortgage revenue with high-interest income, both from higher spreads and a larger overall balance sheet.

On the expense side, in accordance with our guidance, we show a slight increase in cost of services and, in general, an administrative expense primarily as a result of the full quarter expense associated with the Ganis acquisition. This increase was offset by a reduction in selling and marketing expenses, and marketing in our institutionsal business as a bearable component, and with the reduction in institutional revenue, came a current from the decrease in expense.

We've included in the press release the presentation of our new segment recording format. The segments brokerage and banking include, for the first time, the full allocation of corporate overhead and marketing expense and reflect the way that we manage our business. We will make available on our website the new segment recording format for the four quarters of 2002, in addition to the quarter-over-quarter and year-over-year comparisons in the press release. This segment format illustrates that in 2002 the brokerage segment was able to deliver solid profitability throughout the year. Brokerage represented 65% of annual revenue and 43% of the full year's operating income.

Now, banking segment represented 35% of annual revenue and 57% of operating income. Quarter 1 of 2003 saw the banking segment deliver $44 million of operating income, flat with last quarter. The brokerage segment with transaction volumes continuing to be under pressure generated $8 million of operating income in quarter 1 versus $25.7 million last quarter. In summary, on a reported basis, the company's first quarter net income equaled $21 million, or GAAP earnings of 6 cents per share and earnings for longer end operations were 10 cents per share, in line with street estimates.

Now, turning to guidance for our second quarter, we see no external events that will act as an impetus to change. Indeed, we've already seen trading activity decline year over year and quarter over quarter, well below our anticipated average daily transactions for the year. Should trading activity continue to decline, we will be challenged to find ways to accelerate efficiency initiatives and find other sources of revenues and to offset additional lost revenues needed to meet or exceed our original guidance from ongoing operations of 45-55 cents per share for the year. The equivalent on a GAAP reported basis will be EPS of 30-40 cents per share. Nevertheless, we are reiterating our original 2003 guidance prior to the restructuring charges of up to $120 million or up to 20 cents per share expected to occur over the next two quarters.

In closing, a few key messages. The company's two segments, brokerage and banking, are both profitable. Our balance sheet is financially sound, and our reserves are adequate. We continue to use technology to create customer value and competitive advantage. This focus has created one of the lowest cost operating structures in the financial services industry. Our cost structure coupled with our complimentary suite of products provides downside protection in difficult times and enhanced profitability in good times. And finally, we are dedicated to excellence in corporate governance. With that we'll now open up this call to answer your questions.

## QUESTIONS AND ANSWERS

**Operator**

The floor is now open for questions. If you have a question, please press the number 1, followed by 4 on your touch-tone phone. If at any point your question is answered, you may remove yourself from the queue by pressing the pound key. We do ask that while you pose your question that you pick up your handset to provide optimum sound quality. Once again, ladies and gentlemen, to pose a question or a comment please press the numbers 1, followed by 4 on your keypad. Our first question of the evening comes from Justin Hughes with Jeffries.

**Justin Hughes** - *Jeffries*

Good afternoon. You spoke quite a bit about how you estimate that you had picked up market share in the brokerage segment and I was wondering if you could break out the darts for us by month for January, February, and March.

**Leonard Purkis** - *E*TRADE Group, Inc. - CFO*

Justin, it's not something that we break out monthly. I think what you've seen from the other areas of the sector that give out their monthly data, that we're no different from them. We've seen gyrations within the quarter. We've had days where we've had transactions as low as $57,000 and we've had days where we've had transactions as high as $115,000. So it was a very unusual quarter in terms of a lot of volatility in the highs and lows that we saw in the transaction volumes.

**Justin Hughes** - *Jeffries*

How about could -- I guess maybe a little more to the point, could you tell us how march was versus February since nobody's reported March numbers yet?

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**Leonard Purkis** - *E*TRADE Group, Inc. - CFO*

Again, Justin, we prefer to let the other guys come out with their numbers and, you know, it's one of the things we're considering as we go to natural accounts as to whether that's something we want to do in the future is come out with monthly data.

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**Justin Hughes** - *Jeffries*

Okay.

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**Mitchell Caplan** - *E*TRADE Group, Inc. - CEO, Director*

Conceptually, Justin, what I would tell you is if you looked -- and one of the things we are considering, as you know, is beginning to report monthly dart. In the meantime, I would tell you that if you looked at our performance month by month and for the quarter, if you see a decline of 6%, that was pretty much in line each month as it compared to our competitors in terms of our consistent outperformance. So when you looked at how much market share we picked up, what we saw was it was pretty consistent month over month and ending with a final decline of 6% compared to lots of estimates in the industry of it down anywhere from 12-21%.

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**Justin Hughes** - *Jeffries*

Okay. On the bank side, I notice that your deposit growth -- well, you had deposit growth for the first time in several quarters, as well as account growth, and I was wondering, you know, if you are doing something differently there or is that in any way related to Ganis?

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**Mitchell Caplan** - *E*TRADE Group, Inc. - CEO, Director*

Let me turn it over to Arlen, but the first thing to note is we did show growth last quarter, as well. So this is our second quarter of growth in the area and I would say at a high level, it really isn't Ganis. It's singularly focused around the deposits, as you well know, with people being very focused on FDIC insured, very focused on safety and protectionist security and looking to move money into bank deposit accounts. So we clearly benefited from that. As well there was significant spending and marketing around it but let me have Arlen walk you through the details.

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**Justin Hughes** - *Jeffries*

Okay.

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**Arlen Gelbard** - *E*TRADE Group, Inc. - CBO, President E*TRADE Bank*

Yeah. I mean, on the account growth, yes, there was (INAUDIBLE) coming from Ganis but, you know, we really saw some substantial growth particularly in the deposit accounts. We had inflows and outflows, but the thing that we found, you know, most heartening is that it's clear to us that our value proposition is catching on, particularly as we look to stressed and increased growth in transaction accounts. I mean, on an account growth basis, our transactional accounts accounted for almost 707%# of the net growth and transaction deposits, of all of our net inflows for the quarter represented 58% of all of our deposits coming in. So transaction counts -- transaction deposits, overall, are at a solid 51%. Could see these being 49 but, you know, we're seeing that increase quarter over quarter. So we were pleased with that.

**Justin Hughes** - *Jeffries*

Okay. And then on the $120 million charge, what's that primarily related to? Is that primarily real estate or is that right off of capitalized software?

**Mitchell Caplan** - *E*TRADE Group, Inc. - CEO, Director*

It is not primarily real estate the way you are thinking about it in terms of a facilities restructuring for our employees. There is a real estate component, for example, in exiting the New York E*TRADE Financial Center. We're looking at all of our centers. So to the extent that we would exit any of our centers because they are too large, there could be a component there. Otherwise, it really is the discipline of exiting products that aren't successful, but I'm going to turn it over to Jarrett and let him spend a few minutes talking with you about the restructuring charge.

**R. Jarrett Lilien** - *E*TRADE Group, Inc. - President, COO*

Hey, Justin. Just reiterating what Mitch said, it's not being driven by facilities. Being more driven by good practice, and it's an ongoing practice that we will continue or we always look at our businesses and review them and make sure that they are living up to, you know, their promise. And so at this point, we've been looking at the touch-point strategy and, yeah, we've got something like the New York Center, which is a little too big, and the ideal size for us would be something smaller, more like 3,000 square feet. So we'll be looking at refining that and moving on there. Internationally, we've got some bright spots in international, more on the active trader side, but then we've also got some areas that just aren't pulling their weight and we'll finish the review. If they are not living up to their promise, we will exit those areas. And then we've got some products that just haven't taken root. Namely, that the PMM and the baskets and the E adviser, just things that customers didn't respond to. They cost us money to keep, and they take management time, and it's time and money better spent on other projects. So that's really the heart of it.

**Justin Hughes** - *Jeffries*

Okay. So when -- like, if you are exiting stock baskets, is the, you know, the charge you are taking there, is that because you are laying off people that were dedicated to that product, or is that because there was some type of software that was capitalized? I don't imagine it would take up any facilities.

**R. Jarrett Lilien** - *E*TRADE Group, Inc. - President, COO*

Yeah, on something like that, there's not a facilities component at all and that gets back to what Mitch is talking about. A lot of this is more just looking at products and activities that we were involved with, and did they make sense for us today.

**Justin Hughes** - *Jeffries*

Okay. So it sounds like it's mostly the capitalized investment that you had in those products, being software, whatever else?

**R. Jarrett Lilien** - *E*TRADE Group, Inc. - President, COO*

Yes.

**Justin Hughes** - *Jeffries*

Okay.

**Leonard Purkis** - *E*TRADE Group, Inc. - CFO*

Hey, Justin, we're going to have to let some other guys ask some questions. You can come back later.

**Justin Hughes** - *Jeffries*

Thanks.

**Operator**

Thank you, Mr. Hughes. Our next question of the evening comes from Richard Repetto with Putnam Lovell Securities.

**Richard Repetto** - *Putnam Lovell Securities*

Hi, guys.

**Mitchell Caplan** - *E*TRADE Group, Inc. - CEO, Director*

Hey, Rich.

**Richard Repetto** - *Putnam Lovell Securities*

I'm going to try to keep it at two questions here, I think, but first on the guidance. You know, it's pretty much stayed the same and sounded pretty cautious but when you look at what's going on in the mortgage industry there, the MBAA is up by 30% originations, 96% of that is refi, 85% of it is in the next three quarters. So I guess -- plus you have the restructuring and at least some marketing decline this quarter. You know, how can we -- I'm just trying to balance out how you, you know, are looking at the guidance and, you know, with the uptick in mortgages, where are we offsetting it to keep just flat guns?

**Mitchell Caplan** - *E*TRADE Group, Inc. - CEO, Director*

Let me take a first pass at that, Richard, if I can, and then let me turn it over to Len. As you have seen, we have consistently delivered our numbers in accordance with street consensus estimates when many of our competitors have failed to do that. And I think it is exactly what you are referring to, which is the diversified model, that has allowed us to do that. So when we gave the initial guidance, my recollection was we said that transactions would stay flat last year at $88,000. You saw a decline this quarter of about 6%. We offset some of that clearly in connection with the performance that you are seeing at the mortgage company. So again to your point, I think we have more visibility than most as we give guidance because you look at the different components that make up our income.

That being said, it's unclear exactly where transactions will go for any of us. Clearly, our goal is to ensure that we gain market share consistently. We've done it now for the third quarter in a row and will remain focused on that, but it doesn't guarantee that you won't see a decline in transaction and so as we look forward, you know, our hope would be that exactly what you are saying, each of the different components works together in the aggregate to offset. And one decline in revenue could be offset by an increase in the other as well as a decline in expenses. Also, the point that I just want to make really quickly with the restructuring charge is, we intend to finalize it in this quarter. We will begin the implementation over the next two quarters. It will probably be Q4 before you even begin to see any significant pickup, whatsoever, as a result of the benefit, and you should really begin to look forward to next year in terms of those cost savings of 7-8 cents.

**Leonard Purkis** - *E*TRADE Group, Inc. - CFO*

Except if we look at the restructuring, we're really assessing and finalizing that plan to really maintain the profitable future of our model and align it with today's conditions. The benefits we quote of 7-8 cents are on an annualized basis and really position us going into 2004. So, again, I think what Mitch is explaining is that we gave the step-by-step assumptions we had in getting to our guidance for this year. Those parts are moving around and that's part of the beauty of our model is those parts can still move around, and we've still got a challenge to get to the 45-55 cents guidance, but we've got an opportunity to get there.

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**Mitchell Caplan** - *E*TRADE Group, Inc. - CEO, Director*

And I think, Rich, what you really are getting to is, what happens if transactions remain flat or stronger and the mortgage market is better. And the answer is, clearly, we drop it to the bottom line and deliver in-excess earnings. That's clear.

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**Richard Repetto** - *Putnam Lovell Securities*

Okay. I mean, clearly it looks like the mortgages are going to -- it's, the forecast is better than what it was in January. I guess that was one point. But anyway, on to the next question, I guess is -- I'm going to cheat here but it's got two parts. It's about looking at market share and, for example, your trades -- the number of trades looked on less your peers, the competitors. You know, sources, we're thinking about trading being down, say, 14-18%.

So -- but when we look at the commission line, the brokerage commission line, it's down right in the middle of, you know, that range, down about 16%. So I guess my question is, you know, how do you look about, you know, is this incremental market share that we're taking the active trader segment? You know, how do you look about added -- you know, is it actually increasing the revenue line? We know trades are in there but what about revenues? A little bit on the banking, as well. If you look at this segment information, you know, you had banking revenues up 7%, but you had expenses up 10% from quarter to quarter. So I'm just trying to look at, you know, how -- well, I guess they are two separate questions but, you know, how would you address those?

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**Mitchell Caplan** - *E*TRADE Group, Inc. - CEO, Director*

They are. Let me have Lou answer the first one with respect to brokerage, and then Arlen can answer the banking question.

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**Lou unknownLou Klobuchar**

First of all, Rich, with respect to brokerage market share, we're certainly happy to see ourselves gaining on the transaction side of that business, and see ourselves outperforming there. Clearly our average commission per transaction is declining. That's very much what we intended. With our Power of Nine campaign, as you are well aware, we have tried to segment and go after a segment that still remains fairly stable in this environment, the active trader segment. We delivered a value proposition to them that included more aggressive pricing, along with speed and quality guarantees. So it's working there exactly the way we want it to. We intend to really continue that approach to drive increases in market share. Pricing will be one component of that, not the only component.

You are probably also aware that we extended that Power of Nine campaign to options trading in the last quarter, and I think as Mitch reported in the script, we've seen options trading amongst active traders as a percentage of active trader total trades increasing about 12%. We intend to continue to be aggressive and grow that space. We want to be known as a place for options executions for active traders, and want to dominate that space. Those, of course, generally speaking generate higher commissions. So we hope to mitigate the effect of some of these price cuts by going after that type of product. Arlen, I think, do you want to speak about the banking?

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**Arlen Gelbard** - *E*TRADE Group, Inc. - CBO, President E*TRADE Bank*

Yeah, just, Rich, on the banking side of things, you know, the first reason for the change really was all around the corporate allocations which, you know, were just starting to work through here as both Mitch and Len discussed. But also, you know, we are on the banking side in a, you know, in a ramp-up phase as we're looking at new lines of business that are helping to increase our recurring sources of revenue and interest income. So, for example, I mean, you know from following our story that we don't just jump into something new. So, while, for example, we have just started our credit card business, before we really go out with it in a major way, we have to build up the infrastructure to be sure that we can handle what we want to do and be sure that we can manage the risk appropriately. It's the same thing not only in credit cards but as we're up -- you know, as we are increasing on the [ordering side] and home equities. You know, in addition, it was the rolling in of Ganis, and that really had a substantial G&A increase for us. You know, and finally we increased our marketing spin and, you know, we were very pleased to see what the results were as it went quarter to quarter.

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**Richard Repetto** - *Putnam Lovell Securities*

Okay. I can ask more off-line. I just wanted to thank you for the more deliberate pace at the beginning of the conference call as well.

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**Mitchell Caplan** - *E*TRADE Group, Inc. - CEO, Director*

My pleasure. Thanks.

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**Operator**

Thank you, Mr. Repetto. Our next question of the evening comes from Mike Vinciquerra with Raymond James.

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**Michael Vinciquerra** - *Raymond James & Associates*

I'm like Rich. I've got multiples but I'll try to stick to two here. The first one, on the mortgage warehousing, I'm trying to get a feel possibly if you can share with us what the net interest income was on the warehousing. Obviously, if you are carrying a billion plus, say, per month in loans held for sale out of your retail operation, that will have some impact on the margin because of the steep yield curve right now. And the second question, I just want to get a feel for the -- actually I've lost my train of thought. Why don't you answer the first one. I'll come back on the second one. Thank you.

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**Leonard Purkis** - *E*TRADE Group, Inc. - CFO*

You better come back fast because we don't divulge what you asked for in the first part of the question. So what was your second question, Mike?

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**Michael Vinciquerra** - *Raymond James & Associates*

Okay. Second one is actually regarding Dempsey. We just listened to LaBranch call earlier. Can you just clarify for us similarities and differences between Dempsey's operation versus LaBranch on the on the NYSE? Obviously, you've got the captive order flow from your retail system, but give us an idea how they compare, because, obviously, Dempsey did have a challenging quarter much as we saw from some of the other specialists. Thank you.

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**Mitchell Caplan** - *E*TRADE Group, Inc. - CEO, Director*

Let me -- I'm going to have Lou answer the question, but I think as a highlight because he -- it's easier for me to sort of tout the success of Dempsey before I turn it over to him, because it was his baby which we acquired. We have continued to be profitable in Dempsey. So when you look at lots of the other competitors in the market space, they are singularly becoming unprofitable and notwithstanding that, Dempsey is still a bright and shining spot for us and remains profitable as one of our business lines in the brokerage. Notwithstanding, its profitability, it clearly has significant value, as you've pointed out to us is a result of internalization and the benefits that we've gotten there, but let me turn it over to Lou and let him walk you through it.

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**Lou unknownLou Klobuchar**

I mean, from a structural standpoint, the biggest difference between any regional specialist or third market trading firm versus the New York Stock Exchange is that those market centers attract order flow on the basis of offering executions at the national best bidder offer. We surveil all market places and provide executions on the basis of the best bidder offer in any market center. Somewhat ironically, that makes us less able to quote/unquote "see something as captive order flow" because execution quality is what's paramount not only to E*TRADE but many of the other retail order sending firms, and there are 130 of them that send in to Dempsey and Company. So we fight for that order flow on the basis of execution quality and it is as true with the internal order flow as it is from other order sending firms.

Having said all that, Dempsey and LaBranch have in common the fact that we've had three tough months. It's a very difficult market. Generally speaking, over a three-month period, you would see some uptick somewhere for a week or two or three within the period. We really didn't get much of that in this quarter. As Mitch said, the entity remains profitable. It's got a highly variable cost structure which ensures that even at these levels it will remain profitable but it's core to our business. In a tough market it's a defensive play for us. As you may also be aware, if you don't have an internalization mechanism, there are many markets that are beginning to charge to execute order flow. So we think we are well positioned to be defensive there. as well to protect the economics of that order flow for E*TRADE. That's really about the size of it.

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**Michael Vinciquerra** - *Raymond James & Associates*

I appreciate that. Len, if I could come back for one second on the previous question. Could you at least let us know, did the NIM at the bank actually improve because of the warehouse money? I would assume that has to be a yes.

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**Mitchell Caplan** - *E*TRADE Group, Inc. - CEO, Director*

It was -- it's niche and the answer is it has a deminimus impact when you look at it. But let me answer your question a different way, which is if you look at the -- which I think what you are really getting at -- margins in our mortgage business widened quarter to quarter. So in Q4, if you look at our pricing last year on average it was about 189 basis points in terms of margin. It widens in Q1 to 195 basis points. A part of that would really be shown in the income which is in the mortgage operations line, okay? So you saw a widening of margins. And as we've entered into Q2, they have remained relatively flat and consistent with what we've seen in Q1.

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**Michael Vinciquerra** - *Raymond James & Associates*

I appreciate that. Thank you.

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**Mitchell Caplan** - *E*TRADE Group, Inc. - CEO, Director*

Sure.

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**Operator**

Thank you. Our next question comes from Rob Sobhani with Smith Barney.

**Glen Manna** - *Banc of America Securities#Smith Barney*

Actually this is Glen Manna. I just have a quick question on the bank accounts. How many of those accounts came from the Amicus transfer because that closed early in March, right?

**Arlen Gelbard** - *E*TRADE Group, Inc. - CBO, President E*TRADE Bank*

Yes, it did. Amicus was about 6500 count.

**Glen Manna** - *Banc of America Securities#Smith Barney*

Thank you.

**Operator**

Thank you. Our next question comes from Judd Gorsun with Capital.

**Judd Gorsun** - *The Capital*

Hi, Judd Gorsun of The Capital. Great quarter, guys. Just on the charge, what percentage of this is -- what portion of this is cash versus noncash or is the whole charge a cash charge?

**Mitchell Caplan** - *E*TRADE Group, Inc. - CEO, Director*

Let me turn it over to Len.

**Leonard Purkis** - *E*TRADE Group, Inc. - CFO*

The added on -- up to $120 million, about $30 million of that we anticipate as being a cash charge. Not all of that will be up front. That will be spread out over time and with the anticipated savings that we're getting from that, that would be a payback within 12 months.

**Judd Gorsun** - *The Capital*

So $90 million is noncash?

**Leonard Purkis** - *E*TRADE Group, Inc. - CFO*

Correct.

**Judd Gorsun** - *The Capital*

And is any portion of that goodwill or is that something else in the balance sheet?

**Leonard Purkis** - *E*TRADE Group, Inc. - CFO*

No, none of that is goodwill.

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**Judd Gorsun** - *The Capital*

Gotcha. Thank you very much.

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**Leonard Purkis** - *E*TRADE Group, Inc. - CFO*

You're welcome.

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**Operator**

Thank you. And our final question of the evening comes from Greg McCosco with Lord Abbott.

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**Greg McCosco** - *Lord Abbott*

Yes. Thank you. Could you talk about the interest rates, the spread -- on a pro forma basis, I believe it was 160 basis points at the end of last quarter? I assume then it went down?

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**Arlen Gelbard** - *E*TRADE Group, Inc. - CBO, President E*TRADE Bank*

Our spread at the end of last quarter was 140 basis points. We then -- we acquired Ganis right at the end and we said at that point that we expected an increase of 20 basis points on a pro forma basis. We've gotten that from Ganis. But that being said, the same type of macro economic factors that drove our spread down in Q4 originally, you know, are still in play here. You know, to say we're still in the same kind of environment, that's leading to greater and greater mortgage volumes as interest rates stay low. So, you know, you really have a choice. Either you say that you are content with your spreads being where they are, at least initially or, you know, or you try to take other types of risk as one possibility. That's something that we've said over and over again that we're not willing to do. We're not willing to go down that credit spectrum.

But the other thing that we are doing, is that we are constantly optimizing our balance sheet. We are looking for better mixes of assets, better types of assets to put on our balance sheet, and you'll see, for example, you know, if you see the movement, that we moved out of mortgage hold loans at MVS and into ABS and more consumer finance assets, you will see that that's why our spread didn't go down nearly as much this quarter as it otherwise could have. I mean, the other thing is that we are looking to add new asset classes, we're out there looking. We don't base our model on it, but it is something that we want to do. But we have, as those of you who follow our story know, that we have very strict guidelines as -- that we follow when we're looking at an acquisition, and if it doesn't meet our credit criteria and satisfy due diligence 100%, we just won't do it. So you know, I'll give up spread every day rather than putting our execution at risk.

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**Greg McCosco** - *Lord Abbott*

I see that the automated tellers I think went up 3500 and also what was the break-even on the -- break-even on brokerage in terms of number of transactions?

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**Arlen Gelbard** - *E*TRADE Group, Inc. - CBO, President E*TRADE Bank*

Well, just I'll just address that. On the ATM machines, that went up because we closed on our purchase from extra cash of a portfolio of 3500 135# machines. And that quite simply is how it went up. We closed that deal in the middle of February, and as to the brokerage, I'll turn that over to you.

**Lou unknownLou Klobuchar**

The break-even on brokerage continues to be about 63,000 transactions a day,. I think that's consistent with what you've heard from us in the past. Obviously, the restructuring we believe will help us drive that number down more in the future.

**Greg McCosco** - *Lord Abbott*

Okay. Thank you.

**Operator**

Thank you. This concludes the Q&A session. Back to you, Mr. Caplan.

**Mitchell Caplan** - *E*TRADE Group, Inc. - CEO, Director*

Great. Thanks, everybody, for joining us and we look forward to next quarter.

**Operator**

This concludes the first quarter 2003 conference call for E*TRADE Group, Incorporated. Please disconnect your lines at this time and have a nice day.