REFINITIV STREETEVENTS

EDITED TRANSCRIPT

ETFC.OQ^J20 - E*TRADE Financial Corp. at Raymond James 27th Annual Institutional Investors Conference

EVENT DATE/TIME: MARCH 06, 2006 / 2:15PM GMT

CORPORATE PARTICIPANTS

Rob Simmons *E*TRADE FINANCIAL Corp. - CFO*

CONFERENCE CALL PARTICIPANTS

Mike Vinciquerra *Raymond James - Analyst*

PRESENTATION

Mike Vinciquerra - *Raymond James - Analyst*

Good morning, everyone. I am Mike Vinciquerra, with Raymond James Research. Very pleased to have with us this morning E*TRADE FINANCIAL. Adam Townsend, Director of Investor Relations, is here; and Rob Simmons, the Chief Financial Officer, will be presenting. This is a company that, if you guys are familiar with it, has gone through a tremendous transformation over the last two to three years and, we think, has a very good model for long-term growth at this point, combining both a bank and brokerage operation to what we hope in the next six months is going to be one combined regulatory entity that is really going to be able to take advantage of their balance sheet and so forth.

So let me introduce Rob. And thank you very much.

Rob Simmons - *E*TRADE FINANCIAL Corp. - CFO*

Thanks, Mike, and thanks to everybody for coming this morning. It's great to see a nice full room like this. We actually just finished our analyst event; we have an annual analyst day last week that was actually here in Orlando. And so, the things I'm going to say today I will be borrowing somewhat from the presentation and the comments that we made last week.

But one of the things that has been really interesting for us -- as you start at a big-picture layer, we think that there's really some nice secular growth trends that are working very much in our favor right now. And one of those secular growth trends, we think, is that online continues to take share from offline in general. One of the things that's interesting -- just a personal example is that I'm now to the age where my oldest kid just started college last fall. And it's interesting because he, as a fairly tech-savvy kid -- we realized when we were getting set up with bank accounts and ATM cards and credit cards and everything -- he'd actually never been in a bank branch. He'd never had any reason to be in a bank branch. Why would he?

And so, we think that that trend is actually pretty interesting and may continue. Because as we look at the setup that I've got for my kid at college right now, he doesn't need a bank branch. He doesn't need brick and mortar in the same way that I used to, for instance, when I would go in and have to make a deposit across to a teller. So we really like the secular trend that online continues to take share from offline, as we have a new generation moving to the fore, entering the workplace, becoming more important in terms of the overall mix of customers that financial services companies are going to have to be serving over the next 20 years. These are clearly much more tech-savvy kids.

The bulge bracket firms -- again, last week was another example of another bulge bracket firm that basically announced they were abandoning their $100,000-or-under clients and pushing them all off to call centers. So we think that that's another great advantage that E*TRADE FINANCIAL has right now, is that the bulge brackets are moving up in terms of their target focus, and we are very content to service profitably the 50 to $500,000 segment that is very much underserved at this point. And we think that, if you look at what we can bring to the table, it's that we can bring a compelling value proposition profitably to that segment in a way that the traditional bulge brackets can't and the traditional brick and mortar model cannot do.

So let's talk about what we call the mass affluent opportunity. These are the guys that are going online, they are taking control. There's a great transfer of wealth that's occurring right now. As the Baby Boomers are all kind of getting older, moving on, they are starting to leave significant assets down to their children, and those children are much more tech-savvy. We think of mass affluent as being a 44 million household market in the US alone in, again, that 50 to $500,000 of investable assets category. And that's where we are focusing our efforts at this point.

And again, this is where we are stealing market share, actually. If you look at the accounts that we get in, in any given quarter, on average, 25% of them are going to come from the universe of Merrill, Morgan Stanley, Smith Barney and UBS. So again, this is exactly what we are hoping to accomplish here.

Here's our model, and this is what makes us tick, really, that we're trying to build an integrated franchise here. And I'm going to talk a lot about franchise-building with respect to E*TRADE and what we have been able to accomplish over the last three years or so. But at the end of the day, if you see in the middle of this thing that we call our Wheel of Fortune, at the center of it all is a global retail customer. It's all built around the retail opportunity. We offer investing, trading, cash management and lending solutions to that retail customer base and try to engage with them across a broad suite of products. E*TRADE FINANCIAL is much more than just about trading these days, as many if you now know. The cash is very much every bit as important to us as trading. And in fact, if you look at the progress that we have made in cash, it's been significant.

If you exclude the acquisitions that we have done over the past couple of quarters, we grew cash balances organically by $800 million in the third quarter and $1 billion in the fourth quarter, again excluding acquisitions. So this is, again, one of the things that makes us different.

If you look at a customer that trades 15 times a quarter, that's a pretty important customer to the brokerage world. That would be a pretty significant active trader at this point. And there's a very limited population of people that are trading that actively. That sort of trader, 15 times a quarter, is just as profitable or not any more profitable to us than someone that brings $15,000 of new cash to their brokerage account and then does nothing with it, doesn't trade or anything.

So for us, our model is built around driving equal economics, regardless of where our customers happen to be engaging at the time. So as customers move back and forth, from engaging in the market or going to cash, we're happy at any point in that spectrum. And in fact, this is what has helped us really deliver what we have had in terms of financial results over the past couple of years.

Then, if you look at the white ring there, this is our institutional ring, if you will. We have an institutional business that really only exists to the extent it's there to leverage what's going on within retail. We have a market maker. We have an institutional sales and trading business. All of those fundamentally leverage the order flow or the activity that's going on within that retail world, and that really is our model at this point.

Let me talk a little bit about E*TRADE Complete. When I was here with Adam a year ago at this conference, we had just barely launched what we called E*TRADE Complete at that point, which was our complete, integrated value proposition that we had. It included a credit/debit card functionality. It included embedded security. It included a quick transfer capability that allowed people to move cash both in and out of their accounts at will. I think, one year into this progress, we can pretty much declare E*TRADE Complete a victory at this point. Again, as you see the organic growth that this sort of structure, this sort of customer functionality has helped us generate, it has been a big win for us.

Let's talk about some of the trends around Complete. Again, we launched it in the second quarter of 2005. Quick transfers, which give our customers the ability to move cash either within their own E*TRADE account families or even externally, are up 60% from that point in time. Cash inflows are up 234% since we launched Complete a year ago. And for every $3 that has come into our account structure from that quick transfer, we have only had $2 go out. So you can look at it as $1.50 to 1.

And again, as you look at where this cash is coming from, it's coming from the large kind of super-regional world, the BofA's, the Chase's, the Citi's, the Wachovia's of the world. And again, organic cash growth in the last two quarters alone into our model has been $1.8 billion. It's one of the things that has allowed us from a spread perspective to really outperform the entire industry, has been the growth in organic cash.

So let's talk about revenue and the overall mix of revenue at this point, because I think it tells a very interesting story as well. Again, on the left there, you see the pie chart that represents 2001 and where we were. So post-integration, we had a banking business, we had a brokerage business at that point. And if you look at where we were, 30% of our revenues were coming from the trading world at this point. As of 2005, the year that we just ended, only 20% of our revenues are coming from retail trading commissions. So even though many people still think of us as a trading shop, we have got a very, very nicely diversified mix of revenue. And they are not diversified just for diversification's stake. They are diversified in an integrated and synergistic way that we've brought a banking business and a brokerage business together, and now we have what we call a fully-integrated retail business. And it's being leveraged -- the flows from that retail business are leveraged by our institutional business.

And what is it translated into in terms of margin? This is one of the things that kind of the proof is in the pudding. If you go back to 2003, our operating margins were 23% at that point. We ended 2005 at 38%. We have modeled into our guidance for 2006 that we will have operating margins in the 43% range. So you can see the benefit that has come through that integration, and despite what is been a pretty challenging interest rate environment that everyone is aware of. I mean, I think -- we've looked as of Friday; the 2 to 10 spread is actually about a negative 9 basis points as of Friday.

So you can see the trend there, which is the blue line on the top chart. You can see the challenging interest rate environment that there has been. As Fed funds has risen and the 2 to 10 spread has declined, you can see on the bottom chart what we have been able to accomplish in terms of overall enterprise spread. We actually widened spread by 5 basis points last quarter, one of the only financial institutions that I was able to find that was able to do that, despite the flattening that has been going on from the yield curve.

And that has happened not by compromising on credit risk, and not by compromising on the amount of interest rate risk we're taking. It has come by virtue of the organic growth on the liability side of the balance sheet that we have been able to enjoy, as we are connecting more and more with these customers, as we are offering better and better tools and functionality that help these customers manage their own portfolios, whether their cash portfolio, their equity portfolios, their bond portfolio or whatever.

Let's talk about credit for a minute, because again, it's something that really is hardwired into our philosophy at this point. We tend to keep a very, very high credit portfolio at this point. If you look at our whole loan mortgage book at this point, our weighted-average FICO is about 731 in that. Our charge-offs have been running in the low single digits for as long as, really, I can remember. If you look at our consumer book, we have a weighted-average FICO even higher. About 748 is our average FICO on the consumer side, and our charge-offs have been running in the low 100 to 150 basis points. As of the end of the year, it was running about 117 basis points in charge-offs. So you can see the chart on the right, how we compare from a charge-off standpoint to the industry. Again, you see the credit philosophy of E*TRADE FINANCIAL reflected in that.

Let me talk a little bit about organic growth, because this is one of the questions that we get a lot from people, is how are you going to continue the success that you have seen over the last three years? So what we have looked at, what we feel is the opportunity for us in the marketplace, and we have kind of set some longer-term objectives for ourselves. But we want to continue to grow revenue by 10 to 15% a year organically. Obviously, 2006 we are modeling much higher than that, because of the integration of the acquisitions that we have done, but on an ongoing basis this is one of the things that we would like to continue.

Earnings per share -- we would like to continue to enjoy the operating leverage in the model that we have, where on 10 to 15% revenue growth, we would like to grow earnings by 20% or more. And again, we think that is achievable by virtue of the model that we have in place, the fact that it's very efficient from an asset and a capital deployment standpoint, we don't have a large brick and mortar infrastructure to support. So each dollar of incremental revenue that comes into the model, whether it is via trading, whether it is via cash, whether it is via engaging in credit products -- all of that has a very high margin characteristic to each incremental dollar that we get, which we think will allow us to maintain operating margins of 40% or higher going forward. Again, we are modeling about 43% operating margins for 2006.

Let me just talk a little bit about 2005. I know it feels like it's already been a long time ago since 2005 ended. But it certainly merits a moment of reflection, I think. We had as an enterprise 1.7 billion of revenue for the year, which is our highest revenue ever. Net income, 430 million -- again, a record for us. Operating margin, 38%. EBITDA, $869 million for the year. We ended with total client assets of $178 billion, again a record. And finally, we completed the acquisitions of Harris and Brown, which strategically were very, very good fits for us. These were not acquisitions that were done just to get scale in our trading business, although they do bring scale to our trading business. But obviously, it was a way for us to engage with more customers across credit in the form of margin, and also cash that these two acquisitions contributed very nicely to in all three of those areas.

So let's take a look at how we are doing. Just looking year over year, '04 to '05, we grew total net revenue by about 15%, but operating income or what we call pretax segment income grew by 31%. So again, you are seeing the nice operating leverage come out of the business. Incremental revenue has a very nice margin characteristic to it, and that is translating through.

In 2006, let me talk a little bit about retail and institutional separately here. The organic growth plan for retail really is going to be about focusing on that mass affluent segment that we touched on earlier, that 50 to $500,000 segment. We want to grow cash balances. We want to continue to engage through some of the functionality that we have delivered people on our website. We call it our Intelligent Cash Optimizer. I would encourage you all to check it out, if you haven't seen it. It's an interesting product, and has been working nicely for us.

We have also recently launched an Intelligent Lending Optimizer to help people look at their credit relationships that they have, and understand better the full suite of credit products that they have got available, to make sure that they are optimizing that mix of credit products within their portfolio.

And finally, you can look at trading volume increasing as we provide more and more functionality, not only on just regular vanilla equity trades but also on the options side as well. Of the things that has not been as well-publicized as other things about E*TRADE is the success we have had in growing our options business. Our options business has grown from about 5% of our total trading volume two years ago to a little over 11% as of the end of the year in 2005. So the success we have seen in growing our options engagement has really been very nice as well. And option volume is important, because the average commissions for each option trade is much, much higher than the commissions on a vanilla equity trade.

Turning to the institutional side, again, Mike made reference to this a little bit already. But we are starting to look at ourselves and manage ourselves as kind of one global balance sheet, where one of the key asset classes that we have got is going to be margin going forward, for instance -- you know, it's not traditionally thought of as a bank asset. So we are going to manage our enterprise balance sheet globally. We want to really look at how we're looking at risk management, to make sure that we are optimizing what would otherwise be a liability-sensitive bank with an asset-sensitive brokerage, putting them together and making sure that from an overall risk management standpoint, a hedging standpoint, we are really optimizing that mix. And we think there's a tremendous opportunity to do that.

On the institutional equity side, again, it's about leveraging the technology that we have already put in place, the investment that we have already made. We are continuing to deploy that technology to make sure that our institutional customers enjoy the liquidity and the operational efficiency that we can deliver to them and make sure that we make our product out there, get it out there from a marketing standpoint, strengthen the awareness that there is within the institutional world of what those retail volumes can mean for them.

Let me just talk a little bit about the two integrations that we are in the middle of. And again, we talked about this last week at our analyst event as well. We have now closed both the Harris and the Brown deals. Harris was closed about three months ahead of plan, which is great for us because we can begin to realize some of those synergies sooner than we had originally modeled, back in August, when we announced the deal.

The conversion has now occurred. It was completed in mid-January, which allowed us to put those assets and liabilities on our balance sheet now and begin to see the synergies from that. We've had a tremendous spike in call volumes, which we have been working on, on bringing those down. Call volume spiked to about eight times normal levels, partially due to the strength in the market that there was in January, which, with everybody up significantly in terms of trading volumes, but as well as the new calls coming from the new Harris customers. But we are working through those issues.

And the good news is that, as we look at attrition -- I mean, attrition is one of the keys to realizing the economics of these deals. We look at attrition really in two ways. One is account attrition. How many just nominal accounts have we lost since we closed the deal? And then, more importantly, though, what economics do those lost accounts represent? So we had modeled attrition in both the Brown and the Harris case as being around 10% of assets. And the good news is that economic drivers, the trading plus the cash plus the margin that all are represented by that attrition, are running lower than the actual account attrition in the case of Harris and roughly the same in the case of Brown. So it's far too early to declare victory, but we like very much what we have seen from an attrition standpoint so far.

Again, Brown -- same thing. The conversion is slated for sometime in the second quarter for Brown. For us, it will be a little bit of an easier conversion, just by virtue of the fact that Brown was already a self-clearing organization; it was already running on an ADP platform, which we run. So we are obviously going to take some of the lessons that we have learned from Harris and apply them to Brown as well. And again, from an integration standpoint and attrition standpoint, we like very much what we have seen from Brown so far.

So let me just close with a franchise discussion, a franchise slide here. This is the third year in a row that E*TRADE FINANCIAL has participated in this Raymond James conference. We actually took over as a management team going back to Q1 2003, so I use that as the starting point just for fun, because that's when our team kind of took the reins at E*TRADE. From a franchise standpoint, we have really been all about trying to build that franchise, not just take short-term gains, or not just create short-term value, but really create long-term value for shareholders and build a franchise.

And judge for yourself how we have done. If you look at net income, we have grown on a compounded annual growth rate of 85% from that point in time. Operating margins have gone from 14% to 43%, where we actually ended Q4. Client assets have gone from 53 billion to $178 billion; that's a 50% compounded annual growth rate in assets. Margin debt has grown by 95%, on a compounded annual basis. Enterprise spread has gone from 208 basis points to 257 basis points. Assets per customer -- this is one of the things that, three or four years ago, everybody really worried about for us. We were at $18,000 assets per customer. We are at 51,000 today -- seen very nice progress, 40% compounded annual growth in that metric. Products per customers, the cross-sell and engagement metric -- we have gone up from 1.4 products per customer to 2.1. Again, we're not satisfied with 2.1, but we have seen nice progress. And that incremental engagement, again, has come in a very nice high-margin sort of way.

And then, finally, let's look at the operating leverage that we have got. Revenue per customer, up $110 to $140 in Q4, a 9% compounded annual growth rate in revenue. But that 9% revenue growth is translated into a 60% annual revenue growth in segment income per customer. So we feel like at E*TRADE, we are really about building a franchise. We think we've got some nice momentum that we have got. We are going to continue to do what we've said that we've done. We're going to continue to engage with that mass affluent segment and again, hopefully create lots of value for all of our stakeholders.

And with that, Mike, I will -- I think we've got time for a couple questions.

QUESTIONS AND ANSWERS

Unidentified Audience Member

(Inaudible question - microphone inaccessible).

Rob Simmons - *E*TRADE FINANCIAL Corp. - CFO*

The question, for those on the webcast, was about balance sheet growth and the balance of risk aversion versus kind of growth objectives. So I think the way that I would answer that question is that we very much have a philosophy that we don't want to compromise on credit. But that being said, we still want to see it grow. We want to see additional customer engagement, and there's lots of ways for us to do that. Again, we think of managing this global balance sheet, the asset classes are pretty straightforward for us. They are mortgages, one to four family mortgages. They are home equity lines of credit and home equity loans. There's margin as a credit product, which, again, is one of those things that we think of as a very, very attractive asset, possibly the most attractive asset class. If you look at it on a risk-adjusted basis, on a charge-off adjusted basis, margin is a very attractive asset class for us. And then, to a much smaller degree, you've got credit cards, again, that we'll obtain by engaging with our own customers that we have got there.

Again, we have just launched very, very recently our Intelligent Lending Optimizer, which is designed to help people understand the trade-off between all the lending alternatives that we have [then]. So it's really early. It's way too early. I mean, next year, we will give you an update on kind of how we're doing along those lines. But in terms of our global growth objectives, we very much want to grow as fast as we can within the confines of our risk tolerances that we've got.

Unidentified Audience Member

(Inaudible question - microphone inaccessible).

Rob Simmons - *E*TRADE FINANCIAL Corp. - CFO*

So the question was about the overall value proposition for the customer, relative to the growth objectives that we've got --

Unidentified Audience Member

(Inaudible).

Rob Simmons - *E*TRADE FINANCIAL Corp. - CFO*

And relative to other offerings, thank you. I don't get to change the question as part of the process?

So the value proposition is really at the center of it. So if that didn't come through, then mea culpa on on that point, because the value proposition is all about that customer engagement. And that's really what is at the core of it. That is how we have driven $1.8 billion in organic growth on the cash side. It's by giving our customers the best tools available to actually see the offerings that are out there, so that they can make the choice for themselves based on their own liquidity -- for instance, what sort of deposit mix they want to have. There's a certain amount of liquidity that all of us probably keep just in our checking account that's probably way too much, but it's convenient to leave a lot of money in your checking account, so you can always write the next check.

Well, our brokerage customers -- we have an analog for that. The brokerage customers always want to keep a certain amount of liquidity within their account structure for that next trade. It's a matter of convenience, but we give them, actually, the tools so they can manage that liquidity better than anybody else, so that they can see that if they want to, they can move money to a 4.4% money market plus account that we've got available to them today, or they can buy a CD or they can do anything.

So the value proposition is really at the heart of our model. It's really why we don't have a huge national branch infrastructure, because we want to be able to save money in the way that we deliver a product to a customer and pass that savings on to them and make sure that we can do a much better job than anyone else at doing that.

Unidentified Audience Member

(Inaudible question - microphone inaccessible).

Rob Simmons - *E*TRADE FINANCIAL Corp. - CFO*

The question is about how we view the consolidation landscape going forward. Obviously, if you go back to June of 2005, when after a couple years of being both private and public advocates of consolidation, and after having not been able to make anything move, we took the relatively aggressive step of writing a letter to the Board of Ameritrade and suggesting, maybe in stronger terms, that a consolidation would probably be in the best interest of everyone's shareholders. And even though that deal didn't get done, it's undeniable the value that was created in the industry from consolidation. And we were pleased to have been the catalyst for creating tremendous value for shareholders across the industry.

So we continue to feel that consolidation is an opportunity. The cost of deploying technology has never been cheaper. The opportunities to consolidate remain out there, that we just hope that we can get other players on the same page with us, and get past any personal agendas that there may be.

So we see consolidation opportunities still happening across kind of a broad range of products. We would be interested strategically in anything that helps give us scale in any of the areas of our product offering. If you think back to the wheel that we have, there's obviously a whole suite of products that we surround our customers with. Any acquisition that helps us do a better job of delivering a product to a customer could potentially be of interest to us.

So we are out of time. So I think there is going to be a breakout room. I would invite anyone that has any other questions to that. And again, thank you all for your time and your interest today.