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ETFC.OQ^J20 - Q3 2002 E*TRADE Earnings Conference Call

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OVERVIEW:

Company reported 3Q02 EPS of $0.12 on net income of $43m. Net revenues were $330m. Management reiterated 4Q02 EPS estimate of $0.14 and expects to remain cash flow positive. Q and A focused on credit quality, cash flow, the economy and various business segments.

CORPORATE PARTICIPANTS

Christos Cotsakos *E-Trade - CEO*

Mitch Caplan *E-Trade - President*

Len Purkis *E-Trade - CFO*

CONFERENCE CALL PARTICIPANTS

David March *Friedman Billing Ram - Analyst*

Glen Shore *Deutsche Bank - Analyst*

Mike Vinciquerra *Raymond James - Analyst*

Adam Townsend *JP Morgan - Analyst*

Rich Repetto *Putnam Lovell - Analyst*

Colin Clark *Salomon Smith Barney - Analyst*

John Levin *JP Morgan - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for your patience. Remain on the line. Your E*Trade earnings conference call will begin momentarily. If you should experience audio difficulties, please dial star zero and an operator will assist you. We thank you for your patience. Please remain on the line.

Operator

Good afternoon. Welcome to the E*Trade group third quarter conference call. All participants are in a listen-only mode and the floor will be opened for your questions. I would like to turn the floor over to the leader Len Purkis.

Len Purkis - *E-Trade - CFO*

Good afternoon, and thank you for joining us on the third quarter 2002 conference call for E*Trade group. I'm Len Purkis, Chief Financial Officer, and I'm joined here today by Christos Cotsakos, Chairman of the Board and Chief Executive Officer, along with Mitch Caplan, President and Chief Operating Officer. We would like to begin this call with the standard safe harbor statement. During the conference call, we will be sharing with you certain projections or other forward-looking statements regarding future events and future performance of the company. As always, we caution you to certain factors and certain risks and uncertainty in the 10-k and 10-q reports filed periodically with the Securities and Exchange Commission could cause our actual results to differ materially from those indicated by our projections for the statement. This call is being taped and the recording will be available by telephone beginning at 5:30 Pacific time today to 5:30 Pacific time on October 25. The call is also being webcast at www.etrade.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 Christos. After that, I will provide you with specific details of our financials. Christos will make closing remarks and open this briefing for questions.

Christos Cotsakos - *E-Trade - CEO*

Thanks, Len, and thanks everyone for joining us today. In the first quarter for the financial services, which was the worst quarter really for the industry since the crash of the equity markets in 1987, E*Trade grew through both net revenue and ongoing profitability quarter over quarter and year over year. At 12 cents per share from ongoing operations this marks our ninth consecutive quarter of ongoing profitability. We continue to improve operating leverage, produce strong mortgage origination volume and profitability, drive innovation with the use of new technology, prudently improve net interest rate spread at the bank, generate positive cash flow, maintain a strong balance sheet, and realize success in our cross-sell and up sell efforts.

Now, our discipline focus on profitably creating value for our customers has allowed us to decrease our earnings from ongoing operations from break even in our first quarter 2001 to 12 cents per share from ongoing operations this quarter or $443(ph) million from ongoing operations on $330 million on net revenue. On a GAAP basis, we have improved earnings from a net loss for $9 million or negative 3 cents per share to net income of $21 million, or 6 cents per share over the same period. One of the key factors in our improved profitability has been our ability to effectively leverage the inherent strength in our diversified financial services model. As our investors have moved money from bottled equity markets to fixed income securities, driving mortgage rates to historic lows, our model has allowed us to offset declining brokerage revenues with increasing banking revenues. When the equity markets began to fall at the end of quarter one of 2000, our net banking revenues totaled $29 million. This last quarter, our net banking revenues derived from our banking, lending, and asset management activities totaled $120 million. This represents more than a four-fold growth in revenue largely offsetting the decline of net brokerage revenue over the same period.

Specifically, as equity markets continue to decline in February of 2001, we took the necessary steps to further diversify our offerings through the acquisition of our direct to consumer mortgage origination business. We saw the value in originating mortgages as the prudent way to improve investment yield to the bank and to assume more control over the flow of mortgage volume. We also saw the benefits of adding a product line that had appeal to our customers. At the time, we projected total origination volume for 2001 to equal about $1 billion. However, our mortgage business originated over $5 billion in loans last year, exceeding all expectations. In 2002, we predicted volume to abate over time in line with an expected increase in interest rates. Instead, we generated $4 billion (ph) in new mortgage volume year-to-date, including over $1.6 billion (ph) in third quarter as interest rates have plummeted to 30-year lows. We're also experiencing similar growth in the correspondence side of our mortgage business, and were recently recognized by Inside Mortgage Finance as one of the top 15 U.S. correspondent and jumbo producers in 2002. This is the first time that E*Trade financial has appeared in these rankings demonstrating the expanding presence of our correspondence mortgage business over the past two years.

We recognize that at some point in the future, interest rates with will rise, mortgage volumes will decline and investors will return to the equity market. Accordingly, our focus has been leveraging the infrastructure of our brokerage business in order to maximize revenue and profitability. We have lowered our break-even point for retail brokerage by 7% to 65,000 transactions per day, and we continue to introduce new products and integrate new business segments quickly for market making onside traditional trading. In our second quarter, we implemented a simplified $9.99 flat commission rate program for our most active trader segment. As a result, we have seen a growth in market share as demonstrated by a 6% increase in both activity and account in our most active trader segment. In response to this success, we recently announced the extension of this program to any customer averaging nine or more trades per month for a total of 27 or more trades per quarter. Now, the new program encourages customers to enhance their trading by the power of nine and includes a flat commission of $9.99 per stock trade in an industry leading 9 second trade execution guarantee expected at the end of the month on qualified stock trades. Through this expanded service, we reinforced our position as a leader in on-line active trading services and advanced our strategy to increase market share, revenue, and profitability while delivering low cost, high value services to our customers.

The company also improved profitability by leveraging the relationships between each of its business segments. While other market makers have struggled to the effect of decimalization and declining volumes, our market maker, Dempsey and Co., has benefited over the past nine months from increased internal order flow now at approximately 50%. We have done so while maintaining the best execution for our customers and separately adding our nine-second guarantee. Further, we have profitably expanded Dempsey's business into the Boston and UK exchanges resulting in a greater percentage of listed and over-the-counter market share volume. Our institutional business continues to gain market share and is making progress in rolling out electronic trading platform utilizing our route x technology. This platform currently allows our institutional customers electronic access to markets in the U.S., Germany, and Canada. We expect to add the UK, Netherlands and France around the first of the year. In addition to opening up different markets for our institutional clients, route x technology also enables internal cost savings of about $2 million annually.

We also continue to see success in our cross-sell and up sell activities particularly for our mortgage-related products. For the quarter, we saw 28% of demand for our mortgage products come from current account holders and in fact, 53% of our home equity products were sold to existing customers. In a period where the NASDAQ saw decline of 20%, the Dow and the S&P indices experienced comparable declines. We saw total assets in our customers decline only by 11% during the quarter in comparison to these proxies, indicating net cash inflow after adjustments for market losses. We continue to expand our media and content effort across the U.S., enabling us to further extend positive perception of E-Trade financial and expand brand awareness in a very cost efficient manner. We generated approximately 6 million media impressions per month last quarter through initiatives such as broadcasting over 14 minutes of market coverage live from our San Francisco center to Bay area television viewers in a single day. In a mid-quarter on-line survey, 92% of E*Trade financial customers said that they viewed E*Trade financial content as credible as or more credible than content of other financial news and information providers, a big step for us in this direction. In addition, our profitability is enhanced by our ability to lower expenses by successfully executing on our efficiencies initiatives by eliminating, while eliminating unnecessary redundancies and integrating complimentary services while adding to our value proposition through innovation, technology, and pricing power.

Since first quarter 2001, we have delivered over $200 million in operating efficiency savings after adjusting for acquisitions. We also continue to benefit from a flexible cost structure in these challenging times. By being nimble, we have been able to implement effective efficiency initiatives without that kind of wholesale layoff that others in our industry have suffered. Indeed, we believe it's our discipline and deliberate approach to staffing throughout the full economic cycle and our ability to quickly adapt to changes in economic opportunities that have allowed us to continue to grow both revenue and profit. We'll continue to be diligent, prudent, and targeted with respect to sizing our division according to their ever-changing business requirements and environment.

As we mentioned last quarter, which is really exciting for us, the company has taken an industry-leading position in the deployment of low cost limit(ph) systems as well as other industry leading technological advancement in network, management, network architecture and data cashing. The result in reduction in systems cost is $12 million a year. The use of resource management tools and automation has allowed the call centers to adjust costs rapidly to meet changing market conditions. The call center costs have been reduced 12% last quarter and 32% the same quarter a year ago saving an estimated $18 million this year with a corresponding increase in customer satisfaction of 6 percentage points over the quarter as validated by an independent, outside firm. While we have significantly reduced cost expenses, we also improved the speed of execution service. Website performance improved during the quarter as a result of optimizing site performance, networking and deployment of limit(ph)servers. The brokerage website speed as measured by Keynote improved 19% from last quarter and 25% over the same quarter last year.

In addition, site reliability has remained above 99%. A five-percentage point improvement over a year ago, the dot com implosion has neither impaired nor invalidated the internet as a cost effective distribution channel as well as an actual(ph) information and transactional platform for financial services and that really is a key information point going forward. Our systems have won numerous recognition, including Best in the Web for 2002, a discount brokerage category by Institutional Investor, the 18th in I.T. innovation which was critical in Information Week's ranking of 500 top companies and Para(ph) E-Trade ranked number one by Hyperactive Trading in second quarter of 2002. The result of our effort is that every business unit at E*Trade financial is profitable. In that promise, we expect our international retail operation, part of our brokerage unit to break even of run rate by the end of the year. Beyond our ongoing profitability and efficiency initiatives, we continue to acknowledge, appraise and proactively appraise our risks across our lines of business. We also continue to evaluate our processes and procedures and make appropriate changes when necessary.

As a result, we average -- we revisited our reserve policies and strengthened reserves at the bank, important to note not out of a need to address any pending issue but to protect the company from unexpected events beyond our control. Len will speak more on this subject in a few minutes. As you can see, the E*Trade financial story is one of growth, profitability, as we continue to expand brand loyalty and add value as well as improve our product offering and exploit the leverage inherent and across the lines of business and capitalize on new opportunities all by focusing on the needs of our retail, corporate and institutional customers. We're really excited to hear more details about our performance and future plans with you, and we will be hosting an analyst day on Thursday, February 20th, 2003 on the New York Stock Exchange. My team will be joining me in presenting our strategies and tactics for 2003; more details about this event will be available from the Investor Relations group in the next three days. I would like to turn it over to Len to go through the numbers.

Len Purkis - *E-Trade - CFO*

Thanks, Christos. Net revenue of $330 million, up 4% quarter over quarter and up 13% year over year. Further, we were able to drop more of this revenue to the bottom line, delivering earnings from ongoing operations of $43 million, and that's an 11% increase quarter over quarter and a

364% increase year over year. During the quarter, we reached 7.5 million shares at an average price of $3.78 per share. This brings the total shares we purchased to 48 million shares with 9 million shares still available throughout our organization. Consistent with our guidance, we were $16 million cash flow positive for the quarter prior to $28 million in share re-purchases, prior to raising $18 million for equipment financing. We exited the quarter with $341 million in free cash, and that's up from $335 million in last quarter. We expect to remain cash flow positive through the fourth quarter. We continue to diversify the bank's asset portfolio by expanding our consumer loan portfolio as well as home equity loans and lines of credit while maintaining our focus on credit quality.

As a result, net charge-offs for the quarter were only 12 basis points of the total average assets and down four basis points from last quarter well below the provisions second quarter industry average of 19 basis points. Provision for loan losses for the quarter total $4 million. Credit quality of the portfolio remains strong. Weighted average FICA scores for our mortgage quarter portfolio helps firm 7.25 and 7.35, respectively. Mortgage portfolio remains geographically well diversified, comparison to the averages providing protection in the event of rolling recession. The weighted average loan-to-value ratio is less than 70%. Finally, our delinquencies remain flat QoverQ. Total assets are totaling 62 basis points for mortgages and 90 basis points for auto as measured through outstanding loans. So while historically our reserve policies have been adequate for our high credit quality mortgage loan portfolio, we realize that we reflect the risk as we diversify our assets. As a result, we assessed their loan loss reserve policy and consumer loan portfolio and will now maintain a level of reserve to cover a minimum of 12 months expected future losses, and that's up from six months previously.

A reserve for our consumer loan portfolio now equals 61 basis points in the balances, and that's up from 29 basis points last quarter. Now, reserve for mortgages held remains unchanged at approximately 20 basis points. Our revenues in brokerage, brokerage revenue totaled $209 million for the quarter and down 3% for last quarter and up 8% over three quarters last year. This decrease quarter over quarter was related primarily in a slowdown due by the state of the economy. Improvement year over year is where acquisitions were seen. Commission revenue total $72 million, 1% increases over last quarter and last year. Crystal transactions totaled $52 million, up 1% over our second quarter and up 66% year over year. This increase over last year came from the acquisition to benefit our increased market share, particularly in July. As you will note in our press release metric table, we have revised the presentation of on-line and offsite transaction data to better present the transaction structures. We're reporting on site metric average of trades traded per day per quarter separate from our on-line business, which we will continue to report on a quarterly basis so the average daily transaction. The revenue we generate in this professional trading segment is based on per share pricing of the transaction. Daily shares traded for the quarter have averaged 43 million, down 24% of shares in June. This decline is related to a seasonal slowdown as well as the decision to eliminate certain trading replace ships that we determined to be unprofitable. The impact of this business decision was felt in the quarter, but we had a significant increase of professional trading equity the second half of the quarter. The global retail trading and daily transactions average 79,000, down 4% over last quarter, down from 13% year over year in line with anticipated and normal slowdowns reflecting the impact of the challenging macro economic conditions. The banking revenue, banking revenue increased to $128 million for the quarter and 19% increase of last quarter's revenue and 23% increase over the quarter last year. We continue to experience strong mortgage product, and no interest fee income, specifically gain on loans held for sale and other securities and other bank-related revenue was up 34% over last quarter and up 23% for the same quarter last year. We continue to see improvement in net interest income totaling $55 million, an increase of 3% over last quarter and 33% increase over the same quarter last year. This increase came as a result to further diversify our loan portfolio with higher interest earning assets by lowering rates. We will be exiting this year and add on the 200 basis point run rate by winding back interest rate spreads to 152 basis points an 8 basis point increase over last quarter and 47 basis point increase over same quarter last year. Finding assets in the market place and making our spread requirements and credit card proved difficult last quarter. Our efforts to widen our spread also impeded like everyone else in the industry by mortgage refinancing in the bank's portfolio. Interest rate environment that helped our mortgage business part reduced our spread over the quarter.

We're on plan for acquisitions to be effective and significantly increase net interest spread without compromising quality. As a result, you will note that we have shifted a portion of the bank's portfolio held for sale in anticipation of these acquisitions in the fourth quarter. Additionally, this allowed us to rebalance the reserves of our consumer portfolio consistent with our policy. Our mortgage products remain strong with our mortgage business generating $1.6 billion in new origination. We ended up with a billion locked in the pipe. This brings our total origination mortgage volume to over $4 billion for the year on track with last year's record volume. The company experienced similar growth in the current funded side of the mortgage business producing 1.2 billion in the third quarter. On the expense side through the ongoing and successful implementation of efficiency initiatives, we approved that gross margin to $184 million. This represents an increase of needing $2 million or 1% improvement quarter over quarter and 21% improvement over same quarter last year. Ongoing operating expenses for the quarter totaled $106 million, down $9 million over the prior quarter and down $21 million in the same quarter of last year.

Through the past year, we have been able to lower technology development and general and administrative costs as we eliminated unnecessary redundancy's and consolidated operations. In regard to selling and marketing, we prudently lowered expenditures by focusing on brand distribution, harvesting our existing customer base. For the earliest in the company, net income from ongoing operations expanded to $43 million, generating earnings per share from ongoing operations at 12 cents per share. This represents an 11% increase over last quarter and a 364% increase over same quarter last year.

With guidance, we're comfortable with the street consensus of 14 cents earnings per share for ongoing operations for the quarter. We have consistently delivered on our guidance despite worse than anticipated markets and the uncertainty in the macro global arena. Our challenge in this environment is to continue to grow our diversified revenue streams and further improve operating efficiencies allowing us to sequentially increase earnings per share from ongoing operations in the fourth quarter. In conclusion, the improvements in our financial performance over the past 12 months validate the strength of our brand, quality of our service and the benefits of our diversified business model. Our 2001 third quarter results included earnings per share of 3 cents from ongoing operations, just under $300 million in total revenue. This quarter, we generated a four-fold increase in earnings over third quarter last year as we have 12 cents per share of ongoing operations, 13% higher revenue. We're also pleased at the quality of our earnings remain solid and we expand our revenue sources and reduce our dependencies on any single source of income on any one line of business while strengthening our balance sheet through the generation. Now back to you.

Christos Cotsakos - *E-Trade - CEO*

Thanks Len. In August we published quarterly survey tracking customer attitudes about the economy, market and their own financial affairs. More than 1,800 customers participated discussing a diverse range of assets, trading levels, product ownership and service need. They expressed confidence of the markets over the long term and a commitment to maintaining a position in the equity market. In addition, more than 40% of our activity traders say they that they are actively moving money into the market through stocks and mutual funds. A majority of our customers indicated that real estate offers a superior investment motive than the stock market. While some of these appear obvious, the data arrives through the survey through our data warehouse and provides valuable insight into our customer needs, interests and their issues is our ability to focus on customers' views and concerns about the economy and their personal finances and to quickly respond to those changing needs that makes up an important part of the E*Trade group value proposition.

By delivering product excellence at superior price with easy use and easy access, security and stability, we're able to support and add value to individuals managing their financial futures. In return, our flexibility and nimbleness allows to us build for long-term growth and revenue and earnings while adapt to an unpredicted market place to take advantage of opportunities. Despite these challenging times, opportunities do exist for revenue growth and profitability. In the brokerage business will focus on the trading segment and focus on our institution and corporate service businesses. Earlier this month, we began publishing our proprietary research for the benefit of our institutional clients and ultimately our retail clients as well. We also expect a positive response that we experienced last quarter from our limited 999 E*Trade pro-offer to grow over the coming quarter with the recent launch of our expansion of nine campaign. We will gain market share in the active trader market while also positioning ourselves with the leverage revenue as the markets recover.

In banking, we're going to continue to enhance our product line and drive revenue with existed offering and finish home equity lines of credit and auto loans. The growing line of products and the diversified deposit base, we anticipate substantial and sustainable improvement in our industry spread. Drawing on the strength and experience of E*Trade global asset management, we had our first securitization as a manager in September. Going forward, we expect to expand our fee income and generate better economics for our mortgage and consumer loan offerings. Now, it's difficult to determine what the future holds in these challenging times. The financial markets continue to struggle and investor confidence continues to wane marked by political and economic uncertainties. We cannot predict the market environment, but we can control our destiny by staying focused on creating value for our customers and prudently managing risks while maintaining the highest standards of ethics and integrity.

The management team and I believe the company is solidly positioned to sustain growth and future success. We now have the scale, the infrastructure, product, and diversified business model in place to profit economically during challenging times. As well, we have the leverage hand across business line to drive greater revenue to the bottom line when the security industry rebounds. Our job is delivering service and added value for our shareowners is unwavering. In this environment of geopolitical uncertainty knowing what the future of the U.S. and global economy will look like and how it affects us. We are confident that we have the right model in place, the right people onboard and are heading down the right path for long-term success. E-trade has not only survived, but emerged as a leader in the financial services industry in what we believe is the relent focus on the customer experience, product diversification, operation efficiencies, technical and maximum return on equity. With that, we will open it up for questions.

QUESTIONS AND ANSWERS

Operator

Thank you, the floor is open for questions. If you have a question or a comment, please press the number one followed by four on your touch-tone phone. If at any point your question has been answered, you may remove yourself from the queue by pressing the pound key. Questions will be taken in the order they're received. Limit yourself to one question and one follow-up. We do ask that while you pose your question; pick up the handset to provide optimum sound quality. Thank you. Our first question is coming from Glen Shore of Deutsche Bank.

Glen Shore - *Deutsche Bank - Analyst*

Hello, all, just one question.

Christos Cotsakos - *E-Trade - CEO*

We can barely hear you.

Glen Shore - *Deutsche Bank - Analyst*

How is this? Better?

Christos Cotsakos - *E-Trade - CEO*

A little better.

Glen Shore - *Deutsche Bank - Analyst*

Okay. I guess the question revolving around the bank asset portfolio, and I want to revisit some of the earlier comments. So I was interested if the total assets came down, and I thought you were actually building out the auto piece, and that came down 250 or so million, was that a sale of an auto piece, and did that not fit or the spread get to a point where it was a good sale? What I'm focusing on is the 152 basis points. Is it still a good to get to 200, or is it look, let's manage toward profitability, and we'll get as close as we can with doing the right thing on the credit side?

Christos Cotsakos - *E-Trade - CEO*

The first thing is not to compromise credit quality whatsoever and get it as close possible.

Len Purkis - *E-Trade - CFO*

I think what I said in the script is what we've experienced in the third quarter is that in this environment, we want to make sure that we keep that focus on the credit quality and not just go for the 2000 basis points, and sacrificing that. We repositioned the balance sheet at the end of September to enable us to make more diversification plays in the balance sheet and widen the spread, but, again, we're being very choosy about what we're doing there in terms of everything we're doing. On the order of loan portfolio, I will let (inaudible) answer the detail about it.

Mitch Caplan - *E-Trade - President*

Just to talk about it a little bit broader. You know, we are committed to getting to our spread target, but as both Christos and Len said, we're looking at that, but at no point will we focus sacrifice our focus on credit quality. As an integral part to getting to our spread, 200 basis point run rate exiting 2002, it's important that we make room on our balance sheet for the new type of consumer finance assets that we are going to be putting on the balance sheet, and as a result, we sold certain assets in anticipation of what we were going to do in Q4. Accounting rules require that you move them from held for investment to hold for sale in the quarter before, and that's exactly what we did.

Glen Shore - *Deutsche Bank - Analyst*

Maybe it would help me understand. Can you disclose what equity was at the bank? In other words, was it around $800 million or so?

Len Purkis - *E-Trade - CFO*

Yeah, just under 800.

Christos Cotsakos - *E-Trade - CEO*

Let me jump in for a minute here. To answer your specific question about auto, there were no sales of auto last quarter. What we experienced with respect to the auto portfolio is very much what we experienced in the mortgage portfolio, which is significant pre-payment, so to the extent that you see a decline in auto, we're not reversing our strategy in any way. We intend to continue advancing it. You know, you're fighting this trend line of pre-payment that you see both in mortgage and auto.

Len Purkis - *E-Trade - CFO*

We're just being prudent.

Glen Shore - *Deutsche Bank - Analyst*

I totally understand. Let me ask you on something. I think this is something that will be on the minds of many people, and I think we had this conversation the last time --

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Christos Cotsakos - *E-Trade - CEO*

Can you talk a little louder, Glen. You're fading out.

Glen Shore - *Deutsche Bank - Analyst*

Absolutely. I think this is along the same lines of the originated loan. This is something that I think is on a lot of people's minds. Gain on sales and gains on loans held for sale had a spike-up much like they did, I think, back in the fourth quarter. Help us understand. Is there a cost side to this component, or is this all revenue that actually flows right to the bottom line?

Len Purkis - *E-Trade - CFO*

There's definitely a cost side, and you know, this is -- if you look at the first line item, it's our mortgage business and there's customer service there, and there's a very high customer service there which we gained back by having a lower operating source and we have a good operating margin there, and on the other line item, there's definitely costs down there, part of which, again is in services, but, again, we have a fairly high administrative cost there, which gets us to we look -- gets us to looking at these businesses both as being net income generators and not as net revenue generators . . ..

Christos Cotsakos - *E-Trade - CEO*

Glen, to put that in context, there's two different numbers. The first one is the gain on sale of origination mortgages. That's your direct consumer business. By way of example, starting off, we have 430 people in head count associated with that alone for cost of services. Then you have all of your additional opex expenses below the line, whether it's the marketing the tech, or generalized g & a, and the second line that you're seeing which is gain on sale of loans held for investment is our correspondent business. Again, that's the significant part of the 15th Floor, and you have correspondent sales business. All of the comp and benefits associated with it, as well as the tech and building it out and the marketing expenses. So, in fact, you would see both of them having very similar cost structures both in the cost of services and getting to the same gross margin as well as the same opex and getting to the same bottom line. This is the work of (inaudible) and significant amount of effort over the past two and a half and three years building out a mortgage business.

Glen Shore - *Deutsche Bank - Analyst*

That explains why the g & a, and cost of services lines is up sequentially?

Christos Cotsakos - *E-Trade - CEO*

That is exactly right, and they are directly related to those two lines of businesses. So in general head count was flat quarter over quarter, but up 240 or 245 in the two mortgage businesses, as we reengineered and reallocated among the business units.

Mitch Caplan - *E-Trade - President*

And, again, as we said about the environment that we've got and adding head count to those areas that are building revenue, building volume, and we're reengineering head count in those areas that are readapting for the changing environment.

Glen Shore - *Deutsche Bank - Analyst*

Super, just this question. You made money on both an operating and a GAAP basis. Why does equity decline sequentially in the quarter? Is that because of the FAS 133 is going through?

Len Purkis - *E-Trade - CFO*

You will see the premium on shares went down, which is the share buyback impact that we had. We have a couple of places where it's impacted.

Glen Shore - *Deutsche Bank - Analyst*

Great. Thanks, guys.

Len Purkis - *E-Trade - CFO*

Thanks, Glen.

Operator

Thank you. Our next question is coming from Mike Vinciquerra from Raymond James.

Mike Vinciquerra - *Raymond James - Analyst*

One question I have on the loan portfolio is that you have higher prepayments on the mortgage and auto loans and they were there from third-party acquisitions. Are you having any write offs for acquisition premiums on those loans because of the accelerated pre-payments?

Christos Cotsakos - *E-Trade - CEO*

We've had a write off for that.

Mike Vinciquerra - *Raymond James - Analyst*

You didn't pay any premiums when you acquired those loans in the first place?

Christos Cotsakos - *E-Trade - CEO*

No.

Mike Vinciquerra - *Raymond James - Analyst*

Then, could you give us some color on the origination of the correspondent loans, I'm curious as to who your partners are how you developed that piece of business. In the correspondents area, it's my understanding it's, number one, price sensitive, or number two, long-term relationships that you've had with various originators throughout the country.

Christos Cotsakos - *E-Trade - CEO*

We've been work on that business for quite a long time. In the past before the bank actually got into origination of mortgages, itself, and bought the retail mortgage channel, correspondent business is really what we had, so we've been working on that line of business for over 10 years. During that period of time, we developed quite a number of relationships with different sellers throughout the country. We have a sales force that makes relationships, that maintains relationships. Within the past year, we more than doubled our number of sellers, which, for us, is something that we believe is helping us not only currently, but it will help us when the interest rate environment goes up and volumes slow down. At least we will have a broad of people who are continuing to sell us mortgages over time. So we really do have a very broad, diverse base of sellers to us, and in fact, we have very little reliance on any single seller or small group of sellers or in any particular part of the country.

Mike Vinciquerra - *Raymond James - Analyst*

Very good. That's helpful. Can you also give us an idea on the retail side of the mortgage business, what you're seeing in terms of mix between refinancings during the quarter versus purchase business, and I'm just trying to kind of line it up with what we're seeing in the industry?

Mitch Caplan - *E-Trade - President*

Yeah, I think that generally speaking, we're following the industry. I would say at this point in Q3, it was probably about 850% refinance, 15% purchase, as we reported last quarter, it was about two-thirds, one-third, but the quarter before when refinances were still strong, it was similar to the 85/15. You know, it really depends on what's going on in the marketplace, and we're seeing something similar.

Mike Vinciquerra - *Raymond James - Analyst*

I'm going to get in one more here, and then I will shut up. On your mortgage sales, you mentioned that you have done your first securitization yourself, are you guys holding any assets after that securitization in terms of servicing rights, or are you selling everything through credit risk servicing rights and so forth.

Mitch Caplan - *E-Trade - President*

Well, actually, what we did was, we didn't do a securitization of mortgages. What Christos referred to in the transaction done by our local asset management group was actually a sale of a CDO, collateralized debt obligation, and backed by asset-barked securities and mortgage-backed securities and not mortgages. You know, it's not that -- it's not a difficult type of mortgage security ideations.

Christos Cotsakos - *E-Trade - CEO*

That was our first go in that market.

Mitch Caplan - *E-Trade - President*

It was incredible.

Mike Vinciquerra - *Raymond James - Analyst*

Did you maintain any of the loss or the credit risk on any of those?

Mitch Caplan - *E-Trade - President*

: Yes. We maintained a very tiny piece of it. It was a deal of $250 million against which we have preference shares of $9.5 million, and just to speak to the quality of the deal, itself, those preference shares are of such high quality that they're rated investment grade, so we're holding them not because we have to but because we want to.

Mike Vinciquerra - *Raymond James - Analyst*

Okay. Thanks for all the details, guys.

Mitch Caplan - *E-Trade - President*

Sure.

Operator

Thank you. Our next question is from Adam Townsend of J.P. Morgan.

Adam Townsend - *JP Morgan - Analyst*

Good afternoon, guys. Can you provide any detail on the segment profitability at this point, or do we need to wait for the Q to come out for that?

Len Purkis - *E-Trade - CFO*

Well, the Q that comes out will give you segment profitability in a different accounting format. What you can see generally is that the brokerage was profitable in stand alone and corporate allocations merely from the fact that we lowered the break even point in brokerage down to 5,000 and we did 75,000 transactions, and you can go to the other end in the brokerage business. (Inaudible) And obviously bank that was profitable in stand-alone, as well. What we want to do in first quarter of next year and in the court of next year is get our segment pointing more in line so they will be showing bank and brokerage going down to bottom line profitability rather than what was assured in the K right now, which is more accounting.

Christos Cotsakos - *E-Trade - CEO*

That's just internally how we organize the new division structure that we put in place out a month ago, and we also expect E*Trade technologies to start delivering bottom line profits this year and - (inaudible)

Adam Townsend - *JP Morgan - Analyst*

Is it safe to assume that the institutional and global segment is still losing money, but you're approaching profitability by the end of the year? Is that still the goal?

Mitch Caplan - *E-Trade - President*

The answer to that is absolutely. The reason, as I'm sure you understand, the way we're present reporting it in the Q is that it shows institutional and international together, and the institutional business, both globally and specifically in the U.S., is profitable. To Christos' point is imminently clear on the call, and that is there's not a business segment that we're in now that we're not profitable with the exception of retail in Europe and retail in Asia, and again, we have given guidance at a break-even run rate exiting Q4.

Christos Cotsakos - *E-Trade - CEO*

Part of the Asian issue of the write off and the trades taken this quarter and we will exit the quarter at break even.

Adam Townsend - *JP Morgan - Analyst*

Okay. Good color there. Let me ask about really account growth. You know, certainly, the environment is not, you know, very healthy for that, but it seems like there's been, you know, pretty tight contraction in terms of the growth rate there. Can you talk about what you are doing on the marketing front? What you are seeing in terms of trying to acquire accounts. Account acquisition costs seem to be creeping up a bit so we're not getting as much bang for the buck as we would like to see. Maybe some color there would be helpful.

Mitch Caplan - *E-Trade - President*

Part of that is an aberration for the quarter and part of that is we're targeting segment marketing and concentrating on the active trader brokering and we believe in this challenging market will be the most profitable segment, and that is where we gain 6% share in the active trader segment just over the last several weeks, and I believe some of our competitors will lose share in that area. That's where we're concentrating as well as in some of the areas that are growing with mortgage origination, and we're looking at some of the brand aspects and repositioning how do we spend and where we spend through the direct mail and targeted mail.

Christos Cotsakos - *E-Trade - CEO*

Also, as well, and I think you focused on it, what you will see is a gross in household access accounts, and a big part of that is we stepped back and looked at the behavior of our customers in the last quarter, and we recognized that there was an opportunity for us to pro-actively market them and say, listen, this is the best way to manage your cash, and you may want to put a couple accounts together and put it in this particular cash management account and it will generate the highest return for you, so as a result of our success and consolidation of accounts bringing up more households and therefore, more assets per household.

Mitch Caplan - *E-Trade - President*

Also, as a follow-on, Christos will tell you correctly we have spent a huge amount of time trying to take the existing customer base, data mine it, cross-sell it, and particularly, obviously around the mortgage area where we saw huge opportunities, so we have run a couple of direct campaigns which are not necessarily growing new accounts, but are bringing in mortgage loans and then which we resold into the secondary market, but clearly, we retain the marketing rights and will try to gain additional relationships with those customers who we originated mortgages for refinancing activity by way of advance.

Christos Cotsakos - *E-Trade - CEO*

I think the other thing is just consolidation of products is that we're really working on because advertising would be in any media to the brokerage area. (Inaudible) To that effect, the short term will have a higher look for acquisition space in how you spread the marketing funds, but our balance can be directly allocated and appropriately to those that are making us a higher-yielding profitability.

Adam Townsend - *JP Morgan - Analyst*

This is just a follow-up to that in the consolidation of accounts per Household, are you finding there's any sort of benefit from the cost of service standpoint and servicing fewer individual accounts, but, you know, more on households?

Christos Cotsakos - *E-Trade - CEO*

We have services to back off that Especially when you go bank to brokerage, you know, whether it's call center activity and we will increase productivity there and reduce costs, whether it's in consolidation of the website and how we integrate that, so for us, it's a huge productivity that is to double back on our profitability.

Adam Townsend - *JP Morgan - Analyst*

Very good. Great, thank you, guys.

Operator

Thank you. Our next question is coming from Rich Repetto of Putman Levell.

Rich Repetto - *Putnam Lovell - Analyst*

Hi. You said you're comfortable with a 14-cent consensus estimate, and I guess a little bit of this goes to the mortgage-related revenue. I'm just wondering how much of a pipeline can you see, or how much of a view can you get due to the lag of the mortgage origination? I think on the call Len was pretty clear. We're entering the Q4 with a billion pipeline.

Christos Cotsakos - *E-Trade - CEO*

That's solidly locked.

Rich Repetto - *Putnam Lovell - Analyst*

Okay. Well, baked into the 14 cents, then what sort of trading assumptions is embedded to get you, you know, given that you got a billion dollar pipe line locked plus there's probably still some more room for growth there, too, if rates stay low.

Len Purkis - *E-Trade - CFO*

We're pretty much staying with where we've been all year, and that's flat to maybe down a little bit on the transaction.

Christos Cotsakos - *E-Trade - CEO*

You know, the whole issue with us is that we lowered the break even. You know, we're making assumptions that trading activity is remained flat and we're going to concentrate on those areas that will give us the biggest bang for our Buck. And as an active trader segment, gains for share, and I think that will give us some additional leverage, and we would look at that to offset any further declines in the market.

Rich Repetto - *Putnam Lovell - Analyst*

Okay. Next question, and this is going to be my last question is, you know, the stock-still trade at a significant discount to peers out there. I was wondering and I heard you announce the analyst day coming in February. Anything, you know, in between now and then that you think you're working toward to try to, you know, remove or sort of bring this discrepancy back in line with investors or, you know, is this something we are just going to focus in on other areas and sort of let it be and let it work itself out?

Christos Cotsakos - *E-Trade - CEO*

Two things and one, we really can't comment on the stock because there are so many things that are out of our control, and our view is concentrate on the fundamentals and work on building the franchise business that the company will get recognition for it and investor confidence will build as we go forward, so that's not primary. I think the analyst day will go a long way to make that an annual event. Len and Rob just came back from a two-week trip in Europe, and be out on the road for several weeks talking to investors about where we are and where we are going and we think that we it will have a positive effect on the company. I think us continuing to pound out, you know, consecutive quarters of profitability in a market like this where our competitors are will get things in the balance with respect to where we are.

Rich Repetto - *Putnam Lovell - Analyst*

Okay.

Len Purkis - *E-Trade - CFO*

We're building a franchise.

Rich Repetto - *Putnam Lovell - Analyst*

Okay. Thank you.

Operator

Thank you. Our next question is coming from Colin Clark of Salomon Smith Barney.

Colin Clark - *Salomon Smith Barney - Analyst*

Good afternoon. Can you provide us with a trades-cape revenues and expenses for the third quarter on a stand-alone basis? It looks like it's about $8.3 million.

Len Purkis - *E-Trade - CFO*

What we do is trades-cape we break it out in terms of metric table, but we don't break it out in terms of revenue and blend it into (inaudible) commission line (inaudible).

Colin Clark - *Salomon Smith Barney - Analyst*

Okay. Since we don't have too many data points on the professional trading trend, can you at least give us some insights on historical trends? In a weak environment, have volumes tended to be better in.

Mitch Caplan - *E-Trade - President*

Yeah. On the question on trading volumes, I mean, through the summer, they were a little weaker than we had originally anticipated. Part of that, though, was as was mentioned in the in the discussion at the beginning of the call. We went through as part of the integration to look at parts of the business that we wanted to emphasize and other parts of the business we want to de-emphasize, and we weeded out certain parts of the business that were less profitability, and you know, cut them out. What we've seen from probably mid-August and then increasing week by week and certainly continuing now is an increase back in volumes, back to more levels where we would expect.

Christos Cotsakos - *E-Trade - CEO*

What we also found, though, with trades-cape, which is important, we found more integration opportunities or value than we originally expected. At the back office, we found that there's a lot we can do with integrating the back office and driving our clearing cost down.

Mitch Caplan - *E-Trade - President*

We found integration opportunities with our touch point strategies. We moved some of the trainers, for instance, into our center here in New York, and also on the technology side. The technology is quite good, and we're finding that it's got use outside of just the professional trader that we're also being able to leverage it in our other parts of the retail business, but also in the institutional business. In terms of the overall industry, any slowness that we experienced in the summer was experienced industry wide, and that actually, I believe, is benefit for us because part of our strategy there is consolidation, and we've got pricing power that the rest of the market doesn't have, and we've got staying power, obviously, that the rest of the market doesn't have, so any slowness, actually works to be a benefit for us in our continuing strategy.

Christos Cotsakos - *E-Trade - CEO*

You know, just as we learned more about the professional trading environment with the active trader and especially with some of the technology that goes along with that acquisition, we think that integration is going to work well for us in our new campaign coming out with 999. Other programs that we had, and we'll be able to give you more flavor as we get to two or three quarters and get a better handle on professionalizing the professional trader activity, which, before was just a hodgepodge of different franchises all over the U.S. And we will consolidate that and make that a viable business opportunity, and that's a great profit for us.

Colin Clark - *Salomon Smith Barney - Analyst*

Great. Thank you.

Operator

Thank you. Our next question is coming from John Levin of J.P. Morgan.

John Levin - *JP Morgan - Analyst*

Yes. Thank you. Good afternoon. Len, my questions relate to cash and cash flow. First, I'm wondering in the call you had mentioned that the free cash, I guess, at the parent company's 341, and I'm just trying to reconcile that versus is the consolidated cash number in the press release of 1757 and the cash and equivalence at the bank, which is 1194, the difference there is 563, so how would I reconcile the 341 versus 563?

Len Purkis - *E-Trade - CFO*

Cash and equivalence that we show on the balance sheet is 1.7 billion, and we look at cash segregated 924. Obviously, the segregated cash, we don't count. Included in the 1.7 billion is cash that is from regulated entity, so it's not really available on the group level, so we don't count that, so the 341 million is included in that 1.7 billion, and like we say, the other part is regulated.

John Levin - *JP Morgan - Analyst*

So the difference of about 222 then would be at brokerage entities or --

Len Purkis - *E-Trade - CFO*

It's a combination of traditional business, brokerage entities and the bank where that money is not really available. It's about 1.4 billion.

John Levin - *JP Morgan - Analyst*

Okay. Then for cash flow, the press release says that there's about 16 million of positive cash flow from operations before capital items. Can you just break that out into some detail, you know, a lot of us are used to looking at businesses and starting cash flow with EBITDA and seeing things like cash use for capital expenditures and cash used or generated by working capital changes and cash payments for interest and things like that. Can you just give some greater level of detail on the cash flow item?

Len Purkis - *E-Trade - CFO*

Well, the largest part of that it comes from operations and appreciation is running at 27 million a quarter. Our CAPEX was approximately $11 million in the quarter, and the other areas would be areas of working capital and investment in other areas like commitment to our venture partner, so we put out detail in the Q. It's a very forward cash analysis. We include everything in there, whether that's increased investments in brokerage or bank, capital requirements, which there aren't because they are well capitalized. Predominantly, it's coming from our operations and CAPEX.

John Levin - *JP Morgan - Analyst*

Okay. Thank you.

Operator

Thank you, and our last question of the day is coming from David March of Friedman Billing Ram.

David March - *Friedman Billing Ram - Analyst*

Hi, guys, yeah, the last caller asked several of my questions with regard to cash flow. But drilling down a little bit more, it seems to me that the bank must be cash flowing pretty well at this point. Have you dividend any cash from the bank up to the holding company level, and do you have any plans to do that at some point in the near future?

Len Purkis - *E-Trade - CFO*

We have excess capital at the bank. At the end of the third quarter, it's about $60 million, which we include in our free cash. At the moment, the bank, what we're anticipating going forward is going to be profitable, but we don't have to invest more capital into the bank unless we make the strategic decision to economically get some returns that we want to get out of the bank, so there's no immediate need for a dividend back. What we are looking at, first, obviously, is the bank to be successfully getting to a 200 basis point spread run rate, and then we can assess the other opportunities we can do to grow the balance sheet, and we need to get to that bar first.

David March - *Friedman Billing Ram - Analyst*

Okay, and you mentioned the money that you would be putting into the venture funds. Can you discuss how much, if any, went into venture funds in the third quarter, and how much more would be required to be put into that based on the contractual obligations that you have there?

Len Purkis - *E-Trade - CFO*

There are a number of venture funds. The amounts that we committed in the third quarter were insignificant to our cash flow and the commitments that we had outstanding really don't compare when you look at our overall cash. It's just one of the items -- like I said, we included everything when we look at cash.

David March - *Friedman Billing Ram - Analyst*

Thanks.

Len Purkis - *E-Trade - CFO*

Thank you.

Christos Cotsakos - *E-Trade - CEO*

All right. Thanks, everybody. Have a great day. This concludes the call.

Operator

This concludes the E*Trade group third quarter earnings conference call. Please disconnect, and have a nice day.