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ETFC.OQ^J20 - Q4 2002 E*TRADE Group, Inc. Earnings Conference Call

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**OVERVIEW:**

Management today announced 4Q02 EPS of $0.14 on net income of $52m and FY02 EPS of $0.45. FY03 guidance calls for EPS in the range of $0.45-0.55. Q&A focus: FY03 guidance and expectation for continued profitability in depressed economic environment.

## CORPORATE PARTICIPANTS

**Leonard Purkis** *E*TRADE Group, Inc. - Chief Financial Officer*

**Christos Cotsakos** *E*TRADE Group, Inc. - Chairman, Chief Executive Officer*

**Mitch Caplan** *E*TRADE Group, Inc. - Vice President, Chief Operating Officer*

**R. Jarrett Lilien** *E*TRADE Securities, Inc. - CBO, President*

## CONFERENCE CALL PARTICIPANTS

**Rich Repetto** *Putnam Lovell Securities*

**Mike Vinciquerra** *Raymond James*

**Glen Shore** *Deutsche Bank Alex Brown*

**Colin Clark** *Smith Barney*

**Justin Hughes** *Jeffries and Company*

**Gregory McCosco** *Lord Abbott*

## PRESENTATION

**Operator**

Good morning and welcome to the E*TRADE Group, incorporated fourth quarter and year-end 2002 earnings conference call. At this time, all participants have been placed on a listen-only mode. Following the presentation, the floor will be open for questions. I would now like to turn the floor over to E*TRADE Chief Financial Officer Len Purkis.

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**Leonard Purkis** - *E*TRADE Group, Inc. - Chief Financial Officer*

Thanks for joining us on the fourth 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've been advised to begin the call with the standard Safe Harbor statement. During this conference call, we will be sharing with you some projections or other forward-looking statements regarding future events or the future performance of the company. As always, we caution you that certain factors including risks and uncertainties referred to the 10Ks, 10Qs and other reports we periodically file with the SEC, could cause actual results to differ materially from those indicated by our projections for forward-looking statements. This call is being taped. The recording will be available by telephone beginning at 10:30 a.m. Eastern Time today to 6:00 p.m. Pacific time on February 5. 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 will now turn the call over to Christos. After that I'll provide you with more specific details on our financials and Christos will make a few closing remarks then open it up briefly for questions.

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**Christos Cotsakos** - *E*TRADE Group, Inc. - Chairman, Chief Executive Officer*

Thank you, Len, and thanks for joining us this morning. A year ago, we reported earnings per share of 12 cents from ongoing operations for fiscal year 2001 in what we considered at that time to be a very challenging and defining year for the financial services industry. We were hopeful that 2002 would bring economic relief from the recession and with it, a gradually improving equity market. We gave guidance of 45 cents per share from ongoing operations, well over three times 2001 earnings. Our guidance was based on, among other assumptions, flat trading levels with 2001 and a reduction in the bank's mortgage banking revenue by approximately 50% over the year as a result of an anticipated rise in interest rates.

Today, looking back at 2002, we saw a little recovery in the economy. Instead of improvement in the equity markets, we saw double digit declines, the worst performance since 1987 and the third consecutive annual decline in the major stock indices. Our daily average transaction volumes, instead of being flat with 2001, were down 23% in 2002. In response to a sluggish economy, we saw the Federal Reserve reduce rates on fed funds to a 41-year low, thereby helping to extend the refinancing boom that began in 2001.

It is in this sluggish and unpredictable environment that E*TRADE Group grew earnings per share by 275% from 12 cents per share from ongoing operations in 2001 to 45 cents in 2002, making us one of the few companies to deliver results consistent with our original guidance a year ago. Now, we did so by building scale and by expanding our margins to efficiency initiatives. We also grew revenue and experienced the hedging benefits of an effective diversification strategy.

A better than expected market for our lending products offset a worse than modeled trading environment. This is really how our model is designed to work. We maintained our focus and we executed. At 14 cents per share from ongoing operations in the fourth quarter, this also marks our 10th consecutive quarter of ongoing profitability. On a reported basis for the fourth quarter, we generated $30 million in net income or earnings of 8 cents per share. Our proposition that the right model, our model, can generate greater value for our customers and shareowners than merely the sum of the parts has been proven in these challenging times. It is demonstrated by the fact that while we, too, have felt the effects of a long-term declining equity market, we do continue to prosper.

We also believe the corollary will prove true, that as the economy recovers, the operating leverage we have created throughout our business model will create continued opportunities for revenue and earnings growth. This is evidenced by the fact that while many companies lowered costs by contracting and discontinuing services in response to financial constraints and economic uncertainty, we enhanced our value proposition for our customers by strengthening our services and expanding our product offerings. We continue to drive share value for our shareowners by improving our margins, increasing our return on capital and generating positive cash flow.

Our brokerage business is profitable and we continue to build additional operating leverage. This quarter we again lowered the breakeven volume point of our retail brokerage business from 65,000 transactions per day to 63,000. With our current infrastructure, we can generate ongoing earnings of 4 cents per share a year for every additional 10,000 average transactions per day we produce above breakeven. Our focus on operating efficiencies has made us a low-cost producer in the industry.

Now to exploit this leverage, we've escalated our focus to increase market share. We are very encouraged with the initial results of our new Power of Nine campaign, providing a flat 999 commission and a 9 second trade guarantee for active traders who make at least nine stock trades per month. Since its implementation in the fall, E*TRADE Securities online trading market share has increased with our daily transaction volume averaging 88,000 for the quarter, excluding professional trading, an 11% increase from our third quarter. This 11% improvement in transaction volumes during the quarter reflected a sharp increase in our market share and really the success of that value proposition.

During the fourth quarter, we grew accounts in most active trader segments. Those customers who make 300 or more trades per quarter, by 19%. And our accounts in our overall active trader segment by 14%. We also saw our average assets per household increase by 4% to $14,000. A positive directional change from prior quarter declines.

While we focus this year on growing our active trader segment, we also continue to expand and improve service across all retail segments. We recently introduced new cash management functionality which provides our customers with the ability to transfer cash real-time electronically. As a result, customers can transfer cash into and between their E*TRADE Securities brokerage and E*TRADE bank accounts, providing instant adjustment to balances and immediate buying power. Additionally, customers can consolidate their assets at E*TRADE Securities from other brokerage firms by electronically transferring their accounts, eliminating paperwork and delays. Each of these enhancements improves the customer experience, reduces service cost and drives incremental revenue and asset gathering.

In our institutional business, we continue to build scale, completing the acquisition of Engleman Securities, a floor brokerage business and institutional direct access business on the Chicago stock exchange for approximately $7 million in stock and cash. Formed in 1967, Engleman executes principal and agency transactions with other broker dealers, clearing members of the NSCC and institutional customers in its capacity as a registered broker dealer. Through this acquisition, E*TRADE Securities reinforces its position as a leader and a broker-to-broker and institutional trading sector and adds 16 experienced traders to our current talent pool. Assisting in the further development of our institutional brokerage business. The acquisition is accretive and cash flow positive.

Also in keeping with our commitment to have our international retail brokerage operations at breakeven or better in 2003, we've decided to streamline our approach to Germany. We will exiting our German infrastructure as currently constituted and have taken a $12 million related charge this quarter. We continue to support our German customers consistent our global focus on active traders. With this and other initiatives either completed or in process, adding to our existing profitable international businesses like Canada, that has been profitable now for five consecutive quarters, we exit the year positioned at international retail brokerage operations at breakeven or better in 2003. This really positions us for future growth in revenue and income as the international marketplace improves.

At the bank, now the seventh largest OTS regulated thrift as measured by assets, we completed the acquisition of Ganis Credit Corp. for cash on December 23, expanding our diversified portfolio of consumer assets by adding $1.8 billion in recreational vehicle, marine and motor sport loans. The credit profile of borrowers represented by these assets is strong. With an average FICO score of 719 and historical and annualized loss ratios on Ganis' RV and marine loans equaling 45 and 65 basis points respectively. Now this acquisition contributes 20 basis points to the bank's future net interest spread, strengthens operations and increases profitability. The addition of the Ganis origination and servicing platforms and its experienced management team enables to us solidify our position in the consumer lending market. We also expect to create at least $3 million in annual savings by transitioning our existing auto portfolio to Ganis' well-established and profitable servicing business. The purchase of Ganis for a premium of $45 million is also accretive to earnings and is cash flow positive.

By effectively leveraging our expanding line of products, we continue to see success in our cross sale and upsell activities. 25% of our mortgage products and 45% of our home equity products sold during the quarter came from cross sell. Similar to the levels we saw in the third quarter. Our focus on lowering our funding costs, while continually improving the value proposition we offer our bank customers, has generated growth in transaction deposits both quarter-over-quarter and year-over-year. Transaction deposits now account for 51% of total retail deposit balances of 49% in the third quarter and 35% in the fourth quarter last year.

In our mortgage business, we continue to take advantage of opportunities arising from the low interest rate environment, generating a record $2.2 billion in direct originations for the quarter. This brings our total origination volume for the year to $6.2 billion, a 19% annual increase. Similarly, through our correspondent relationships, we originated over $1.4 billion in mortgage home loans for the quarter and $5.8 billion for the year. While we anticipate a decline in direct and indirect origination volumes, when interest rates rise and refinancing demands wanes, we have expanded our correspondent relationships by 41% over the past 12 months. We expect these correspondence to provide additional sources of ongoing purchase money and refinancing mortgage revenue. We also expect to offset declines in mortgage revenue to growth in our lending products such as home equity loans and lines of credit that see greater demand and usage as interest rates rise. We also carried $1.1 billion of originated mortgage whole loan product locked in the pipeline in the first quarter of 2003.

Now, our model strength and scalability is rooted in our powerful technology. Having invested early in a highly flexible, highly scalable state of the art technology platform, we are now able to rebalance our investment into future technology developments and reinnovation. Our development of industry-leading network routing technology provides reliable, fast access to the E*TRADE financial website. In addition, this was our first full quarter utilizing Linux and open standard space technologies. Utilizing this platform, we improved keynote transaction speed by 30% to under five seconds while improving reliability to 99.4%.

Besides improving performance of our core technologies, we've accomplished numerous technology initiatives this year to enhance our customer experience. Such as a completely redesigned website while reducing technology costs by $86 million year-over-year. We made significant investments in improved call management software and additional associate training to improve our level of customer service. We also consolidated our call centers, strengthened quality monitoring and improved response times. As a result, we saw significant improvement over the last 12 months in our quality measurements such as a 39% reduction in increase per transaction.

In demonstration of our commitment to corporate governance and to comply with both the spirit and intent of the Sarbannes-Oxley Act, all executive officer loans have been fully satisfied. These loans are part of the shareowner approved stock option plan that granted loans to executive officers to allow them to exercise options and hold stock. Repayment of the loans was made through a combination of cash payments and the company's redemption of that stock.

We also remain active in our search for two independent outside directors to fill two open positions on our board. Including key slots on the compensation and audit committees. The independent nominating committee of the board has retained Christian [INAUDIBLE] in this effort. The search for new directors is being conducted consistent with Calpers and NYSE guidelines. Our board meets both the NYSE and the Calpers guidelines for board independence. Our board is composed of eight directors, 75% of whom are independent. We have an independent lead director who presides over the other independent directors that meet regularly without management and we made proactive changes to our board in April, 2002, two months before the NYSE published its new standards. Now to Len for the numbers.

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**Leonard Purkis** - *E*TRADE Group, Inc. - Chief Financial Officer*

Thank you, Christos. This quarter we generated total net revenues of $349 million up 6% from last quarter and up 1% for the same quarter last year. This brings our total net revenues to $1.3 billion for the year, a 4% increase over last year. Due to creation of greater operating leverage, we continue to improve earnings, delivering quarterly income from ongoing operations to $52 million, 21% increase quarter-over-quarter and a 111% increase year-over-year. For the year, we generated ongoing earnings of $161 million, compared to $40 million in 2001 for a 300% increase in 2002 over 2001. We were $26 million cash flow positive for the quarter, bringing our year-end free cash position to $367 million. This represents our third consecutive quarter of positive cash flow, exceeding the commitment we made a year ago to be cash flow positive for the second half of this year.

At the bank, we continue to expand our consumer loan portfolio and our home equity products, improving return on equity while remaining focused on credit quality. As a result our net charge-offs for the quarter were 14 basis points of total average assets up two basis points from last quarter but well below the OTS third quarter industry average of 24 basis points. Credit quality of our active portfolio remains strong as demonstrated by the weighted average FICO scores for our mortgage and consumer portfolios, holding solid at 724 and 727 respectively.

Our brokerage revenue for the quarter totaled $218 million, a 4% increase from our third quarter and a 5% decrease from same quarter last year. The sequential increase in brokerage revenue reflected our gains in market share during the quarter. For the calender year we produced $867 million in net brokerage revenue, a 5% decline from calendar year 2001. This decline was due almost exclusively to reduced retail trading activity and lower interest income from lower market balances, partially offset by the addition of professional trading and increased principal transaction revenue.

Our banking revenue for the fourth quarter grew to $131 billion, a 9% increase from third quarter and a 13% increase over last year's same quarter. Annually, net banking revenue totaled $459 million, a 26% increase over 2001. This improvement both on a quarterly and an annual basis is attributable to increases in both interest and non-interest income. The declining interest rate environment hindered our ability to widen spreads because of high prepayments experienced throughout the industry, but enabled us to drive record revenues and income in our mortgage banking activity. As a result, we saw a decline in net interest revenue over the quarter by $2 million or 4%. But saw an increase in mortgage banking revenue by $10 million. For the year, mortgage banking revenue totaled $212 million, a $41 million increase over 2001. And in net interest income, we generated $215 million in 2002, a $54 million increase over 2001.

While we do not anticipate this level of mortgage revenue generation to be sustainable when interest rates rise and refinancing volumes slow, we expect to offset declining mortgage revenue with higher interest income, both from higher spreads and a larger overall balance sheet as we enter 2003. Our net interest spread totaled 140 basis points, a 12-basis point decline from our third quarter spread. Escalated prepayments, the limited availability of asset portfolios for purchase that met our credit requirements during the year and the closing of Ganis late in the quarter combined to cause us to miss our target in the quarter of 200 basis points [INAUDIBLE] net interest spread. But maintaining our credit quality standards was more important to us than an internal spread count. Nonetheless, we remain optimistic in achieving our goal in 2003 with the addition of prime credit quality, high yielding assets like those from Ganis.

With the acquisition of the Ganis assets and its 20 basis point positive impact on our spread, we closed the quarter with a pro forma spread of 160 basis points. As you will find detailed in our expanded bank metric table, provision for loan losses totaled $3 million, a 35% decline quarter-over-quarter and 38% decline year-over-year, reflecting the strong credit characteristics of our mortgage and consumer portfolios. Our reserve now total is $27 million, an increase from $16 million last quarter with the addition of reserves acquired with Ganis and continues to represent the equivalent of 12 months forward expected losses in both our mortgage and consumer loan portfolios. With these recent changes, our reserves as a percentage of total nonperforming assets now equal 104%, a 29 percentage point increase from 75% at the end of the third quarter and an 8 percentage point increase from 96% at the end of fourth quarter last year.

Turning to the expense side, cost of services equaled $147 million for the quarter, a 1% increase over third quarter and a 9% decrease over last year same quarter. The $2 million increase over the third quarter was largely related to incremental costs associated with our mortgage business. However, more importantly for the year, cost of services totalled $567 million, down $28 million or 5% year-over-year including the addition of professional trading and the first full year of [DEMPSEY] and the additional incremental costs associated with the sustained mortgage origination fund. This gives us a gross margin of $202 million or 58% as a percent of revenue for the fourth quarter and $759 million or 57% as a percent of revenue for the year. On a quarterly basis, this represents a 2 percentage point improvement over last quarter, a 5 percentage point improvement over same quarter last year and on an annual basis, a 4 percentage point improvement over 2001.

The benefits of our efficiency initiatives can also be seen in our operating costs. Operating expenses totaled $112 million for the quarter, up 6% from third quarter and down 17% from same quarter last year. The increase in operating expense over third quarter is largely driven by a $6 million increase in selling and marketing expenses. As we increased our visibility in the marketplace, we continued our Power of 9 promotion.

Annually, ongoing operating expenses totaled $470 million, $109 million less than ongoing operating expenses in 2001. Reductions were made in all three categories of ongoing expense, being selling and marketing, technology development and general administrative. As a result, our ongoing operating margin increased to $90 million or 26% as a percent of revenue in the fourth quarter, up $12 million from our third quarter and up $42 million from the same quarter last year. Annually, our ongoing operating margin totaled $289 million or 22% of revenue, up $187 million from 2001.

On an ongoing basis, we produced earnings of $52 million or 14 cents per share for the fourth quarter, 21% increase in dollars from the third quarter and 111% increase in dollars over the same quarter last year. On a reported basis, the company's fourth quarter net income grew to $30 million or earnings of 8 cents per share. This represents a 47% increase from last quarter and a 41% increase from last year's same quarter.

Turning to our guidance for 2003, we anticipate current tensions in the world will continue, causing an uncertain global marketplace and a challenging operating environment absent of any real global growth stimulative in the near term. Specifically we put our 2003 business traffic era with the following assumptions. The U.S. economic recovery and financial markets will remain sluggish. Interest rates will not increase significantly with little flexibility remaining for additional cuts. Investors will remain skeptical of performance of equities with doubts lingering around corporate governors and the global economy will be in a similar or weaker state with European and Asian economies uneven. As a result of these anticipating conditions, our guidance for 2003 is a range of 45 cents to 55 cents earnings per share from ongoing operations. We have provided a table in the earnings release outlining our range of assumptions.

Our assumptions are based around five key drivers of our business model, specifically transaction volumes, excluding professional trading, mortgage revenues, consisting of both our retail and corresponding businesses, bank net interest spread, marketing expense and operating efficiencies. At the lower end of our guidance at 45 cents, we have assumed average daily transactions to be flat with 2002 between 85,000 to 90,000. The decline in mortgage revenue of approximately 60% over the year. Average bank net interest spreads between 160 to 170 basis points. Marketing spread flat with 2002 and no material improvement in operating efficiencies.

At the mid-range of our guidance at 50 cents, we've assumed average daily transactions to be up slightly from 2002 between 90,000 and 95,000 with gains in market share. The decline in mortgage revenue of approximately 55% over the year, average bank net interest spreads of between 170 to 180 basis points, an increase in marketing spend by 15 to 20% over 2002 levels to drive gains in market share and additional operating efficiencies were around $15 million.

At the high end of our range of our guidance at 55 cents, we've assumed average daily transactions up 10% from 2002 between 95,000 and 100,000 with gains in market share. With decline in mortgage revenue of approximately 50% over the year. Average bank net interest spreads between 180 to 190 basis points. An increase in marketing spend by 20 to 25% over 2002 levels to drive gains in market share and additional operating efficiencies of around $30 million. Actual performance is a mix of these key drivers and could vary from these assumptions. So, within these ranges we anticipate being cash flow positive for the year. We also expect our first quarter will be the softest quarter with earnings per share below fourth quarter levels by approximately 20 to 30% as we increase our disciplined and targeted marketing investment that has provided such positive returns and the mortgage business flows from the record pace of the fourth quarter. We expect earnings per share to improve for the rest of the year.

While [INAUDIBLE] guidance that could include a fourth straight year of decline in the financial markets, a quicker than expected drop-off in mortgage lending and a credit environment that inhibits our ability to widen spreads outpacing the development of additional operating efficiencies. We also know that we have the business model that can produce strong returns should the environment turn more positive. It is this strength of flexibility in our business model that gives us the confidence that we can produce positive returns in the most challenging of times and that the operating leverage in our model has the capability to be highly profitable when the environment improves.

So, closing, in a highly challenging market environment, on an ongoing basis we produced the most profitable year in the history of this company. We not only generated three quarters of positive cash flow, we repurchased and retired another 15 million shares in 2002 for a total of 53 million shares since August of 2001. We've also continued to deleverage our balance sheet by retiring an additional $65 million in convertible debt this year for a total of $280 million retired since June 2001. Even more importantly, through strategic and tactical acquisitions, [INAUDIBLE] and execution of efficiency initiatives, we've been able to build significant operating leverage within and between business segments to produce profit in challenging times and position to us be even more profitable when market conditions improve. With that, back to you, Chris.

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**Christos Cotsakos** - *E*TRADE Group, Inc. - Chairman, Chief Executive Officer*

Thank you, Len. In December, we announced the results of our quarterly customer index tracking investor sentiment about the economy, the market and their personal finances. During the quarter, we found that investor outlook on the U.S. stock market remains unchanged for the third quarter of 2002 survey with a 73% majority remaining confident that the market will improve within the next 6 to 24 months. Further, 84% of respondents thinks it's likely that the U.S. will go to war with Iraq. And 54% believe a war will have a negative impact on the U.S. economy. Notably 40% of respondents did not feel a war would have any impact on investment behavior.

With regard to financial outlook in investing strategies, our studies show that approximately 60% of respondents indicated that they would continue to stay the course and hold their equity investment, similar to 64% in the third quarter. While 8% said they would sell out and move to cash, comparable to 11% last quarter. Active traders are significantly more optimistic about the general economy and the stock market recovery than other customer segments. And more than half of customers, 57%, still find real estate investments more attractive than stocks, similar to 58% in the third quarter. This information paints a challenging picture in 2003.

The financial markets remain volatile while investor near term confidence is flat, marked by geopolitical, economic and market uncertainty. In response, we're focused entirely on the following eight key initiatives in 2003 to maximize results and to drive growth through E*TRADE financial. First is to further refine our value proposition around product offerings and pricing for both bank and brokerage. Continue to improve it in customer experience at all call centers through training and ongoing performance evaluation. Ongoing growth in brokerage market share with a focus on the most profitable active trader segment. Further optimization of our touch point strategy centered on relationship management.

Continued diversification of the bank's asset portfolio, driving wider spreads without sacrificing credit quality. Additional integration and synergy optimization of acquired entities. Delivery of additional operating leverage in our institutional and market making businesses and operating efficiencies across all areas of business. And number eight, strategic investment in marketing around product offerings in our brand.

So what does this potentially mean for E*TRADE Group shareowners? Stable to improving revenue and profitability, driven by increased operating leverage in brokerage and banking, improved customer service and an expanded share of our customer's wallet. Not only have we delivered what we promised during the challenging times, we're better poised than ever to take advantage of most opportunities to grow both top and bottom lines as prudent prospects become available. We will maintain our focus, through the proven financial model we have built, we believe you, our shareholders, not only get superior operating leverage, you will reap the benefits of the business model that provides downside protection in challenging times and greater upside potential in better times. With that, we now open the call to your questions.

## QUESTIONS AND ANSWERS

**Operator**

Thank you, 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. Please limit yourself to one question and one follow-up. We ask that while you pose your question, that you pick up your handset to provide optimum sound quality. Thank you, our first question is coming from Rich Repetto of Putnam Lovell Securities.

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**Rich Repetto** - *Putnam Lovell Securities*

Yeah, hi, guys. If we're going to limit it to one question, my question has to do with the guidance going forward. As an example, even if you look at the first quarter, you know, if we brought on Ganis, if the mortgage pipeline is flat with the prior quarter, the refi index is looking pretty robust, why are numbers down 20 to 30% just in the first quarter? And to me it points to marketing spend. Is there any, you know, why in all these scenarios did we, in your up scenario are we looking at a 20% increase in market spend in the coming year?

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**Leonard Purkis** - *E*TRADE Group, Inc. - Chief Financial Officer*

Well, we're looking at the marketing of investments starting in the first quarter, Rich. And that's, you know, the predominant driver of why we're saying, you know, that the first quarter will be our softest quarter. That's going to be the kickoff to driving that marketing expense. In the upside case, the increased overall investment we're going to be putting into marketing shows that we have a market that's receptive to an even more increased marketing investment.

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**Christos Cotsakos** - *E*TRADE Group, Inc. - Chairman, Chief Executive Officer*

The big key is, Rich, we've been so successful in the Power of 9 marketing campaign, where we've gained share dramatically over the last quarter, we believe that some of the value propositions we now have with enhanced customer experience, some of the improvements we've made in technology, that now is the time for us to continue to invest in that arena and make the awareness more widespread with regard to our product pricing and service offering.

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**Rich Repetto** - *Putnam Lovell Securities*

Okay, and as a follow-up to the question, the guidance. The Power of 9 program, you know, it seemed -- I think you spent around -- was it $45 million or so marketing this quarter? I guess the question is what's the revenue assumption in the first quarter given that you have Ganis, you know, mortgages are still fairly robust, trading, you know, one could assume flat. So, what's the revenue sort of outlook quarter-to-quarter in your first quarter assumption?

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**Leonard Purkis** - *E*TRADE Group, Inc. - Chief Financial Officer*

Rich, at this stage we're only giving EPS guidance. I think that's reasonable in terms of what we've given out in terms of the detail in the earnings release on the key assumptions. There's enough there with our investment in marketing and our assumptions on what the mortgage is -- mortgage book is going to do in the first quarter to make some reasonable assumptions on the revenue for the year. And for the quarter.

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**Rich Repetto** - *Putnam Lovell Securities*

Okay. Thanks, guys.

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**Mitch Caplan** - *E*TRADE Group, Inc. - Vice President, Chief Operating Officer*

Thanks.

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**Operator**

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

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**Mike Vinciquerra** - *Raymond James*

Thanks, good morning. Had a question on the -- kind of the professional trader commissions. I'm trying to figure out what the breakdown if you could, Len, between your retail commissions and professional commissions are, because there was an increase in the quarter from I guess .003 cents per share to .004. Can you give us a little bit of detail on that, please?

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**Leonard Purkis** - *E*TRADE Group, Inc. - Chief Financial Officer*

Yeah, the professional trading per share commission went up just purely based on volume and how we really looked at the profitability of customers we have in that business and the profitability of customers is up and you see that being reflected in the shares.

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**Mike Vinciquerra** - *Raymond James*

Can you add maybe a decimal place just so we can get a feel for the magnitude of the change in that commission portrayed quarter-over-quarter?

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**Leonard Purkis** - *E*TRADE Group, Inc. - Chief Financial Officer*

We can get you that.

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**Mike Vinciquerra** - *Raymond James*

Okay. And the breakdown in commissions between the professional and retail, do you have that available by chance?

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**Leonard Purkis** - *E*TRADE Group, Inc. - Chief Financial Officer*

No, we don't break that out in terms of -- what you're seeing when you get the earnings release is the commission per transaction is on retail brokerage only.

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**Mike Vinciquerra** - *Raymond James*

Right.

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**Leonard Purkis** - *E*TRADE Group, Inc. - Chief Financial Officer*

And then you will see, below that, the commission per share, which is just professional trading. And the reason we've done that is we don't want to mix apples and oranges. You have two very different revenue producers there on different bases, so we've kept them separate.

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**Mike Vinciquerra** - *Raymond James*

I understand completely. It makes a lot of sense, it's just with such a small number on the professional trading, it's tough to determine what the magnitude of the changes. If you could get us the number --

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**Leonard Purkis** - *E*TRADE Group, Inc. - Chief Financial Officer*

We can add a couple more decimal points --

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**Mitch Caplan** - *E*TRADE Group, Inc. - Vice President, Chief Operating Officer*

And Mike, at a high level, I would tell you it was pretty flat quarter-over-quarter. What you saw was an increase in commission per share traded and a decrease in the number of shares that were traded in the quarter so that basically all in all it was flat to Q3.

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**Operator**

Thank you, our next question comes from Glen Shore of Deutsche Bank Alex Brown.

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**Glen Shore** - *Deutsche Bank Alex Brown*

Hi, thanks, guys. I guess limiting the question. one of the five key drivers on the assumptions for next year's operating efficiencies, and you have a range for no material improvements to plus 30 -- or minus 30 in this case. Can you give us a little color from where might it come from? Or where your gut is, and how much cost is there to take out? And maybe you could weave into, I'll squeeze two questions into one, weave into the facility of restructuring in Germany, how much costs does that free up and are there others out there?

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**Mitch Caplan** - *E*TRADE Group, Inc. - Vice President, Chief Operating Officer*

Hi, Glen, it's Mitch.

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**Glen Shore** - *Deutsche Bank Alex Brown*

Hi, Mitch.

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**Mitch Caplan** - *E*TRADE Group, Inc. - Vice President, Chief Operating Officer*

Let me start -- if you look at traditionally the areas that we have evaluated, it's been in the cost conservative area, it's been in G&A, it's been in tech, it's been in marketing. I think based on Len's answer to his last question we see an opportunity for a prudent marketing investment in 2003.

As we look forward, I think the big difference is rather than seeing that marketing investment spent the way we necessarily have in the past on brand, it will be significantly more product-focused around the attributes of particular products in the value proposition. So, accordingly where we will look to save the most significant costs will be in cost of services as a result of additional technology infrastructure initiatives as well as in the general G&A area. And I think you can assume, as you have seen us do the in past, that we will continue to prudently review our operating costs and trim excess out where it is available. I think if you look at the range of guidance, we do believe that there is some opportunity there for continued cost savings through these operating efficiencies. The issue being how much of those savings will we reinvest back in the business in the form of marketing as well as tech [INAUDIBLE].

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**Christos Cotsakos** - *E*TRADE Group, Inc. - Chairman, Chief Executive Officer*

One of the big issues for us this year that Josh is working on is technology reinnovation, much like what we did with the new-improved website this year. There is a lot of opportunity through integration like with the real-time cash transfer now, to really, we believe, blow ahead of the competition in how we're integrating our products, services and suite of offerings with pricing that we think can continue to gain market share in a very substantial way over the next year.

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**Mitch Caplan** - *E*TRADE Group, Inc. - Vice President, Chief Operating Officer*

So, the number you're seeing, Glen, when we're giving guidance is net. Meaning obviously the gross cost savings, net of the reinvestments that we think are applicable in order to continue to enhance the value proposition technologically of all the product and the marketing of those specific products.

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**Glen Shore** - *Deutsche Bank Alex Brown*

And am I pushing it to ask the Germany question --

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**Mitch Caplan** - *E*TRADE Group, Inc. - Vice President, Chief Operating Officer*

No, not at all. Germany, as you know, we had committed to exit this year, breakeven for retail brokerage in Europe and in Asia. We wanted to abide by that commitment and so one of the things that we simply did was say, as we have always talked about that, with respect to Europe we wanted to have one global technology platform and to the greatest degree possible, we wanted to operate out of one location in Europe and passport into the other countries. So, exiting Germany is not exiting with respect to customer relationships, it's really infrastructure. That $12 million charge is built into the numbers in allowing us to be able to pro forma be it breakeven for both Europe and Asia as well going forward in our retail brokerage operation.

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**Glen Shore** - *Deutsche Bank Alex Brown*

So, bottom line is right now you feel that Europe is running at breakeven --

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**Mitch Caplan** - *E*TRADE Group, Inc. - Vice President, Chief Operating Officer*

Post these--- That's correct.

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**Glen Shore** - *Deutsche Bank Alex Brown*

Okay. Super. Thanks, guys.

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**Mitch Caplan** - *E*TRADE Group, Inc. - Vice President, Chief Operating Officer*

Absolutely.

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**Operator**

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

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**Colin Clark** - *Smith Barney*

Hi. Good morning. I was hoping you could comment a couple of the trends in the brokerage areas, specifically the average daily trades was up sequentially while the shares traded in the professional trading segment was down. I was hoping you could comment on that trend and additionally what drove the average commission per trade down? Thanks.

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**R. Jarrett Lilien** - *E*TRADE Securities, Inc. - CBO, President*

Sure, Jarrett can handle that. You have three questions in there, I think.

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**Colin Clark** - *Smith Barney*

Sorry about that.

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**R. Jarrett Lilien** - *E*TRADE Securities, Inc. - CBO, President*

You have to break them up into three. On the professional side, I think what was being touched on before, you know, that's a totally different animal, what drives the trading behavior there. And what you saw in the quarter was obviously, you know, holidays, you saw a period of volatility decreasing and, you know, you have a smaller number of people doing a larger amount of trades in that part of the business. Volatility, when there's a lot of it, will drive them to the market and their volumes will be up more than the market. When volatility is down, that will have the magnifying effect the other way.

And also when you go around holiday times and people take time off, you know, that tends to impact the numbers. You also throw on there the entrance of Super Montage and people like to sit back and see how these new systems impact the market. So, really that's what's going on in the professional segment, just a lot of, you know, stuff coming together, lower volatility, holidays and a new system in the marketplace. So, you know, we're already seeing some of that bounce back here in January as people come back to the market.

On the broader side, the 88,000 trades per day in the quarter, we're seeing a good pickup as we noted in market share and the Power of 9 has been extremely successful and actually we've had now market share gains in the more active segment for the last two quarters but they're growing momentum of that pickup here in the fourth quarter. And that gets you to the average commission per trade was down about I believe 49 cents. There were two things that contributed to that, actually it's down 47 cents and there were two things contributed to that. One was a change of mix with the type of trades people were doing, specifically you saw a decrease in the amount of options business which carries a higher commission on it and out of the 47 cents that was responsible for about 12 cents of that. And then the rest was the success of Power of 9 and more market share pickup on the active trading side which has got a lower commission and that was responsible for the other 35 cents.

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**Colin Clark** - *Smith Barney*

Great. Thank you.

**Mitch Caplan** - *E*TRADE Group, Inc. - Vice President, Chief Operating Officer*

Also, if you step back quickly and if you remember on the earnings call last quarter, one of the things we talked to you about in the professional trader segment was that we did in fact, have certain unprofitable trading arrangements and that we were going to eliminate those. As a result, what you did see was a decline in shares traded because of that, but an increase in the commission. So, again, it's the focus on making sure that every transaction in all the segments are profitable.

**Colin Clark** - *Smith Barney*

Okay. Thank you.

**Operator**

Thank you. Our next question is coming from Justin Hughes of Jeffries and Company.

**Justin Hughes** - *Jeffries and Company*

Good morning. I wanted to ask a question on the bank side. I was wondering, you touched on it briefly in the comments, but I wonder if you had more detail on why the loss provision went down when your dollar amount of nonaccruals went up and your dollar amount of charge-offs went up?

**Christos Cotsakos** - *E*TRADE Group, Inc. - Chairman, Chief Executive Officer*

Well, when you look at the provision itself, the reason why the provision went down is because we -- we look at our overall reserves at the end of the quarter relative to our expected losses. Then as you know, we reserve 20 basis points for mortgages held for investment and a minimum of 12 months on consumer assets. But in connection with the Ganis acquisition, we acquired a reserve from Ganis also. So at the end of the quarter, you look back and you see what is the total reserve that you have on your books, after your charge-offs for the quarter, to determine whether your ending reserves are adequate and prudent. And it worked out for us that we had to provision less because of that.

**Justin Hughes** - *Jeffries and Company*

Okay. So basically part of the acquired reserve is -- was covering the existing portfolio.

**Christos Cotsakos** - *E*TRADE Group, Inc. - Chairman, Chief Executive Officer*

That's right.

**Justin Hughes** - *Jeffries and Company*

Okay. I'll get back in queue. Thanks.

**Operator**

Thank you. Our next question is coming from Rich Repetto of Putnam Lovell Securities.

**Rich Repetto** - *Putnam Lovell Securities*

Yeah, guys, I just wanted to -- I'm not sure whether I missed this in your initial talk, but on the buyback, any update on the buyback, and, you know, what's the outlook there in the quarter?

**Leonard Purkis** - *E*TRADE Group, Inc. - Chief Financial Officer*

You're talking about the stock buyback?

**Rich Repetto** - *Putnam Lovell Securities*

Yes.

**Leonard Purkis** - *E*TRADE Group, Inc. - Chief Financial Officer*

Yes, we have 4 million shares still available under the board-approved plan which was 50 million shares.

**Christos Cotsakos** - *E*TRADE Group, Inc. - Chairman, Chief Executive Officer*

Yes.

**Leonard Purkis** - *E*TRADE Group, Inc. - Chief Financial Officer*

And that's where we are right now.

**Rich Repetto** - *Putnam Lovell Securities*

Okay. And then as far as any other VC transactions, I know there was some selling this past quarter. Could you comment on that? What was the rationale or what you knew about it and any more of that expected this quarter?

**Christos Cotsakos** - *E*TRADE Group, Inc. - Chairman, Chief Executive Officer*

Sure, one of our very long-term early stage investors, General Atlantic, which has been in the stock almost seven years now, or close to eight, you know, reduced all of their exposure this last quarter. The two big overhangs that we did have in the marketplace from those two initial investors were General Atlantic at 6.5 million shares and [SOFT BANK] with all of their shares. Both of those now are down to zero. So with the exception of that, it's just the normal ebb and flow of what institutions look at in their holding positions.

**Rich Repetto** - *Putnam Lovell Securities*

Okay. Thank you.

**Operator**

Thank you. As a reminder, if you do have a question, please press 1 followed by 4 on your touch-tone phone. Our next question is a follow-up from Mike Vinciquerra of Raymond James.

**Mike Vinciquerra** - *Raymond James*

Thanks, justice a question on the commission rate, a follow-up. Can you provide any sort of guidance on where we would expect the global transaction commission to go, I mean it's at about $12 now. Is that expected to continue to fall over the course of '03? And can you give us an idea of where might it go to?

**Mitch Caplan** - *E*TRADE Group, Inc. - Vice President, Chief Operating Officer*

Yeah, I mean I think at this point, you know, it depends, obviously, on a lot of variables, but we're estimating for that to be pretty flat.

**Mike Vinciquerra** - *Raymond James*

Thank you.

**Mitch Caplan** - *E*TRADE Group, Inc. - Vice President, Chief Operating Officer*

I think the big issue, as you know, it's just a pure rate volume analysis. So for us as we model it out, I think flat is a rational assumption. If, however, you saw it decline, net top line revenues would grow more as would bottom line profitability just based on the volume pickup.

**Operator**

Thank you. Our next question is coming from Glen Shore of Deutsche Bank Alex Brown.

**Glen Shore** - *Deutsche Bank Alex Brown*

Just a quick question on the balance sheet. Two mental items. One is mandatory redeemable preferred securities went up around $50 million in the quarter. I was curious where that came from? And then if someone could explain what accumulated other comprehensive losses and why it's creeping up a little bit each quarter?

**Leonard Purkis** - *E*TRADE Group, Inc. - Chief Financial Officer*

Okay, the redeemable preferences are full trust preferreds which are at the bank level and we see this as a low-cost way of raising tier 1 capital for the bank and that we went out and did two traunches this quarter for the increase there. And that just gets -- I think we raised $50 million and funded down to the bank $40 million of that. So, that's just a nice way of having low cost tier 1 capital for the bank. In terms of OCI, the biggest drivers in OCI are the effects of the swaps and that just moves as the market moves as the balance sheet moves and it's a point in time situation and gets fully disclosed when we do the Qs.

**Glen Shore** - *Deutsche Bank Alex Brown*

So there's nothing inside the OCI that should lead to a writedown effort because the swaps hang out there in ebb and flow.

**Leonard Purkis** - *E*TRADE Group, Inc. - Chief Financial Officer*

No, we put the disclosure in the Qs and Ks. It will eventually get through the income statement but on the other hand it will [INAUDIBLE] the gains that offset that.

**Glen Shore** - *Deutsche Bank Alex Brown*

Understood. On the bank side, so, the balance sheet is bigger now, could you make us not wait for the call report and hit us with the equity at the bank right now?

**Leonard Purkis** - *E*TRADE Group, Inc. - Chief Financial Officer*

Yeah, the average equity at the bank for calculation is about $795 million.

**Glen Shore** - *Deutsche Bank Alex Brown*

Great, thanks very much.

**Leonard Purkis** - *E*TRADE Group, Inc. - Chief Financial Officer*

I beg your pardon, on a GAAP basis, it's going to be $805 million.

**Christos Cotsakos** - *E*TRADE Group, Inc. - Chairman, Chief Executive Officer*

Okay, with that, Glen, we will take one more question.

**Operator**

Thank you. Our last question will be coming from Gregory McCosco of Lord Abbott and Company.

**Gregory McCosco** - *Lord Abbott*

Yes, thank you. Could you talk a little bit about the breakeven? I believe you said that on a 10,000 share per day basis it would change, do you just mean 4 cents?

**Christos Cotsakos** - *E*TRADE Group, Inc. - Chairman, Chief Executive Officer*

That's correct. Above our model we will get 4 cents a share. Our goal is, we're down to 63,000 trades a day for breakeven today. Our goal is to get down to under 50. That's just the operating efficiencies that have been built in by our brokerage team.

**Gregory McCosco** - *Lord Abbott*

And that's significantly different than what you -- I think you said it was something much less in terms of the -- previously in the last quarter or the last few quarters?

**Leonard Purkis** - *E*TRADE Group, Inc. - Chief Financial Officer*

Well, the breakeven point last quarter was 65,000 and before that, up in the 70s. And a year ago, we were over 100,000. So, we've taken a tremendous amount of cost out of the brokerage business to get to that level.

**Christos Cotsakos** - *E*TRADE Group, Inc. - Chairman, Chief Executive Officer*

I think what you may be thinking of, we were looking at taking it down to 50,000 trades a day for breakeven and now looking at getting it down to 45,000.

**Gregory McCosco** - *Lord Abbott*

Okay. Good. And then, with regard -- I think you said something with regard to the $1.1 billion pipeline, was that with mortgages? Could you explain that again?

**Christos Cotsakos** - *E*TRADE Group, Inc. - Chairman, Chief Executive Officer*

Yes, that's the locked pipeline at the end of Q4 coming in, meaning people already paid locked fees for those mortgages.

**Gregory McCosco** - *Lord Abbott*

And what was that at the end of Q3?

**Christos Cotsakos** - *E*TRADE Group, Inc. - Chairman, Chief Executive Officer*

It was also about 1.1. It's pretty consistent.

**Gregory McCosco** - *Lord Abbott*

Okay. Thank you.

**Christos Cotsakos** - *E*TRADE Group, Inc. - Chairman, Chief Executive Officer*

Okay, thank you, everybody, have a good day.

**Operator**

Thank you, this concludes E*TRADE Group Incorporated fourth quarter and year-end 2002 earnings conference call. Please disconnect your lines at this time and have a wonderful day.