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# E\*TRADE Financial Corp. (ETFC)

Q1 2018 Earnings Call

## CORPORATE PARTICIPANTS

**Karl A. Roessner**  
*Chief Executive Officer & Director*

**Michael A. Pizzi**  
*Chief Financial Officer*

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## OTHER PARTICIPANTS

**Christian Bolu**  
*Sanford C. Bernstein & Co. LLC*

**Richard Repetto**  
*Sandler O'Neill & Partners LP*

**Steven Chubak**  
*Nomura Instinet*

**Christopher Harris**  
*Wells Fargo Securities LLC*

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*Autonomous Research US LP*

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*Rosenblatt Securities, Inc.*

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*Keefe, Bruyette & Woods, Inc.*

## MANAGEMENT DISCUSSION SECTION

Karl A. Roessner

*Chief Executive Officer & Director*

### Q1 RESULTS

- Q1 was yet another quarter defined by meaningful progress across the business and excellent financial results, as we faced significantly amplified customer activity and demonstrated strong operating discipline
- Within the context of all our team has accomplished these past 18 months, it should be pretty clear by now that this high-performance operating culture is our new business as usual

#### Business Environment

- Before diving into our operating metrics, let me take a moment to comment on the environment and provide an update on our core initiatives
- During Q1, the team navigated a confluence of meaningful market gyrations to deliver for customers
- While January kicked off the year strongly on the trading front, February was unprecedented presenting a sudden and dramatic reversal in the multi-year downward trend in volatility
  - And while market activity moderated in March, it was the third strongest trading month in the company's history trailing only the two months that preceded it
- Altogether, customer activity was remarkable, with quarterly DARTs shattering the record we set in Q4 and producing 7 of our top 10 trading days ever, including one in early February when we approached 0.5mm DARTs, but it wasn't just transactions
- Customers truly leaned into the market more than doubling typical Q1 net buying and driving margin receivables to another all-time high

#### Platform Growth

- I am particularly pleased to report that amid this record-setting customer activity, our platforms showed their resilience and strength
- Our risk management infrastructure also proved its value, as losses from high volatility products were kept to a minimum relative to the steep declines witnessed in the markets
- And most importantly, our people proved their mettle, as our team worked tirelessly and intelligently throughout it all to maintain and bolster our reputation as a digital first broker that traders and investors can depend on

### CORE BUSINESS INITIATIVES

#### Marketing Activity

- Turning to our core initiatives, on the marketing front, we kicked February off with a bang at the Super Bowl dropping our first big game spot in several years helping to put us back on the map as the irreverent, challenger brand consumers love while also delivering an important message about saving for retirement

- The ad was included in virtually all top Super Bowl ad countdowns, generating significant buzz and driving strong interest in E\*TRADE
  - That interest was evident in the increased traffic to our site following its debut, as well as an uptick in retirement account openings
- And while our Super Bowl spot may be the most visible of our efforts, this past quarter, we were hard at work behind the scenes delivering a host of great new tools and enhancements for our customers

#### Product Innovation

- On the trader front, we continue to generate solid momentum from our Power E\*TRADE program in growing our most active population and driving incremental interactions and transactions
- Further, product innovation is alive and well at E\*TRADE, as we introduced a first of its kind technical pattern recognition and education tool, rolled out 24-hour trading in some of today's most widely traded ETFs, launched the futures ladder on mobile and relaunched the fan favorite Spectral Analysis tool on the OH web platform
  - These enhancements, when taken with our entire suite of offerings, attracted industry recognition, as this quarter, we were awarded a wide array of honors from industry expert StockBrokers.com in their annual review, including number one for mobile trading for the fifth time in six years, number one for options trading for the seventh consecutive year, and best web-based platform for the second year in a row

#### Recognition

- We also earned recognition from Barron's annual broker review, winning a handful of best of distinctions, including options trading and long-term investing

#### New Managed Account Dashboard

- To name a few of our enhancements on the investing side of the house, we revamped our advice continuum intuitively packaging our managed products and meaningfully streamlining the experience to select and fund an account
- We launched our new managed account dashboard, creating a central hub for investors to monitor the performance of their accounts, check on allocations, make contributions, and perform other common tasks without leaving the page
- And we significantly expanded our commission-free ETF list offering customers multiple paths to easily diversify their portfolios

#### Corporate Services

- In corporate services, our new business momentum kept pace as we onboarded \$3.6B in plan assets, covering 15,000 plan participants, while replenishing our pipeline which remained intact at \$14B
  - Despite this influx and, in fact, encouraged by it, we kept our eye squarely on the ball in terms of delivering more enhancements, more functionality, and more automation for both participants and administrators

#### Tax Planning Resources Rollout

- We rolled out tax planning resources, including a new supplemental tax statement that eliminated several participant pain points and has been very well received

- We also rolled out a new cash plan module on the Equity Edge administrator platform and we are in beta with an industry first initiative regarding 10b5-1 automation which should greatly simplify the administration of these plans
  - In addition, while the numbers are still small, we've seen decent traction in our securities-based lending product
- In this quarter, we also rolled out a fully paid lending program, giving customers another path to generate value from their securities holdings

#### Customer Experience Enhancement Activity

- Beyond what we've already highlighted, the quarter was also marked by the perpetual process of improving the customer experience
- With enhancements to our mobile chat and SMS capabilities, further refinements to the site navigation experience and other enhancements to our storefronts, both digital and brick-and-mortar, as well as improving the onboarding experience across several of our account types
- Outside of our everyday efforts, we've also established E\*TRADE Labs, obtaining focus solely on leveraging leading-edge technology for the benefit of our customers
  - They're hard at work exploring ways to harness disruptive technologies like natural language processing, AI and blockchain to name a few
- So while we will always work to close competitive gaps and improve the platforms we offer today, we are dedicated to looking beyond that horizon at what could transform our industry tomorrow

#### Acquisition of TCA

- Earlier this month, we announced the closing of our acquisition of TCA, bringing this powerful asset into the E\*TRADE family well ahead of our targeted completion date, further proving the team's ability to execute
- Our new advisory services offering bolsters our ability to further diversify our business model, tapping into a meaningful opportunity for long-term growth while expanding fee-based revenue
- It has been just a couple of weeks and we are well on our way to executing on the exciting initiatives we contemplated at the outset of this transaction

#### Integration of Capital One Accounts

- Lastly, we've begun to carefully map out the integration of the Capital One accounts, which we expect to onboard during Q3
- While welcoming roughly 1mm relationships is no small task, the team is working hard to ensure a smooth transition and we continue to see tremendous opportunity in introducing this population to all that E\*TRADE has to offer

### OPERATING HIGHLIGHTS .....

#### DARTs

- As for our operating metrics, as I mentioned earlier, DARTs of 309,000 were the highest in E\*TRADE's history, up over 30% from Q4's record levels
- However, we have seen moderation with April to-date tracking down 13% from March levels
- Our derivative DARTs also struck a record at 98,000 for the quarter, up 41% sequentially

#### Derivatives

- Our derivative mix came in at 32%, as the raging equity volumes continued to dilute the effect of the incredible growth in derivatives
- Suffice it to say, we are quite pleased with how we are performing on the derivatives front
- Customer margin balances grew to record levels during the quarter ending the period at \$10.5B, with an improvement in yield reflecting the Fed's December hike
- In the wake of the extreme drop in value of certain levered volatility products in early February, we incurred approximately \$5mm of losses within our margin and futures books
- While we are never happy taking losses, we are pleased with how we performed through this period, as our risk management tools and conservative policies surrounding the margining of leveraged products served us well

#### Net New Brokerage Accounts

- Net new brokerage accounts in the quarter of 60,000 equates to a 6.6% annualized growth rate
  - The recent acceleration in account growth portends good things as a leading indicator of net new asset growth, as customers will generally start modestly and commit more assets over time as they experience our service and become aware of the breadth of our offering
- Net new brokerage assets of \$5.3B during the quarter was another record and represents a 6.3% annualized growth rate

#### Net New and Managed Assets

- Following the record level of net new assets raised in 2017, we are more than pleased with this momentum
- Further, with \$6.9B in net securities purchases during the quarter, our customers are engaging with the markets in a meaningful way giving us additional encouragement regarding investor sentiment
- Finally, managed assets increased by over \$100mm during the quarter to \$5.6B, reflecting \$220mm in net inflows, partly offset by the impact of lower market levels

#### Business Growth Goals

- Before I hand it over to Mike to walk through the financial results in more detail, I want to address a recurring topic of investor interest regarding our growth goals and the timeline we introduced in Q3 2016
- First in representing the views of the board and of our management team, I can confidently state that we feel good about what we've accomplished to-date
  - As you know, we originally set these 18 to 24-month goals with a singular purpose of reinvigorating growth of the franchise
- And while there will always be work to do, all evidence suggests we are accomplishing exactly that
- Second, just as we were very public in setting these goals at the outset, we will be very public in communicating their resolution
- On our third quarter earnings call, we expect to share with you the board's definitive assessment of our overall progress and our path to the next phase of long run value creation
- Third, while our public goals offer a window into the growth of the business, the core of our strategic initiatives continues to be enhancing the overall operating and financial performance of the company and driving meaningful value for shareholders

- As such, our assessment will incorporate but look beyond the quantitative tracking of these metrics, to evaluate all avenues for long-term shareholder value creation
- We look forward to discussing these in greater detail in October

#### Summary

- So in summation, this has been an exciting year and a half for E\*TRADE, continually punctuated by accomplishments, progress and results
- Where 2017 raised the bar on customer engagement, Q1 2018 vaulted it well above expectations
- I am tremendously proud of the team and their continued drive to deliver more for our customers and for our shareholders

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### Michael A. Pizzi

*Chief Financial Officer*

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## FINANCIAL RESULTS AND OUTLOOK

### Net Revenues

- For the quarter, we reported net income of \$247mm or \$0.88 per share
- Net revenues of \$708mm were up \$71mm from the prior quarter and represent a record level for the company
  - This growth was driven by record customer trading volumes as well as the continued increase in average interest earning assets and the expansion in net interest margin

### Net Interest Income and Margin

- Net interest income increased \$26mm to \$445mm during the quarter, as average interest earning assets grew by \$2.5B and net interest margin expanded by 5BPS to 297BPS
- An improvement in interest rates, higher average margin balance and better investment yields in the securities portfolio were among the key drivers of the sequential improvement in NIM
- Based on recent upward movement in the belly of the curve, our average reinvestment rate in the securities portfolio is now in the 280-basis-point to 300-basis-point range, up 30BPS from the prior quarter

### 2018 OUTLOOK

- For the full year 2018, we are forecasting net interest margin to fall within the range of 300BPS to 310BPS, assuming no moves in Fed funds and that our customer margin balances hold at current levels of around \$10.2B (sic) [\$10.5 billion]
  - However, if the Fed moves rates in June as the market broadly anticipates and we model some level of associated deposit repricing, we could add an additional 2BPS to 3BPS to this range
- I'll cover ongoing balance sheet growth dynamics in a moment

### Commission Revenue

- Commission revenue of \$137mm increased 26% sequentially, driven by a 31% increase in DARTs to 309,000, partially offset by \$0.14 decline in our average commission per trade, which was \$7.27 for the quarter

- Similar to last quarter's trend, the elevated level of equity volume is having a dilutive impact on our commission per trade and we continue to see a migration of customers toward the active trading pricing tier
  - Additionally, while the number of options trades hit record highs, derivative traders utilized fewer contracts to express their opinions, largely attributable to the higher premiums in periods of volatility to achieve similar economic exposure, as well as the relative richness of many of the most commonly traded underlying stocks

#### OUTLOOK

- Going forward, we expect our average commission per trade to be in the \$7.20 to \$7.40 range based on the factors I just mentioned, as well as an increasing contribution from futures

#### Fees and Service Charges

- Fees and service charges increased \$12mm to \$105mm in the quarter, primarily on higher order flow revenue reflecting elevated trading volumes, as well as seasonally higher FX fees attributable to our stock plan channel
- Partly offsetting this, off-balance sheet cash revenues declined by \$4mm, as balances reduced during the quarter
  - The average yield on third-party customer cash was up 12BPS to 135BPS, reflecting movements in short-term rates

#### OUTLOOK

- With the March rate hike, we expect the yield to rise to approximately 145BPS when the full benefit is reflected in Q2
- We recorded \$21mm provision benefit, which included \$5mm in net recoveries

#### Allowance for Loan Losses and Non-Interest Expense

- Our allowance for loan losses now stands at \$58mm, while the run-off portfolio continues to decline ending the quarter at \$2.5B
- Non-interest expense was \$395mm, up \$31mm from the prior quarter

#### Adjusted Operating Margin

- This quarter's adjusted operating margin, which excludes provision benefit, was 44%, an improvement of 140BPS from the prior quarter
- Total marketing expense was \$60mm reflecting the seasonally higher period
  - We are still on target with our initial forecast of roughly \$200mm in marketing spend for 2018
- Compensation expense was \$152mm, up \$14mm sequentially, reflecting seasonally higher FICA-related expenses, additional hiring in our service centers and incentive compensation tied to strong company performance

#### OUTLOOK

- With respect to our full year 2018 adjusted operating margin outlook, we now anticipate delivering results in the 44.5% to 45% range, assuming no further rate hikes



- The key driver of the increase is the modestly better revenue environment including a higher expected NIM, a larger margin balance and robust trading volumes
  - They're down from record levels in Q1
- If we see a Fed hike in June and move deposit rates in line with our model betas, we would expect our adjusted operating margin to surpass 45% for the year

#### Capital Allocation

- On the capital front, just two brief highlights:
  - First, we repurchased 2.7mm shares at an average price of \$52.12 for \$140mm during the quarter, leaving approximately \$500mm remaining in our share repurchase program
    - We continue to expect to complete the program at a relatively measured pace through the end of 2018
  - Second, we closed the acquisition of TCA on April 9, which has the effect of lowering our consolidated Tier 1 leverage ratio by approximately 50BPS

#### Balance Sheet Highlights

- With respect to balance sheet growth, excluding money market balances, we now expect to maintain approximately \$3.5B in our off-balance sheet sweep cash program to maximize FDIC insurance coverage
- We've increased this amount by \$500mm to account for potentially higher volatility in deposit flows given recent market and customer activity trends
- For the remainder of 2018, the primary influencers of balance sheet size should be the following
  - The additional deposits we onboard related to our recent acquisitions including \$1.5B of TCA customer cash, which is down \$300mm from the closing date driven by customer net buying and \$1.7B of customer cash from the Capital One accounts, which we anticipate bringing on during Q3
  - And of course, growth in the core business as well as customer activity will always be an important factor in our balance sheet size
- This quarter's record \$6.9B in customer net buying should prove a stark reminder of just how much this can influence our size in any given period
- For your modeling purposes, note that TCA revenue impact will be split roughly evenly between fees and service charges and net interest income, and the majority of expenses will impact compensation and amortization of intangibles

#### Corporate Cash

- As for corporate cash, we ended the quarter at \$439mm, down \$102mm sequentially, reflecting \$125mm distribution from the broker dealer to the parent, offset by share repurchases and payments attributable to year-end compensation
- For Q2, we expect the distribution from the broker to be \$100mm

#### Tax Rate

- Our effective tax rate in Q1 was 26% reflecting the seasonable impact of share-based compensation
- While we continue to expect quarterly volatility, we currently anticipate a full year 2018 tax rate of approximately 27%

Changes in Disclosures

- Finally, I want to point out a few changes in our disclosures
- First, we've removed the account attrition rate from our key performance metrics
- At one point in the time, this metric was more relevant though it has never offered a clear view into the retention of valuable accounts
- Today, as we focus squarely on growth and the retention of our most valuable customers, it is not a key measure
- Second, we now provide the average yield for the total investment securities portfolio instead of the component categories available for sale and held to maturity
  - This overall yield more appropriately corresponds to the investment rates and portfolio duration measures we have been consistently providing
- Third, we reclassified net deferred tax assets into other assets, including prior periods presented
- Our net DTA at March 31 ended at \$218mm vs. \$251mm at year-end
- We expect about this balance to continue to decrease and convert into a net liability by the end of 2018
- As noted last quarter, we expect to fully utilize our Federal NOL later in 2018 and become a cash tax payer in 2019

CLOSING REMARK.....

- In closing, we're off to a great start in 2018 and look forward to continuing to deliver value for our customers and shareholders

## QUESTION AND ANSWER SECTION

Christian Bolu

*Sanford C. Bernstein & Co. LLC*

Q

So maybe not to front run what will be an exciting Q3 call, but just wanted to get your – maybe your view on how you think your progress on growth initiatives, I guess very strong core growth metrics in the quarter. You're pretty much within striking distance of all targets the board set out. I do appreciate it was a very strong operating backdrop, but it does feel like the management team has kind of done more – basically done more than enough to show that you can grow the business.

So I guess the question is really what else should we be thinking of or should we just go ahead and delete our merger models here and assume the company will be standalone for the foreseeable future.

Karl A. Roessner

*Chief Executive Officer & Director*

A

Well, that's a pleasant thought, Christian. I wouldn't do that quite yet. What I would say is I am extremely pleased with how the whole organization has responded, right? We started this journey quite a long time ago in building out a risk management framework and taking [ph] ours (00:23:41) to the second, third lines of defense audit, our compliance guys, our risk guys, making sure we have the organization that was ready to walk before we started to run, right?

Then, we built out the overall sort of business model, bringing back some real true leaders on the brokerage side who really knew how to drive at things. And the most recent things that we've done is really all around technology and shoring up that organization bringing in some of the best and brightest talented individuals that I've seen in the company for quite some time.

So what I would say in terms of looking forward is you should expect to see more of the same from us in terms of execution of bringing new products online and new services online, of shoring up our active trader platform, making sure that it has the best and brightest tools for our customers to use, right, as they interact with their finances. So first and foremost, we want to be the leading broker for traders and investors, go forward bar none. So that is our overall goal and we will do that through efficiently executing on the strategy that we've put forward.

In terms of the growth goals and the way that we look at those, our board, as we've talk about numerous times, is very engaged. They are a very intelligent board and they want to see results, right? They put our feet to the fire. When we developed the growth goals, that was exactly what we did. We wanted to accelerate where we are. I think we show that quite regularly as a management team. Certainly, we've had some tailwinds at our backs, but you still have to be able to execute to get through that.

They will go through and I will participate in the process of having the outside third party come in and take a look at value and see where we are, and there will be a very deliberate process about this, right? Well, I'd like to check the box now and I think the team has absolutely performed. You guys are going to have to wait until October to sort of hear the full recital of that.

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Christian Bolu

*Sanford C. Bernstein & Co. LLC*

Okay. Can't wait.

Q

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Karl A. Roessner

*Chief Executive Officer & Director*

Me either.

A

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Christian Bolu

*Sanford C. Bernstein & Co. LLC*

On the question on cryptocurrencies, just love to get your broader thoughts on E\*TRADE being a bigger player in the space, even though interest has died down a little bit in the last few months, it does seem like it is the best customer acquisition tool for millennials and just given none of the online broker incumbents are major players, I would've thought given your focus on growth, your heritage as a digital-minded innovator, seems like it would be right up E\*TRADE's alley. So just curious kind of your thoughts on E\*TRADE being a bigger player in this space.

Q

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Karl A. Roessner

*Chief Executive Officer & Director*

Yeah. So it's a great question and what I would say is when you look at what we have done and it sort of dovetails with the answer I just gave to the prior question, technology first, right, being digital that's part of who we are, making sure that we are using our new labs that we just stood up with some very talented individuals to really look at new technologies and having our retail brokerage guys, the folks who know the markets and the segmentation extremely well, taking a look at where we can adapt that technology, where we can get ahead, right? We don't want to just get into it. We'd like to leapfrog and move forward.

A

So that's who we are that as sort of the smallest on the Street, we're able to be a little more nimble. So we are looking at AI, at blockchain, at voice, right, how can we use that to better serve our customers. So I'd say you're on the right track in terms of things that we're focusing on, just more to come as we really get labs and integrate go forward.

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Richard Repetto

*Sandler O'Neill & Partners LP*

Q

The first question is on the deposit betas and when you put out – you increased rates with the March rate hike. So, Mike, I was just trying to see what the deposit beta – I don't think you're going to break out the tiers, but what the deposit beta is. And then, what you anticipate, if there was another rate hike in June, would you see some [ph] – what type (00:27:56) deposit beta are you looking at for that?

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Michael A. Pizzi

*Chief Financial Officer*

A

Yeah, I mean look, the betas will differ by each tier and how we're looking at it. There's obviously different competitive pressure at different points relative to the cash balance. If you're looking for a deposit rate including customer payables for Q2, we would put that sort of in the 7 to 8-basis-point range with no hike. So we just stay where we are today.

If the Fed does hike in June, we're going to evaluate the competitive environment. We think we're at a point now where it makes sense to continue to move. Rates have moved considerably away from where they were over a year ago and where we will continue to evaluate sort of the competitive environment and move accordingly.

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Richard Repetto

*Sandler O'Neill & Partners LP*

Q

Okay, that's helpful. Thanks. And then, I guess one other thing, Karl. So the head count, if you look quarter-to-quarter from year-end, up 4.5%, almost 5%, I guess, if you include the consultants. So I guess trying to understand the head count and how that plays into, because that does help you reach your goals. I'm trying to understand like you did mention also that there'd be an assessment going on. I'm trying to get it a little bit more clear, but there's an assessment that will be done by a third party. And we'd expect to see that in Q3 on Q3 call.

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Karl A. Roessner

*Chief Executive Officer & Director*

A

So let me take the last part of that question first, Rich, and then I'll ask Mr. Pizzi to play in a little bit on comp and head count. So what I'd say there's something we've been through before and that is the board is truly one of the sort of fully informed boards and they've been doing this for a very long period of time in having one of the big banks on the Street come in and really look at intrinsic value, right, and take a look at how the company's set up, what our growth model is, how it plays out and what the real value is of the growth plans that management has put in place. So they have third-party independent verification.

They will use that information this year in connection with the results of the growth goals, the value that we've created for shareholders over the past 18 months, and then, at that point 24 months, where we are in the cycle and they'll look at that in its entirety, as they form the answer and the results that will present on Q3 call. So I wouldn't say third-party is the same independent sort of valuation that the board goes through on a pretty regular basis.

Michael A. Pizzi

*Chief Financial Officer*

A

Sure. The buildout in head count, the 160 or so heads you see there is largely a buildout on our service channels, to support increased volumes and customer interactions that have really been building during this sort of market environment and during this period of elevated growth. The consultants are so that you see there that the 30 or so increase, that is really support to continue to process online account openings, tax, other items to keep a streamlined and high level of service offering processes to our customers, that's really the driver of the key head count.

Overall, compensation in the period, it's – some of that is the typical Q1 FICA resets and payroll taxes that go through. The payroll taxes are a little elevated this period given the performance in the stock that generates higher overall amount of payroll tax that goes through, that's driving a bit of the compensation as well. Benefits costs are up and the company did elect to increase the match on its 401(k) to bring it in line with the peer set in the marketplace. So that is – that also added a little bit to the overall comp expense in the period. And then, lastly, the performance itself increasing the amount we accrue for compensation.

Steven Chubak

*Nomura Instinet*

Q

So question on the long-term NIM outlook, clearly, a strong NII result this quarter, deposit beta as you noted, Mike, continues to surprise positively. I'm just wondering longer term, as we look out Fed futures curve is now pricing in about additional four rate hikes through 2019, how should we think about the steady state in NIM target and against that backdrop, if we get four hikes, what are you guys assuming in terms of a model deposit beta supporting that target?

Michael A. Pizzi

*Chief Financial Officer*

A

Yeah. I mean looking at the four hikes, from looking at how we will – NIM will adjust, a lot will depend on really what happens on the shape of the curve with those hikes. We are flattening a great deal, but we are seeing rates in the belly where we invest move up considerably and that's really what's affecting that overall reinvestment yield moving it into that 280-basis-point to 300-basis-point range.

Some would say that if you're going to get four hikes, you've got to see more movement across the yield curve; if not, you're going to get to a point really where the yield curve starts to invert. So if we see that, you continue to see that the reinvestment rates move higher, that will ultimately show up in our net interest margin driving us to higher margins from the guidance here.

We also are benefiting from the movements in LIBOR. To the extent, LIBOR is widened above funds, which has also been going on in the market, so that is driving some additional benefit and coming through into the net interest margin guidance that we're giving. But strictly to adjust a rate hike, the June rate hike is about 2BPS to 3BPS in terms of value for half a year. You can really approximately double that on a full year interval, if we were to sort of annualize out the hikes. So I think you can kind of see what that's modeled at in terms of total net interest margin relative to the estimated beta, which is included in that estimate.

Steven Chubak

*Nomura Instinet*

Q

That's perfect, Mike. Thanks for all that color. And just one follow-up relating to Rich's earlier question and your comments around the comp ratio, but thinking about it bigger picture, certainly, you guys have outlined growth targets, you've made significant progress and it's certainly evident this quarter on the revenue side.

I'd say the one area that's been a bit disappointing and I recognized there's some seasonality dynamics related to expense sort of lack of operating leverage. I'm wondering as you evaluate the progress as we get closer to Q3, how should we think about your ability to deliver more significant operating leverage where clearly you're having progress on those growth targets that you've outlined. But a lot of that seems to be driven by accelerating investment and investment levels that appear to be in excess of peers.

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Michael A. Pizzi

*Chief Financial Officer*

A

We had a 140-basis-point improvement in operating margin. So you can see how incremental revenue volumes move through to the bottom line. It was disappointing. I think we had a – we view it as a pretty strong result in terms of the degree to which the revenue build is translating. We are upping sort of our long-term guidance given the revenue environment quite considerably in terms of the operating margin guidance going forward. We think ultimately now with a 100-basis-point parallel shift and really with the achievement of our growth goals, operating margins as high as 49% are realizable.

All of that said, we are looking at sort of ways to improve, always retool and improve our efficiency, and find productivity to fund the investment overall. You don't see that this quarter. We had to respond with head count and some other cost builds to absorb some of the volume and call pressure, but we're always looking for ways to be more efficient overall.

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Steven Chubak

*Nomura Instinet*

Q

Got it, so that 49% target that you outlined, it feels like that's a reasonable path that you see and it's just some ephemeral or seasonal dynamics that maybe dampen some of the progress this quarter.

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Michael A. Pizzi

*Chief Financial Officer*

A

Well, as we continue to build out our growth initiatives and we onboard the cash and other items from the acquisitions, the growth that we're experiencing, plus the acquisitions that work through, especially when sort of fully synergized and you have the full impact of the higher rate environment overall, from a revenue base, we see especially with continuations in the increases in interest rates, as the prior question pointed out, four hikes embedded into the curve, 49% is realizable.

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Christopher Harris

*Wells Fargo Securities LLC*

Q

You guys are at 6% to 7% organic growth today. Wondering if you think there's a lot of upside to those numbers or is the focus really on trying to preserve that level of growth. And then, if you do think there's upside, what do you think the drivers could be?

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Karl A. Roessner

*Chief Executive Officer & Director*

A

Well, look, I like to think that we can always do better, and then, we can continue to improve and a lot of the upside or the generation is keeping the base of customers that you have and your active trader base in particular



and the higher end of the book. Extremely pleased with both the technological offering and their interface every day that they use to interact with their finances and also providing top tier customer service on the back-end to make sure they know that they have a human being who's there to listen to them and to help them when they have an issue or when they want some thoughts around what it is they're doing, and then, also improving the value chain for them.

So I look at it as you need to maintain, protect and defend the base as you bring them in to make sure that those folks who are with you, investors and traders, are happy at all times, right? And they like using E\*TRADE and they're comfortable with it and they love the brand, and it continues to punch above its weight.

In terms of growing that go-forward, I look at what we've done even with the TCA acquisition, and the ability to keep that customer relationship on us when they would normally be moving to an investment advisor or going off to start to use that chain through referral networks and otherwise to have them stay as a longer term sort of E\*TRADE family customer, if you will, and also taking that same platform and trying to crack the code of the stock plan participant population and turn some of those folks into longer term E\*TRADE customers, right, give a more fulsome relationship with those individuals.

That comes from both the technology we put out there on the stock plans side, the offerings that we have for them, moving forward, making the stock plan experience that much better. And these are all things that are working in progress and sort of real time as we speak, so launching them out there. So I do think there's additional upside. This is not a management team that's sort of happy or satisfied to say, hey we're done. The growth goals were just the beginning. It's definitely not an end state.

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Conor Fitzgerald

*Goldman Sachs & Co. LLC*

Q

Like you mentioned, you had a record quarter for net buying in Q1. I think your recent Street-wise survey show that there had been a significant downshift in investor sentiment at the beginning of April. So just wondering if you see any signs of your customer base changing its behavior or if you see any signs that the recent market volatility could spur some growth in your deposit base.

---

Karl A. Roessner

*Chief Executive Officer & Director*

A

So look, we've definitely – and we've said in the prepared remarks, we've seen a decrease. I think April was down about 13% on volumes over where we were in March. So we have seen some of the slowdown in that, some of the activity that you'd seen around the cryptos or the marijuana stocks and some of the other pieces that were there. So you've definitely seen some slowdown going on.

But our customer base, in terms of the net buying, the volatility that's there, that's when our – the top of our book and our customers who use margin and who do a lot of trading activity with us, that's when they are most active. So I think you've seen those folks, really, as we said in the prepared, lean into this market and become very active. So if history repeats itself when the sort of markets go down or volatility starts to come out of the marketplace, you would see a rise in some of the cash balances and in this environment, we'd be extremely pleased with that.

I don't know, Mike, if you have anything to add on top.

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**Michael A. Pizzi***Chief Financial Officer*

A

No, I think we gave the percentage to which DARTs have moderated a bit thus far in April, margin down to 10.2% from 10.5%. I think that's your best indicator of customer risk appetite, so a small moderation there overall. Customers are still fairly engaged in the market. The volatility is generally still beneficial although some of the categories that Karl noted have come down quite a bit from where they were earlier in the quarter.

**Conor Fitzgerald***Goldman Sachs & Co. LLC*

Q

It's very helpful color. Thanks. And then, maybe just from a big picture perspective, with the Fed funds now at 175BPS, the risk/reward equation for further rate hikes vs. the risk the Fed cuts rates for some unforeseen reason has got a lot more balanced. Just given that have you given any thought to changing the interest rate profile of the firm?

**Michael A. Pizzi***Chief Financial Officer*

A

It's difficult to do still in terms of just where we've come from an interest rate, but it's a very good question. As you move further away from sort of the zero rate floor and you fully restore the value of the deposit, the ability to hedge some further downside does become possible. It's something that is always a matter of discussion at ALCOs, but at this point in time, it's not something we're doing.

**Brennan Hawken***UBS Securities LLC*

Q

So you guys have highlighted a couple of times about activity levels pulling back and just curious whether or not you think that that might have an impact on the margin loan balances that – and where it stood at quarter end.

**Karl A. Roessner***Chief Executive Officer & Director*

A

Yeah, I mean, look, we've definitely seen some slight deterioration from quarter end, this quarter to today, as Mike just went through, we're down from 10.5% to around 10.2%, but our customers, at that end of the book, are still extremely engaged in this market and are still, as far as we can tell, taking the opportunities that some of the market dips in the volatility are presenting.

**Brian Bedell***Deutsche Bank Securities, Inc.*

Q

Maybe just go back to the deposit beta question and the NIM guidance, just can you repeat that? I think you were saying on the payables, I think you were seeing 8BPS, which is not a whole lot, were you talking about the entire retail deposits?

**Michael A. Pizzi***Chief Financial Officer*

A

Yeah. We just look at the sweep deposits, so total deposits plus customer payables, put the two categories together, so our total on balance sheet customer-related funding. If you want a number for Q2, it's going to be in that 7 to 8-basis-point range, knowing that there are deposits that shift up and down in tier, so that it doesn't – it's not completely precise, but it's going to land somewhere in that range overall on the total deposit profile. That's



without any further action in deposit rates. If the Fed does raise in June, we'll most likely to move in line. In terms of expectation that follows our NIM guidance, it should be about 2 to 3BPS of additional net interest margin.

Brian Bedell

*Deutsche Bank Securities, Inc.*

Q

Got it. Okay. And then, so I assume margin lending is also moving up almost in lockstep. [ph] Are you testing through most of that (00:44:41)?

Michael A. Pizzi

*Chief Financial Officer*

A

Yeah, margin lending moves up in lockstep. You see some competitive give back in that book for some of the larger customers who request some accommodation around the hikes, but we are largely moving the book 100% with movements in the funds rate.

Brian Bedell

*Deutsche Bank Securities, Inc.*

Q

Okay, great. And then, just get back to Q3 board assessment, Karl, if – I guess in that process, in their due diligence process of evaluating E\*TRADE's independent internal progress, are they also looking at what the firm value would be from a potential acquirer perspective and essentially looking out in the market at firms that would be interested in E\*TRADE, seeking those types of valuations, and also, considering the macro environment where we are in the bull market cycle and economic expansion where we might be going over the next few years?

Karl A. Roessner

*Chief Executive Officer & Director*

A

So it's a good question and what I would say is that the evaluation that they will go through will be an intrinsic value calculation. Part of that will include the third-party bank's assessment of who is out in the marketplace, a capacity to pay sort of the interest levels, the market environment, in general, where we are. I mean just keep in mind this is a very active board, who is very well informed so pretty much anything that you can think about them evaluating before they come to their decision, they will have taken that into account before we could tell in the October call.

Brian Bedell

*Deutsche Bank Securities, Inc.*

Q

Okay. And that would include the macro environment?

Karl A. Roessner

*Chief Executive Officer & Director*

A

Absolutely.

Devin P. Ryan

*JMP Securities LLC*

Q

Maybe just one follow-up here on the margins, so the \$5mm mark this quarter from the inverse mix products, I mean that seems like a pretty aberrational situation, but does that make you change the risk parameters at all in terms of how you think about the book? And then, just bigger picture as the mix moves more towards derivatives with the firm, does that make margin balances stickier at all than in the past? I guess I'm just trying to think about the variability and stress testing it in a volatile environment if it goes back to kind of similar trends here.

Karl A. Roessner

*Chief Executive Officer & Director*

A

So on the risk parameters and what we went through on the vol products, primarily in sort of the aftermarket when those things just moved, we haven't changed/modified, we constantly look at those. And it's one of the things that I highlight as our risk management process and the interaction and the collaboration between our risk team and the business is one-to-one. I mean they work very, very well together. They got through this situation together, and I think they did an amazing job at coming through. So while this makes you more vigilant, it doesn't necessarily change what we've done, because I think what we had in place and what we've been doing all along has been quite good and it performed. So we're able to be there.

In terms of derivatives and driving margin balance, look, the folks who we are – Power E\*TRADE and the platform that we've gone out with the 30 trades per quarter and the lower pricing and sort of the service team that's available on the derivative side, we've definitely seen more engagement. We've seen more volumes coming out of that. You've seen our derivatives as an absolute number grow to a number that, quite honestly, I'm still impressed and sort of astounded by what we hit over the past three months in terms of derivative trades. That will drive additional margin.

We've seen the interaction with it. Whether or not it's more sticky than it has been in the past, I couldn't give you that in terms of guidance or help you on that one. I can just say that we have a customer base right now that has leaned into the marketplace, is very engaged in the margin book even given the recent sort of activity in the marketplace and the slowdown in volumes of absolute trades just from the end of March, that hasn't receded as much as I would have thought given what's going on.

So that's about as helpful as I can be on that one. Sorry about that.

Devin P. Ryan

*JMP Securities LLC*

Q

Yeah, I know. Appreciate the color. And then, just with respect to the stock plan accounts, a nice increase from your end and I know that's been a focus. But maybe if you could just give us a little bit more breakdown of kind of what drove the success there this quarter, and then, just expectation for growth maybe over the next few quarters, if you can.

Karl A. Roessner

*Chief Executive Officer & Director*

A

Yeah. So I mean, look, it's been a great story, the stock plan. And I'm always – as you guys know, I'm always happy to sort of drone on about this one because it's been such a win for us. A lot of what we talked about when we started this journey is coming to fruition, a lot of the stock plans that we're on some of the larger players who are moving to a technology solution or a third-party solution, those customers have come into play, right, those stock plan customers.

And we are, as we had hoped and as quite frankly I expected, we are winning our fair share of those. So even this past quarter, I think we onboarded \$3.6B, 15,000 new customers and we were at \$14B at the end of the quarter. We refilled that so we're back at another \$14B during the period. So we've definitely been winning our fair share of engagements and I fully expect that that will continue, particularly as we take some of the technology solutions that we're working on and roll more into the Equity Edge Online. It's number one now. We don't plan on just sitting on our laurels on the Equity Edge Online platform. We're moving it forward and looking for the next-gen so that

we continue to win these accounts and that you keep your customers happy. So I do expect continued growth there and I'm very pleased with what the team has done and what they've been able to do to onboard these folks.

Daniel Thomas Fannon

*Jefferies LLC*

Q

Thanks. Can you update us on some of the metrics for TCA, the number of advisors, it looks like it's gone up and the revenue numbers you're, I think, referring to are still from June 30 of last year?

Michael A. Pizzi

*Chief Financial Officer*

A

Yeah, just to give you, the net interest income that we're going to pick up from TCA is now fully factored into our guidance. So I won't give any detail on that, because it's just it's in the total and we gave the cash expectation in terms the amount of cash we onboarded.

We expect fees and service charges to improve by about \$10mm on their custody fees, per quarter, per quarter. And then, on the expense side, we're going to pick up about \$6mm in comp, about \$2mm in intangible amortization per quarter, and then, about another \$4mm across other random categories on the expense side.

Daniel Thomas Fannon

*Jefferies LLC*

Q

Great. And then, can you just talk about their historical growth profile organically, how we can think about net new assets based on maybe the last 12 months?

Karl A. Roessner

*Chief Executive Officer & Director*

A

So when I look at TCA, I sort of look go forward with them. When I look at putting the power of the brand behind them and helping them become TCA by E\*TRADE, and then, longer term, establishing them as a brand within E\*TRADE as it sits under sort of E\*TRADE Savings Bank, so our advisor solution go forward.

In terms of onboarding and historical growth rates, I can tell you that if early days are any indication, our brand and the power that we've been able to put behind this fantastic property is going to be a nice thing go forward. I don't know that the historical growth rates are really going to give you an indication of go forward just by some of the interest that we've had as we come into this marketplace.

So more to come on TCA, we've had it under the hood a couple of weeks now. And I think, next quarter, we'll have a better handle on initial indication of where we are, where we're headed and what the pipeline looks like for the rest of 2018.

Zachary N. Feierstein

*Morgan Stanley & Co. LLC*

Q

Just a question on the account growth, can you give us an idea of the makeup of these new accounts? Are they new clients to investing or are they maybe taking share from other competitors?

Karl A. Roessner

*Chief Executive Officer & Director*

A

So look, when I look at it, it's pretty much across the board. We've had engagement from new customers coming in new entrants into the marketplace with smaller accounts who are looking to place a trade or engage with E\*TRADE for the first time. And then, we've also had our own customers bringing more to us or opening other accounts. So it's really been across the board. I don't think there's a specific designation of where they're coming from.

We definitely have a hotly competitive environment for the, as we define it, active trader accounts and those folks in the upper end of the population. And a lot of the individuals who come on, who are the new traders, are really just coming in to take a look at what you offer, what's online, what your experience is like and they're shopping around. So there, a lot of them are in and out, but it's pretty healthy right now across all avenues.

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Zachary N. Feierstein

*Morgan Stanley & Co. LLC*

Q

And if we stay on the account theme, if we look ahead to the Capital One accounts that would be onboard in Q3, what kind of opportunity do you see on the potential revenue synergies with that? That's about 25% or 30% of your current account base being added, it seems they would be potentially significant.

---

Michael A. Pizzi

*Chief Financial Officer*

A

Yeah, keep in mind it's a much lower active population. The DART number is in the teens thousands, 16,000 to 17,000 range. Well, it's a lot of accounts. The average assets per account is smaller than ours. But I think what we see there is a really significant amount of potential. A large number of million customers who have engaged in digitally distributed financial services have managed their money online have made investments over time and saved and invest through that platform, we're going to give them a greatly expanded platform, greatly expanded service and features that they're not getting today. And we believe over time that we will be able to get significant amount of revenue synergy from that acquisition.

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Karl A. Roessner

*Chief Executive Officer & Director*

A

Yeah. To be able to market to that population who will now be on us when we translate them into E\*TRADE customers, right, and when they're onboarded onto our platforms, that's the real opportunity for us. And as Mike said, these are folks who have engaged with their finances. They have been, to a certain extent, self-directed and for us, it's a perfect audience for us to turn on our marketing machine and see what we can do to help them with their finances.

---

Douglas R. Mewhirter

*SunTrust Robinson Humphrey, Inc.*

Q

Yeah. My primary question has been answered. Just one quick follow-up on the Capital One portfolio. Do you anticipate any incremental expenses beyond any kind of one-time integration, are you sort of budgeting extra staff or extra IT budget, on-going IT budget or staff post that integration? I realized just a bunch of accounts, but didn't know if you were – had built anything in your model.

---

Karl A. Roessner

*Chief Executive Officer & Director*

A

The easiest way to answer this is that, it is all within the operating guidance that we provided. The operating leverage that Mike set out, it's all in there.

Vincent Hung

*Autonomous Research US LP*

Q

Hi. Just on the growth goals again, so you touched upon it before, but seeing industry growth is quite strong right now, how exactly will you pass through what is the result of the industry tailwinds and what's the result of successful execution by the management team?

Karl A. Roessner

*Chief Executive Officer & Director*

A

So when we look at what we set out for growth goals and what we laid out in terms of the numbers that we needed to generate, we needed to show the board and our shareholder base that we could actually have a serious growth initiative and that we could push E\*TRADE forward, because we had stagnated a bit both in terms of brand and in terms of the offering that we had out there.

I look at what we've done and I think the entire industry has been aided somewhat by tailwinds that are out there now. And I'm quite pleased with the results that we've been able to generate given those tailwinds. You still have to have an offering that resonates with individuals. You need to be able to drive account growth, you need to be able to go out and garner new assets and you need to have the technological advancements that keep you current. So I look at what we've done as hugely successful and I think we always say that we're very happy for the tailwinds that we've had, but I'd put the successes that we've had up against pretty much anyone.

Chris Allen

*Rosenblatt Securities, Inc.*

Q

Hey, guys. Just a couple of quick ones. Obviously, derivatives as a percentage of DARTs picking back up again. I wonder if you could give us any granularity in terms of the percentage of your customer base that are active users and maybe frame kind of the opportunity from that perspective moving forward.

Michael A. Pizzi

*Chief Financial Officer*

A

We don't really disclose that. We continue to show derivative opportunities [ph] are work (00:58:54) with what we're doing in the education area to show customers how they can use derivatives from a protection of principal perspective, from covered calls for return enhancement. I mean roughly the amount of derivative users today is around 20% or so of the overall customer base, but we're optimistic through our efforts that we'll be able to drive that higher over time.

Chris Allen

*Rosenblatt Securities, Inc.*

Q

Got it. Thanks, guys. And just one other quick one, just obviously the head count went up a decent amount. You discussed that at length. It sounds like you just – you're preparing yourself for the higher activity you saw this quarter and probably the deals that you're going to be closing on the near term. What are the hiring plans moving forward? You're in a good spot for now in terms of kind of the outlook from a business perspective moving forward this year?

Karl A. Roessner

*Chief Executive Officer & Director*

A

And I think look, Mike hit it pretty well in the beginning of the call. We brought on some heads. We had to take some additional head count and some additional customer service people both to get us through increased

volumes as well as tax season, which is always a big task for our service guys, just helping customers with all the tax information that comes through in the way it's all presented.

Going forward, I think we're in a pretty good place. And as Mike said, we're back to looking at how can we drive additional efficiencies in the organization, how can we make sure we continue to run as lean and mean as we have, and we'll continue to fund new investment through finding in the organization those pockets where we can move dollars or transfer dollars around. So I'm very comfortable with the op margin guidance that we've given and I wouldn't expect any additional heavy builds.

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### Kyle Voigt

*Keefe, Bruyette & Woods, Inc.*

Q

Maybe just one from me, really, just on the managed product growth, I think you cited net inflows again in the quarter and you're very quickly approaching that \$6B goal. I'm just wondering if you could help us understand what's been working there, maybe some examples of things you've changed or done differently over the past 12 to 18 months to really help accelerate the growth in that business. Thank you.

---

### Karl A. Roessner

*Chief Executive Officer & Director*

A

Thanks. So the investment area, we've always – well, we have – can't say we always have – we launched some of this back in about 2009 in terms of putting those products out there and trying to grow out the investing side of the business. But it wasn't laid out in a way that was very user friendly. It wasn't set forth in a way that a lot of our customers knew what we had on the site. So reinvigorating that through the investing advice continuum that we now have out that on the website, it's very easy to find the products. It starts with a basic core portfolio, which is our robo offering, and then, there's a little more blended portfolio that has a little bit of assistance, and then, you can go right into the sort of full FC back to working with an FC to design your own independent portfolio.

So laying it out in a way that's helpful, the products that we have are pretty good at matching or beating their performance indices. So we've had the product, we've had the people to help us do that, but we haven't done a lot to put our muscle behind it and show E\*TRADE is a place for investors as well as trading and not some of the initial success we've had is just realigning that business organization, getting the right people driving it forward and making sure that it fits within the digital ethos, that is us, right, that is E\*TRADE, and then, it's very easy for people to find, easy for them to interact with and really driving them towards the value proposition that we have on that side of the house.

So for me, it's more about alignment and awareness, and we're finally there. So don't take the \$6B again as an end game. That was a proof point for us to say how quickly can we grow it, lots more to come on the investing side of the house.

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