25-Jul-2016

E*TRADE Financial Corp. (ETFC)

Acquisition of Aperture New Holdings, Inc by E*TRADE Financial Corporation Call

CORPORATE PARTICIPANTS

Paul Thomas Idzik
Chief Executive Officer and Director

Michael A. Pizzi
Chief Financial Officer & Executive Vice President

OTHER PARTICIPANTS

Richard Henry Repetto
Sandler O'Neill & Partners LP

Chris M. Harris
Wells Fargo Securities LLC

Devin P. Ryan
JMP Securities LLC

Steven J. Chubak
Nomura Securities International, Inc.

Conor Fitzgerald
Goldman Sachs & Co.

Michael Roger Carrier
Bank of America Merrill Lynch

Doug R. Mewhirter
SunTrust Robinson Humphrey, Inc.

Brian Bedell
Deutsche Bank Securities, Inc.

Chris Allen
The Buckingham Research Group, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and thank you for joining today's call. Hosting the call today are Chief Executive Officer, Mr. Paul Idzik; and Chief Financial Officer, Mr. Michael Pizzi.

Today's call may include forward-looking statements which reflect management's current estimates or beliefs and are subject to risks and uncertainties that may cause actual results to differ materially. During the call, the company may also discuss non-GAAP financial measures. For a reconciliation of such non-GAAP measures to the comparable GAAP figures, and for a discussion of additional risks and uncertainties that may affect the future results of E*TRADE Financial, please refer to our earnings release, furnished with Form 8-K, and our 10-Ks, 10-Qs, and other documents that the company has filed with the SEC.

Note that we have not reconciled our forward-looking non-GAAP measures to the most directly comparable GAAP measures because material items that impact those measures are out of our control and/or cannot be reasonably predicted. All of these documents are available at about.etrade.com. This call will present information as of July 25, 2016. The company disclaims any duty to update forward-looking statements made during the call.

This call is being recorded and a replay will be available via phone and webcast later this evening at about.etrade.com. No other recordings or copies of this call are authorized or may be relied upon.

With that, I will now turn the call over to Mr. Idzik.

Paul Thomas Idzik

Chief Executive Officer and Director

Thank you, Amanda. Good morning and thank you for joining us on short notice. When we spoke with you a few days ago on the earnings call, this was on our horizon. However, we didn't reach the finish lines until this past weekend, so it's a pleasure to speak with you yet again, this time about a landmark transaction for E*TRADE.

The acquisition of OptionsHouse for $725 million in cash is an important chapter in our story, to bring the number one options platform in the industry while adding scale to our business with the addition of a rapidly growing customer base. This is the first acquisition E*TRADE has made in 10 years and is indicative of our financial strength, commitment to grow our core business and be selective. With this announcement, we have agreed to purchase OptionsHouse from General Atlantic, a well-regarded private equity firm with deep experience in our space. As you will recall, OptionsHouse is the remaining organization following the 2014 merger of OptionsHouse and tradeMONSTER.

When acquisitions came into our consideration last year, we thought deeply about how to best drive long-term growth in the franchise while enhancing returns on capital. Scale acquisitions in the brokerage business naturally rose to the top of the list, given excess capacity in our platforms and the ability to expand our product set. And that's what brings us together today, announcing this highly attractive transaction and then on-boarding the essential components that make this industry and product class so attractive: a strong sophisticated platform, which will augment our derivates trading capability; a host of advanced and engaged customers, which will bring us a rich community of active traders; and a colleague base of seasoned veterans who know how to definitely succeed in this arena. This is, of course, all geared to accelerate growth, both by assuming a growing and active base of customers, but also by invigorating our existing customer base through the introduction of enhanced capabilities.

Starting with the platform. This will provide us with an options trading pedigree that is significantly beyond what we enjoy today. OptionsHouse has been rated number one for options traders for five consecutive years in Barron's annual online broker view, a highly respected review that is the longest running in our industry. And StockBrokers.com, another bellwether in our space concluded the same, also rating the options platform number one. Translation? This is a great platform.

Upping our options capability had long been a goal of ours as we relinquished a strong industry position in 2009, giving way to a competitor who completed an acquisition of an option-centric platform. And while today we execute around 20% of the retail market's options contracts and then nearly a quarter of our own customer trades are in options, our growth in the product leveled off some time ago.

Options also tend to be one, if not the most coveted components of retail trading, not only because they carry a higher associated level of commission than cash equities, but they generally set the stage for additional transactions due to their fixed expiration. They tend to also more greatly serve the sophisticated investor but have become increasingly accessible to many investor types, as digital education and easy to use tools have made this once-challenging investment an increasingly attractive value proposition for more retail investors.

What customers undoubtedly appreciate the most about options is the ability to generate income or protect positions in any kind of market. And certainly, the one in which we find ourself of low interest rates and high volatility is particularly attractive as we think about this platform.

An upgraded options platform is a natural fit for us. While we've invested much in our options capability, our offering has not been the sharpest instrument in our drawer, and we've seen it as a competitive gap. To fill that one needs to either continue to develop scale or purchase and established platform. Until now, we had focused on the former. So we'll able to eliminate those development costs from our plan, thus creating even more efficiencies than we are capturing on the face of this deal.

Now regarding talent, the CEO of the entity we are acquiring, Michael Curcio, will continue in his current role until the deal closes at which point he will assume a senior role with the combined company. Ultimately, he and I will determine in what capacity he will best serve the combined organization as a member of E*TRADE's executive leadership team. For those unaware, Mr. Curcio is a seasoned industry and E*TRADE veteran, having spent more than a decade of his career with our company before he left and shepherded the merger of tradeMONSTER and OptionsHouse. I'm excited to bring his energy and perspective back into the fold.

With respect to the OptionsHouse customer base, we're maintaining access to the superior options platform to which they are accustomed, then will gain access to the full breadth of capabilities and resources of E*TRADE, including 24/7 customer service from registered reps, comprehensive research and educational resources, branch locations throughout the U.S., best-in-class web and mobile capabilities, and for the active traders, access to a host of powerful tools.

With so few properties left in our space after multiple waves of consolidation, we were fortunate to find a product and customer base that will fit in so well. They boast 154,000 brokerage accounts, $3.6 billion in customer assets, including $1.4 billion of that in cash, $240 million of margin loan balances and 27,000 DARTs, more than 60% of which are options. On a pro forma basis, our portion of retail options trades would increase from about 23% to around 30%. To put a finer point on it, they have 5% of our accounts, 18% of our total DARTs and 48% of our options DART volume. Again, that's 48% of our options volume on just 5% of our account base.

Before I hand it over to Mr. Pizzi to cover financial specifics and synergies, I'd just like to close by saying that this is our first acquisition in some time. We have been very disciplined in getting here and we're eager to begin capitalizing on the strong virtues of both the options platform and the customer base we're gaining. It's a great day to be at the helm of the good ship, E*TRADE, and I'm very much looking forward to a successful integration, which will create a world-class offering, an unparalleled customer experience and invigorate our growth in a highly profitable segment.

Further, I want to underscore that I feel quite confident in achieving the synergy targets. And rest assured, everyone here will be relentlessly focused on not only delivering the targets, but also doing everything we can to find additional sources of value.

And with that, I'll turn it over to our coruscating CFO, Mr. Pizzi.

Michael A. Pizzi

Chief Financial Officer & Executive Vice President

Thank you, Mr. Idzik. It's great to be speaking with you all again so soon, and it's very rewarding to see our hard work come to fruition in this deal. It's an incredibly attractive one for us given the scale, the efficiencies, the accretion, and most importantly, the enhancements to our customer offering. Paul touched on what the OptionsHouse franchise looks like today, and I wanted to emphasize the terrific growth the company has experienced in recent years, a testament to their world-class trading capabilities, brand and value proposition.

In 2015, a somewhat muted year of growth for the major players in our industry, OptionsHouse exhibited phenomenal growth in net new accounts, margin balances and DARTs. Now, with respect to deal synergies, we are targeting $65 million in total, which includes $16 million in revenue primarily related to cash optimization, and $49 million in expenses related to cuts on both sides as a result of the combination. These compared to OptionsHouse's revenue for the last 12 months of $104 million and adjusted expenses of $82 million.

With regard to OptionsHouse's customer cash, they currently have a third-party sweep arrangement where the economics are not incredibly attractive. The structure that we have in place allows us to fully monetize customer cash, both on and off our balance sheet, the former being the more profitable. So with our decision to cross $50 billion, which we discussed last week, these cash balances become all the more compelling. As of June 30, pro-forma for our money fund conversion, we have approximately $6 billion in customer cash available to bring on balance sheet when we cross $50 billion. The addition of OptionsHouse's customer cash would raise that amount to over $7 billion.

On the expense side, by 2018, we'll have room to cut approximately $49 million in total, and those fit into two broad buckets. First clearing, OptionsHouse clears through a third party today and will eventually come on to our platform. As a self-clearing organization, we can harvest significant savings, creating favorable economics to us. Second, redundancies, including corporate overlap, digital, operations and marketing. Those will come from both sides as we work through the integration, but there are significant savings here across a broad array of areas.

Moving on to the funding structure. We've selected one that will maximize returns while optimizing our capital flexibility by issuing up to $400 million of preferred stock and utilizing cash for the remainder. We ended Q2 with $523 million in corporate cash and expect to add $125 million during Q3, following distributions from ourselves. Given the surplus and the regular distributions from our bank and broker to the parent, this is clearly the most accretive currency we can utilize.

With respect to the preferred issuance, as Tier 1 qualifying capital, this will support our leverage ratio and to help fill the gap created by adding goodwill and intangibles to our balance sheet. It will also leave us well positioned to continue deploying capital in other forms shortly after the deal closes.

Importantly, there is no change to our plan to cross $50 billion in balance sheet size in the first part of next year, and we anticipate resuming share repurchases in the second half of next year. Given our plans for balance sheet growth, we have been considering for some time layering in some preferred equity to our capital base and the opportunity to both efficiently finance this deal and preserve our capital flexibility, just crystallized our thinking and timeline.

Now a few other impacts to the P&L as a result to the deal. Outside of the cost synergies, we'll benefit from about $20 million of cost avoidance on the E*TRADE side over about three years. As Paul mentioned, buying this platform eliminates the need to build out functionality internally, and thus lowers our planned investment spend. And the transaction will come with one-time deal related costs, which we expect to be approximately $45 million incurred over two years and $7 million incurred at the close.

So given all of the pieces, we expect the deal to be relatively neutral to earnings in 2017 and accretive in 2018, and accretive to earnings in 2018 in the low to mid-single digit range. Additionally, the transaction is accretive to our return on equity and reflects double digit return on invested capital, well in excess of our cost of capital. To echo previous sentiments, this a great transaction. As Paul noted, we felt quite confident that these targets are readily achievable and we'll do everything we can to find additional sources of value.

To provide you some sense of what those areas of upside might include, we have not factored in the following. First, significant opportunities to cross sell, including our retirement, investing and savings tools to OptionsHouse customers. And next, any upside from other products or channels, that we do not have today, like their futures offering RIA channel and education franchise. We certainly see value here, but wanted to be conservative in what we put in front of you today.

Having served E*TRADE for over a decade, it is truly an honor to help shepherd us into this phase of our evolution. And it is distinctively gratifying to look back from this vantage point we enjoyed today and see the hard path we've journeyed here, to get here.

And with that, operator, we will open the call for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you so much, sir. [Operator Instructions] And our first question comes from the line of Ron (sic) [Rich] (14:08) Repetto with Sandler O'Neill. Your line is open. Please go ahead.

Richard Henry Repetto
Sandler O'Neill & Partners LP

Q

Good morning. Good morning, Paul and Mike Pizzi. The first question is on the revenue synergies. I got the $16 million in synergies, but could you go through what the average commission is for Aperture or OptionsHouse, and as well as how does that compare with yours, and is there any potential for some revenue dis-synergies if the pricing is disparate between the two?

Michael A. Pizzi
Chief Financial Officer & Executive Vice President

A

Yeah, Rich. Their basic commission rate is $4.95 per trade. But when you factor in their contracts per trade, they get a lot closer to our overall commission rate. For their existing book of business, our intention is to keep the pricing the same. So day one, you will see some weighted average of the two commissions come together. But over time, we expect the increased value proposition of our platform in combination with theirs to support our current pricing for go-forward business.

Richard Henry Repetto
Sandler O'Neill & Partners LP

Q

And just a follow-up on the synergies – that's helpful, Mike. And the follow-up on the synergies, timeline, you expect them all to be in place by, I guess, the end of 2017, so you'll realize the full benefit in 2018?

Paul Thomas Idzik
Chief Executive Officer and Director

A

So Rich, when we look at the synergies on the revenue side, that number that we put forward is related to bringing on the balance sheet benefits of them using our platform, both the cash and the clearing, et cetera. So we feel very confident in achieving those revenue synergies.

Richard Henry Repetto
Sandler O'Neill & Partners LP

Q

And I was asking about the timeline, I guess, of the expenses. Should we just sort of look at that...

Paul Thomas Idzik
Chief Executive Officer and Director
A

[indiscernible] (16:00).

Michael A. Pizzi
Chief Financial Officer & Executive Vice President
A

Yeah. We see the bulk of the synergies on the expense side coming in over 2017, as well as the revenue synergies with some tail into 2018.

Richard Henry Repetto
Sandler O'Neill & Partners LP
Q

Okay. And just a quick thing. I know they have some technology about same-day funding, is that similar? Is that anything that you can use from your side? I've talked to them and they've mentioned they thought they were pretty advanced there. Is that what you found or not?

Paul Thomas Idzik
Chief Executive Officer and Director
A

Well, I mean, with respect to the same-day funding, there's a lot of technical advancement to the platform that we like, so I'll just leave it at that. There's a lot of different items in technical advancement that we found that we don't have, both in the realm of screeners and tools and other elements of the platform. So all of that was taken into account.

Richard Henry Repetto
Sandler O'Neill & Partners LP
Q

Super. Thanks, guys, and congrats on the transaction.

Paul Thomas Idzik
Chief Executive Officer and Director
A

Thank you.

Operator: And our next question comes from the line of Chris Harris with Wells Fargo. Your line is open. Please go ahead.

Chris M. Harris
Wells Fargo Securities LLC
Q

Thanks. Hey, guys.

Paul Thomas Idzik
Chief Executive Officer and Director
A

Good morning, Chris.

Chris M. Harris
Wells Fargo Securities LLC
Q

They're earnings neutral for 2017, is that – I assume that's excluding the deal-related costs of $45 million, is that right?

Michael A. Pizzi
Chief Financial Officer & Executive Vice President

A

That is. That is.

Paul Thomas Idzik
Chief Executive Officer and Director

A

That's correct.

Chris M. Harris
Wells Fargo Securities LLC

Q

Okay.

Michael A. Pizzi
Chief Financial Officer & Executive Vice President

A

And the $45 million, we expect over – part of that will be in 2016, some in 2017 and with some going into 2018.

Chris M. Harris
Wells Fargo Securities LLC

Q

Got you. Okay. And then a question regarding the strategic benefit of this deal, this obviously is increasing your exposure to some extent to – well, it is increasing your exposure to commissions. And others in the business are trying to diversify away from that to some extent. So just wondering if you guys could talk to us a little bit about how you feel about the stability of the commission business over the next 5 years or 10 years. I mean, I guess when you're doing a deal like this, you feel pretty good about it. But maybe talk about why you feel good about it?

Paul Thomas Idzik
Chief Executive Officer and Director

A

Sure. Let me put it into strategic context, and then I think Mr. Pizzi has a very succinct and logical way of talking about the commission structure. When we look at this, Chris, we look at the ability to diversify away just from equity trades and the fact that those trades in options tend to withstand market vagaries more. The volume doesn't dip as much when customers pull away from the equity markets because people put on trades, they expire, they put them back on. So we think this is going to actually help stabilize our earnings stream.

Now with regard to the structural situation with regard to commissions across the industry, Mike's been thinking about this quite a bit and he's got a very good answer on this one.

Michael A. Pizzi
Chief Financial Officer & Executive Vice President

A

Well, I mean, when we look at commissions from an overall return perspective, the ability to generate them and really just be a very high ROE component of the business is something that we like. When we look at derivative based commissions, especially in the options space, the frequency of which traders engage in that space and the growth of the market segment over the past few years is something that we find very compelling about this transaction.

Paul Thomas Idzik
Chief Executive Officer and Director
A

More broadly on the commissions structure, Chris, we think there's a reasonable equilibrium this will reach. People could reach for a lower cost commission platforms than ours or others, frankly. And they keep coming back because the overall value proposition is quite good, I mean people are able to get personal advice, people are able to get 24/7 service, we have issues with taxes, et cetera, People value that, and they see the value in the overall platform. And so that's the way we think about it. We are concerned always about what might happen in the future of the dynamics on our business, but we think things are in a reasonable status right now.

Chris M. Harris
Wells Fargo Securities LLC
Q

Got you. Thank you.

Operator: And our next question comes from the line of Devin Ryan with JMP Securities. Your line is open. Please go ahead.

Devin P. Ryan
JMP Securities LLC
Q

Hey, thanks. Good morning, everyone.

Paul Thomas Idzik
Chief Executive Officer and Director
A

Good morning.

Michael A. Pizzi
Chief Financial Officer & Executive Vice President
A

Good morning.

Devin P. Ryan
JMP Securities LLC
Q

If you can, can you just talk a little bit about the process of how this deal came together? Did you approach to them? Were you approached and it was a competitive situation?

Paul Thomas Idzik
Chief Executive Officer and Director
A

Devin, we're not going to talk about the particulars of how we get from day zero to today.

Devin P. Ryan
JMP Securities LLC
Q

Okay. I figured I'd try. And then just want to make sure I'm clear on the math here. So the synergies of $65 million, that's on top of what the business is currently generating in kind of net income, to try to – or pre-tax or just try to get a sense of kind of just dollar amount where that ends once you've realized all that would be identified synergies?

Paul Thomas Idzik A
Chief Executive Officer and Director

Yeah. The identified synergies are $65 million. What we're not including in that is an additional $20 million of cost avoidance on our side, which relates to us not building out the additional sets of tools that we would want to build out that are similar to the tools that we are getting.

Devin P. Ryan Q
JMP Securities LLC

Okay. Got it. All right. Thank you.

Operator: And our next question comes from the line of Steven Chubak with Nomura. Your line is open. Please go ahead.

Steven J. Chubak Q
Nomura Securities International, Inc.

Hi. Good morning.

Paul Thomas Idzik A
Chief Executive Officer and Director

Hey, Steven.

Michael A. Pizzi A
Chief Financial Officer & Executive Vice President

Hello.

Steven J. Chubak Q
Nomura Securities International, Inc.

Mike, in the release you had mentioned that you're really excited about the opportunity to optimize your capital structure with additional preferred equity issuance. And as we think about different uses of capital or how to optimize that structure, maybe a better way to frame it, should we expect to see additional preferred issuance going forward to support growth of the bank?

Michael A. Pizzi A
Chief Financial Officer & Executive Vice President

I don't think we intend to have additional issuance to support growth. I think there is enough organic generation of capital combined with the preferred we intend to issue it here to complete both the acquisition, as well as the funding of the balance sheet through the $50 billion mark, and fully utilize all of our cash. It is a tool. It is a source of Tier 1 eligible capital other than common. It's really the only source of Tier 1 eligible capital other than common. And anyway, it's a fairly reasonable cost relative to common for Tier 1 equity. So we thought it's an efficient use in this deal and an efficient use for balance sheet.

Steven J. Chubak Q
Nomura Securities International, Inc.

Thanks. And one follow-up regarding some of the commentary about the $20 million of cost avoidance. My understanding is that you mentioned that that's going to be realized over a three-year planned investment spend horizon. In passing, you had mentioned that they also have an RIA platform. I didn't know if that might require additional investment in areas such as DOL or other regulatory and compliance efforts to build out that capability. And is that something you'd look to grow either organically or inorganically via additional acquisitions?

Michael A. Pizzi
Chief Financial Officer & Executive Vice President

A

Yeah. As we said in the prepared remarks, there's a number of areas that we didn't put a whole – ascribe a whole lot of value to for various reasons. That you have a very small RIA platform, which we're going to do a lot more work on. The futures platform, we believe an integrated futures platform is central to derivatives capability. And right now, our existing futures platform is not integrated, so really building a best-in-class product there. Looking at all those items, those are all items that we're going to do more work around, but we don't really see any sort of significant expense there, but we may possibly identify investment opportunities to gain even more growth from this acquisition.

Steven J. Chubak
Nomura Securities International, Inc.

Q

Okay. And one quick follow-up from me, maybe – might be jumping the gun here a bit but do you have a rough sense as to what level you can issue preferreds at? Even if it's a fairly wide range, it would be helpful.

Paul Thomas Idzik
Chief Executive Officer and Director

A

The market today would be in the mid-6s.

Steven J. Chubak
Nomura Securities International, Inc.

Q

Perfect. Thanks so much.

Paul Thomas Idzik
Chief Executive Officer and Director

A

Thanks, Steven.

Operator: And our next question comes from the line of Conor Fitzgerald with Goldman Sachs. Your line is open. Please go ahead.

Conor Fitzgerald
Goldman Sachs & Co.

Q

Thanks for taking my question. So you mentioned some of the revenue synergies that aren't considered on things like selling E*TRADE products into their customer base. Could you maybe give us a little sense on how large you think this opportunity is and maybe just highlight that a little bit?

Paul Thomas Idzik
Chief Executive Officer and Director

A

Conor, if we had a good idea of what that might be, we would've baked it into these comments. I think what you're helping underscore is the conservatism on our projections on synergies. So if you are asking are we being conservative, we think so. We think that's the prudent way to analyze a potential acquisition. We have great hope that this will turn out even better than the attractive return on capital and accretion that it's generating in its current estimates.

Conor Fitzgerald
Goldman Sachs & Co.

Q

Got it. And then Rich's question touched a little bit on how you're going to handle the pricing on the trading side, so I just have a similar question on the margin lending side. Should we expect a similar philosophy there?

Michael A. Pizzi
Chief Financial Officer & Executive Vice President

A

Yeah. I think you could expect a very similar philosophy. I mean overall, because they don't self clear, they don't have as much ability to negotiate margin as we do today, and essentially the rack rates will converge over time.

Conor Fitzgerald
Goldman Sachs & Co.

Q

Okay. And then last one from me. Just the mid-single digit EPS accretion in 2018, did that incorporate kind of slowing down the buyback over the next couple of quarters?

Michael A. Pizzi
Chief Financial Officer & Executive Vice President

A

Yeah. I mean we've already contemplated slowing down the buyback to really begin to raise capital for the funding of the balance sheet growth. The transaction here today continues our line of thinking. We see buybacks really picking up in earnest again in Q3 of next year.

Conor Fitzgerald
Goldman Sachs & Co.

Q

That's helpful. Thanks for taking my questions.

Paul Thomas Idzik
Chief Executive Officer and Director

A

You're welcome.

Operator: And our next question comes from the line of Michael Carrier with Bank of America Merrill Lynch. Your line is open. Please go ahead.

Michael Roger Carrier
Bank of America Merrill Lynch

Q

Thanks, guys. Hey, Mike. You mentioned the attractive growth that OptionsHouse put up in 2015, just wanted to see if you had any details on whether it's the net new assets, the margin, the DARTs. And then I know it's early and it's probably tough, but just wanted to get a sense if you have any like pro forma leverage ratios, when you think of the preferreds plus the assets that are moving on the balance sheet?

Michael A. Pizzi
Chief Financial Officer & Executive Vice President

A

Yeah. On the latter part of the question, the floors, what we've given is 7%, so the preferred plus the cash utilization at close, we would anticipate being at or above that 7% minimum that we've indentified. And we'll continue to operate at that level overall as we bring the size of the balance sheet up.

In terms of the growth rates, the growth was really across all metrics. Account growth is very strong, DART growth also very strong as well. If you kind of look at sort of 2.5 year levels of growth, we're looking at account growth in the 10%-plus range, margin growth in the 36% range, DART growth in the 8% range. And compare that to an industry on DARTs that's been relatively flat with a couple of volatile periods driving that growth, we find the overall growth prospects of the business to be compelling.

Michael Roger Carrier
Bank of America Merrill Lynch

Q

All right, that's helpful. And then just a follow-up. When you look at the buyback option versus these types of transactions, obviously it seems like given the accretion and especially when you layer in the $20 million, the other costs from the investment side, it seems like it's pretty attractive. And over time you've got to be investing for growth. But just wanted to get your sense when you look at the return on investment, buybacks versus this type of a transaction, how do they stack up?

Michael A. Pizzi
Chief Financial Officer & Executive Vice President

A

Yeah. When we layer in full synergies, we get to a place where the return on invested capital is well in excess of our cost of capital. When we look at that, that puts us in a place where we feel really good in terms of the comparison of this to our overall buyback alternative. The low- to mid-single digit accretion in 2018 really is showing that you're accreting relative to a strategy that would rely on those buybacks in terms of the base case. So we are achieving an earnings result above that and the transaction is accretive to our ROE overall. Putting all those facts together, we felt very good about the return characteristics as a use of capital versus continuing with buybacks.

Paul Thomas Idzik
Chief Executive Officer and Director

A

And Mike, we can't – at the end of the day, you can't buy back your way to greatness and we have a compelling use of capital here that's equal or better than our buying back of shares. And let's just remember, we're not turning our back on buying back shares, we're taking this opportunity to generate value for our owners and we'll be back – with everything else being equal, buying back shares Q3 of 2017.

Michael Roger Carrier
Bank of America Merrill Lynch

Q

Yeah, makes sense. Thanks a lot.

Paul Thomas Idzik
Chief Executive Officer and Director

A

Thank you.

Operator: And our next question comes from the line of Doug Mewhirter with SunTrust. Your line is open, please go ahead.

Doug R. Mewhirter
SunTrust Robinson Humphrey, Inc.

Q

Hi, good morning. Most of my questions were answered. I just had one very quick clarification to Rich's question about the price points. So you said that you're going to be keeping the OptionsHouse, I guess, rack rates and your rack rates separate for now and then they would converge. And I didn't get whether it would converge to E*TRADE's price point or to OptionsHouse or somewhere in the middle?

Paul Thomas Idzik
Chief Executive Officer and Director

A

No, that's not – let me just take a pass at this and then Mr. Pizzi will correct me if I get it wrong. We intend to grandfather OptionsHouse customers on their existing trading rates. We expect over time due to the benefits we have of our balance sheet for the margins rates to start to converge, which we think will be a benefit across the board.

We've done this before in previous acquisitions, in terms of how to manage different customer sets and their expectations. As you're aware, more active traders often have negotiated rates off their rack rate anyway, so this is more than a couple of moving piece parts. So no, we're not migrating the OptionsHouse rates to ours. And we think OptionsHouse customers will get a benefit over time from our ability to do a good job on managing the margin front. Is that clear?

Doug R. Mewhirter
SunTrust Robinson Humphrey, Inc.

Q

Yes. That's very helpful. Thank you.

Operator: And our next question comes from the line of Brian Bedell with Deutsche Bank. Your line is open. Please go ahead.

Brian Bedell
Deutsche Bank Securities, Inc.

Q

Hi. Good morning, folks. Thanks for taking my questions. Most have been answered, but maybe just can you give us the revenue segmentation of the $104 million between commissions and net interest revenue?

Paul Thomas Idzik
Chief Executive Officer and Director

A

We're not going to disclose that. But keep in mind, Brian, they don't self clear. So they're revenue as a percentage of overall is low compared to the commission side.

Brian Bedell
Deutsche Bank Securities, Inc.

Q

Okay. Okay. And then just to be clear on the low- to mid-single digit accretion if I heard you right, Mike, you are phasing that against an alternative of repurchasing shares rather than just on an absolute basis, is that correct?

Michael A. Pizzi
Chief Financial Officer & Executive Vice President

A

That's correct.

Brian Bedell
Deutsche Bank Securities, Inc.

Q

Okay, great. Thank you.

Operator: And our next question comes from the line of Chris Allen with Buckingham. Your line is open, please go ahead.

Paul Thomas Idzik
Chief Executive Officer and Director

A

Mr. Allen?

Chris Allen
The Buckingham Research Group, Inc.

Q

Sorry, guys. I was on mute, apologies. I think most of the stuff has been covered, I just wanted to see if you assumed any customer attrition in your estimates. And if not, what are kind of your plans to retain customers moving forward?

Paul Thomas Idzik
Chief Executive Officer and Director

A

They're going to keep the same great platform, they're going to keep the same great price and they're going to gain from our service and they're going to gain from our product offering. So while we modeled in a minimal amount of attrition to be conservative, we don't see a significant amount of attrition from this deal.

Chris Allen
The Buckingham Research Group, Inc.

Q

Got it. Thanks, guys.

Paul Thomas Idzik
Chief Executive Officer and Director

Well I want to thank everyone for getting up early. I know this is earlier than most of you want to have a call, but I really appreciate the support you guys give in covering us, and thanks for calling in and thanks for your well-positioned questions. Thanks very much. Have a nice rest of the day.

Operator: Ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines.