INTEGRATION  SERVICE  GROWTH

Andrew Yeh

Agenda

- Business Overview
- Strategy & Competition
- Investment Drivers & Risks
- Street Expectations
- Quantitative Measures
Business Overview

- E-Trade Complete: Broker-Bank
- Manage financial activities on one platform
- Investing, savings, checking, first, second-lien loans, credit cards
- Symbiosis between broker / bank

Revenue Breakdown

- Net Interest Income, 56.17%
- Commission, 24.53%
- Other Shit, 19.30%
Broker Segment

- Key Drivers: Commissions rates and DARTs (Daily Average Revenue Trades)
- Commissions = 27% of 06 Op. Revenues
- Declining commissions due to competition
- Composition of trading matters: options vs. equities

Bank Segment

- Key drivers: average interest earning assets, deposits, and net interest margin
- Size of balance sheet drives interest income
- Broker – Bank deposit sweep
- Use swept deposits to fund bank B/S activities
- Cross sell bank products
Bank Segment

- Net interest income (NII) – interest revenues minus interest expenses
- Size of B/S and the composition of assets & liabilities drive the spread and NII
- Key idea: take credit risk to earn interest income
- Mgmt focus: diversity geographic risk, low LTV (leverage) loans, high FICO (>720)

Automatic Stabilizer

- When markets fall, people trade less
- Retail investors retain more cash
- This is good for ETFC because they can invest that cash in loans or securities
Net Interest Income

Average Interest Earning Assets

Net Interest Margin

Commission and Trading

Effective Commission (LHS)

Daily Average Revenue Trades (RHS)
The Mass Affluent Customer

- $50,000 – 200,000 in investible assets
- 80 mm households fall with 12 trillion in investible assets
- Segment growing 2x as fast as U.S. population
- ETFC, SCHW best positioned to gain share
Merrill Lynch Acquisition

- Buying First Republic Bank at 44% premium, over 2.5x book value
- Goal: better serve high net-worth clients who want deposit and loan products
- Brick and mortar brokers can’t offer better value because of higher cost structure

ETFC vs. Schwab

<table>
<thead>
<tr>
<th>ETFC</th>
<th>Schwab</th>
</tr>
</thead>
<tbody>
<tr>
<td>less focused on advice business (higher operating margins)</td>
<td>more investing advice</td>
</tr>
<tr>
<td>banking</td>
<td>lesser extent banking products</td>
</tr>
<tr>
<td>trading</td>
<td>trading and mutual funds</td>
</tr>
</tbody>
</table>

- Same demographic, different niches
- Why not get together? (Not our core thesis)
Quantification

- Mass affluent segment = high engagement across all products
- Every 1% gain in market share of mass affluent space: $480mm of revenue for ETFC (2.2 bln op. rev in 06)
- Every 1% gain in active trader: $22mm
- Every 1% gain in main street: $133mm

Other Businesses

- Only E-Broker that offers trading / bank products internationally
- International Target: 30% of revenues in 2010
- Corporate services, higher cash retention
- Other lines of business we won’t concentrate on
- Not main focal point of our presentation
Investment Drivers & Risks

Investment Drivers

- Mildly successful penetration into mass affluent segment
- Leads to rapid B/S expansion, which drives NII
- Higher engagement drives commissions
- Customers use margin for purposes other than purchasing securities
Risks

- Will their marketing be effective?
- Can they match Schwab?
- Does ETFC have the infrastructure to service mass affluent investors?
- How much incremental margins are in this business? (currently 75%)
- Will credit be an issue in 2007?

Street Expectations
## Analyst Coverage

<table>
<thead>
<tr>
<th>Analyst Name</th>
<th>Firm</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Richard Herr</td>
<td>KBW</td>
<td>Buy</td>
</tr>
<tr>
<td>Michael Vinciquerra</td>
<td>Raymond James</td>
<td>Buy</td>
</tr>
<tr>
<td>Matt Snowling</td>
<td>Friedman Billings Ramsey</td>
<td>Buy</td>
</tr>
<tr>
<td>Richard Repetto</td>
<td>Sandler O'Neil</td>
<td>Buy</td>
</tr>
<tr>
<td>Michael Mayo</td>
<td>Prudential Equities</td>
<td>Buy</td>
</tr>
<tr>
<td>Roger Freeman</td>
<td>Lehman Brothers</td>
<td>Buy</td>
</tr>
<tr>
<td>Howard Chen</td>
<td>Credit Suisse</td>
<td>Neutral</td>
</tr>
<tr>
<td>Patrick Pinschmidt</td>
<td>Merrill Lynch</td>
<td>Neutral</td>
</tr>
<tr>
<td>Michael Hecht</td>
<td>Banc of America</td>
<td>Neutral</td>
</tr>
<tr>
<td>Cameron Ghaffari</td>
<td>Morgan Stanley</td>
<td>Neutral</td>
</tr>
<tr>
<td>David Trone</td>
<td>Fox Pitt Kelton</td>
<td>Neutral</td>
</tr>
<tr>
<td>Prashant Bhatia</td>
<td>Citigroup</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

## Problem

- Marketing spending ramping up in 07
- Sell side analysts with neutrals model no impact on those marketing dollars
- That is, they don’t buy ETFC’s mass affluent story
The valuation disconnect

<table>
<thead>
<tr>
<th>Company</th>
<th>07 FWD P/E</th>
<th>Mkt. Cap</th>
</tr>
</thead>
<tbody>
<tr>
<td>E-Trade</td>
<td>14.028</td>
<td>10.38B</td>
</tr>
<tr>
<td>TD Ameritrade</td>
<td>15.140</td>
<td>10.64B</td>
</tr>
<tr>
<td>Charles Schwab Corp.</td>
<td>21.011</td>
<td>24.19B</td>
</tr>
<tr>
<td>Investment Technology Group</td>
<td>19.837</td>
<td>2.03B</td>
</tr>
<tr>
<td>Tradestation Group</td>
<td>19.669</td>
<td>0.59B</td>
</tr>
<tr>
<td>Average ex-ETFC</td>
<td>18.914</td>
<td></td>
</tr>
<tr>
<td>E-Trade</td>
<td>14.028</td>
<td>10.38B</td>
</tr>
<tr>
<td>Compass Bancshares</td>
<td>16.156</td>
<td>7.94B</td>
</tr>
<tr>
<td>Synovus Financial Corp.</td>
<td>16.556</td>
<td>10.14B</td>
</tr>
<tr>
<td>Union Bancal Corp.</td>
<td>13.948</td>
<td>9.00B</td>
</tr>
<tr>
<td>Zion Bancorp</td>
<td>14.137</td>
<td>9.12B</td>
</tr>
<tr>
<td>Average ex-ETFC</td>
<td>15.199</td>
<td></td>
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</tbody>
</table>

WTF, Why is ETFC so cheap?

- The buyside community does not understand the story
- Evidenced by the B of A announcement and emerging market sell off of 2006
- Sell-side analysts are broker analysts who don’t understand banks
Premium Valuation

- More stable deposits, automatic stabilizing model should deserve a premium multiple
- At least 17 – 18x 2007 earnings
- Mgmt guidance of 1.60 – 1.80
- $1.78 \times 19 = 33.63 / 24.26 - 1 = \text{at least } 40\% \text{ upside!}$
- $1.60 \times 14.5 = 23.2 / 24.26 - 1 = 6\% \text{ downside}$

Quantitative Measures