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E*TRADE Group, Inc. (NASDAQ: EGRP)

Acquisition of Telebanc Financial Corporation
Rating: ACCUMULATE

July 31, 2000

KEY CONSIDERATIONS

- E*TRADE has acquired Telebanc, a branchless savings bank that offers all banking services via the Internet. This makes E*TRADE one of the first combinations of a brokerage and a bank on the web.

- E*TRADE has increased its customer account base by over 10% in the past quarter alone. The company now has over 2.9 million total accounts in its online brokerage and bank, an increase of 125% over 3Q99.

- Over the past two quarters (2Q00 and 3Q00), E*TRADE has posted its two best revenue quarters ever. The company has already gone over $1 billion in revenue for the year after just the first three quarters of fiscal 2000. By comparison, revenues totaled only $657 million for all of fiscal 1999.

- Competition in the Internet financial services industry has increased in the past few months. Gomez Advisors included over 50 online brokerages in their most recent quarterly survey. Competition now comes from Internet portals such as Yahoo!, Inc. (NASDAQ: YHOO), banks such as Net.B@nk, Inc. (NASDAQ: NTBK), and other brokerages such as Charles Schwab & Co., Inc. (NYSE: SCH).

Recent Price	$16(5/8)
52WK Low	$13(1/8)
52WK High	$40
P/E	N/A
P/Book	2.71
P/Account	10.98
P/Sales	3.76
Market Capitalization	$5.086 billion
Shares Outstanding	291.71 million
Float	160.40 million
Daily Volume (3-month Average)	5.01 million
EPS	
1997A	0.14
1998A	0.00
1999A	(0.20)
2000E	(0.09)
2001E	0.07
FINANCIALS	
Current Ratio	1.12
Total Debt to Equity	1.73
LT Debt	0.35
Total Cash	$371 million

ONE-YEAR PRICE AND VOLUME GRAPH

Courtesy of Bigcharts.com

COMPANY PROFILE

E*TRADE is a global leader in online personal financial services, offering value-added investing and research features, premium customer service, and a redundant, proprietary Stateless ArchitectureSM infrastructure. In addition to the U.S., E*TRADE presently serves customers through branded web sites in Denmark, Korea, Japan, the U.K., Sweden, France, Australia, New Zealand and Canada. E*TRADE has been recognized as a leader in online financial services by Gomez Advisors, Lafferty Information and Research Group, PC Magazine and Smart Computing magazine. E*TRADE Securities, Inc. (Member NASD/SIPC), and its parent company, E*TRADE Group, Inc. have offices in Northern California and in other major business centers in the U.S. and worldwide.

This report was prepared by Vincent Marchi and David R. Rivas, Ph.D.

THE COMPANY

E*TRADE Group, Inc. ("E*TRADE" or the "Company"), through its wholly-owned subsidiaries, E*TRADE Securities, Inc., TIR (Holdings) Limited ("TIR") and Telebanc Financial Corporation ("Telebanc"), is a leading provider of online brokerage and banking services and has established a popular, branded destination Web site for self-directed investors. In the past few months, E*TRADE has expanded its base of investment services to include online banking, loan, tax, and retirement service centers. Largely through the acquisition of Telebanc, E*TRADE aims to become the first one-stop financial services company on the Internet. Customers can now invest in a stock, access their checking account, and get tax advice all from the same website.

On January 12, 2000, the Company completed its acquisition of Telebanc through the merger of a wholly owned subsidiary of E*TRADE with and into Telebanc, in which Telebanc survived as a wholly owned subsidiary of E*TRADE. Telebanc is the holding company of Telebank, an Internet-based, federally chartered savings bank. Telebanc provides financial products and services primarily over the Internet through its subsidiary, Telebank. Telebanc offers a wide range of FDIC-insured and other banking products and services with significantly higher rates on deposits and lower account and transaction fees than traditional banks with brick-and-mortar branches. Using Telebanc's secure, comprehensive and customer friendly Web site, individuals can open an account, transfer funds between accounts, view account balances, pay bills and compare Telebanc's premium rates to national averages. Customers can deposit funds using direct deposit, wire or U.S. mail and withdraw cash from over 425,000 automated teller machines on the Cirrus and MAC networks worldwide.

During 3Q00 E*TRADE added 330,000 net new brokerage and banking accounts, bringing its total active accounts to nearly 3 million, reflecting a growth of 125% from a base of 1.3 million accounts a year ago. Average transactions per day were 169,000, up 109% from 80,600 a year ago. E*TRADE Bank added 52,000 net new accounts and $800 million in deposits during 3Q00. Total deposits held in customer accounts were $3.9 billion, up 141 percent from $1.6 billion a year ago, and up 23 percent from the fiscal second quarter.

INDUSTRY OUTLOOK AND COMPETITION

The online financial services industry has become filled with competition. As mentioned earlier, Gomez Advisors surveyed over 50 online brokerages for its latest rankings. There are an abundance of places to trade securities online; however industry demand has the potential to grow even more. Barron’s Online estimates that by the by 2001, 9.2 million people in the U.S. alone will be investing online, and by 2003 they estimate that number could grow to over 20 million. They estimate those 9.2 million people could hold $906 billion in assets online, with that number growing to $3.1 trillion by 2003. However, that number is contingent on the popularity of online investing growing rapidly, something that may be hindered by a poor performance from the overall stock market. Any downturn in the U.S. securities markets that affects the popularity of stock market investing will negatively influence E*TRADE’s revenues.

Furthermore, the competition in this industry has continued to expand and now includes some unusual participants. Not only are purely electronic and traditional brick-and-mortar brokerages competing, but other Internet and computer companies are also getting involved. Companies like Microsoft—which has launched its Microsoft Money program that lets customers perform banking operations, pay bills and track investments online—and America Online have become competitors for E*TRADE.

Also, the top online brokerages—E*TRADE, Charles Schwab, DLJ Direct, Ameritrade, and Fidelity Investments, among others—are all battling to differentiate themselves from one another. All currently offer IPOs, mutual funds, bond and options trading, real-time quotes, 24x7 customer service and extended hours trading. E*TRADE now also offers online banking and tax advice. We believe that this consolidation of financial services will continue as online banking becomes more prolific and because both banks and brokerages will look to stay competitive with one-stop financial centers. In our opinion, reliable investment research will also become another commodity that sets firms apart from each other as investors look for better customer service and investment advice.

STRATEGIES FOR GROWTH

E*TRADE's growth strategy is based upon diversifying products and services, improving customer service, and increasing brand name recognition through marketing and advertising. In the past few months, E*TRADE has expanded its offering of financial services by adding online banking, stock news from sources like CBS MarketWatch, and an updated Bond Center. E*TRADE introduced Destination E*TRADE 2.0, a faster and easier website, and Power E*TRADE, a feature geared towards active investors offering $4.95 trades after the 75th trade of the quarter. As a result, E*TRADE ranked as the top online brokerage for on-site resources (i.e. news, charts, stock screening, portfolio analysis and breadth of product line) on Gomez Advisors' Summer 2000 scorecard.

In addition, E*TRADE has recently improved its customer service by adding a 24-hour-a-day, seven-day-a-week customer service help line and improved demos on their website. These features give customers more ways to get all the information they need to use E*TRADE. In fact, E*TRADE was rated the second best online brokerage in terms of ease of use by Gomez Advisors in their Summer 2000 survey. Also, E*TRADE has continued its strategy of exhibiting a strong advertising presence both in financial publications and on the Internet. E*TRADE advertises in such publications as Barron's, Forbes and The Wall Street Journal, and there are links to their website from over 1000 other sites on the web. We believe that these strategies have helped to make E*TRADE on of the most recognized brand names in the online brokerage industry.

ALLIANCES AND PARTNERSHIPS

E*TRADE pursues strategic relationships to increase access to online consumers, to build brand name recognition and to expand the products and services that the company can provide to online customers. In the past few months it has acquired the online bank Telebanc and created agreements with other financial services companies and even retail stores. These alliances are important to E*TRADE's business growth because they allow the company to reach new customers and to improve its customer financial services and research.

- *Telebanc:* E*TRADE acquired Telebanc, the nation's largest pure-play Internet bank. This acquisition allows E*TRADE to offer online banking to all of its existing brokerage customers and to add Telebanc's account base to its own. This also enables E*TRADE to become one of the first one-stop e-commerce websites in the financial sector as its customers will be able to do both banking and securities trading in the same place.
- *TIR Holdings, Ltd.:* E*TRADE recently acquired TIR Holdings, Ltd., an international financial services company offering multi-currency securities execution and settlement services. The acquisition is expected to accelerate E*TRADE's goal of building the first global cross-border trading network for online investors. We believe this will help E*TRADE increase its international presence in the e-finance industry and make more foreign securities markets available to their U.S. customers.
- *Prudential Securities Inc.:* E*TRADE Business Solutions Group, a wholly owned subsidiary of E*TRADE Group, Inc., and Prudential Securities Inc. signed a strategic agreement to offer a new co-branded stock option service program, PruPlan, to corporate clients. Through the agreement, the first of its type in the financial services industry, Prudential Securities and E*TRADE Business Solutions Group will offer record-keeping, administration and execution of stock option plans to corporate clients, in addition to an online employee communications platform.
- *Wit SoundView:* E*TRADE and Wit SoundView, the online investment banking subsidiary of Wit Capital Group, Inc. formed a strategic alliance in which Wit SoundView will be the exclusive source of IPOs, follow-on offerings and other investment banking products to E*TRADE, and E*TRADE will acquire Wit SoundView's retail brokerage business, representing approximately 100,000 accounts. In addition, E*TRADE will purchase two million shares of Wit Capital Group common stock. Wit Capital Group has also signed a definitive agreement to acquire E*TRADE affiliate E*OFFERING. Under the terms of the

transaction, E*OFFERING shareholders will recieve approximately 32 million shares of Wit Capital Group, representing approximately 25 percent of Wit Capital's fully diluted shares.

- *Target Stores:* E*TRADE and Target Stores announced and agreement that calls for piloting an in-store E*TRADE financial service center at a SuperTarget store. The alliance also includes the creation of a co-branded Target/E*TRADE website for Target guests. This alliance should allow E*TRADE's brand to reach even more customers and will provide more customer service for existing customers without the costs of building free-standing branch offices.
- *Ernst & Young LLP:* E*TRADE and Ernst & Young LLP recently signed a letter of intent to jointly establish a new company that will provide financial advice for investors by creating a personal electronic advisory service for E*TRADE's 2.9 million customer accounts to help them achieve their financial goals. E*TRADE and Ernst & Young will each contribute $25 million to the joint venture. In our opinion, this will allow E*TRADE to more effectively cater to individual customers' needs and better assist them with financial planning.
- *Verizon Wireless, GTE Wireless, and AT&T Wireless Group:* Through this agreement, E*TRADE customers will be able to access the E*TRADE website through web-enabled mobile phones. E*TRADE will also be able to offer real-time wireless financial information, account services, and access to transaction capabilities to its customers and members directly from the Verizon Wireless, GTE Wireless, and AT&T Digital PocketNet services. This series of alliances with wireless communications firms allows E*TRADE to give its customers even more access to their investments and puts the company in a good position as wireless communications and investing become more prevalent.

KEY RISK FACTORS

One of E*TRADE's biggest risk factors is the increased competition in the online brokerage and banking industry. E*TRADE faces direct competition from financial institutions, brokerage firms, banks, mutual fund companies, Internet portals and other organizations. We believe competition will increase as more commercial banks (such as Bank of America and Wells Fargo) and other Internet companies (such as AOL and Microsoft) enter the online financial services sector.

As a significant portion of E*TRADE's revenues come from online investing services, any downturn in the securities industry could significantly harm E*TRADE's business. The U.S. securities markets are characterized by considerable fluctuation and a downturn in these markets could adversely affect operating results. The recent stagnation and any possible future decline in the NASDAQ and NYSE markets may affect the size of the demand for online investing services.

Another risk factor for E*TRADE is the possibility of system failures or interruptions. Malfunctions or errors in E*TRADE's systems can be caused by software problems or even heavy traffic on its website. Lawsuits against E*TRADE have been filed stemming from a system failure in February 1999. These lawsuits are potential losses of revenue and sources of bad publicity for the company. In efforts to allay this problem in the future, E*TRADE has invested heavily in infrastructure and support systems for its network. We believe that this risk will be minimized in the future with the measures taken by E*TRADE—which include the establishment of redundant technology centers in California and Georgia.

INVESTMENT OPINION

The leading companies in the online brokerage industry have varying P/S ratios. E*TRADE, at 3.76, is somewhere in the middle. Others are Ameritrade (4.33), Charles Schwab (9.93), DLJ (0.80), and Morgan Stanley Dean Witter (2.73). E*TRADE is lower than Ameritrade, the company that is the most similar in terms of business plans. Ameritrade is another purely web-based company, unlike Charles Schwab, Morgan Stanley Dean Witter and DLJ, which are all the online branches of more traditional brick-and-mortar brokerages. This makes it somewhat harder to compare these firms to E*TRADE.

E*TRADE has had poor stock performance over the past few months. As the Internet Index and other brokers such as Charles Schwab and Morgan Stanley Dean Witter have had increases in their stock price, E*TRADE is down from its 52-week high of $40, dropping over 50% since last August. This poor performance is a caution against any future price increase, especially in the face of the Internet Index's 75% price gains over the same period. In Charts 1 and 2, it can be seen that E*TRADE mostly follows the trends of the financial services sector and also the broader Internet industry. However, it does so with much lower returns than the other securities shown.

E*TRADE's 3Q00 revenues were down almost 20% from the previous quarter. This may be due in part to a decline in NASDAQ volume over the past quarter. With less trades occurring, E*TRADE's revenues are lower this quarter. On the other hand, E*TRADE added 330,000 new customer accounts, and increase of over 10% in this quarter alone. In our opinion, this increase in customer base will lead to higher revenues in the future. We expect that earnings will stay negative for the next quarter (4Q00), but will turn positive in the next fiscal year. With E*TRADE's expanded offering of financial services and online banking, along with a growing customer base, E*TRADE can be expected to make an upward movement from its presently low stock price. Therefore we give an ACCUMULATE rating to the E*TRADE Group.

Chart 1

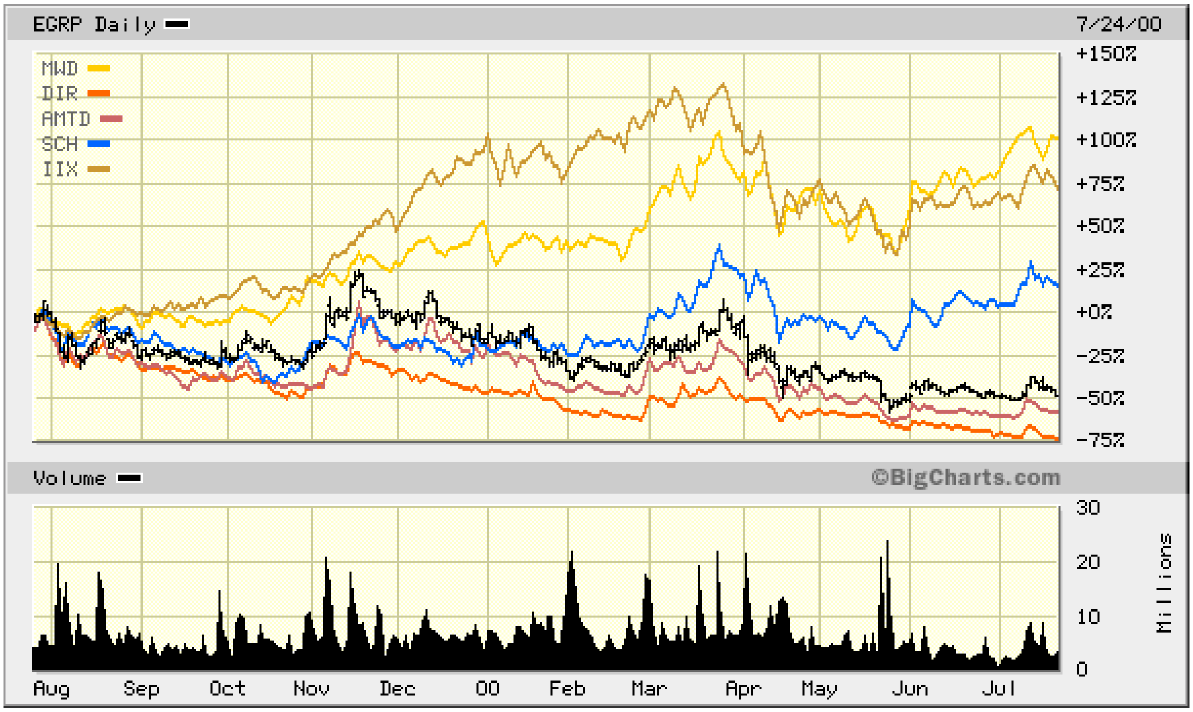
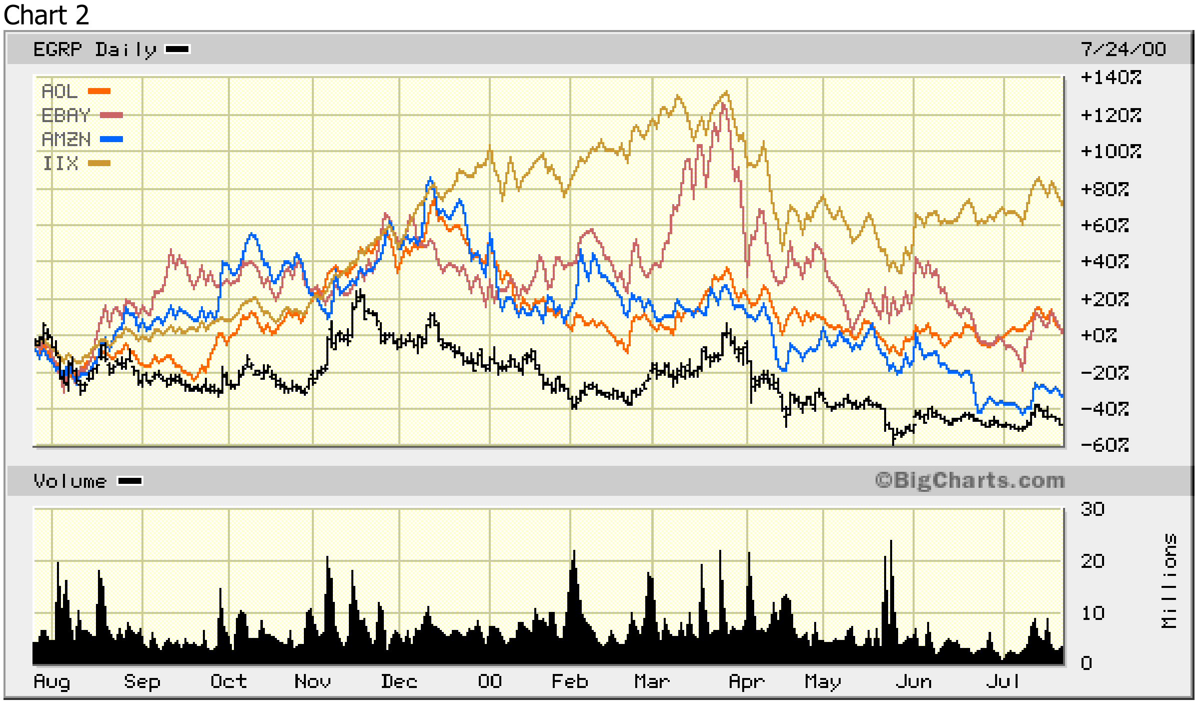


Chart 2



E*TRADE Statement of Operations (in thousands of dollars)

	1997A	1998A	1999A	1Q00A	2Q00A	3Q00E	4Q00E	2000E	2001E
Revenue:									
Transaction Revenue	109,659	162,097	355,830	152,312	254,596	206,192	214,890	827,990	1,353,846
Net Interest income	35,453	65,470	152,601	62,885	96,066	83,218	78,965	321,134	443,120
Other Revenue	103,961	123,992	151,502	52,982	58,024	40,890	56,845	208,741	399,599
Total Revenue	248,152	350,654	657,150	267,642	407,430	330,300	350,700	1,356,072	2,196,565
Cost of Revenue	99,312	145,018	292,910	111,507	130,474	137,912	120,989	500,882	730,139
Gross Profit	148,840	205,636	364,240	156,135	276,956	192,388	229,711	855,190	1,466,426
Operating Expenses:									
Selling and Marketing	69,327	124,408	321,620	129,680	177,484	129,873	154,697	591,734	895,537
Technology Development	13,731	33,926	76,878	36,380	42,127	22,131	40,198	140,836	241,622
General and Administrative	31,353	50,067	102,138	42,078	50,225	25,979	53,363	171,645	316,964
Merger-related expenses	0	1,167	7,174	5,787	24,599	13,905	1,254	45,545	3,476
Total Operating Expenses	114,411	209,568	507,810	215,950	299,594	191,888	249,512	956,944	1,457,599
Operating Income (loss)	34,429	-3,932	-143,570	-59,815	-22,638	500	-19,801	-101,754	8,827
Non-Operating Income	1,162	10,469	64,823	54,822	-9,066	8,269	14,098	68,123	23,040
Income before taxes (loss)	35,591	6,537	-78,747	-4,993	-31,704	8,769	-5,703	-33,631	31,867
Income tax expense (benefit)	11,787	1,873	-31,306	-697	-8,923	2,989	-1,733	-8,364	11,154
Net Income (loss)	23,410	3,302	-52,092	-4,791	-23,189	5,700	-3,970	-26,250	20,713
Fully Diluted EPS	0.14	0.00	-0.20	-0.03	-0.08	0.02	-0.01	-0.09	0.07
Shares Outstanding	163,396	208,224	266,036	266,001	285,004	291,710	292,809	292,809	295,900
Margin Analysis (%age of revenue)									
Gross Margin	59.98%	58.64%	55.43%	58.34%	67.98%	58.25%	65.50%	63.06%	66.76%
Selling and Marketing	27.94%	35.48%	48.94%	48.45%	43.56%	39.32%	44.11%	43.64%	40.77%
Technology Development	5.53%	9.68%	11.70%	13.59%	10.34%	6.70%	11.46%	10.39%	11.00%
General and Administrative	12.63%	14.28%	15.54%	15.72%	12.33%	7.87%	15.22%	12.66%	14.43%
Merger-related expense	0.00%	0.33%	1.09%	2.16%	6.04%	4.21%	0.36%	3.36%	0.16%
Operating Margin	13.87%	-1.12%	-21.85%	-22.35%	-5.56%	0.15%	-5.65%	-7.50%	0.40%
Net Margin	9.43%	0.94%	-7.93%	-1.79%	-5.69%	1.73%	-1.13%	-1.94%	0.94%
Growth									
Total Revenue		41.31%	87.41%		52.23%	-18.93%	6.18%	106.36%	61.98%
Gross Profit		38.16%	77.13%		77.38%	-30.53%	19.40%	272.29%	71.47%
Operating Expense		83.17%	142.31%		38.73%	-35.95%	30.03%	88.45%	52.32%
Operating Income		-111.42%	3551.32%		-62.15%	-102.21%	-4060.20%	-29.13%	-108.67%
Net Income		-85.89%	-1677.59%		384.01%	-124.58%	-169.65%	-49.61%	-178.91%