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# E\*TRADE Financial Corp. (ETFC)

Q3 2017 Earnings Call

## CORPORATE PARTICIPANTS

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

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

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## OTHER PARTICIPANTS

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

**Steven Chubak**  
*Nomura Instinet*

**Devin P. Ryan**  
*JMP Securities LLC*

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

**Brennan Hawken**  
*UBS Securities LLC*

**Daniel Thomas Fannon**  
*Jefferies LLC*

**Chris M. Harris**  
*Wells Fargo Securities LLC*

**Michael Carrier**  
*Bank of America Merrill Lynch*

**Kyle Voigt**  
*Keefe, Bruyette & Woods, Inc.*

**Jeremy Campbell**  
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*Morgan Stanley & Co. LLC*

## MANAGEMENT DISCUSSION SECTION

### GAAP AND NON-GAAP FINANCIAL MEASURES.....

- During the call, the company will 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 the company's earnings release furnished on Form 8-K along with Forms 10-Ks and 10-Qs and other documents the company has filed with the SEC.
  - Note that the company has not reconciled its forward-looking non-GAAP measures, including non-GAAP adjusted operating margin to the most directly comparable GAAP measures, because material items that impact the measure are out of company's control and cannot be reasonably predicted

### Karl A. Roessner

*Chief Executive Officer & Director*

### Q3 HIGHLIGHTS.....

- It's a pleasure to speak with you again, now with a little more than a year under my belt as E\*TRADE's CEO and especially in the wake of strong results and solid progress across our key initiatives and growth goals
  - This past quarter, we were busy to say the least
- So, I'll start with the hit parade and then revisit each element in more detail

#### Integration of OptionsHouse

- In early August, we completed the integration of OptionsHouse, bringing all of our customers into the E\*TRADE ecosystem and capturing all expected revenue and expense synergies
  - With this work behind us, we have now pivoted our efforts towards the most exciting component of this initiative, unleashing the full power of the industry's top derivatives platform

#### Marketing Front and New Campaign

- On the marketing front, we enjoyed an overwhelmingly positive response to our new brand campaign, driving strong customer growth and increased engagement
- We are on to the second phase of our new campaign, in which we evolve our messaging to further highlight E\*TRADE's value proposition along with new, powerful and irreverent creative

#### Services and Platforms

- We continue to improve the customer experience through several enhancements across our services and platforms
- We marched forward on our capital deployment initiatives, buying back \$187mm worth of stock and onboarding customer deposits to grow our balance sheet to slightly north of \$60B in total assets
  - We capitalized on the continued improvement to our credit profile and a recent ratings upgrade to refinance our corporate debt, landing a three handle on our average coupon for savings of \$17mm in annual interest expense

#### DARTs and Customer Margins

- We enjoyed strong customer activity in continuation of the summer's trend and we're now tracking toward our best year in E\*TRADE's history for DARTs and customer margin balances
- We made solid progress against our growth objectives
  - With 32% derivatives mix, in line with last quarter's record, \$4.9B in managed assets, YTD account growth in our targeted range, and YTD asset growth up considerably from last year

#### New Corporate Services Clients

- We gained significant ground in our push to win new Corporate Services clients, closing meaningful new business for approximately \$8B in stock plan assets to come on to our platform in the coming quarters, and we generated solid revenue growth against sequential and year-ago periods, in spite of the shifts to the commissions landscape, demonstrating the strength and effectiveness of the E\*TRADE model in market environments like today's

#### Organic Initiatives

- In a nutshell, we're very pleased with our progress and today's results
- Results that allow us to focus, not just on organic initiatives, but also on those strategic ones that will further generate value for our shareholders

#### Customers' Investable Wealth

- As you may know, E\*TRADE strives to be the number one digital broker and advisor to self-directed traders and investors
- Yet with only 10% to 12% share of our customers' investable wealth, we fully recognize that key segments of our customers look elsewhere for hands on management

#### Acquisition of TCA

- Accordingly, we have been searching for the optimal way to approach this population through a superior technology and custody platform in service of independent RIAs
- And within that context, I'm thrilled to announce the acquisition of TCA, a leader in the RIA custody space, which will enable E\*TRADE to tap into a growing segment of our industry, while bolstering our ability to retain customers and assets in need of higher touch services

#### Corporate Services Channel and TCA Platform

- And as you recall, this is one of the areas we've been evaluating through an inorganic lens for some time

- Particularly within our Corporate Services channel, where many participant executives leverage our stock plan administration services, but seek financial planning and wealth management elsewhere, we want to expand our ability to serve their needs within E\*TRADE.
  - By incorporating our custody platform and addressing the advisor services space through select independent advisors on the TCA platform, we dramatically expand the opportunities to capture this wealth
- Additionally, we believe the extension of the E\*TRADE brand will provide this team with ample opportunities to showcase their superior platform to more advisors
  - Their technology is truly a stand out in the space with an open architecture framework that interacts seamlessly with top platforms for accounts aggregation, risk profiling, compliance and CRM.
- They offer full mobile accessibility for advisors and end-clients, robust customization tools that enable advisors to develop personalized branded applications for their clients and they package all functionality in one easy-to-use platform

#### INNOVATION IN DNA

- Further, from our interactions with TCA, it's abundantly clear that we are cut from the same cloth
- The company has innovation in its DNA and an exciting culture that closely aligns with ours
- We fully intend to continue to foster this spirit under their existing structure with their CEO as the head of the unit within the E\*TRADE family
  - Mike will cover the financial considerations and how we intend to fund the deal, which we expect to close during Q2 next year

#### INITIATIVES

##### OptionsHouse Integration

- Now, back to our results
- Since I took the helm over a year ago, I've outlined and reiterated three core initiatives, which we have been tirelessly focused on to fuel our growth and meet our goals
- First is the OptionsHouse integration; second, our marketing; and third, improving the customer experience
- So, allow me to walk through where we stand on each one
- With regard to the integration, following a year's worth of mapping, planning and hard work, we completed the customer conversion during the first week of August
  - With all of our customers now within one ecosystem and the back and middle office connections forged, we are focused on the more exhilarating task of delivering a topnotch experience that caters to derivatives traders, long-term investors and novice consumers alike

##### UNIFIED PRODUCT OFFERING AND ACTIVE TRADER CHOPS

- I'm grateful to say that we are placing a checkmark on our to-do list by the word integration
- There is still much work to do to deliver a unified product offering that showcases the best of all we have to offer, but it will happen as one company
- As it relates to our reengineered Active Trader chops, when taken as part of our new Active Trader offering, upon which I will elaborate shortly, we believe we are well poised to welcome more of this attractive segment to E\*TRADE, while introducing the power of derivatives to more main street investors

## Brand Campaign

- And on that note, following the June launch of our brand campaign, we've been exceptionally pleased with the response to the work we have deployed, which is reflected in our brand health, advertising effectiveness scores, and most importantly in our business results, where we have truly benefited from the improved awareness

## ADVERTISING

- At E\*TRADE, we're known for our advertising
- And while we enjoy this reputation, we believe it is equally important to understand that our marketing does not begin and end with our ads
- Marketing, particularly how we approach it, is far more
- It's how we address our customers and prospects at every touch point
  - From the positioning on our public site to how our offerings are presented across our platforms, to the messaging leveraged by our customer service reps, to the way our entire set of products and services is packaged together into an overall value proposition

## POWER E\*TRADE AND BRAND LEVEL CAMPAIGN

- And in that spirit, we're gearing up to complement the brand campaign with the launch of a consolidated offering and value proposition for our Active Trader segment called Power E\*TRADE.
  - This package delivers a one, two, three punch of a best-in-class trading platform backed by support from trading specialists and offered with exceptional pricing
- Qualification for this program is 30 trades per quarter and leverages are lower pricing tier of \$4.95 equity trades, \$0.50 option contracts and \$1.50 futures contracts
- At these prices, when coupled with exceptional guidance from a dedicated services team and a killer trading platform, we believe we can grow our market share among active traders and win in this space
  - The work supporting this program is strong and I look forward to its launch in the weeks to come
- To complement this highly functional product-centric work, we'll also shortly roll out Phase 2 of our brand level campaign, Don't get mad Get E\*TRADE.
- Our messaging will continue to evolve further unpacking our value proposition and ensuring that E\*TRADE reclaims its mantle as the undisputed home for active traders
  - After all, we are the original place to invest online
- Stay tuned, because it's going to be a fun ride

## DISTINCTIVE MARKETING

- In reflecting on all that we've accomplished in such a short period of time, I can confidently say that we have addressed the need to improve our marketing
- We are moving steadily in the right direction with bold, distinctive marketing that places us back on the map
- Our charge was to recapture our brand and speak to our customers more directly and forcefully than ever before
- I firmly believe we're doing just that
  - So, let's again pull out our E\*TRADE to-do list and etch a big fat checkmark next to the second key area of focus

#### Customer Experience

- Our third and final key area of focus is our commitment to improve the customer experience
- Frankly, this work will never be complete, so I won't give this one a checkmark, but simply say, I could not be prouder of the team's work in this important area
  - This past quarter, we delivered a host of enhancements from the exciting to the mundane, but all focused on serving our customers better

#### SECURITIES-BASED LENDING PRODUCT

- So, for a few of the highlights from this quarter, we launched a securities-based lending product, delivering another avenue for customers to utilize their portfolios and E\*TRADE to achieve their financial goals
- We made enhancements throughout our investing offerings, launching a new managed account dashboard and refreshing our managed account pages, making them easier, more intuitive and more useful
  - It's evident that we are fostering real growth against our \$6B managed asset goal through the enhancements we're making here

#### TRADING

- And lastly, we took some initial steps in our concerted push into futures trading, releasing capabilities across some of our platforms
- There will be much more to share on this front over the next two quarters as we expand the availability of futures across our platforms and meaningfully enhance the experience from where it stands today
- We were also pleased to be showcased during Apple's announcement of the new iPhone X and look forward to incorporating their technology to make a seamless and secure experience for our customers

#### Housekeeping Enhancements

- As for the housekeeping enhancements we made, which while certainly less adorned than our shinier initiatives, are no less important
- We transformed our document upload process
- This sounds a bit boring, but it's actually a top driver of customer feedback
  - Enhancing this process has removed one of our key customer dissatisfiers
- We also improved our online application process to more seamlessly verify customer information, while expanding the information and functionality for IRAs
  - Translation, we're making it easier to become an E\*TRADE customer, and that's certainly a good thing

#### Customers and Derivatives Trades

- As for our metrics, our customers remain highly engaged with the markets this past quarter, generating DARTs of 206,000, down just slightly from last quarter's record levels, but still on pace for our strongest year ever in trading
- Our mix of derivatives trades also held strong at 32% for the quarter

### Pricing

- One important element within our customer trading is the price point at which it is taking place and why
- When we initially struck the bifurcated pricing schedule defined by our \$6.95 standard rate, and our \$4.95 Active Trader tier, we reasoned that by lowering the qualification threshold from 150 trades to just 30 trades a quarter for the discounted offering, we could assist less active customers in engaging a little more meaningfully to realize a better value proposition
  - This has indeed proven to be the case and we have noted an increase in trading by customers to meet the qualification for lower pricing
- While this migration was a large driver behind the dilution of commission per trade, this is a trend we can certainly live with, as we're capturing more volume from our existing customers and our value is clearly resonating
  - We're excited to see what more we can accomplish as our Power E\*TRADE campaign takes flight

### Customer Margin Balances and Net New Brokerage Assets

- To continue, we ended Q3 with customer margin balances at a record \$8.5B.
- Net new brokerage assets of \$2.2B brought our YTD growth rate to a healthy 4.4%, a full 100BPS higher than the same period last year and well on our way to reaching our targeted rate
  - Managed assets ended the quarter at \$4.9B, an increase of 32% from last year, more than double the growth of the equity markets
- We added 26,000 net new brokerage accounts for our strongest Q3 ever, bringing us to 126,000 YTD, which is more than 60% higher than the same period last year and reflects a YTD growth rate of 4.8%, within our targeted range
- In terms of our October activity, through yesterday, DARTs for the month were trending at around 206,000, flat with Q3 levels
  - And customer margin balances had come in slightly to around \$8.3B.

### Corporate Services Channel

- As I discussed last quarter, our Corporate Services channel continues to be a strategically important driver of retail brokerage accounts, assets and cash
- And by adding new business to this pipeline, we essentially increase our metabolism from within
- And we amplified our focus on growing new business as the market is presenting a significant opportunity for a leading offering like ours to win share
- Our third quarter proved fruitful in this reinvigorated pursuit

### Equity Compensation Administration Platform

- For the sixth year in a row, our equity compensation administration platform, Equity Edge Online, was rated number one in overall satisfaction and loyalty by Group Five
- This year we were also rated highest in overall satisfaction for brokerage services
  - These are welcome accolades and serve as a testament to how tirelessly we work to arm our clients with forward thinking technology and support

## New Participant Companies

### NEW STOCK PLAN ASSETS

- We also made a splash in the wake of some turbulence in competitor offerings and were able to win some serious business
- As noted, landing 22 new participant companies, representing \$8B in stock plan assets across more than 110,000 new participants
  - This is in addition to the \$4B in new stock plan assets implemented YTD, which is a 60% increase from the same period last year and represents 20,000 new participants now enjoying our service

## Implementations Pipeline

- Let's keep in mind, though, that this is a very long lead business with many implementations taking a year or more to complete
- For those in our current implementation pipeline, we expect to have them on our platform within the next six quarters
- Further, all indications point to more interest and more agreements on the horizon and I look forward to sharing more as these come to fruition

## Corporate Services and Referral Program

- We're very encouraged by these trends and are intensely focused on building out a fulsome offering that caters to the specific needs of high net worth investors who come to us through Corporate Services
- We're approaching this challenge from several angles
- In addition to the acquisition we announced today, we're also exploring other ways to serve these participants, including the rollout of the tailored cash product, as well as the securities-based lending offering I mentioned earlier, which will provide another tool for participants to capitalize on the value of their stock plans
  - We are also piloting a referral program with a prestigious private bank to offer services to the senior executives of our participant companies

## Management Team

- Now, before Mike takes you through our results and capital, I wanted to touch on some promotions within our management ranks during the quarter
- As we welcome two internal stars to the executive leadership team, appointing Lea Stendahl as CMO, and Lance Braunstein as CIO.
- Lea is an E\*TRADE veteran and marketing maven with a heavy hand in some of E\*TRADE's most successful and memorable campaigns throughout our history
  - She recently returned home following a three-year stint with the competition, and on the heels of a phenomenally successful brand launch and a reinvigorated marketing department, we have elevated her title to match the scope of her responsibilities
- As for Lance, in addition to adding a brokerage industry leader, Mike Curcio, and best-in-class derivative trading capabilities, one of the things that excited us most about OptionsHouse was their approach to tech dev under Lance's leadership, specifically in their delivery of cutting edge trading technology and user experiences on much leaner resources

- Lance has been running our tech dev since we closed the acquisition and his fresh perspective has pushed us to work faster and smarter, reigniting our innovative spirit
- To further stoke these fires, I have placed all of our technology efforts under Lance and I move the role to report directly to me to ensure our delivery receives all the attention it needs
- We are, after all, a tech company

## CLOSING REMARKS

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- Bottom line, as I wrap up these opening remarks, it was yet another blockbuster quarter
  - We are in a period of the company's history where homeruns are frequent and high performance is business as usual
    - Frankly, this makes my job a heck of a lot of fun and I'm excited by what more we will be able to share with you along the way in continuing to deliver value for our customers and for our shareholders
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## Michael A. Pizzi

Chief Financial Officer

## FINANCIAL HIGHLIGHTS

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### Net Income

- For the quarter, we posted net income of \$147mm or \$0.49 per share, which includes a handful of notable items that had the net impact of reducing results by \$0.06
- Overall, it was another quarter of solid results across-the-board, as our business maintained strong momentum in trading volume and margin balances, we on-boarded deposits to grow the balance sheet closer to our year-end target, benefited from the full quarter impact of the June Fed hike and maintained prudent control over our expenses

### Loss and Interest Expenses

- As for the notable items, first, we reported \$58mm loss related to the early extinguishment of debt associated with the refinancing in mid-August, when we issued \$1B of 5-year and 10-year senior notes at a weighted average coupon of 3.3%, replacing an equivalent amount at a 5% average rate
  - This reduces our annual interest expense by approximately \$17mm

### Costs

- Second, we recorded approximately \$11mm in costs related to the OptionsHouse integration, as well as the regulatory build out related to crossing the \$50B threshold
- As Karl mentioned, this quarter mark the final step of the OptionsHouse integration and this will be the last time we discuss costs associated with that deal
- Partially offsetting these negative items was \$29mm benefit to provision for loan losses
- The portfolio outperformed our assumptions and we had net recoveries during the period, which together drove the provision benefit
  - The allowance for loan losses ended the quarter at \$94mm

#### Tax Rate

- And finally, our effective tax rate for the quarter included an \$8mm income tax benefit to the revaluation of our net deferred tax assets
  - This revaluation typically occurs during Q3, and excluding this benefit, our rate was closer to 38%
- We expect the full-year 2017 tax rate of approximately 37% and a full-year 2018 tax rate in the mid-38% range
  - We expect to see quarterly volatility in our tax rate going forward due to these reevaluations and the impact of share-based compensation awards

#### Revenues

- Now, let's move on to the core results
- Net revenue of \$599mm was up \$22mm from the prior quarter, primarily driven by an increase of \$35mm in net interest income, as we grew average interest earning assets by \$2.9B and net interest margin expanded 11BPS to 285BPS.
  - This was better than our forecast as we refinanced our corporate debt, we're opportunistic in our timing of securities purchases, grew customer margin balances to record levels and securities lending came in strong
- For Q4, we are assuming net interest margin in the low- to mid-280s, assuming margin balances remain at their current levels and we reinvest in securities in the 240-basis-point to 260-basis-point range, consistent with current market levels

#### Commissions and CPT

- Commissions of \$100mm declined \$5mm from Q2
- While overall DARTs moderated slightly, average commission per trade declined by \$0.26 to \$7.76 on the dynamics Karl discussed earlier of higher pricing tier customers qualifying for a lower pricing tier, as well as lower overall stock plan trades in the period, which is consistent with seasonal trends
- Including these variables and assuming the successful adoption of futures trading over the course of the next few quarters, we expect CPT will decline additionally from today's levels to the low 760s going forward, on average

#### Fees and Service Charges

- Fees and service charges declined by \$6mm, largely attributable to the shift of third-party cash to our balance sheet
- One housekeeping note, we are now providing the detailed breakout – breakdown of this line item in the press release, in addition to the 10-Q, where it's been included for some time
  - So, go ahead and add that tier list of enhancements to the analyst experience
- We're here to please

#### Debt and Costs

- Excluding the charge for the early extinguishment of debt, non-interest expense was \$347mm in the quarter, placing our adjusted operating margin at 42%, which excludes the provision benefit, but includes the \$11mm in costs related to the OptionsHouse integration and crossing the \$50B threshold
  - This marks the final installment of the OptionsHouse implementation costs and we expect \$50B related costs to be around \$3mm next quarter and \$10mm over the course of 2018

- Given the relative size of these remaining costs, we do not plan to continue breaking them out

#### Operating Margins and Investments

- With respect to full-year adjusted operating margin, we previously guided towards 39%, including an expectation for Q3 to be in line with Q2 level of around 38%
  - While we grew the balance sheet as planned, customer margin growth and overall NIM outperformed and customer volumes came in strong
- Additionally, we shifted some planned investments to Q4 and added to our marketing spend to coincide with the launch of Power E\*TRADE.
- For Q4, we are expecting our adjusted operating margin to be 40%, which includes total marketing expense in the \$45mm to \$50mm range
- I will cover our views on next year's adjusted operating margin in my closing remarks

#### Capital and Balance Sheet Growth

- With respect to capital, we repurchased \$187mm or 4.6mm shares at an average price of \$40.64, on track to complete the \$1B program by the end of 2018
- On balance sheet growth, we continue to plan to end the year at \$63B.
- Given current off-balance sheet deposits of around \$7B, with more than \$3B available to be on-boarded, we have the ability to grow to around \$64B if we were to deploy all available deposits today
  - Beyond 2017, we assume that our balance sheet will scale in line with customer deposits

#### Corporate Cash and Distribution

- As for corporate cash, we ended the quarter at \$309mm, down \$160mm sequentially, driven by a repurchase activity and the debt refi
- This was offset by \$100mm distribution during the quarter to the parent from the broker dealer
- For Q4, we expect this distribution to be \$125mm

#### Acquisition of TCA

- With respect to the acquisition of TCA, for the full-year 2018, we expect the deal to be neutral to our bottom-line results, inclusive of the cost of the preferred stock we plan to issue to fund the transaction
- For 2019, we expect \$0.02 of earnings accretion with an IRR of approximately 20%
  - This assumes only modest expense synergies as TCA will continue to operate as a standalone platform

#### Growth and Synergies

- Additionally, we'd expect an acceleration of their growth in their assets under custody, driven by the extension of our brand against the platform and capabilities
- When full synergies are achieved in 2019, we expect TCA to contribute approximately \$80mm in revenue and be slightly accretive to our overall operating margin
- Finally, while it should go without saying, this acquisition does not alter our share repurchase program and doesn't have any bearing on our short-term growth targets, but it unlocks the potential for significant long-term growth

## Expenses and Rates

- Now turning to expenses and our outlook for next year
- As we enter the final stages of our budgeting process, we have developed an informed view of our outlook for 2018 and are targeting an adjusted operating margin for the full-year of 42%
  - This assumes no increase in the Fed benchmark rate from current levels, includes the impact of the TCA acquisition and incorporates our plans to increase investments in the business over the course of the year, including a ramp-up in marketing spend and other areas we believe will enhance our growth
- If the Fed were to raise rates in December, as is widely anticipated, we believe we can achieve a 43% op margin for next year
  - Hitting these targets will not be easy and will require discipline on how we manage the business and our investments, but we are steadfast in our approach to deliver on these goals

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## QUESTION AND ANSWER SECTION

Richard Henry Repetto

*Sandler O'Neill & Partners LP*

Q

If I heard you properly that in 2018 you're expecting \$80mm in revenue from TCA. It looks like the last 12 months run rate was \$50mm, so I'm just trying to understand how you – is – are my numbers correct? A little background on the synergies if I am correct. And then, what are the margins right now at TCA?

Michael A. Pizzi

*Chief Financial Officer*

A

On the fully synergized, so it's 2019 is the year for the \$80mm in revenue. Next year is only going to be half year on the close. We expect margins to build in line. We think it's not – it's in the operating margin guidance we gave for next year, 42% based on a Q2 close. We think when fully synergized, it will be modestly accretive to our overall operating margin.

Richard Henry Repetto

*Sandler O'Neill & Partners LP*

Q

And then, my one follow-up. Karl, we talked a lot about the trade – average commission and the movement of people down to the lower rate. And I'm just trying to understand, I guess, did you find it – is that accretive – did you find it accretive that the trades made up for the low commission in this quarter or is this something that will happen going forward you expect?

Michael A. Pizzi

*Chief Financial Officer*

A

We've been seeing the effect since the pricing change. Now, is it existing customers feeling like they add a few more trades to the mix or is it a customer who's trading at a multiple different accounts across companies that's pushing more to us, it's accretive, it's a positive impact, our customers are engaging more with us and doing more and giving us more activity. So, overall, we think it's a great outcome.

Karl A. Roessner

*Chief Executive Officer & Director*

A

And the big thing for me, Rich, when I look at this and Mike is exactly right, we're just about to roll our Power E\*TRADE campaign and what this demonstrates for us and gives us some early anecdotal evidence is that the value prop that we're putting out there is the right one. There are people interested in engaging with their finances through us in derivatives, particularly at this price point with the service team that we have available to them on our platform. So, it's early good results in my view.

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Steven Chubak

*Nomura Instinet*

Q

I wanted to start off with a question on payment for order flow. It's certainly a topic that's been garnering a lot of focus since the October Treasury report, and a lot of investors seem to be going through this exercise of order flow game theory. So, trying to anticipate how you might respond if a large competitor chose to potentially rebate order flow fees back to their clients? And I was hoping you can give us some insight into whether you view this type of response as analogous to what we saw in February with the commission price cuts, which ultimately prompted you and some of your peers to respond with similar actions or are the considerations around order flow a bit different in your view?

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Karl A. Roessner

*Chief Executive Officer & Director*

A

People have talked about order flow and payment for order flow and routing and how market structure fits in and what are we going to do in this space and there must be a change, and there is money here, there is money there. The way I look at it, our investors and the folks who invest with us and the folks who interact with our transactions have never received better execution quality than they're receiving right now, both in terms of speed, in terms of what they get back when we do price improvement for them, it's a very strong dynamic right now.

So, looking at payment for order flow in a bucket where should you rebate it or should you do these different things, in my view, you'd be – in this parlance you'd be mil-wise and pound-foolish to take away some of the payment that comes in to us. A lot of what we do with that and a lot of what we look at are further improvements to our site, further improvements into the trading experience. So, that's one of the things that allows us to continue at the price points that we do and drive the kind of value prop that we do for our folks who interact with us for our customers.

So, I don't see this as the same thing in terms of price pressure, price competition. Obviously, we've said this before and we'll stand by it again, we'll do whatever it takes to defend our book. So, if anything like this were to go on or there were to be changes that take place, we'd evaluate them in the same vein and take a look at how they're going to impact our customers. Is it going to cause people to go and move elsewhere? I strongly doubt it, right, we still haven't seen the dislocation from the price cuts and those were hell of a lot bigger deal than something like this. So, I don't see it coming that way, but we'll obviously continue to evaluate it. But the way I look at it, the value proposition that we have right now is unlike any that we've seen in the history of trading.

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Steven Chubak

*Nomura Instinet*

Q

And maybe a question, Mike, for you on deposit beta. Your deposit costs have stayed remarkably low, despite some recent increases that we've seen at some of your retail brokerage peers. As we think about the deposit price competition from here, do you feel any pressure to potentially stay competitive with some of the large e-brokers or because they have a much larger RIA operation, even after this latest deal where deposit beta should in theory be higher, is it reasonable to expect that you will continue to lag the peer set with future hikes?

Michael A. Pizzi

*Chief Financial Officer*

A

We've always thought of our deposits as rate insensitive. We model them that way and it shows as evidence in the beta. And I would say that in this hiking cycle from the Fed that we've been going through, they are even more insensitive than we modeled. Yes, it's a concern for some customers and we do look at the competitive environment. We look at the set of products that we offer across various [ph] sweep (34:08) products and other cash management alternatives and really factor it in to our assessment. But overall, by and large, we're not seeing a large need to move deposit rates at this time.

Devin P. Ryan

*JMP Securities LLC*

Q

Maybe a follow-up here on TCA and just kind of thought process. Obviously, it's a scale business, some of the large custodians have hundreds of billions of assets, some over \$1 trillion, and I know you understand that it's a scale business. So, I'm just trying to think about when you're looking to purchase this business, how it's really differentiated? And when you look at the technology that you referenced, is there overlap with what's being offered at some of the other custodians, or do you feel like there's a big point of differentiation there?

Karl A. Roessner

*Chief Executive Officer & Director*

A

I feel like some of the usability on their platform in the way that it's rolled out to their – the customer set, both on the RIA themselves and then to the end-user and the availability on mobile and the way that they can interact and plug-in in the open architecture, I think, they do have a differentiated offering, well aware that this is a scale business, when we look at TCA, we see a couple of different things, right. One is obviously the ability to diversify our revenue streams and bring additional into us for a channel that we haven't played in, it is a custody platform for us.

The second thing is, putting our marketing and branding behind us to help them grow, and go out and garner additional assets. But one of the most important things that we look at and we talked about strategically, both with the board, the management team first and then with the board, was giving us additional tools and an additional avenue to really go out and work on our stock plan participant base.

A lot of the assets that leave us through that channel do indeed go either to bulge bracket firms or to RIA channel, and it is something that we think we can use to harvest additional share of wallet and continue to keep more of those assets on us, so that's the way we look at it, just holistically, as looking at this deal.

Devin P. Ryan

*JMP Securities LLC*

Q

And just a follow-up here. You spoke about some of the competitive dynamics in the corporate stock plan business, which E\*TRADE has been benefiting from, and I know that some of your competitors are outsourcing onto certain FinTech platforms, I'm assuming that was what you were referring to. But, do you have a sense of how long that window will be open as firms are kind of migrating, and are you having more conversations around some of the migration where you feel like you can win some contracts away?

Karl A. Roessner

*Chief Executive Officer & Director*

A

We're still in early days of the migration and moving on to those outsourced technology platforms. So, we're just starting to see some of the early results, some of the deals that we announced, and actually most of those are not a result of dislocation, they're just a result of the stellar team that we've built around this and the guys who go out and work with these big corporates everyday and satisfy their needs. I mean, Equity Edge Online provides lots of functionality to these companies and we've been able to tailor it in a way that is extremely helpful. And when you get into some of the bigger players in this space, you can grow quite quickly just in terms of being helpful with their HR departments, helpful with their legal departments and moving from there, so you get a good reputation which we have a stellar one and you grow from there. So, the dislocation, I believe, is still to come, we're starting to see some initial RFPs, remember when they change their stock plan provider, most of these companies will – that's what it's doing when they go to their outsourced technology platform. So, we get a shot at that and I like our chances in every one of them.

---

Conor Fitzgerald

*Goldman Sachs & Co. LLC*

Q

Just on the TCA acquisition again, can you just give us a breakdown of the \$30mm of revenue synergies you talked about? Is there anything kind of from a revenue uplift per dollar client assay you think you can see vs. some of maybe the growth you kind of talked about? And then – and on that, just how will the advisor experience at TCA change post this acquisition?

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Karl A. Roessner

*Chief Executive Officer & Director*

A

The experience for the RIA will not change at all. This is going to be run as a separate unit for us. Their senior management team, which I'm quite impressed with, will remain in place and will run it together, so there won't be a change to their overall experience. So, Mike, you want to go through the numbers?

---

Michael A. Pizzi

*Chief Financial Officer*

A

When you think about further synergies of a deal like this, first off, you have synergies from just a general corporate type integration. So, what I would consider finance functions like I run, the risk function or other areas where we can bring at scale operation to them. That's obviously a very modest amount of cost synergies, but it is a factor in the deal.

When you look to the revenue side, we expect our brand and, say, some modest investment in the business, should be able to drive additional growth overall. We think, it's a capable technology platform that is differentiated in the space and will allow some degree of additional growth.

And then, really, like a third category, I would say, is our relationships with vendors, our relationships with fund companies, asset managers, where we think we can deliver overall better economics to them, what they are earning on those relationships.

Putting all of those pieces together, you get to the fully synergized revenue. Now, keep in mind, you took the last 12 months from the investor deck and you took the number we gave in the prepared remarks and said that the synergies, there is a level of baseline organic growth. They have been growing. So, it's not entirely correct to call that number the synergies.

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Conor Fitzgerald

*Goldman Sachs & Co. LLC*

Q

And then, I appreciate the expense outlook for 2018. Just I'm trying to think through some of the moving pieces, you had a really strong expense disciplined quarter, I think, a 44% core pre-tax margin. When you're thinking about setting the 42% target for next year, can you just give us a sense of how much will be kind of investment in the business vs. if revenues come in better in some of the strong trends we've seen on trading continue, what that upside scenario could look like?

Michael A. Pizzi  
*Chief Financial Officer*

A

The key investment that we call out really and you can see it in the plan really going into Q4 from Q3. Q3 is a period of time where we didn't spend as much on marketing simply because it's, generally, a quieter time. So, we shifted some of that into Q4 of this year.

So, similarly, for next year, with the launch of Power E\*TRADE, with the now fully integrated OptionsHouse platform, with our investments really in a more capable futures platform and everything that we're doing, correspondingly, we're upping marketing again. That's really one of the key drivers. But, we are really looking through and continuing to apply discipline in other areas of expenses, so that overall we can deliver a pretty compelling operating margin of 42% for the year, and that's really without the Federal Reserve – any action from the Federal Reserve in December. With the Fed moving 43%, and a good market backdrop like we've been having, we think 43% is very achievable.

Brennan Hawken  
*UBS Securities LLC*

Q

One quick one on the commission indication. I think, you said that you expect it to go to the low 760s going forward, but does that include what you expect will be the impact of Power E\*TRADE or is that for that?

Michael A. Pizzi  
*Chief Financial Officer*

A

That includes the impact of the launch of Power E\*TRADE, additional customers coming on from that in the \$4.95 type level, that's really a forecasted level. And, I think, also, it's in the remarks, but I'll reiterate it. It'll also – it considers a build in our futures trading at \$1.50 that does drag, I mean, on the number as well, but we think that's a very compelling price point to be putting out there in that market.

Brennan Hawken  
*UBS Securities LLC*

Q

And then, one more on TCA. When we think about this and your comments with how it fits in with the wealth management opportunity and the tie-in with your corporate stock plan, is that tied to previous comments? I believe you've indicated in the past that you're looking more to target the middle management layers for your corporate stock plan customers or does the acquisition of TCA lead you to adjust those aspirations at this point?

Karl A. Roessner  
*Chief Executive Officer & Director*

A

The way I look at the stock plan, and we talk about this a bit, right now before we talk about what we're onboarding and how well we've been doing in that space, it's about 1.5mm plan participants who are on us that have an event taking place, whether it'd be a restricted stock ground, an option or a performance share unit or something in their pipeline with us.

So, we're looking at the entire spectrum. I believe some of the comments we made in the past have been around the C-suite, the senior management folks, then the Section 16 officers, a lot of those folks are tied into some of the bolt bracket relationships that the companies have, whether it'd be through the underwriting – underwriters and an IPO or other senior members. So, that is definitely an echelon that's a bit tougher to crack and you need to be able to go after that segment with the right tools of the trade.

So, we talked a little bit about our initial sort of fledgling relationship that we're developing with a private bank to go in and offer additional services to that group. And some of those folks in that tier and the tier down also move off of their own platforms and move out of our platform and go to investment advisors, right. So, and then, the other folks in terms of education and the folks who would be more in the main street population as our customers, it's really about driving them through education and providing the tools and services to let them interact with their finances seamlessly and very easily, giving them technology that works for them, getting to them early and providing them with opportunities to understand how they can do better with their – interacting with their finances.

So, it's really the entire spectrum, I don't think we're changing anything. What we're trying to do is, put as many tools in our arsenal as we possibly can, to make sure that we don't lose any of those customers who we could otherwise keep if we had the service they were looking for out of that lane. So, it's really raising E\*TRADE's profile with that group of individuals, so that they don't just look at us as a service provider, but more as their stop when they want to deal with their finances.

---

Daniel Thomas Fannon

*Jefferies LLC*

Q

Another question on TCA. I guess, could you give us a sense of what the growth has been organically over the last couple of years? And then, also, if you could be more specific about kind of the growth assumptions you're kind of making, as well as what market assumption you're making as you think about the growth – the 2019 revenue target?

---

Michael A. Pizzi

*Chief Financial Officer*

A

When we think about sort of the level of growth, we think that picking up a couple of percentage points just for making some modest investment and backing the platform with our brand is readily achievable. Historically, they've grown to about \$17B in assets under custody, there are about 180 total advisors. Again, a very capable platform, growing in the high single-digit range.

---

Daniel Thomas Fannon

*Jefferies LLC*

Q

And your assumption for the market over those next year-and-a-half, two years?

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Michael A. Pizzi

*Chief Financial Officer*

A

That's a consistent market environment for the one we've been in.

---

Chris M. Harris

*Wells Fargo Securities LLC*

Q

On the Power E\*TRADE, it sounds like you're confident that you're going to be picking up share there. So, wondering if you guys could comment on what capabilities you think Power E\*TRADE has or does a better job with than the competition?

Karl A. Roessner

*Chief Executive Officer & Director*

A

I've to look back at where OptionsHouse sort of came from and the growth that they were able to experience, offering best-in-class platform out to their customers, putting our brand behind that, rolling out those tools and functionality out to a broader base, including our existing E\*TRADE population, as well as those who are underserved in this marketplace, we're extremely confident about the brand, about the service platform that we'll go out with and also about our Active Trader sales team that is dedicated to this group and to this platform. So, we very much like the market opportunity this brings to us.

Chris M. Harris

*Wells Fargo Securities LLC*

Q

The other question I had was on your NIM, and specifically the securities portfolio yields. We've been pleasantly surprised that how well that yield has hung in over the years. And if we look at it now, though, it still has a weighted average yield higher than the 10-year treasury rate. And so, just not sure how that's possible, given that, I thought your portfolio duration will be much lower than that. Could you guys can maybe talk to us a bit about that dynamic and how it's been so stable?

Michael A. Pizzi

*Chief Financial Officer*

A

Primarily, we buy agency products. So, we're buying agency mortgage product typically in that sort of belly of the curve. I think, if you look at sort of the type of yields that offers and that's on sort of a duration match basis to our deposit liability, that has allowed us really to invest in the type of marginal investment ranges over the course of this year. This – right now, in the market, we think the right investment rate is going to be right around the mid-2s, and you can compare that to kind of where our overall asset yields are, and that's – those yields are readily available on a variety of type of products that we invest in.

Michael Carrier

*Bank of America Merrill Lynch*

Q

Just one more on TCA. On the revenues, just wanted to get any color on, I guess, like the revenue mix in terms of when we think about commissions vs. fees, cash, and obviously if you can grow that business just over time, how that would maybe either diversify your earnings stream?

Michael A. Pizzi

*Chief Financial Officer*

A

Right now they come to us with about \$1.1B or so of customer cash that is going to be directly and into our sweep program on the close date. So, that does give us overall available cash. Now, because these are advisor relationships, they hold less cash on average per account than what we have in our sort of retail brokerage accounts, but it's going to scale really as they grow assets over time in terms of the amount of cash that they provide. They have some other ancillary revenues, but the rest of it comes from the fees they charge on the assets under custody.

Michael Carrier

*Bank of America Merrill Lynch*

Q

And then, second, just if – as we get into 2018, Mike, if we end up getting further Fed hikes in addition to, say, one in December, how would that impact either the margin outlook or maybe the incremental investment spend? Like, well, most of that be coming to the bottom-line or are there investments on the horizon or on the backlog that

if you do get more in terms of rate benefits that you would spend more to accelerate some of the growth initiatives?

Karl A. Roessner

*Chief Executive Officer & Director*

A

The way we look at this if we get more rate hikes or there's additional revenue available, we'll obviously drop as much as we can to the bottom-line, but obviously, the sort of all boats rise in the rising tide. So, to the extent that we see additional competition, which I would greatly expect, you would see us investing more in our marketing dollars, you may see us investing more in the platform and in technology. We've been pretty clear in terms of the long-term earnings slide that we put out there and where we'd be and how we'd handle this. We are a little bit conservative in those estimates, which I freely acknowledge, but I think, there are a lot of things that we will need to be doing to keep up in a competitive landscape like that in a rising rate environment.

Michael A. Pizzi

*Chief Financial Officer*

A

The long-term earnings slide does a great job. If you think about 100-basis-point parallel shift and what could be achievable from that, we have it at a 46% operating margin. That roughly implies almost an 80% sort of flow through on the marginal economics of increases in rates.

I guess, what I would sort of – the only thing I would put out there is sort of deposit betas, which we've already sort of talked about on the call, but we think that, those assumptions in that slide do assume that we move our deposit rates with market. So, to the extent you think there's going to be outperformance, there could be, or there's a catch up, there may be. But we think that operating margin expansion is very possible – not possible, but highly likely with continued interest rate hikes overall and still allowing some of that to be reinvested into the business.

Kyle Voigt

*Keefe, Bruyette & Woods, Inc.*

Q

Just one follow-up on the strategy with TCA. You already noted earlier that the RIA spaces, the custody space is a scale business. Just wondering, as we get into 2018 and this deal closes, just trying to understand if you continue to look for other small bolt-on type deals in order to gain scale in that space?

Karl A. Roessner

*Chief Executive Officer & Director*

A

The way that we've talked about our inorganic strategy is, we'll continue to look through the same lens that we've looked through for the use of our capital, right, what makes the most sense, is it buying back, is it moving more onto our balance sheet and maximizing that and monetizing the cash that's available to us.

So, that remains the same. The areas that we're interested in obviously remain the same if there is a scale play that would be available on the brokerage side, we'd definitely look to take a look at that opportunity, if there was something in the Corporate Services side, which is a business very important to us to help us grow scale in that space. And then, as we look at TCA, if we get the acquisition done in the middle of 2018, we'll look at where it is from a strategic perspective, but we'll continue to be the same stewards of capital that we've been during the past number of years now.

Kyle Voigt

*Keefe, Bruyette & Woods, Inc.*

Q

And then, just a follow-up, just really on the additional preferred issuance. I guess, I'm just wondering if you can give an update on your desired capital structure really just, I guess, between preferred and common? Thanks.

Michael A. Pizzi  
*Chief Financial Officer*

A

When we look at the overall sort of the amount of preferred we have at \$400mm today, the size of this acquisition at \$275mm and the current state of the preferred markets from a cost perspective, which we think, if you just look at the existing one that we have, would probably put an issuance somewhere in the low-5% range. I think, when you put all that backdrop together, it's pretty compelling. But then, from a capital structure standpoint, I think, we start to limit out as we approach sort of 20% or so of overall capital. This will move us up into the mid-teens. We think it's the perfect vehicle for this acquisition, but at some point, it becomes limited, but it has a very positive effect in the overall capital structure at these type of levels.

Jeremy Campbell  
*Barclays Capital, Inc.*

Q

Just wanted to follow-up quickly on that last point. If you guys look ahead to next year post kind of TCA closure and doing more bolt-ons, again, how do we – if you're going to kind of start plateauing out on the preferred side, how do you think about kind of capital usage in that scenario or are you going to tap the debt market, is there common issuance, what kind of mix would that be in the bolt-ons on a go-forward?

Michael A. Pizzi  
*Chief Financial Officer*

A

If you – as soon as you reach a point where you have essentially reached capacity from a capital perspective in terms of what you want from a capital structure and preferreds, I think, then obviously we're generating a pretty considerable amount of free cash. We could have deployed that cash to this acquisition, we still would have had a pretty compelling overall return on invested capital if we did so. So, that becomes the metric. It provide – that sort of the discipline we look at through every – at every acquisition, in terms of the use of capital, is it a compelling return on that capital vs. an alternative use of share buybacks. So, from a longer-run perspective, we can continue to look at bolt-ons largely sort of supported by the cash flow that we're generating.

Jeremy Campbell  
*Barclays Capital, Inc.*

Q

And then, it seems like a lot of your initiatives are going well and the TCA deal makes sense from a big picture kind of strategy sense with getting the RIA exposure. And I know you guys kind of – you run the business with the expectation you'll stay independent going-forward and the deal isn't that big. But I'm just wondering, does this deal at all kind of reduce the board's optionality and perhaps kind of preclude strategic alternatives like exploring a sale?

Karl A. Roessner  
*Chief Executive Officer & Director*

A

What I would say is, I can't speak for the entire board as they have fiduciary duties aligned with this whole routine. But what I would say is, it doesn't – this deal is going to be run as a sort of separate standalone business. We will make sure that it is enveloped within our enterprise risk management structure, which we are extremely proud of and we've built out quite well. So, that will be sort of at the touch points into E\*TRADE itself and we'll put the brand behind it, but it will be run as relatively standalone. I do not believe that this transaction inhibits in any way the board's ability to do whatever they think is right as they exercise their view of our strategic future.

We laid out growth goals. We've been reporting on those growth goals religiously to you all and to everybody else coming out. We post them internally, we've used them as a mechanism to really align the organization from top to bottom and drive results and make sure that we are an execution/accountable culture, two goals that we've set out to show both the board and the Street and our investors and everybody else who is interested on us that we can continue to grow organically.

So, don't misinterpret. This acquisition, we think, is strategically very good, but we will continue to track to our growth goals, which we fully expect to meet, but it's not going to, first of all, detract or distract this management team from what we set out and have been very clear cut as the most important things to us and that is being the number one digital broker in this space to investors and advisors alike, right, known for ease-of-use and our functionality. So, it's – it is what we've laid out and I don't believe that this in any way changes anything that we set forth.

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Michael J. Cyprys

*Morgan Stanley & Co. LLC*

Q

I just wanted to circle back to the stock plan business. You mentioned some new wins there. So, just curious to your perspective on what are some of the aspects of your value proposition that you think are most resonating with those clients driving to these new wins here that you spoke about? And as you look out into 2018, what are some of the objectives and kind of growth priorities that you have in the stock plan business?

---

Karl A. Roessner

*Chief Executive Officer & Director*

A

I love talking about this business, so thank you. It's really – it starts with a team that is focused on providing excellent service and a platform that works for the team that has to administer the plan within the organization, right. It's not just looked at as a plug-and-play or a piece of software that you go out and sell to these folks and have them clone it and try to adapt to it. They actually build and learn, right. When we talked about the OptionsHouse acquisition, we talked a lot about, it's going back away, but in the first conference I did back way in September of 2016 was sort of working through what they bring to us in terms of Agile.

This is one of the businesses that we had run as an Agile format from the entire time. So, our tech guys, right, our customer service guys, our product guys, the sales folks, the installation teams, they all work with the customer or the prospect to make sure they understand what they want and they build it out for them, right. We are very user-friendly in this space. It has to be a high touch space, because there are human beings on the other end dealing with real life problems. So, it's – it really starts with that, it's a focus on the business, it's a focus on what can we do to help serve this corporate to make sure that their HR department, their legal department has a stress-free existence within Equity Edge Online, right. That's our job every day.

So, that's why I talk about wins and what we can do and where we can go with this, because I know the teams on the ground and I know who they're competing with, right. If you look around in this marketplace, I am quite comfortable that our team can outdo anybody out there as long as they're given the opportunity and the chance and we have the bandwidth to take on the customers we're looking at. That's sort of where we are right now. So, I like the prospects of this business, I like their opportunities given the dislocation in the marketplace. And if we had another hour, I could keep going.

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Michael J. Cyprys

*Morgan Stanley & Co. LLC*

Q

And just wanted to lastly follow-up on a point you made earlier about making it easier to become an E\*TRADE customer with some of the improvements. Where do you stand on that today vs. where you'd like to be along that spectrum and maybe you could just talk a little bit about what's left on your to-do list as you look out over the next 12 to 18 months there?

Karl A. Roessner

*Chief Executive Officer & Director*

A

On our customer dissatisfiers, right, we have a running list of those and those are generated from – right out of our call centers and right out of the folks who are on the help lines and dealing with the customer service on the frontline. So, it's a constant and evolving list. Some of the things you heard me talk about in the prepared remarks were just something as easy as uploading documents or fixing our online application to make sure that it is extremely intuitive and easy-to-use, right, helping find information from – for customers who are helping them populate the fields more easily. So that their experience with E\*TRADE from day – minute one is pain-free, right, that's what we strive for.

As I said in the prepared remarks, this is not one I can ever give a checkmark to, it is a constant work in process. Somebody will always have a better touch point, something nicer out there, a better look and feel. We have teams of people internally working on this every day to make sure our customers get the best from us in every interaction they have with us, from our prospect site, all the way through to their first login, to their first ACH or the money that comes in from whatever source they're going to use, to make sure that that's seamless. That's the way you keep customers or you keep them happy from their first interaction with you. So, that's what we continue to drive at and you will see more, and I will never put a checkmark on this one, because I'll never be satisfied, right. We need to continue to improve every day.

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