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FORM 10-Q

E TRADE FINANCIAL CORP - ETFC

Filed: May 17, 1999 (period: March 31, 1999)

Quarterly report with a continuing view of a company's financial position

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
for the quarterly period ended March 31, 1999

Commission file number 1-11921

E*TRADE Group, Inc.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

94-2844166
(I.R.S. Employer
Identification Number)

Four Embarcadero Place, 2400 Geng Road, Palo Alto, CA 94303
(Address of principal executive offices and zip code)

Registrant's telephone number, including area code: (650) 842-2500

Indicate by check mark whether the registrant (1) has filed all reports
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of
1934 during the preceding 12 months (or for such shorter period that the
registrant was required to file such reports), and (2) has been subject to
such filing requirements for the past 90 days. Yes [X] No []

Indicate the number of shares outstanding of each of the issuer's classes of
common stock, as of the latest practicable date:

As of May 07, 1999, the number of shares outstanding of the registrant's
common stock was 116,617,126.

E*TRADE GROUP, INC.

Form 10-Q Quarterly Report
For the Quarter Ended March 31, 1999

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UNLESS OTHERWISE INDICATED, REFERENCES TO "COMPANY" MEAN E*TRADE GROUP, INC. AND ITS SUBSIDIARIES.

FORWARD-LOOKING STATEMENTS

Certain statements in this discussion and analysis, including statements regarding the Company's strategy, financial performance and revenue sources, are forward-looking statements based on current expectation and entail various risks and uncertainties that could cause actual results to differ materially from the results anticipated in these forward-looking statements as a result of certain factors set forth under "Risk Factors" and elsewhere in this report. Readers are urged to carefully review and consider the various disclosures made by the Company in this report and in the Company's other reports filed with the SEC, including the Company's Annual Report on Form 10-K as filed with the SEC, that attempt to advise interested parties of certain risks and factors that may affect the Company's business. Readers are cautioned not to place undue reliance on these forward-looking statements to reflect events or circumstances occurring after the date hereof. The following should be read in conjunction with the Company's financial statements and notes thereto.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

E*TRADE GROUP, INC. AND SUBSIDIARIES
 Consolidated Statements of Operations
 (in thousands, except per share amounts)
 (Unaudited)

	Three Months Ended March 31,		Six Months Ended March 31,	
	1999	1998	1999	1998
Revenue:				
Transaction revenues.....	\$ 90,524	\$37,778	\$150,844	\$ 75,462
Interest-net of interest expense (A)....	28,460	12,617	50,104	24,653
International.....	876	1,593	2,016	1,620
Other.....	6,793	4,142	11,762	8,402
Net revenues.....	126,653	56,130	214,726	110,137
Cost of services.....	56,467	25,254	97,638	48,824
Operating expenses:				
Selling and marketing.....	59,952	11,723	100,881	20,916
Technology development.....	15,127	7,065	29,449	13,368
General and administrative.....	18,061	4,619	32,374	10,602
Total operating expenses.....	93,140	23,407	162,704	44,886
Total cost of services and operating expenses.....	149,607	48,661	260,342	93,710
Operating income (loss).....	(22,954)	7,469	(45,616)	16,427
Non-operating income (expense):				
Gain on sale of investment.....	33,367	--	33,367	--
Loss on equity investments.....	(1,231)	--	(1,334)	--
Total non-operating income.....	32,136	--	32,033	--
Pre-tax income (loss).....	9,182	7,469	(13,583)	16,427
Income tax expense (benefit).....	3,409	2,961	(6,163)	6,793
Net income (loss).....	\$ 5,773	\$ 4,508	\$ (7,420)	\$ 9,634
Net income (loss) per share (Note 5):				
Basic.....	\$ 0.05	\$ 0.06	\$ (0.06)	\$ 0.12
Diluted.....	\$ 0.05	\$ 0.05	\$ (0.06)	\$ 0.11
Shares used in computation of net income (loss) per share (Note 5):				
Basic.....	115,052	80,718	114,270	80,397
Diluted.....	123,426	85,949	114,270	86,080

(A) Interest is presented net of interest expense. Interest expense for the three months ended March 31, 1999 and 1998 was \$16,035 and \$8,578, respectively. Interest expense for the six months ended March 31, 1999 and 1998 was \$25,938 and \$17,290, respectively.

See notes to consolidated financial statements.

Consolidated Balance Sheets

(in thousands, except share amounts)

	March 31, 1999	September 30, 1998
	-----	-----
	(Unaudited)	
ASSETS		

Current assets:		
Cash and equivalents.....	\$ 49,658	\$ 21,834
Cash and investments required to be segregated under Federal or other regulations.....	5,000	5,000
Investment securities.....	409,192	502,534
Brokerage receivables--net.....	2,276,014	1,310,235
Other assets.....	18,873	11,635
	-----	-----
Total current assets.....	2,758,737	1,851,238
Property and equipment--net.....	65,328	48,128
Investments.....	482,043	58,342
Related party receivables.....	--	3,719
Other assets.....	6,193	7,491
	-----	-----
Total assets.....	\$3,312,301	\$1,968,918
	=====	=====

LIABILITIES AND SHAREOWNERS' EQUITY

Liabilities:		
Brokerage payables.....	\$2,133,456	\$1,184,917
Accounts payable, accrued and other liabilities....	208,488	73,765
	-----	-----
Total liabilities.....	2,341,944	1,258,682
	-----	-----

Commitments and contingencies (Note 7)

Shareowners' equity:

Common stock, \$.01 par value; shares authorized, 300,000,000; shares issued and outstanding: March 1999, 115,956,901; September 1998, 113,206,582....	1,160	1,132
Additional paid-in capital.....	727,032	681,058
Retained earnings.....	7,890	15,310
Accumulated other comprehensive income.....	234,275	12,736
	-----	-----
Total shareowners' equity.....	970,357	710,236
	-----	-----
Total liabilities and shareowners' equity.....	\$3,312,301	\$1,968,918
	=====	=====

See notes to consolidated financial statements.

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E*TRADE GROUP, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

Six Months Ended

	March 31,	
	1999	1998
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss).....	\$ (7,420)	\$ 9,634
Reconciliation to net cash provided by (used in) operating activities:		
Deferred income taxes.....	(2,909)	(481)
Depreciation and amortization.....	12,008	4,332
Loss on equity investments.....	1,334	--
Options issued to consultants.....	2,200	--
Gain on sale of investment.....	(33,367)	--
Other.....	(19)	(849)
Net effect of changes in brokerage-related assets and liabilities:		
Cash and investments required to be segregated under Federal or other regulations.....	--	10,001
Brokerage receivables.....	(965,779)	(298,923)
Brokerage payables.....	948,539	290,958
Other changes, net:		
Other assets.....	(7,039)	346
Accounts payable, accrued and other liabilities....	16,082	30,916
Net cash provided by (used in) operating activities.....	(36,370)	45,934
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment.....	(29,208)	(13,647)
Purchase of investments and investment securities....	(3,143,914)	(864,237)
Sale/maturity of investment securities.....	3,237,157	874,680
Proceeds from sale of investment.....	33,495	--
Acquisition of OptionsLink.....	--	(3,500)
Purchase of investments.....	(50,708)	--
Related party receivable.....	3,738	--
Net cash provided by (used in) investing activities.....	50,560	(6,704)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from employee stock transactions.....	13,612	2,036
Other.....	22	--
Net cash provided by financing activities.....	13,634	2,036
INCREASE IN CASH AND EQUIVALENTS.....	27,824	41,266
CASH AND EQUIVALENTS--Beginning of period.....	21,834	23,234
CASH AND EQUIVALENTS--End of period.....	\$ 49,658	\$ 64,500
SUPPLEMENTAL DISCLOSURES:		
Cash paid for interest.....	\$ 28,663	\$ 16,429
Non-cash activities:		
Unrealized gain on available-for-sale securities...	\$ 373,384	\$ 96
Tax benefit on exercise of stock options.....	\$ 30,190	--

See notes to consolidated financial statements.

E*TRADE GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 1.--Basis of Presentation

The accompanying unaudited consolidated financial statements include E*TRADE Group, Inc. and its subsidiaries (collectively, the "Company"), including E*TRADE Securities, Inc. ("E*TRADE Securities"), a securities broker-dealer.

These consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and, in the opinion of management, reflect all normal recurring adjustments necessary to present fairly the financial position, results of operations and cash flows for the periods presented in conformity with generally accepted accounting principles. All significant intercompany accounts and transactions have been eliminated. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report to Shareowners on Form 10-K for the fiscal year ended September 30, 1998.

The consolidated financial statements of the Company have been prepared to give retroactive effect to the acquisition of ShareData, Inc. ("ShareData") in July 1998, as well as the reallocations made in the fourth quarter of fiscal 1998 for the allocation of the purchase price paid for OptionsLink, which was acquired in the first quarter of 1998 (See Note 15 to the annual financial statements filed with the SEC on Form 10-K).

Note 2.--Net Brokerage Receivables and Payables

Net brokerage receivables and payables consists of the following (in thousands):

	March 31, 1999	September 30, 1998
	-----	-----
Receivable from customers and non-customers (less allowance for doubtful accounts of \$6,450 at March 31, 1999 and \$862 at September 30, 1998).....	\$1,887,959	\$ 961,305
Receivable from brokers, dealers and clearing organizations:		
Net settlement and deposits with clearing organizations.....	31,342	14,854
Deposits paid for securities borrowed.....	346,129	328,989
Securities failed to deliver.....	3,977	728
Other.....	6,607	4,359
	-----	-----
Total net brokerage receivables.....	\$2,276,014	\$1,310,235
	=====	=====
Payable to customers and non-customers.....	\$ 570,534	\$ 340,044
Payable to brokers, dealers and clearing organizations:		
Deposits received for securities loaned.....	1,535,386	839,422
Securities failed to receive.....	5,324	1,222
Other.....	6,712	4,229
Bank loan payable.....	15,500	--
	-----	-----
Total net brokerage payables.....	\$2,133,456	\$1,184,917
	=====	=====

Receivable from and payable to brokers, dealers and clearing organizations result from the Company's brokerage activities. Receivable from customers and non-customers represents credit extended to finance their purchases of securities on margin. At March 31, 1999 and September 30, 1998, credit extended to customers and non-customers with respect to margin accounts was \$1,878 million and \$956 million, respectively. Securities owned by customers and non-customers are held as collateral for amounts due on margin balances (the value of which is not reflected on the accompanying consolidated balance sheets). Payable to customers and non-customers represents free credit balances and other customer and non-customer funds pending completion of securities transactions. The Company pays interest on certain customer and non-customer credit balances.

Note 3.-- Investments

In January 1999, the Company acquired a 25 percent voting interest in Archipelago Holdings, LLC ("Archipelago"). Archipelago owns 100 percent of Archipelago, LLC, which operates an Electronic Communication Network ("ECN") for Nasdaq stocks. In connection with such investment, the Company entered into an assistance agreement with Archipelago, which requires the Company to provide certain operational and technical assistance to Archipelago. The agreement provides that the Company will initially be entitled to representation on Archipelago's board of managers in proportion to its holding of voting interests.

In February 1999, the Company acquired a 28 percent voting interest in E*OFFERING, a full-service, Internet-based investment bank. E*OFFERING plans to provide individual and institutional investors greater access to public offerings. E*OFFERING leverages the Internet to improve the process of raising capital for companies by reducing time to market and underwriting costs traditionally associated with the registration process, while broadening capital distribution. Additionally, E*OFFERING provides after-market support and shareholder communication services.

The Company accounts for these investments according to the equity method of accounting, whereby the Company's proportionate share of each affiliate's net income (loss) is included in equity income (loss).

Note 4.--Comprehensive Income

On October 1, 1998, the Company adopted Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income, which requires that an enterprise report, by major components and as a single total, the change in net assets during the period from non-owner sources. The reconciliation of net income (loss) to comprehensive income is as follows (in thousands):

	Three Months Ended March 31,		Six Months Ended March 31,	
	1999	1998	1999	1998
Net income (loss).....	\$ 5,773	\$4,508	\$ (7,420)	\$9,634
Changes in other comprehensive income:				
Unrealized gain on available-for-sale securities, net of tax.....	194,719	38	221,022	96
Cumulative translation adjustments.....	(274)	--	517	--
Total comprehensive income.....	\$200,218	\$4,546	\$214,119	\$9,730

Note 5.--Net Income (Loss) Per Share

The following table sets forth the computation of shares used in the computations of basic and diluted net income (loss) per share (in thousands):

	Three Months Ended March 31,		Six Months Ended March 31,	
	1999	1998	1999	1998

Shares Used in Computation:

Weighted average common shares outstanding used in computation of basic net income (loss) per share.....	115,052	80,718	114,270	80,397
Dilutive effect of stock options.....	8,374	5,231	--	5,683

Shares used in computation of diluted net

income (loss) per share..... 123,426 85,949 114,270 86,080
 =====

E*TRADE GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements--(Continued)

Because the Company reported a net loss for the six months ended March 31, 1999, the calculation of diluted earnings per share does not include common stock equivalents as it would result in a reduction of net loss per share. If the Company had reported net income in this period, there would have been 8,175,000 additional shares in the calculation of diluted earnings per share.

The following options to purchase shares of common stock were not included in the computation of diluted net income (loss) per share because the options' exercise price was greater than the average market price of the Company's common stock for the periods stated, and therefore are not common stock equivalents for purposes of this calculation (in thousands, except exercise price data):

	Three Months Ended		Six Months Ended	
	March 31,		March 31,	
	1999	1998	1999	1998
Options excluded from computation of diluted net income (loss) per share.....	33	4,060	44	2,685
Exercise price ranges:				
High.....	\$60.78	\$23.03	\$60.78	\$23.03
Low.....	\$48.12	\$12.03	\$38.91	\$13.13

Note 6.--Regulatory Requirements

E*TRADE Securities is subject to the Uniform Net Capital Rule (the "Rule") under the Securities Exchange Act of 1934 administered by the SEC and the National Association of Securities Dealers, Inc. ("NASD"), which requires the maintenance of minimum net capital. E*TRADE Securities has elected to use the alternative method permitted by the Rule, which requires that the Company maintain minimum net capital equal to the greater of \$250,000 or 2 percent of aggregate debit balances arising from customer transactions, as defined. E*TRADE Securities had amounts in relation to the Rule as follows (in thousands, except percentage data):

	March 31, 1999	September 30, 1998
Net capital.....	\$124,500	\$97,355
Percentage of aggregate debit balances.....	6.2%	9.5%
Required net capital.....	\$ 40,062	\$20,429
Excess net capital.....	\$ 84,438	\$76,926

Under the alternative method, a broker-dealer may not repay subordinated borrowings, pay cash dividends or make any unsecured advances or loans to its parent or employees if such payment would result in net capital of less than 5% of aggregate debit balances or less than 120% of its minimum dollar amount requirement.

Note 7.--Commitments, Contingencies and Regulatory Matters

The Company is a defendant in civil actions arising from the normal course

of business. In the opinion of management, these actions are expected to be resolved with no material effect on the Company's consolidated financial position or results of operations.

On November 21, 1997, a putative class action was filed in the Superior Court of California, County of Santa Clara, by Larry R. Cooper on behalf of himself and other similarly situated individuals. The action alleges, among other things, that the Company's advertising, other communications and business practices regarding the Company's commission rates and its ability to timely execute transactions through its online brokerage services

E*TRADE GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements--(Continued)

were false and deceptive. The action seeks injunctive relief enjoining the purported deceptive and unfair practices alleged in the action and also seeks unspecified compensatory and punitive damages, as well as attorney fees. This proceeding is at an early stage and the Company is unable to predict its ultimate outcome. However, the Company believes it has meritorious defenses to the claims and intends to conduct vigorous defenses. An unfavorable outcome in any matters, which are not covered by insurance, could have a material adverse effect on the Company's business, financial condition and results of operations. In addition, even if the ultimate outcomes are resolved in favor of the Company, the defense of such litigation could entail considerable cost and the diversion of efforts of management, either of which could have a material adverse effect on the Company's results of operations.

On February 8, 1999, a putative class action was filed in the Superior Court of California, County of Santa Clara, by Coleen Divito, on behalf of herself and other similarly situated individuals. Subsequently on February 19, 1999, a putative class action was filed in Superior Court of California, County of Santa Clara, by Mario Cirignani, on behalf of himself and other similarly situated individuals. Both complaints allege damages and seek injunctive relief arising out of, among other things, the February 3, 4 and 5, 1999 system interruptions and allege a class of all E*TRADE account holders as of February 2, 1999. Pursuant to a stipulation of counsel dated March 23, 1999, the Court consolidated the Divito and Cirignani actions for all purposes. This proceeding is currently at a very early stage and the Company is unable to predict its ultimate outcome.

On February 11, 1999, a putative class action was filed in the Supreme Court of New York, County of New York, by Evan Berger, on behalf of himself and other similarly situated individuals. The action alleges, among other things, that the Company's advertising, other communications and business practices regarding its ability to timely execute and confirm transactions through its online brokerage services were false and deceptive. This proceeding is currently at a very early stage and the Company is unable to predict its ultimate outcome.

On March 1, 1999, a putative class action was filed in the Court of Common Pleas, Cuyahoga County, Ohio, by Truc Q. Hoang. The Hoang complaint seeks damages and injunctive relief arising out of, among other things, the plaintiff's alleged problems accessing his account and placing orders. Plaintiff alleges causes of action for breach of contract, fiduciary duty and unjust enrichment, fraud, unfair and deceptive trade practices, negligence/intentional tort and injunctive relief. This proceeding is currently at a very early stage and the Company is unable to predict its ultimate outcome.

On March 10, 1999, a putative class action was filed in the Superior Court of California, County of Santa Clara, by Raj Chadha. The Chadha complaint seeks damages and injunctive relief arising out of, among other things, the February 3, 4 and 5, 1999 system interruptions. Plaintiff brings causes of action for breach of fiduciary duty and violations of the Consumer Legal Remedies Act and California Unfair Business Practices Act. This proceeding is currently at a very early stage and the Company is unable to predict its ultimate outcome.

On March 11, 1999, a putative class action was filed in Superior Court of California, County of Santa Clara, by Elie Wurtman. The Wurtman complaint seeks damages and injunctive relief arising out of, among other things,

plaintiff's alleged problems accessing her account and placing orders. The complaint also makes allegations regarding access problems relating to E*TRADE customers residing or traveling outside of the United States. Plaintiff brings causes of action for negligence and violations of the Consumer Legal Remedies Act and California Unfair Business Practices Act. This proceeding is currently at a very early stage and the Company is unable to predict its ultimate outcome.

From time to time the Company has been threatened with, or named as a defendant in, lawsuits and administrative claims. Compliance and trading problems that are reported to the NASD or the SEC by dissatisfied customers are investigated by the NASD or the SEC, and, if pursued by such customers, may rise to the level of arbitration or disciplinary action. One or more of such claims or disciplinary actions decided adversely against

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E*TRADE GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements--(Continued)

the Company could have a material adverse effect on the Company's business, financial condition and results of operations. The Company is also subject to periodic regulatory audits and inspections.

The securities industry is subject to extensive regulation under federal, state and applicable international laws. As a result, the Company is required to comply with many complex laws and rules and its ability to so comply is dependent in large part upon the establishment and maintenance of a qualified compliance system.

The Company maintains insurance in such amounts and with such coverage, deductibles and policy limits as management believes are reasonable and prudent. The principal risks that the Company insures against are comprehensive general liability, commercial property damage, hardware/software damage, directors and officers, and errors and omissions liability. The Company believes that such insurance coverage is adequate for the purpose of its business.

The Company has entered into employment agreements with several of its key executive officers. These employment agreements provide for annual base salary compensation, stock option acceleration and severance payments in the event of termination of employment under certain defined circumstances, or change in the Company's control. Base salaries are subject to adjustments according to the Company's financial performance.

Note 8.--Subsequent Events

Acquisition

On April 30, 1999, the Company acquired ClearStation Inc. ("ClearStation"). ClearStation is a financial media web site that integrates technical and fundamental analysis and discussion for investors. The Company issued approximately 470,000 shares of common stock in exchange for all outstanding common stock and equivalents of ClearStation. The acquisition is expected to be accounted for as a pooling of interests. The disclosures herein do not reflect the acquisition of ClearStation.

Stock Split

On April 22, 1999, the Company's Board of Directors voted to effect a two-for-one stock split by distributing one additional share of Common Stock, par value \$.01, for every share of Common Stock outstanding to shareowners of record on May 7, 1999. The disclosures herein do not reflect the two-for-one stock split which will be distributed after the close of market on May 21, 1999.

Lawsuit

On April 14, 1999, a putative class action was filed in Superior Court of California, County of Los Angeles, by Matthew J. Rosenberg. The Rosenberg complaint alleges violations of the Consumer Legal Remedies Act and the California Unfair Business Practices Act in relation to E*TRADE's IPO business. This proceeding is currently at a very early stage and the Company

is unable to predict its ultimate outcome.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

The following discussion of the financial condition and results of operations of the Company should be read in conjunction with the consolidated financial statements and notes thereto included elsewhere in this Form 10-Q. This discussion contains forward-looking statements, including statements regarding the Company's strategy, financial performance and revenue sources which involve risks and uncertainties. The Company's actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth elsewhere in this Form 10-Q.

Results of Operations

Revenue Detail (in millions)

	Three Months Ended March 31,			Six Months Ended March 31,		
	1999	1998	Percent Change	1999	1998	Percent Change
Revenues:						
Transaction revenues:						
Commissions.....	\$ 80.6	\$31.7	154 %	\$133.0	\$ 62.6	112%
Order flow.....	9.9	6.1	62 %	17.9	12.9	39%
	-----	-----	---	-----	-----	---
Total transaction revenue.....	90.5	37.8	140 %	150.8	75.5	100%
	-----	-----	---	-----	-----	---
Interest-net of interest expense (A):						
Brokerage.....	22.5	10.6	112 %	38.7	20.5	89%
Other.....	6.0	2.0	200 %	11.4	4.2	171%
	-----	-----	---	-----	-----	---
Total interest.....	28.5	12.6	126 %	50.1	24.7	103%
	-----	-----	---	-----	-----	---
International.....	0.9	1.6	(44) %	2.0	1.6	25%
Other.....	6.8	4.1	64 %	11.8	8.4	40%
	-----	-----	---	-----	-----	---
Total revenues.....	\$126.7	\$56.1	126 %	\$214.7	\$110.1	95%
	=====	=====	===	=====	=====	===
Transactions per day.....	0.7	0.3	168 %	0.6	0.3	122%
Transaction per period.....	4.3	1.6	166 %	7.1	3.2	121%

(A) Interest is presented net of interest expense. Interest expense for the three months ended March 31, 1999 and 1998 was \$16,035 and \$8,578, respectively. Interest expense for the six months ended March 31, 1999 and 1998 was \$25,938 and \$17,290, respectively.

The Company's revenues increased to \$126.7 million in the second quarter of fiscal 1999, up 126% from \$56.1 million in the equivalent period of fiscal 1998. The Company's revenues increased to \$214.7 million for the six months ended March 31, 1999, up 95% from \$110.1 million in the equivalent period of fiscal 1998. Revenues increased mainly due to higher customer trading volume and an increase in customer assets.

Transaction revenues consist of commission revenues and payments based on order flow. Transaction revenues increased to \$90.5 million in the second quarter of fiscal 1999, up 140% from \$37.8 million in the equivalent period in fiscal 1998. This increase was primarily attributable to an increase in the number of transactions processed, to an average of 70,200 transactions per day, up 168% from the prior year quarter. The increase in transaction

processing volume was primarily a result of a significant increase in customer accounts resulting from the substantial advertising expenditures made by the Company during fiscal 1999. Growth in transaction revenues reflected the overall high level of trading volume in U.S. financial markets as well as the increase in new customer accounts. Transaction revenues increased to \$150.8 million for the six months ended March 31, 1999, up 100% from \$75.5 million for the equivalent period in fiscal 1998.

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Commission revenues for the second quarter of fiscal 1999 increased to \$80.6 million, up 154% from \$31.7 million for the same period a year ago. Commission revenues for the six months ended March 31, 1999 increased to \$133.0 million, up 113% from \$62.6 million for the same period a year ago.

Order flow revenue increased to \$9.9 million for the second quarter of fiscal 1999, up 62% from \$6.1 million for the same period in the prior year. Order flow revenue accounted for 11% of transaction revenue in the second quarter of fiscal 1999 compared to 16% in the comparable period in fiscal 1998. Order flow revenue increased to \$17.9 million for the six months ended March 31, 1999, up 39% from \$12.9 million for the same period in the prior year. Order flow revenue accounted for 12% of transaction revenue in the six months ended March 31, 1999 compared to 17% in the comparable period in fiscal 1998. Order flow revenue as a percentage of total revenue decreased primarily due to the loss of Roundtable earnings, which ended when Roundtable was reorganized as Knight/Trimark, Inc. and went public in July 1998. Until its initial public offering, Knight/Trimark, Inc. would allocate a portion of its earnings to its owners, including the Company, based on the percentage its owners contributed to Knight/Trimark, Inc.'s total order flow. The Company previously recorded the amounts it received from this allocation as order flow revenue.

Net interest revenues primarily represent interest earned by the Company on credit extended to its customers to finance their purchases of securities on margin, interest earned on customer assets invested in money market accounts and interest earned on investment securities, offset by interest paid to customers on certain credit balances, interest paid to banks and interest paid to other broker-dealers through the Company's stock loan program. Pursuant to Securities and Exchange Commission ("SEC") regulations, customer cash balances that are not used for margin lending are segregated into an investment account that is maintained for the exclusive benefit of customers.

Net interest revenues increased to \$28.5 million for the second quarter of fiscal 1999, up 126% from \$12.6 million for the same period in fiscal 1998. This increase was primarily due to interest derived from customer operations of \$22.5 million in the second quarter of fiscal 1999, up \$11.9 million or 112% compared to the equivalent period in fiscal 1998. Average customer margin debit balances were up 68% to \$1.6 billion, and average customer money market fund balances increased 35% to \$2.9 billion. Additionally, interest earned on investment securities increased to \$6.0 million in the second quarter of fiscal 1999, up 200% from \$2.0 million in the equivalent period in fiscal 1998. Net interest revenues increased to \$50.1 million for the six months ended March 31, 1999, up 103% from \$24.7 million for the same period in fiscal 1998.

International revenues were \$0.9 million in the second quarter of fiscal 1999 compared to \$1.6 million for the same period in fiscal 1998. International revenues represent international licensing fees and royalties based on the licensee's transaction revenues. The Company may, from time to time, seek to enter into similar licensing agreements with others as part of its international expansion strategy. There can be no assurance that any such future agreements will be consummated or that the terms thereof will be comparable to those of the aforementioned agreements or that the recognition of any licensing fees will occur during the period in which an arrangement is consummated.

Other revenues increased to \$6.8 million in the second quarter of fiscal 1999, up 64% from \$4.1 million for the comparable period in fiscal 1998. Other revenues increased to \$11.8 million for the six months ended March 31, 1999, up 40% from \$8.4 million for the comparable period in fiscal 1998. Other revenues increased primarily due to increases in broker-related fees for services, growth in ShareData licensing revenue, and increased revenues from mutual funds and advertising on the Company's Web site.

Cost of Services

Total cost of services increased to \$56.5 million in the second quarter of fiscal 1999, up 124% from \$25.3 million for the comparable period in fiscal 1998. Cost of services as a percentage of net revenues was 45% in the second quarter of fiscal 1999 and 1998. Cost of services as a percentage of net revenues was 46% for the six months ended March 31, 1999 compared to 44% in the comparable period in fiscal 1998. Cost of services

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includes expenses related to the Company's clearing operations, customer service activities, system maintenance and communications. These increases reflect the overall increase in customer transactions processed by the Company, customer service inquiries, and operations and maintenance costs associated with the technology centers in Palo Alto and Rancho Cordova, California, and Alpharetta, Georgia.

Operating Expenses

Selling and marketing expenses increased to \$60.0 million for the second quarter of fiscal 1999, up 411% from \$11.7 million for the comparable period in fiscal 1998. As a percentage of net revenue, selling and marketing expenses were 47% for the second quarter of fiscal 1999 and 21% for the second quarter of fiscal 1998. Selling and marketing expenses increased to \$100.9 million for the six months ended March 31, 1999, up 382% from \$20.9 million for the comparable period in fiscal 1998. As a percentage of net revenue, selling and marketing expenses increased to 47% for the six months ended March 31, 1999, from 19% in the equivalent period of fiscal 1998. Selling and marketing expenses include media, print and direct mail advertising, and related production, printing and postage costs. The increase in selling and marketing expenses reflect the Company's aggressive account and membership acquisition strategy which includes major marketing expenditures for advertising placements, creative development and collateral materials resulting from a variety of advertising campaigns directed at building brand name recognition, growing customer base and market share, and maintaining customer retention rates. These increased expenditure levels are expected to continue throughout fiscal 1999. The Company's selling and marketing expenses vary depending upon a variety of factors including, without limitation, the launch of new products or services.

Technology development expenses increased to \$15.1 million for the second quarter of fiscal 1999, up 114% from \$7.1 million for the comparable period in fiscal 1998. As a percentage of net revenue, technology development remained fairly consistent at 12% for the second quarter of fiscal 1999 and 13% for the second quarter of fiscal 1998. Technology development expenses increased to \$29.4 million for the six months ended March 31, 1999, up 120% from \$13.4 million for the comparable period in fiscal 1998. As a percentage of net revenue, technology development increased to 14% for the six months ended March 31, 1999, from 12% for the six months ended March 31, 1998. The increased level of expenses was incurred to enhance the Company's existing product offerings and reflects the Company's continuing commitment to invest in new products and technologies to support potential future growth.

General and administrative expenses increased to \$18.1 million for the second quarter of fiscal 1999, up 291% from \$4.6 million for the comparable period in fiscal 1998. General and administrative expenses increased to \$32.4 million for the six months ended March 31, 1999, up 205% from \$10.6 million for the comparable period in fiscal 1998. This increase is the result of personnel additions, the development of administrative functions resulting from the overall growth in the Company, and the costs associated with the opening of a new technology and customer service support facility in Alpharetta, Georgia.

Non-operating income (expense)

In February 1999, the Company sold 39% of its holdings in Knight/Trimark, Inc., a market-maker, recognizing a pre-tax gain of \$33.4 million on the sale. The investment had been classified as available-for-sale under the provisions of SFAS 115.

Loss on equity investments was \$1.2 million in the second quarter of fiscal 1999 which resulted from the Company's minority ownership in certain investments that are accounted for under the equity method. Equity in losses

of affiliates for the quarter ended March 31, 1999 includes the results from the Company's minority ownership in Archipelago and E*OFFERING, as well as the Company's international joint ventures in Japan and the United Kingdom. The Company expects that its affiliate companies will continue to invest in the development of their products and services, and to incur operating losses for at least the next 12 months, which will result in future charges being recorded by the Company to reflect its proportionate share of such losses.

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Income Tax Expense (benefit)

Income tax expense (benefit) represents the provision for federal and state income taxes at an effective rate of 37.1% for the second quarter of fiscal 1999 and 39.6% for the comparable period in fiscal 1998. Income tax expense (benefit) represents the provision for federal and state income taxes at an effective rate of (45.4%) for the six months ended March 31, 1999 and 41.4% for the comparable period in fiscal 1998. Prior to its merger with the Company, ShareData was a Subchapter S corporation and was not subject to federal and state corporate income taxes. Additionally, the rate for the second quarter of fiscal 1999 reflects tax benefits from tax-exempt interest income.

Liquidity and Capital Resources

The Company currently anticipates that its available cash resources and credit facilities will be sufficient to meet its presently anticipated working capital and capital expenditure requirements for at least the next 12 months. However, the Company may need to raise additional funds in order to support more rapid expansion, develop new or enhanced services and products, respond to competitive pressures, acquire complementary businesses or technologies or take advantage of unanticipated opportunities.

Cash used in operating activities was \$36.4 million for the six months ended March 31, 1999 compared with cash provided by operating activities of \$45.9 million in the equivalent period in fiscal 1998. Cash used in operations decreased primarily due to increased operating expenditures, including significant increases in sales and marketing expenses associated with the Company's aggressive account and membership acquisition strategy.

Cash provided by investing activities was \$50.6 million for the six months ended March 31, 1999, compared to cash used in investing activities of \$6.7 million in the equivalent period in fiscal 1998. The increase in cash provided by investing activities for the second quarter of fiscal 1999 was primarily a result of proceeds of \$33 million from the sale of a portion of the Company's investment in Knight/Trimark, Inc., and net purchases and sale/maturity of investment securities of \$93.2 million, offset by purchases of investments of \$50.7 million and purchases of property and equipment of \$29.2 million. The Company expects that it will incur approximately \$50 to \$75 million of capital expenditures during the second half of fiscal 1999.

Cash provided by financing activities was \$13.6 million for the six months ended March 31, 1999, compared to \$2.0 million in the equivalent period in fiscal 1998. The increase in cash provided by financing activities in the second quarter of fiscal 1999 was primarily a result of increases in the proceeds from employee stock transactions.

Year 2000 Compatibility

Many computer systems use only two digits to identify a specific year and therefore may not accurately recognize and handle dates beyond the year 1999. If not corrected, these computer applications could fail or create erroneous results by or at the year 2000. The Company utilizes, and is dependent upon, data processing systems and software to conduct its business. The data processing systems and software include those developed and maintained by the Company's third-party data processing vendors and software which is run on in-house computer networks.

Due to the Company's dependence on computer technology to conduct its business, and the dependence of the financial services industry on computer technology, the nature and impact of year 2000 processing failures on the Company's business, financial position, results of operations or cash flows could be material. During the first quarter of fiscal 1998, the Company initiated a review and assessment of all hardware and software to evaluate

whether it will function properly in the year 2000 without material errors or interruptions.

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The Company believes that all year 2000 issues revealed as a result of that evaluation to date can be remedied in a timely manner, and therefore does not expect a material risk of disruption of operations. With respect to outside vendors, those vendors that have been contacted have indicated that their hardware or software is or will be year 2000 compatible in time frames that meet regulatory requirements. Evaluation of these issues is continuing and there is a risk that other problems, not presently known to the Company, will be discovered which could present a material risk of disruption to the Company's operations and result in material adverse consequences to the Company. Furthermore, there can be no assurance that the Company will not experience unexpected delays in remediation of any year 2000 issues that may be discovered. Any inability to remediate such issues in a timely manner could cause a material disruption of the Company's business. In addition, the method of trading employed by the Company is heavily dependent on the integrity of electronic systems outside of the Company's control, such as online and Internet service providers, and third-party software such as Internet browsers. A failure of any such system in the trading process, even for a short time, could cause interruption to the Company's business. The year 2000 issue could lower demand for the Company's services while increasing the Company's costs. These combining factors, while not quantified, could have a material adverse impact on the Company's financial results.

Because systems critical to the Company other than its computer systems may be affected by the century change, the Company's year 2000 efforts also encompass facilities and equipment, which rely on date-dependent technology, such as, building equipment that contains embedded technology and the Company's third-party providers.

At this time, it does not appear that the costs of addressing year 2000 issues will have a material adverse impact on the Company's financial position. However, in the event that the Company and third parties upon which it relies are unable to address these issues in a timely manner, it could result in a material financial risk to the Company.

Status of Year 2000 Efforts

The Company's year 2000 efforts address all computer systems, equipment and business partner relationships considered essential to the Company's ability to conduct its business. The objective of the Company's year 2000 project is to identify the core business processes and associated computer systems and equipment that may be at risk due to the use of two-digit year dates. Once identified, the systems and equipment are rated for risk and are prioritized for conversion or replacement according to their impact on core business operations. The Company's year 2000 project follows a structured approach in analyzing and mitigating year 2000 issues. This approach consists of six phases: awareness, assessment, remediation, validation, implementation and industry-wide testing. The work associated with each phase may be performed simultaneously with other phases of the project, depending on the nature of the work to be performed and the technology and business requirements of the specific business unit. For example, awareness is an ongoing effort and occurs in each phase. As part of this project, the Company reviews its vendor relationships (suppliers, alliances and third-party providers) in an attempt to assess their ability to meet the year 2000 challenge. In addition, this plan seeks to ensure that all of the Company's business partners and service providers are also year 2000 ready. In addition, written contingency plans are being developed for all mission critical systems and many non-critical systems to address any unexpected year 2000 failures. However, there can be no assurance that contingency plans will adequately address all year 2000 failures.

Currently, the Company's primary focus is the completion of remediation and testing, and on-going contingency planning and vendor management efforts. However, the Company is continuing to assess the impact of year 2000 issues on its products, internal information systems and third-party vendor relations. The Company has begun, and in many cases completed, corrective efforts in these areas. The Company does not anticipate that addressing year 2000 issues for its internal information systems and current and future products will have a material impact on its operations or financial results. However, there can be no assurance that these costs will not be greater than anticipated, or that

corrective action undertaken will be completed before year 2000 issues may arise.

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In March 1999, the Company completed its assessment phase on mission critical systems including a significant amount of the implementation and testing. The Company's primary focus remains on the successful remediation and testing of all critical systems, including systems owned by third parties. Additional focus will be placed on non-critical systems and written contingency plans in the later half of the third quarter. The Company anticipates that work on the awareness, contingency planning, and vendor management phases of the project will continue through the century change.

The success of the Company's year 2000 efforts depends in part on the adequacy of compliance by vendors with their representations concerning their systems, and on parallel efforts being undertaken by vendors and other third parties with which the Company's systems interact and the Company is therefore taking steps to determine the status of critical third parties' year 2000 compatibility. The Company has implemented a vendor management program. Activities include creating an inventory of vendors, inquiring directly as to the status of vendors' year 2000 efforts, and continuing contact with vendors to monitor the progress of vendors who may not yet be year 2000 capable. If these suppliers fail to adequately address year 2000 issues for the products and services they provide to the Company, this could have a material adverse impact on the Company's operations and financial results. The Company is still assessing the effect year 2000 issues will have on its suppliers and at this time, cannot determine the impact it will have. There can be no assurance that all third parties will provide accurate and complete information or that all their systems will be fully year 2000 capable. Third parties' year 2000 processing failures may have a material adverse impact on the Company's systems and operations.

As the year 2000 project continues, the Company may discover additional year 2000 issues, may not be able to develop, implement, or test remediation or contingency plans, or may find that the costs of these activities exceed current expectations and become material. In many cases, the Company is relying on assurances from suppliers that new and upgraded information systems and other products will be year 2000 capable. The Company plans to test such third-party products, but cannot be sure that its tests will be adequate or that, if problems are identified, they will be addressed by the supplier in a timely and satisfactory way.

Because the Company uses a variety of information systems and has additional systems embedded in its operations and infrastructure, the Company cannot be sure that all of its systems will work together in a year 2000 capable fashion. Furthermore, the Company cannot be sure that it will not suffer business interruptions, either because of its own year 2000 issues or those of its customers or suppliers whose year 2000 issues may make it difficult or impossible for them to fulfill their commitments to the Company. If the Company fails to satisfactorily resolve year 2000 issues related to its products in a timely manner, it could be exposed to liability to third parties.

The Company is continuing to evaluate year 2000-related risks and corrective actions. However, the risks associated with the year 2000 may be pervasive and complex; they can be difficult to identify and to address, and can result in material adverse consequences to the Company. Even if the Company, in a timely manner, completes all of its assessments, identifies and tests remediation plans believed to be adequate, and develops contingency plans believed to be adequate, some issues may not be identified or corrected in time to prevent material adverse consequences to the Company.

The Company's plan may also be affected by regulatory changes, changes in industry customs and practices, and significant systems modifications unrelated to the year 2000 project including upgrades and additions to capacity, and the cost and continued availability of qualified personnel and other resources.

The Company spent approximately \$1.5 million in the six months ended March 31, 1999 and currently estimates that it will cost approximately an additional \$3.5 million to ascertain that its core computer systems and those of its vendors are year 2000 capable. These expenditures will consist primarily of compensation for information technology employees and contractors dedicated to

this project and related hardware and software costs. This estimate excludes the time that may be spent by management and administrative staff in guiding and assisting the information technology effort described above or for making systems other than core brokerage computer systems year 2000 capable. The Company expects to fund all year 2000 related costs through operating

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cash flows. These costs are not expected to result in increased information technology expenditures because they will be funded through a reallocation of the Company's overall development spending. In accordance with generally accepted accounting principles, such expenditures will be expensed as incurred.

Risk Factors

You should carefully consider the risks described below before making an investment decision in our company. The risks and uncertainties described below are not the only ones facing our company and there may be additional risks that we do not presently know of or that we currently deem immaterial. All of these risks may impair our business operations. This document also contains forward-looking statements that involve risks and uncertainties and actual results may differ materially from the results we discuss in the forward-looking statements. If any of the following risks actually occur, our business, financial condition or results of operations could be materially adversely affected. In such case, the trading price of our Common Stock could decline, and you may lose all or part of your investment.

In accordance with "plain English" guidelines provided by the Securities and Exchange Commission, the risk factors have been written in the first person.

Risks Associated with Systems Failure

We receive and process trade orders mostly through the Internet, online service providers and touch-tone telephone. Thus, we depend heavily on the integrity of the electronic systems supporting this type of trading, including our internal software programs and computer systems. Our systems or any other systems in the trading process could slow down significantly or fail for a variety of reasons including:

- . undetected errors in our internal software programs or computer systems;
- . our inability to effectively resolve any errors in our internal software programs or computer systems once they are detected; or
- . heavy stress placed on our system during certain peak trading times.

If our systems or any other systems in the trading process slow down significantly or fail even for a short time, our customers would suffer delays in trading, which could cause substantial losses and possibly subject us to claims for such losses or to litigation claiming fraud or negligence. We have experienced such systems failures and degradation in the past, and on certain days in February 1999, we again experienced similar systems failures. We could experience future system failures and degradations. To promote customer satisfaction and protect our brand name, we have on certain occasions compensated customers for verifiable losses from such failures. To date, during our systems failures we were able to take orders by telephone, however, only associates with securities brokers' licenses can accept telephone orders. An adequate number of such associates may not be available to take customer calls in the event of a future systems failure. We could experience a number of adverse consequences as a result of these systems failures including the loss of existing customers and the inability to attract or retain new customers. There can be no assurance that our network structure will operate appropriately in any of the following events:

- . subsystem, component or software failure;
- . a power or telecommunications failure;
- . human error;
- . an earthquake, fire or other natural disaster; or
- . an act of God or war.

There can be no assurance that in any such event, we will be able to prevent an extended systems failure. Any such systems failure that interrupts our operations could have a material adverse effect on our business,

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financial condition and operating results. We have received, in the past, including as a result of our systems failures in February 1999, adverse publicity in the financial press and in online discussion forums primarily relating to systems failures.

Risks Associated with Encryption Technology

A significant barrier to online commerce is the secure transmission of confidential information over public networks. We rely on encryption and authentication technology, including cryptography technology licensed from RSA Data Security, Inc. ("RSA"), to provide secure transmission of confidential information. There can be no assurance that advances in computer and cryptography capabilities or other developments will not result in a compromise of the RSA or other algorithms we use to protect customer transaction data. If any such compromise of our security were to occur, it could have a material adverse effect on our business, financial condition and operating results.

Risks Associated with Significant Fluctuations In Quarterly Operating Results

We expect to experience large fluctuations in future quarterly operating results that may be caused by many factors, including the following:

- . the timing of introductions or enhancements to online investing services and products by us or our competitors;
- . market acceptance of online investing services and products;
- . the pace of development of the market for online commerce;
- . changes in trading volume in securities markets;
- . trends in securities markets;
- . domestic and international regulation of the brokerage industry;
- . changes in pricing policies by us or our competitors;
- . changes in strategy;
- . the success of or costs associated with acquisitions, joint ventures or other strategic relationships;
- . changes in key personnel;
- . seasonal trends;
- . the extent of international expansion;
- . the mix of international and domestic revenues;
- . changes in the level of operating expenses to support projected growth; and
- . general economic conditions.

We have also experienced fluctuations in the average number of customer transactions per day. Thus, the rate of growth in customer transactions at any given time is not necessarily indicative of future transaction activity.

Risks Associated with the Year 2000

Because many computer systems were not designed to handle dates beyond the year 1999, computer hardware and software may need to be modified prior to the year 2000 in order to remain functional. This may affect us in numerous ways:

- . We have assessed the impact of the year 2000 issue on our products,

services and internal information systems. We do not expect our financial results to be materially affected by the need to address

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year 2000 issues, but if the costs associated with addressing these issues are greater than planned, our earnings and results of operations could be affected. Furthermore, if corrective actions are not completed before year 2000 problems occur, demand for our products and services could drop;

- . We must rely on outside vendors to address year 2000 issues for their hardware and software. We are still assessing the effect that year 2000 issues will have on our outside vendors and, at this time, cannot determine the impact on our products, services and operations. Contingency plans are being developed in the event that we or our key vendors will not be year 2000 capable, but any such noncompliance may have a negative effect on our financial results;
- . The method of trading we employ depends heavily on the integrity of electronic systems outside of our control, such as online and Internet service providers, and third-party software such as Internet browsers. A failure of any of these systems due to year 2000 issues would interfere with the trading process and, in turn, may have a material adverse effect on our business, financial condition and operating results.

Due to our dependence on computer technology to conduct our business, the nature and impact of year 2000 processing failures on our business, financial condition and operating results could be material. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Year 2000 Compatibility."

Risks Associated with Management of a Changing Business

We have grown rapidly and our business and operations have changed substantially since we began offering electronic investing services in 1992 and Internet investing services in February 1996, and we expect this trend to continue. Such rapid change and expansion places significant demands on our administrative, operational, financial and other resources.

We expect operating expenses and staffing levels to increase substantially in the future. In particular, we have hired and intend to hire a significant number of additional skilled personnel, including persons with experience in both the computer and brokerage industries, and, specifically, persons with Series 7 or other broker-dealer licenses. Competition for such personnel is intense, and there can be no assurance that we will be able to find or keep additional suitable senior managers or technical persons in the future. We also expect to expend resources for future expansion of our accounting and internal information management systems and for a number of other new systems and procedures. In addition, we expect that future expansion will continue to challenge our ability to successfully hire and retain associates. If our revenues do not keep up with operating expenses, our information management systems do not expand to meet increasing demands, we fail to attract, assimilate and retain qualified personnel, or we fail to manage our expansion effectively, there would be a material adverse effect on our business, financial condition and operating results.

The rapid growth in the use of our services has strained our ability to adequately expand technologically. As we acquire new equipment and applications quickly, we have less time and ability to test and validate hardware and software, which could lead to performance problems. We also rely on a number of third parties to process our transactions, including online and Internet service providers, back office processing organizations, service providers and market-makers, all of which will need to expand the scope of the operations they perform for us. Any backlog caused by a third party's inability to expand sufficiently to meet our needs could have a material adverse effect on our business, financial condition and operating results. As trading volume increases, we may have difficulty hiring and training qualified personnel at the necessary pace, and the shortage of licensed personnel could cause a backlog in the processing of orders that need review, which could lead to not only unsatisfied customers, but also to liability for orders that were not executed on a timely basis.

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Risks Associated with Government Regulation

The securities industry in the United States is subject to extensive regulation under both federal and state laws. Broker-dealers are subject to regulations covering all aspects of the securities business, including:

- . sales methods;
- . trade practices among broker-dealers;
- . use and safekeeping of customers' funds and securities;
- . capital structure;
- . record keeping;
- . conduct of directors, officers and employees; and
- . supervision.

Because we are a self-clearing broker-dealer, we have to comply with many complex laws and rules. These include rules relating to possession and control of customer funds and securities, margin lending and execution and settlement of transactions. Our ability to so comply depends largely on the establishment and maintenance of a qualified compliance system.

Our mode of operation and profitability may be directly affected by:

- . additional legislation;
- . changes in rules promulgated by the SEC, the NASD, the Board of Governors of the Federal Reserve System, the various stock exchanges and other self-regulatory organizations; or
- . changes in the interpretation or enforcement of existing laws and rules.

The SEC, the NASD or other self-regulatory organizations and state securities commissions can censure, fine, issue cease-and-desist orders or suspend or expel a broker-dealer or any of its officers or employees. Our ability to comply with all applicable laws and rules is largely dependent on our establishment and maintenance of a compliance system to ensure such compliance, as well as our ability to attract and retain qualified compliance personnel. Our growth has placed considerable strain on our ability to ensure such compliance, and we have experienced turnover of compliance personnel in the past. The principal purpose of regulation and discipline of broker-dealers is the protection of customers and the securities markets, rather than protection of creditors and shareowners of broker-dealers. We could be subject to disciplinary or other actions due to claimed noncompliance in the future, which could have a material adverse effect on our business, financial condition and operating results.

We have initiated an aggressive marketing campaign designed to bring brand name recognition to E*TRADE. All marketing activities by E*TRADE Securities are regulated by the NASD, and E*TRADE Securities compliance officers must review all marketing materials prior to release. The NASD has in the past asked us to revise certain marketing materials. The NASD can impose certain penalties for violations of its advertising regulations, including:

- . censures or fines;
- . suspension of all advertising;
- . the issuance of cease-and-desist orders; or
- . the suspension or expulsion of a broker-dealer or any of its officers or employees.

We do not currently solicit orders from our customers or make investment recommendations. However, if we were to engage in such activities, we would become subject to additional rules and regulations governing, among other things, sales practices and the suitability of recommendations to customers.

We intend to expand our business to other countries and to broaden our customers' abilities to trade securities of non-U.S. companies through the Internet and other gateways. International alliances signed during fiscal year 1998 cover a number of countries in Europe and Asia. These agreements grant the licensees the exclusive right to offer online investing services under the E*TRADE name. In addition, the Company has established joint ventures with strategic partners in Japan and the U.K. E*TRADE's global network should extend to 32 countries and territories when fully implemented. These agreements provide that the Company will receive licensing fees and royalties based upon their transaction revenues. In order to expand its services globally, E*TRADE Securities must comply with the regulatory controls of each specific country in which it conducts business. Our international expansion will be limited by the compliance requirements of other national regulatory jurisdictions. We intend to rely primarily on local third parties for regulatory compliance in international jurisdictions. See "Risks Associated with International Strategy."

There can be no assurance that other federal, state or foreign agencies will not attempt to regulate our online and other electronic activities. We anticipate that we may be required to comply with record keeping, data processing and other regulatory requirements as a result of proposed federal legislation or otherwise. We may also be subject to additional regulation as the market for online commerce evolves. Because of the growth in the electronic commerce market, Congress has held hearings on whether to regulate providers of services and transactions in the electronic commerce market. As a result, federal or state authorities could enact laws, rules or regulations affecting our business or operations. We may also be subject to federal, state and foreign money transmitter laws and state and foreign sales and use tax laws. If such laws are enacted or deemed applicable to us, our business or operations would be rendered more costly or burdensome, less efficient or even impossible. Any of the foregoing could have a material adverse effect on our business, financial condition and operating results.

Due to the increasing popularity of the Internet, laws and regulations may be passed dealing with issues such as user privacy, pricing, content and quality of products and services. In addition, the New York Attorney General has recently announced his intention to investigate the online brokerage industry, citing consumer complaints about delays and technical difficulties in online stock trading. Increased attention focused upon these liability issues could adversely affect the growth of the Internet, which could in turn decrease the demand for our services or could otherwise have a material adverse effect on our business, financial condition and operating results.

Risks Associated with Net Capital Requirements

The SEC, the NASD and various other regulatory agencies have stringent rules with respect to the maintenance of specific levels of net capital by securities broker-dealers. Net capital is the net worth of a broker or dealer (assets minus liabilities), less deductions for certain types of assets. If a firm fails to maintain the required net capital it may be subject to suspension or revocation of registration by the SEC and suspension or expulsion by the NASD, and could ultimately lead to the firm's liquidation. If such net capital rules are changed or expanded, or if there is an unusually large charge against net capital, operations that require the intensive use of capital would be limited. Such operations may include trading activities and the financing of customer account balances. Also, our ability to withdraw capital from brokerage subsidiaries could be restricted, which in turn could limit our ability to pay dividends, repay debt and redeem or purchase shares of our outstanding stock. A large operating loss or charge against net capital could adversely affect our ability to expand or even maintain our present levels of business, which could have a material adverse effect on our business, financial condition and operating results.

As of March 31, 1999, E*TRADE Securities was required to maintain minimum net capital of \$40.1 million and had total net capital of approximately \$124.5 million, or approximately \$84.4 million in excess of the minimum amount required.

Risks Associated with Early Stage of Market Development; Dependence on Online Commerce and the Internet

The market for electronic brokerage services, particularly over the Internet, is at an early stage of development and is rapidly evolving. Consequently, demand and market acceptance for recently introduced services and products are subject to a high level of uncertainty. For us, this uncertainty is compounded by the risks that consumers will not adopt online commerce and that commerce on the Internet will not adequately develop or flourish to permit us to succeed.

Sales of many of our services and products will depend on consumers adopting the Internet as a method of doing business. This may not occur because of inadequate development of the necessary infrastructure, such as a reliable network infrastructure, or complementary services and products such as high speed modems and communication lines. The Internet has grown and is expected to grow both in number of users and amount of traffic. There can be no assurance that the Internet infrastructure will continue to be able to support the demands placed on it by this continued growth. In addition, the Internet could lose its viability due to slow development or adoption of standards and protocols to handle increased Internet activity, or due to increased governmental regulation. Moreover, critical issues including security, reliability, cost, ease of use, accessibility and quality of service remain unresolved and may negatively affect the growth of Internet use or commerce on the Internet. Because use of the Internet for commerce is new and evolving, there can be no assurance that the Internet will prove to be a viable commercial marketplace. If these critical issues are not resolved, if the necessary infrastructure is not developed, or if the Internet does not become a viable commercial marketplace, our business, financial condition and operating results will be materially adversely affected.

Adoption of online commerce by individuals that have relied upon traditional means of commerce in the past will require such individuals to accept new and very different methods of conducting business. Moreover, our brokerage services over the Internet involve a new approach to securities trading which will require intensive marketing and sales efforts to educate prospective customers regarding its uses and benefits. For example, consumers who trade with more traditional brokerage firms, or even discount brokers, may be reluctant or slow to change to obtaining brokerage services over the Internet. Also, concerns about security and privacy on the Internet may hinder the growth of online brokerage trading, which could have a material adverse effect on our business, financial condition and operating results.

Risks Associated with the Securities Industry; Concentration of Services

Almost all of our revenues in recent years have been from electronic brokerage services, and we expect this business to continue to account for almost all of our revenues in the foreseeable future. We, like other securities firms, are directly affected by economic and political conditions, broad trends in business and finance and changes in volume and price levels of securities and futures transactions. In recent months, the U.S. securities markets have fluctuated considerably and a downturn in these markets could adversely affect our operating results. In October 1987 and October 1989, the stock market suffered major declines, as a result of which many firms in the industry suffered financial losses, and the level of individual investor trading activity decreased after these events. Reduced trading volume and prices have historically resulted in reduced transaction revenues. When trading volume is low, our operating results may be adversely affected because our overhead remains relatively fixed. Severe market fluctuations in the future could have a material adverse effect on our business, financial condition and operating results. Some of our competitors with more diverse product and service offerings might withstand such a downturn in the securities industry better than we would. See "Risks Associated with Substantial Competition."

Our brokerage business, by its nature, is subject to various other risks, including customer default and employees' misconduct and errors. We sometimes allow customers to purchase securities on margin, therefore we are subject to risks inherent in extending credit. This risk is especially great when the market is rapidly declining and the value of the collateral we hold could fall below the amount of a customer's indebtedness. Under specific regulatory guidelines, any time we borrow or lend securities, we must correspondingly disburse or

receive cash deposits. If we fail to maintain adequate cash deposit levels at

all times, we run the risk of loss if there are sharp changes in market values of many securities and parties to the borrowing and lending transactions fail to honor their commitments. Any such losses could have a material adverse effect on our business, financial condition and operating results.

Risks Associated with Delays In Introduction of New Services and Products

Our future success depends in part on our ability to develop and enhance our services and products. There are significant technical risks in the development of new services and products or enhanced versions of existing services and products. There can be no assurance that we will be successful in achieving any of the following:

- . effectively using new technologies;
- . adapting our services and products to emerging industry standards;
- . developing, introducing and marketing service and product enhancements;
or
- . developing, introducing and marketing new services and products.

We may also experience difficulties that could delay or prevent the development, introduction or marketing of these services and products. Additionally, these new services and products may not adequately meet the requirements of the marketplace or achieve market acceptance. If we are unable to develop and introduce enhanced or new services and products quickly enough to respond to market or customer requirements, or if they do not achieve market acceptance, our business, financial condition and operating results will be materially adversely affected.

Risks Associated with Substantial Competition

The market for electronic brokerage services over the Internet is new, rapidly evolving and intensely competitive. We expect competition to continue and intensify in the future. We face direct competition from discount brokerage firms providing either touch-tone telephone or online brokerage services, or both. These firms generally only execute transactions for their customers, without offering other services such as portfolio valuation, investment recommendations and research. This limitation on service offerings may result in other firms having a lower cost structure. These competitors include, among others, such discount brokerage firms as:

- . Charles Schwab & Co., Inc.;
- . Fidelity Brokerage Services, Inc.;
- . Waterhouse Securities, Inc.;
- . Quick & Reilly, Inc. (a subsidiary of Fleet Financial Group, Inc.);
- . National Discount Brokers (a subsidiary of National Discount Brokers Group);
- . Discover Brokerage Direct, Inc. (a subsidiary of Morgan Stanley Dean Witter Discover & Company);
- . Ameritrade, Inc. (a subsidiary of Ameritrade Holding Corporation);
- . DLJdirect (a subsidiary of Donaldson, Lufkin & Jenrette Securities Corporation);
- . Datek Online Holdings Corporation (Datek Online); and
- . SURETRADE, Inc.

We also encounter competition from established full commission brokerage firms such as PaineWebber Incorporated, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Salomon Smith Barney, Inc., among others. In addition, we compete with financial institutions, mutual fund sponsors and other organizations, some of which provide electronic brokerage services.

Many of our competitors have longer operating histories and significantly greater financial, technical, marketing and other resources than we do. In addition, many of our competitors offer a wider range of services and financial products than we do, and thus may be able to respond more quickly to new or changing opportunities, technologies and customer requirements. Many of our competitors also have greater name recognition and larger customer bases that could be leveraged, thereby gaining market share from us. Such competitors may conduct more extensive promotional activities and offer better terms and lower prices to customers than we do, possibly even sparking a price war in the electronic brokerage business. Moreover, certain competitors have established cooperative relationships among themselves or with third parties to enhance their services and products. For example, Charles Schwab's One-Source mutual fund service and similar, more complete services, may discourage potential customers from using our brokerage services. Accordingly, it is possible that new competitors or alliances among existing competitors may significantly reduce our market share.

General financial success within the securities industry over the past several years has strengthened existing competitors. We believe that such success will continue to attract new competitors to the industry, such as banks, software development companies, insurance companies, providers of online financial and information services and others, as such companies expand their product lines. Commercial banks and other financial institutions have become more competitive with us by offering their customers certain corporate and individual financial services traditionally provided by securities firms. The current trend toward consolidation in the commercial banking industry could further increase competition in all aspects of our business. Commercial banks generally are expanding their securities and financial services activities. While we cannot predict the type and extent of competitive services that commercial banks and other financial institutions ultimately may offer, or whether legislative barriers will be modified, we may be adversely affected by such competition or legislation. To the extent our competitors are able to attract and retain customers based on the convenience of one-stop shopping, our business or ability to grow could be adversely affected. In many instances, we are competing with such organizations for the same customers. In addition, competition among financial services firms exists for experienced technical and other personnel.

There can be no assurance that we will be able to compete effectively with current or future competitors or that such competition will not have a material adverse effect on our business, financial condition and operating results.

Volatility of Stock Price

The market price of our Common Stock has been and is likely to continue to be highly volatile and subject to wide fluctuations due to various factors, many of which may be beyond our control, including:

- . quarterly variations in operating results;
- . announcements of technological innovations or new software, services or products by us or our competitors; and
- . changes in financial estimates and recommendations by securities analysts.

In addition, there have been large price and volume fluctuations in the stock market which have affected the market prices of securities of many technology and services companies, often unrelated to the operating performance of such companies. These broad market fluctuations may adversely affect the market price of our Common Stock. In the past, volatility in the market price of a company's securities has often led to securities class action litigation. Such litigation could result in substantial costs and a diversion of our attention and resources, which could have a material adverse effect on our business, financial condition and operating results.

Risks Associated with Dependence on Intellectual Property Rights

Our success and ability to compete are dependent to a significant degree on our proprietary technology. We rely primarily on copyright, trade secret and trademark law to protect our technology. Effective trademark protection may not be available for our trademarks. Although we have registered the trademark "E*TRADE" in

the United States and certain other countries, and have certain other registered trademarks, there can be no assurance that we will be able to secure significant protection for these trademarks. Our competitors or others may adopt product or service names similar to "E*TRADE", thereby impeding our ability to build brand identity and possibly leading to customer confusion. Our inability to adequately protect the name "E*TRADE" would have a material adverse effect on our business, financial condition and operating results. Despite any precautions we take, a third party may be able to copy or otherwise obtain and use our software or other proprietary information without authorization or to develop similar software independently. Policing unauthorized use of our technology is made especially difficult by the global nature of the Internet and difficulty in controlling the ultimate destination or security of software or other data transmitted on it. The laws of other countries may afford us little or no effective protection for our intellectual property. There can be no assurance that the steps we take will prevent misappropriation of our technology or that agreements entered into for that purpose will be enforceable. In addition, litigation may be necessary in the future to:

- . enforce our intellectual property rights;
- . protect our trade secrets;
- . determine the validity and scope of the proprietary rights of others; or
- . defend against claims of infringement or invalidity.

Such litigation, whether successful or unsuccessful, could result in substantial costs and diversions of resources, either of which could have a material adverse effect on our business, financial condition and operating results. We currently have several ongoing trademark infringement litigation actions that we have filed in an effort to protect our trademarks.

Risks Associated with Infringement

We may in the future receive notices of claims of infringement of other parties' proprietary rights. There can be no assurance that claims for infringement or invalidity (or any indemnification claims based on such claims) will not be asserted or prosecuted against us. Any such claims, with or without merit, could be time consuming and costly to defend or litigate, divert our attention and resources or require us to enter into royalty or licensing agreements. There can be no assurance that such licenses would be available on reasonable terms, if at all, and the assertion or prosecution of any such claims could have a material adverse effect on our business, financial condition and operating results.

Risks Associated with Entering New Markets

One element of our strategy is to leverage the E*TRADE brand and technology to enter new markets. No assurance can be given that we will be able to successfully adapt our proprietary processing technology for use in other markets. Even if we do adapt our technology, no assurance can be given that we will be able to compete successfully in any such new markets. E*TRADE Securities has established investment banking operations, and plans to raise public and private equity capital for companies over the Internet and other electronic media. We are currently in the process of investing over \$150 million in a new marketing campaign centered on our new Internet Web site, Destination E*TRADE. We also plan to pursue additional related revenue opportunities, such as revenue from correspondent clearing, advertising and subscriptions. There can be no assurance that our new marketing efforts or our pursuit of any of these opportunities will be successful. If these efforts are not successful, we could realize less than expected earnings, which in turn could result in a decrease in the market value of our Common Stock. Furthermore, such efforts may divert management attention or inefficiently utilize our resources.

Risks Associated with International Strategy

One component of our strategy is a planned increase in efforts to attract more international customers. To date, we have limited experience in providing brokerage services internationally. There can be no assurance that

our international licensees will be able to market our branded services and products successfully in international markets. In addition, there are certain risks inherent in doing business in international markets, particularly in the heavily regulated brokerage industry, such as:

- . unexpected changes in regulatory requirements, tariffs and other trade barriers;
- . difficulties in staffing and managing foreign operations;
- . political instability;
- . fluctuations in currency exchange rates;
- . reduced protection for intellectual property rights in some countries;
- . seasonal reductions in business activity during the summer months in Europe and certain other parts of the world; and
- . potentially adverse tax consequences.

Any of the foregoing could adversely impact the success of our international operations. Under these agreements, we rely upon third parties for a variety of business and regulatory compliance matters. We have limited control over the management and direction of these third parties. We run the risk that their action or inaction could harm our operations and/or the goodwill associated with our brand name. Additionally, our international licensees have the right to sell sub-licenses. Generally, we have less control over sub-licensees than we do over licensees. As a result, the risk to our operations and goodwill is higher. There can be no assurance that one or more of the factors described above will not have a material adverse effect on our future international operations, if any, and, consequently, on our business, financial condition and operating results.

Risks Associated with Acquisitions, Strategic Relationships

We may acquire other companies or technologies in the future, and we regularly evaluate such opportunities. Acquisitions entail numerous risks, including:

- . difficulties in the assimilation of acquired operations and products;
- . diversion of management's attention from other business concerns;
- . amortization of acquired intangible assets; and
- . potential loss of key employees of acquired companies.

We have limited experience in assimilating acquired organizations into our operations. No assurance can be given as to our ability to integrate successfully any operations, personnel, services or products that might be acquired in the future. Failure to successfully assimilate acquired organizations could have a material adverse effect on our business, financial condition and operating results.

We have established a number of strategic relationships with online and Internet service providers and software and information service providers. There can be no assurance that any such relationships will be maintained, or that if they are maintained, they will be successful or profitable. Additionally, we may not develop any new such relationships in the future.

Due to the foregoing factors, quarterly revenues and operating results are difficult to forecast. We believe that period-to-period comparisons of our operating results will not necessarily be meaningful and you should not rely on them as any indication of future performance. Our future quarterly operating results may not consistently meet the expectations of securities analysts or investors, which in turn may have an adverse effect on the market price of our Common Stock.

Risks Associated with Potential Reduction In Order Flow Rebates

Order flow revenue as a percentage of revenue has decreased due to the loss of Roundtable earnings, which ended when Roundtable was reorganized as Knight/Trimark, Inc. and went public in July 1998. Until its initial public offering, Knight/Trimark, Inc. would allocate a portion of its earnings to its owners, including the Company, based on the percentage its owners contributed to Knight/Trimark, Inc.'s total order flow. The Company previously recorded the amounts it received under this allocation as order flow revenue. In addition, there can be no assurance that payments for order flow will continue to be permitted by the SEC, the NASD or other regulatory agencies, courts or governmental units. Loss of any or all of these revenues could have a material adverse effect on our business, financial condition and operating results.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market Risk Disclosures

The following discussion about the Company's market risk disclosures involves forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements. The Company is exposed to market risk related to changes in interest rates, foreign currency exchange rates and equity security price risk. The Company does not have derivative financial instruments for speculative or trading purposes.

Interest Rate Sensitivity

The Company maintains a short-term investment portfolio consisting of mainly income securities with an average maturity of less than two years. These available-for-sale securities are subject to interest rate risk and will fall in value if market interest rates increase. If market interest rates were to increase immediately and uniformly by 10 percent in levels at March 31, 1999, the fair value of the portfolio would decline by an immaterial amount. The Company has the ability to hold its fixed income investments until maturity, and therefore the Company would not expect its operating results or cash flows to be affected to any significant degree by the effect of a sudden change in market interest rates on its securities portfolio.

Equity Price Risk

The Company holds a small portfolio of marketable-equity traded securities that are subject to market price volatility. Equity price fluctuations of plus or minus 15 percent would not have a material impact on the Company.

Financial Instruments

For its working capital and reserves which are required to be segregated under Federal or other regulations, the Company invests in money market funds, resale agreements, certificates of deposit, and commercial paper. Money market funds do not have maturity dates and do not present a material market risk. The other financial instruments are fixed rate investments with short maturities and do not present a material interest rate risk.

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PART II. OTHER INFORMATION

Item 1. Legal and Administrative Proceedings--

On November 21, 1997, a putative class action was filed in the Superior Court of California, County of Santa Clara, by Larry R. Cooper on behalf of himself and other similarly situated individuals. The action alleges, among other things, that the Company's advertising, other communications and business practices regarding the Company's commission rates and its ability to timely execute and confirm transactions through its online brokerage services were false and deceptive. The action seeks injunctive relief enjoining the purported deceptive and unfair practices alleged in the action and also seeks unspecified compensatory and punitive damages, as well as attorney fees. This proceeding is currently in the discovery phase and the Company is unable to predict its ultimate outcome.

On February 8, 1999, a putative class action was filed in the Superior Court of California, County of Santa Clara, by Coleen Divito, on behalf of herself and other similarly situated individuals. Subsequently on February 19, 1999, a

putative class action was filed in Superior Court of California, County of Santa Clara, by Mario Cirignani, on behalf of himself and other similarly situated individuals. Both complaints allege damages and seek injunctive relief arising out of, among other things, the February 3, 4 and 5, 1999 system interruptions and allege a class of all E*TRADE account holders from February 2, 1999. Pursuant to a stipulation of counsel dated March 23, 1999, the Court consolidated the Divito and Cirignani actions for all purposes. This proceeding is currently at a very early stage and the Company is unable to predict its ultimate outcome.

On February 11, 1999, a putative class action was filed in the Supreme Court of New York, County of New York, by Evan Berger, on behalf of himself and other similarly situated individuals. The action alleges, among other things, that the Company's advertising, other communications and business practices regarding its ability to timely execute and confirm transactions through its online brokerage services were false and deceptive. This proceeding is currently at a very early stage and the Company is unable to predict its ultimate outcome.

On March 1, 1999, a putative class action was filed in the Court of Common Pleas, Cuyahoga County, Ohio, by Truc Q. Hoang. The Hoang complaint seeks damages and injunctive relief arising out of, among other things, plaintiff's alleged problems accessing his account and placing orders. Plaintiff alleges causes of action for breach of contract, fiduciary duty and unjust enrichment, fraud, unfair and deceptive trade practices, negligence/intentional tort and injunctive relief. This proceeding is currently at a very early stage and the Company is unable to predict its ultimate outcome.

On March 10, 1999, a putative class action was filed in the Superior Court of California, County of Santa Clara, by Raj Chadha. The Chadha complaint seeks damages and injunctive relief arising out of, among other things, the February 3, 4 and 5, 1999 system interruptions. Plaintiff brings causes of action for breach of fiduciary duty and violations of the Consumer Legal Remedies Act and California Unfair Business Practices Act. This proceeding is currently at a very early stage and the Company is unable to predict its ultimate outcome.

On March 11, 1999, a putative class action was filed in Superior Court of California, County of Santa Clara, by Elie Wurtman. The Wurtman complaint seeks damages and injunctive relief arising out of, among other things, plaintiff's alleged problems accessing her account and placing orders. The complaint also makes allegations regarding access problems relating to E*TRADE customers residing or traveling outside of the United States. Plaintiff brings causes of action for negligence and violations of the Consumer Legal Remedies Act and California Unfair Business Practices Act. This proceeding is currently at a very early stage and the Company is unable to predict its ultimate outcome.

On April 14, 1999, a putative class action was filed in Superior Court of California, County of Los Angeles, by Matthew J. Rosenberg. The Rosenberg complaint alleges violations of the Consumer Legal Remedies Act and California Unfair Business Practices Act regarding the extent to which shares in IPO's are made available to the Company's customers. This proceeding is currently at a very early stage and the Company is unable to predict its ultimate outcome.

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The Company believes that these claims are without merit and intends to defend against them vigorously. An unfavorable outcome in any matters, which are not covered by insurance, could have a material adverse effect on the Company's business, financial condition and results of operations. In addition, even if the ultimate outcomes are resolved in favor of the Company, the defense of such litigation could entail considerable cost and the diversion of efforts of management, either of which could have a material adverse effect on the Company's results of operation.

From time to time the Company has been threatened with, or named as a defendant in, lawsuits and administrative claims. Compliance and trading problems that are reported to the NASD or the SEC by dissatisfied customers are investigated by the NASD or the SEC, and, if pursued by such customers, may rise to the level of arbitration or disciplinary action. One or more of such claims or disciplinary actions decided adversely against the Company could have a material adverse effect on the Company's business, financial condition and results of operations. The Company is also subject to periodic

regulatory audits and inspections.

The securities industry is subject to extensive regulation under federal, state and applicable international laws. As a result, the Company is required to comply with many complex laws and rules and its ability to so comply is dependent in large part upon the establishment and maintenance of a qualified compliance system. The Company is aware of several instances of its noncompliance with applicable regulations. In particular, in fiscal 1997, the Company's failure to timely renew its broker dealer registration in Ohio resulted in a \$4.3 million pre-tax charge against earnings.

The Company maintains insurance in such amounts and with such coverages, deductibles and policy limits as management believes are reasonable and prudent. The principal risks that the Company insures against are comprehensive general liability, commercial property, hardware/software damage, directors and officers, and errors and omissions liability. The Company believes that such insurance coverages are adequate for the purpose of its business.

Item 2. Changes in Securities and Use of Proceeds--

Not applicable.

Item 3. Defaults Upon Senior Securities--

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders--

The annual meeting of share owners was held on March 9, 1999. Christos M. Cotsakos, William A. Porter, Richard S. Braddock, and Masayoshi Son were elected as directors, as tabulated below.

Against or Election of Directors -----	For	Withheld -----
Christos M. Cotsakos.....	48,747,545	886,844
William A. Porter.....	48,751,179	883,210
Richard S. Braddock.....	48,749,965	884,424
Masayoshi Son.....	48,750,100	884,289

In addition, William E. Ford, George Hayter, Lewis Randall and Lester C. Thurow will continue as directors.

The proposal to amend the Company's certificate of incorporation was approved , as tabulated below.

	For	Against or Withheld	Abstentions -----
Votes.....	49,166,541	444,728	23,120

The proposal to approve a series of amendments to the Company's 1996 Stock Incentive Plan (the "Plan"), including a 2,750,000 share increase in the maximum number of shares of Common Stock reserved for issuance under the Plan was approved, as tabulated below.

	For	Against or Withheld	Abstentions -----
Votes.....	44,661,995	4,900,595	71,799

The proposal to ratify the selection of Deloitte & Touche LLP as independent public accountants for the Company for the fiscal year ending September 30, 1999 was approved, as tabulated below.

	For	Against or Withheld	Abstentions
	-----	-----	-----
Votes.....	49,554,317	52,520	27,552

Item 5. Other Information--

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Reports on Form 8-K

On April 14, 1999, the Company filed a Current Report on Form 8-K, relating to an acquisition agreement with ClearStation, Inc., a California corporation ("ClearStation"), pursuant to which Crystal Acquisition Corporation, a wholly owned subsidiary of E*TRADE, will be merged with and into ClearStation, with ClearStation continuing as the surviving entity and as a wholly owned subsidiary of E*TRADE. The security holders of ClearStation will receive an aggregate of 469,536 shares of E*TRADE Common Stock in the merger.

(b) Exhibits.

27 Financial Data Schedule

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

E*TRADE Group, Inc.
(Registrant)

Dated: May 17, 1999

/s/ Christos M. Cotsakos

Christos M. Cotsakos,
Chairman of the Board and Chief
Executive Officer
(principal executive officer)

/s/ Leonard C. Purkis

Leonard C. Purkis,
Executive Vice President, Finance
and
Administration, Chief Financial
Officer
(principal financial and accounting
officer)

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE FINANCIAL STATEMENTS INCLUDED IN THIS REGISTRATION STATEMENT FILING AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

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