

E*TRADE Financial (ETFC)

\$54.73 (As of 02/20/20)

Price Target (6-12 Months): **\$57.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 12/02/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:C

Value: B

Growth: D

Momentum: A

Summary

Shares of E*TRADE have outperformed the industry over the past three months. Also, the company has an impressive earnings surprise history, surpassing the Zacks Consensus Estimate in all the trailing four quarters. The fourth-quarter results reflected improved DARTs, rise in non-interest income and a benefit to provisions, partly muted by bleak NII and high costs. Continued improvement in DARTs acts as a tailwind. Further, several restructuring measures and balance-sheet growth plans keep us encouraged. Focus on core operations and strategic initiatives are likely to boost the top line. Recently, E*TRADE entered into an all-stock acquisition deal under which it will be acquired by Morgan Stanley. Yet, rising costs due to growing franchise is a major concern. Further, introduction of zero trading commission plan is likely to impede revenue growth.

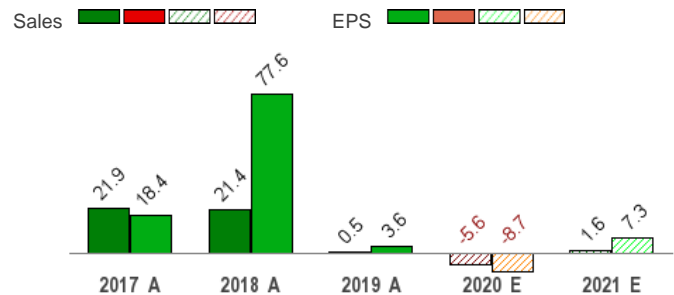
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$57.30 - \$34.68
20 Day Average Volume (sh)	4,664,927
Market Cap	\$13.4 B
YTD Price Change	20.6%
Beta	1.22
Dividend / Div Yld	\$0.56 / 1.0%
Industry	Financial - Investment Bank
Zacks Industry Rank	Top 36% (91 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.2%
Last Sales Surprise	0.2%
EPS F1 Est- 4 week change	1.1%
Expected Report Date	04/15/2020
Earnings ESP	0.0%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	677 E	674 E	675 E	678 E	2,769 E
2020	691 E	681 E	676 E	676 E	2,725 E
2019	755 A	685 A	767 A	679 A	2,886 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.90 E	\$0.98 E	\$0.96 E	\$1.02 E	\$3.95 E
2020	\$0.83 E	\$0.93 E	\$0.89 E	\$1.00 E	\$3.68 E
2019	\$1.09 A	\$1.12 A	\$1.08 A	\$0.84 A	\$4.03 A

*Quarterly figures may not add up to annual.

P/E TTM	13.3
P/E F1	14.9
PEG F1	1.4
P/S TTM	4.6

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/20/2020. The reports text is as of 02/21/2020.

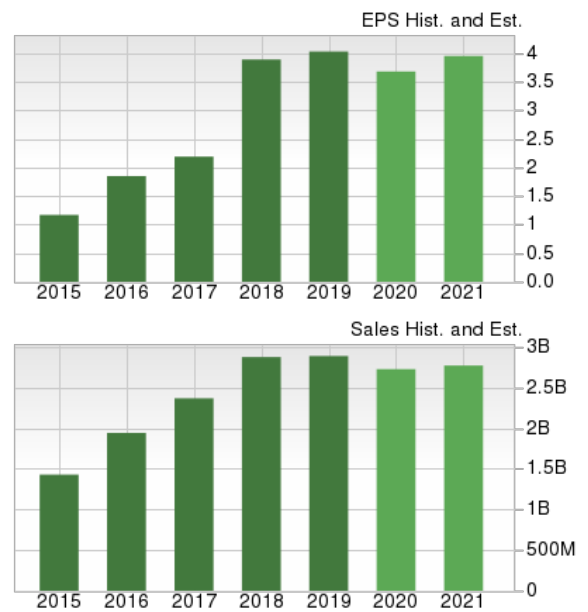
Overview

Founded in 1982 in California and headquartered in New York, E*TRADE Financial Corporation provides online brokerage and related products and services primarily to individual retail investors, under the brand name of “E*TRADE Financial” worldwide. The company was reincorporated in Delaware in July 1996. Along with its subsidiaries, E*TRADE offers various brokerage products and services including automated order placement and execution of the U.S., as well as international equities, currencies, futures, options, exchange-traded funds, mutual funds, and bonds. The banking products and services include checking, savings and clearing facilities, along with money market and certificates of deposit products. E*TRADE operates worldwide, primarily in the U.S., Europe and Asia. The company provides these services to customers online through its network of customer service representatives, investment professionals, and investment advisors – over the phone and in person in all of its 30 E*TRADE branches.

Previously, the company operated through two reporting segments – *Trading and Investing* and *Balance Sheet Management*. However, the company made several reporting changes in the first quarter of 2016 including consolidation of its reporting segments. Given that most of the company’s legacy costs are behind it and balance sheet strength now depends on maximizing the value of customer deposits, management viewed that it was the right time to terminate the balance sheet management segment as well as the corporate category.

In January 2015, the company obtained regulatory approval for moving its two U.S. broker-dealers – E*TRADE Clearing LLC and E*TRADE Securities LLC – from under E*TRADE Bank. E*TRADE Securities and E*TRADE Clearing were moved from under E*TRADE Bank in February 2015 and July 2015, respectively. The reorganized structure will aid in simplification of distribution of capital generated by those entities to the parent.

In April 2018, E*TRADE completed the Trust Company of America (TCA) acquisition deal, diversifying business and securing access to high growth Advisor service delivery model. Previously, in an effort to fortify its derivatives platform, the company completed the acquisition of online options broker — OptionsHouse — in September 2016.



Reasons To Buy:

- ▲ E*TRADE, with the introduction of brokerage products and services and enhancement of capabilities on professional trading and mobile platforms, is focused on improving its technology space to offer a better digital experience to customers. The company's DARTs recorded a four-year compound annual growth rate (CAGR) of 21% in 2019. Notably, second-quarter 2018 marked the second best quarter in the company's history in terms of recording DARTs.
- ▲ In an effort to boost its derivatives platform and diversifying business, E*TRADE completed a number of acquisitions since 2016. The company is focused on derivatives mix and crossed the target of increasing it to 35% of DARTs in third-quarter 2019 and also set managed account AUM target of \$6 billion within the next two years. The company aims to achieve 2-3% improvement in its rate of annual organic growth, across accounts, assets and trades. We expect several of its ongoing initiatives and customer services to further lower the attrition rate of the annual brokerage accounts and support its overall growth strategy.
- ▲ E*TRADE continues to streamline its balance sheet risk by reducing credit risk in its legacy loan portfolios. Notably, the company's loan portfolio reported a negative CAGR of 23.3%, over the last five years (2015-2019). We believe successful completion of the balance sheet restructuring will significantly strengthen the company's financials in the mid to long term.
- ▲ Driven by a solid capital position, E*TRADE is now focused on returning capital to shareholders. This July, it announced a new share-repurchase plan worth \$1.5 billion and initiated common stock dividend in October 2018. Notably, the company completed its previous \$1-billion authorization in third-quarter 2019 and made progress toward the current \$1.5-billion program. We believe, with strengthening of its overall performance, the company enhances shareholders' value with the commitment to return excess capital to them.
- ▲ E*TRADE has seen improvement in its net interest margin (NIM) after witnessing a declining trend for years. It recorded NIM of 3.18%, 3.08%, 2.79%, 2.65%, 2.50% and 2.30% in 2019, 2018, 2017, 2016, 2015 and 2014, respectively. Amid Fed's accommodative-monetary policy stance, improvement in economy and decent loan growth might support margin further.
- ▲ The stock seems undervalued when compared with the broader industry. Its current PEG and price-to-book ratios are below the respective industry averages. Also, it has a Value Score of B.

E*TRADE remains well positioned for growth due to its online innovations and renewed focus on trading business. Further, strategic moves and steady capital-deployment activities are commendable.

Reasons To Sell:

- ▼ E*TRADE's expanding cost base exposes the company to operational risks. Notably, non-interest expenses recorded a CAGR of 8.9% over the last four years (2015-2019), primarily due to rise in almost all the cost components. Therefore, mounting expenses will likely be a near-term headwind as the company focuses on growing its franchise.
- ▼ E*TRADE has to compete with many established and renowned players with greater financial, marketing and technical capabilities. Some of these competitors are in position to withstand the changing market conditions in a better way and can mould to take advantages of the opportunities. Also, these big peers can easily come out with better terms, conduct promotional activities and can offer better terms to entice customers. This intense competition can have adverse impact on the company's revenues and customer base.
- ▼ We remain apprehensive about E*TRADE's significant dependence on interest-based revenue streams (net interest income constituted 64% of net revenues in 2019). Therefore, following the recent moves of Fed on rate cuts, the top line will likely be impacted.
- ▼ Shares of E*TRADE have outperformed the industry over the past six months. Despite this favorable trend, the company's current-year earnings estimates have been revised slightly downward over the past 60 days. Therefore, given the above concerns and lack of positive estimates revision, the stock has limited upside potential.

Escalating expenses and significant dependence on interest-based revenue streams remain key concerns for E*TRADE. Further, intense competition with other established companies keeps us apprehensive.

Last Earnings Report

E*TRADE Q4 Earnings Beat Estimates, DARTs Escalate

Riding on an impressive DARTs' performance, E*TRADE came up with a positive earnings surprise of 1.2% in fourth-quarter 2019. Adjusted earnings of 84 cents per share comfortably surpassed the Zacks Consensus Estimate by a penny. However, the reported figure compares unfavorably with the prior-year quarter's \$1.06.

The company's results reflect improved DARTs. Further, rise in non-interest income and a benefit to provision for loan losses were tailwinds. Additionally, the company registered a rise in customer accounts during the period. Nonetheless, bleak net interest income and escalating expenses were major drags.

Including net losses of \$18 million, or 8 cents per share associated with restructuring costs, the benefit to provision for loan losses and other items, net income available to common shareholders came in at \$172 million or 76 cents per share compared with the \$270 million or \$1.06 recorded in the year-ago quarter.

For full-year 2019, adjusted net income was \$999 million or \$4.03 per share, beating the Zacks Consensus Estimate of \$3.90. Including net losses of \$44 million, or 18 cents per share, associated with losses from balance-sheet repositioning, the benefit to provision for loan losses, and other items, net income came in at \$955 million or \$3.85 per share compared with the \$1.05 billion or \$3.88 witnessed in the prior year.

Quarter Ending **12/2019**

Report Date	Jan 23, 2020
Sales Surprise	0.20%
EPS Surprise	1.20%
Quarterly EPS	0.84
Annual EPS (TTM)	4.13

Revenues Slump, Expenses Soar

Net revenues in the fourth quarter declined 7.6% year over year to \$679 million on lower net interest income. Yet, the reported figure outpaced the Zacks Consensus Estimate of \$677.7 million.

For full-year 2019, total net revenues climbed 22.2% year over year to \$2.89 billion, driven by a rise in net interest income as well as non-interest income. Results, however, lagged the Zacks Consensus Estimate of \$2.91 billion.

Net interest income slipped 13.9% year over year to \$415 million in the quarter, primarily due to elevated interest expenses and lower interest income. Net interest margin was 3.01%, down 19 basis points (bps) from the 3.20% reported in the prior-year quarter.

Non-interest income was \$264 million, up 4.3% year over year. Elevated fees and service charges, higher gains on securities and other revenues primarily led to this upside, partly offset by lower commissions.

Total non-interest expenses escalated 16.8% year over year to \$446 million. This upswing mainly resulted from rise in almost all components of expenses.

Steady Trading Performance

Total DARTs increased 16% year over year to 330,821 during the December-end period, including 34% in derivatives. At the end of the quarter, E*TRADE had 7.2 million customer accounts (including 5.2 million retail accounts), up 4% from the year-ago quarter.

Additionally, DARTs for the full year were 291,000, up 36% year over year, including 34% in derivatives.

Also, the company's total customer assets were \$677.5 billion, up 33% year over year. Brokerage-related cash increased 18% year over year to \$71 billion.

Notably, customers were net sellers of about \$2 billion of securities compared with net buyers of \$1.6 billion recorded in the prior-year quarter. Net new retail assets totaled \$5.8 billion, down 17% from the comparable period last year.

Credit Quality

E*TRADE's overall credit quality displayed a decent performance. Net recoveries were \$9 million during the October-December period compared with the \$8 million recorded as of Dec 31, 2018. Also, the company recorded a provision benefit of \$19 million compared with the \$12 million witnessed in the comparable period last year.

Balance Sheet and Capital Ratios

E*TRADE's loan portfolio totaled \$1.6 billion at the end of the reported quarter, down from \$2.1 billion as of Dec 31, 2018.

As of Dec 31, 2019, E*TRADE had total assets of \$61.4 billion compared with \$65 billion as of Dec 31, 2018.

The company's capital ratios remained strong. As of Dec 31, 2019, E*TRADE reported Tier 1 risk-based capital ratio of 37.9% compared with the 37.3% witnessed in the year-ago quarter. Total risk-based capital ratio was 38.2%, up from the prior-year quarter's 37.8%. Tier 1 leverage ratio was 6.9% compared with the year-earlier quarter's 6.6%.

Capital Deployment

During 2019, E*TRADE returned \$1.2 billion to shareholders, including dividends worth \$135 million and share repurchases worth \$1.1 billion. Notably, during the fourth quarter, the company returned \$208 million to shareholders, including dividends worth \$32 million and share repurchases worth \$176 million.

Outlook

Assuming fed funds rates to remain stable throughout the year, margin balances to remain flat to current levels, a flat balance sheet with customer deposit growth directed off-balance sheet and continuation in shifting premium savings deposits off-balance sheet, management expects 2020 NIM to be about 300 bps.

For first-quarter 2020, management anticipates gross fees from off-balance sheet brokerage and bank sweep deposits will be around 180 bps. Further, accounting for the cost of deposits, management expects net fees to be around 165-170 bps on brokerage and 5-10 bps on banking deposits swept to third parties. Also, among the remaining components of fees and service charges, gains are expected to realize around \$10-\$15 million per quarter.

For first-quarter 2020, with the assumption of holding the balance sheet flat, management anticipates executing a minimum of \$200 million of repurchases.

After completing the review of the new accounting standard for current expected credit losses, also known as CECL, management anticipates a benefit to opening retained earnings of around \$80 million effective the beginning of first-quarter 2020.

The full-year tax rate is expected to be around 27%.

For 2020, non-interest expenses will likely be around \$1.6 billion or below that.

Recent News

Morgan Stanley to Acquire E*TRADE for \$13 Billion - Feb 20, 2020

Morgan Stanley entered into an all-stock acquisition deal with E*TRADE, per which the former will acquire the latter for \$13 billion. Post completion, Morgan Stanley will be well positioned as a leader in the Wealth Management industry across all channels and wealth segments, with significant increase in the scale and breadth of its franchise.

E*TRADE's more-than 5.2-million client accounts and \$360 billion of retail client assets will augment Morgan Stanley's current 3-million client relationships and \$2.7 trillion of client assets. Thus, the combined entity will have client assets worth \$3.1 trillion, 8.2 million retail client relationships and accounts, and 4.6 million stock-plan participants.

Morgan Stanley will be able to serve clients with superior products and services catering the advisor-driven model, combined with E*TRADE's direct-to-consumer and digital processes. Therefore, Morgan Stanley will be transitioned to a more balance-sheet light business mix, with strong and diversified revenue sources.

"E*TRADE represents an extraordinary growth opportunity for our Wealth Management business and a leap forward in our Wealth Management strategy. The combination adds an iconic brand in the direct-to-consumer channel to our leading advisor-driven model, while also creating a premier Workplace Wealth provider for corporations and their employees. E*TRADE's products, innovation in technology, and established brand will help position Morgan Stanley as a top player across all three channels: Financial Advisory, Self-Directed, and Workplace," said James Gorman, chairman and CEO of Morgan Stanley. "In addition, this continues the decade-long transition of our Firm to a more balance sheet light business mix, emphasizing more durable sources of revenue," Gorman further noted on this.

However, the deal awaits certain regulatory approvals and customary approvals by shareholders of E*TRADE. The transaction is anticipated to close in the final quarter of 2020.

Terms of the Deal

Per terms of the deal, each common shareholder of E*TRADE will get stock equivalent to 1.0432 of Morgan Stanley shares for every E*TRADE share held. This represents per share value of \$58.74 based on the closing price of Morgan Stanley common stock as on Feb 19, 2020.

Strategically, the combined entity will enhance through advanced technologies, innovative products and create a competitive edge with financial stability. Remarkably, on completion of the acquisition, online brokerage and digital banking services will enhance clients' experience.

Mike Pizzi, CEO of E*TRADE, will join Morgan Stanley, looking after the E*TRADE business within Morgan Stanley and head the ongoing integration process. Moreover, one of E*TRADE's independent directors is likely to join Morgan Stanley's board.

Financial Benefits

Catering huge funding benefits to Morgan Stanley, the deal comes with around \$56 billion of low-cost deposits. The acquisition move follows the bank's efforts to record revenues from balance-sheet light and more lasting sources of revenues. Notably, post integration, the combined wealth and investment management businesses are likely to contribute about 57% of the bank's pre-tax profits, excluding potential synergies, above the 26% recorded in 2010.

Post combination, significant cost savings worth \$400 million is expected with optimization of technology infrastructure and shared corporate services, along with funding synergies of \$150 million from E*TRADE's around \$56 billion of deposits. In addition, \$7.3 trillion of combined current customer assets is likely to generate significant revenue opportunities.

Per Morgan Stanley, the acquisition is likely to be accretive once fully phased-in estimated cost and funding synergies are realized. Furthermore, the bank's common equity tier 1 ratio is estimated to expand by more than 30 basis points (bps) on closure and augment the bank's return on tangible common equity by more than 100 bps, with fully phased-in cost and funding synergies. Apart from this, Wealth Management's pre-tax profit margin is expected to be up more than 30%.

E*TRADE's January 2020 DARTs Rise 31% From December - Feb 12, 2020

E*TRADE has reported a rise in DARTs for January. According to its monthly-market activity, the company's DARTs came in at 463,739, up 31% from the previous month and 68% year over year. Notably, derivatives comprised 33% of DARTs in January.

E*TRADE Announces Commission Free Trading, Revenues to Take a Hit - Oct 2, 2019

E*TRADE has eliminated retail commissions for online U.S. listed stock, ETF and options trades. Also, it reduced the options contract charge to 65 cents per contract for all traders while maintaining its active trader pricing at 50 cents per contract. These changes took effect on Oct 7, 2019.

The company estimates that this move will have a 10% adverse impact on its net revenues.

Post this news, Moody's Investors Service downgraded the outlook for E*TRADE to negative from stable. However, the ratings of the three firms were not changed. Moody's affirmed their ratings.

Per Moody's, relatively lower interest rates and flattening of the yield curve are already adversely impacting financials of the brokerage firm. With this fee cut, profitability is likely to be hurt even more. This is the main reason why Moody's downgraded the outlook.

Dividend Update

On Jan 23, E*TRADE's board of directors announced a quarterly common stock cash dividend of 14 cents per share. The dividend will be paid

Valuation

E*TRADE's shares are up 20.6% in the year-to-date period and 11.9% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are up 5.3% and 0.9%, respectively, in the year-to-date period. Over the past year, the Zacks sub-industry and the sector is up 11.3% and 8.7%, respectively.

The S&P 500 Index is up 5.1% in the year-to-date period and 20.5% in the past year.

The stock is currently trading at 14.71X forward 12 months earnings, which compares to 11.85X for the Zacks sub-industry, 14.97X for the Zacks sector and 19.38X for the S&P 500 Index.

Over the past five years, the stock has traded as high as 24.13X and as low as 8.09X, with a 5-year median of 16.27X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$57 price target reflects 15.32X forward earnings.

The table below shows summary valuation data for ETFC

Valuation Multiples - ETFC					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	14.71	11.85	14.97	19.38
	5-Year High	24.13	15.3	16.21	19.38
	5-Year Low	8.09	6.05	12.01	15.18
	5-Year Median	16.27	11.42	14.15	17.47
P/TB TTM	Current	4.23	2.51	3.32	17.63
	5-Year High	5.03	3.33	3.98	17.63
	5-Year Low	1.56	1.6	2.44	6.03
	5-Year Median	3.14	2.4	3.46	9.12
P/S F12M	Current	4.9	4.24	6.55	3.59
	5-Year High	5.85	4.53	6.65	3.59
	5-Year Low	2.97	2.8	5.39	2.54
	5-Year Median	4.25	3.63	6.04	3

As of 02/20/2020

Industry Analysis Zacks Industry Rank: Top 36% (91 out of 255)



Top Peers

LPL Financial Holdings Inc. (LPLA)	Outperform
WisdomTree Investments, Inc. (WETF)	Outperform
TD Ameritrade Holding Corporation (AMTD)	Neutral
Evercore Inc (EVR)	Neutral
Raymond James Financial, Inc. (RJF)	Neutral
The Charles Schwab Corporation (SCHW)	Neutral
GAIN Capital Holdings, Inc. (GCAP)	Underperform
Virtu Financial, Inc. (VIRT)	Underperform

Industry Comparison Industry: Financial - Investment Bank				Industry Peers		
	ETFC Neutral	X Industry	S&P 500	AMTD Neutral	RJF Neutral	SCHW Neutral
VGM Score	C	-	-	D	C	B
Market Cap	13.39 B	651.41 M	24.34 B	27.58 B	14.10 B	62.29 B
# of Analysts	6	3	13	7	2	7
Dividend Yield	1.02%	0.00%	1.78%	2.43%	1.46%	1.48%
Value Score	B	-	-	C	C	C
Cash/Price	0.24	0.34	0.04	0.41	0.52	0.60
EV/EBITDA	7.25	5.49	14.18	5.99	5.47	6.92
PEG Ratio	1.33	1.53	2.09	1.21	NA	2.74
Price/Book (P/B)	2.29	2.09	3.30	3.15	2.04	3.42
Price/Cash Flow (P/CF)	10.95	9.94	13.49	10.87	12.02	15.12
P/E (F1)	14.55	12.15	19.28	16.69	13.24	18.56
Price/Sales (P/S)	4.64	1.61	2.68	4.76	1.75	5.81
Earnings Yield	6.72%	8.29%	5.17%	6.00%	7.54%	5.39%
Debt/Equity	0.24	0.40	0.70	0.41	0.40	0.40
Cash Flow (\$/share)	5.00	3.02	7.03	4.69	8.43	3.21
Growth Score	D	-	-	F	B	C
Hist. EPS Growth (3-5 yrs)	39.47%	14.18%	10.84%	29.83%	22.28%	29.67%
Proj. EPS Growth (F1/F0)	-8.68%	15.23%	7.09%	-26.01%	3.31%	-3.78%
Curr. Cash Flow Growth	-5.88%	15.37%	6.72%	17.86%	13.40%	-1.06%
Hist. Cash Flow Growth (3-5 yrs)	11.65%	13.89%	8.25%	21.50%	17.54%	20.15%
Current Ratio	0.29	1.33	1.22	1.11	1.10	0.30
Debt/Capital	17.73%	28.05%	42.37%	28.90%	28.53%	25.81%
Net Margin	33.09%	11.13%	11.56%	34.26%	13.03%	34.55%
Return on Equity	17.09%	11.77%	16.80%	24.24%	16.15%	20.22%
Sales/Assets	0.05	0.22	0.55	0.14	0.21	0.04
Proj. Sales Growth (F1/F0)	-5.59%	3.93%	3.90%	-14.42%	6.83%	0.01%
Momentum Score	A	-	-	A	D	A
Daily Price Chg	21.81%	0.00%	0.01%	2.41%	0.00%	2.40%
1 Week Price Chg	1.33%	0.47%	1.65%	0.47%	5.21%	-0.17%
4 Week Price Chg	18.80%	0.33%	0.36%	0.61%	10.98%	0.33%
12 Week Price Chg	23.02%	3.24%	4.39%	-2.20%	11.91%	-2.53%
52 Week Price Chg	13.48%	0.00%	15.29%	-9.22%	22.13%	6.26%
20 Day Average Volume	4,664,927	55,624	1,992,841	3,620,648	854,301	8,248,015
(F1) EPS Est 1 week change	-0.09%	0.00%	0.00%	1.13%	0.00%	0.38%
(F1) EPS Est 4 week change	1.05%	0.00%	-0.02%	1.86%	-4.74%	-0.33%
(F1) EPS Est 12 week change	0.11%	0.42%	-0.17%	1.97%	-5.03%	1.89%
(Q1) EPS Est Mthly Chg	2.54%	-1.07%	-0.48%	4.28%	-3.03%	0.00%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	D
Momentum Score	A
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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