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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **March 31, 2004** or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number **000-25621**

**E-LOAN, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

**77-0460084**

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification Number)

**6230 Stoneridge Mall Road**  
**Pleasanton, California 94588**

(Address of principal executive offices including zip code)

**(925) 847-6200**

(Registrant's telephone number, including area code)

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 reports), and (2) has been subject to such filing requirements for the past 90 days. YES ☒ NO ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES ☒ NO ☐

As of May 3, 2004, 62,950,365 shares of the Registrant's Common Stock, \$0.001 par value per share, were issued and outstanding.

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**E-LOAN, INC.**  
**QUARTERLY REPORT ON FORM 10-Q FOR THE PERIOD ENDED MARCH 31, 2004**  
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## PART I -- FINANCIAL INFORMATION

### ITEM 1. FINANCIAL STATEMENTS

#### E-LOAN, INC. CONDENSED CONSOLIDATED BALANCE SHEETS (IN THOUSANDS)

	December 31, 2003	March 31, 2004 (Unaudited)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents (includes \$4,850 and \$2,350 of restricted cash).....	\$ 33,973	\$ 45,559
Loans held-for-sale.....	50,874	81,554
Accounts receivable, prepaids and other current assets.....	28,287	19,979
Total current assets.....	113,134	147,092
Fixed assets, net.....	11,484	12,537
Retained interests in auto loans - trading.....	11,658	13,378
Total assets.....	\$ 136,276	\$ 173,007
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Warehouse and other lines payable.....	\$ 44,283	\$ 77,765
Accounts payable, accrued expenses and other current liabilities.....	10,366	13,747
Total current liabilities.....	54,649	91,512
Total liabilities.....	54,649	91,512
Commitments and contingencies (Note 15):		
Stockholders' equity:		
Preferred stock, 5,000,000 \$0.001 par value shares authorized at December 31, 2003 and March 31, 2004; 0 shares issued and outstanding at December 31, 2003 and March 31, 2004.....	--	--
Common stock, 150,000,000 \$0.001 par value shares authorized at December 31, 2003 and March 31, 2004; 62,136,790 and 62,514,567 shares issued and outstanding at December 31, 2003 and March 31, 2004.....	62	63
Additional paid-in capital.....	265,144	266,131
Accumulated deficit.....	(183,579)	(184,699)
Total stockholders' equity.....	81,627	81,495
Total liabilities and stockholders' equity.....	\$ 136,276	\$ 173,007

The accompanying notes are an integral part of these financial statements.

**E-LOAN, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(IN THOUSANDS)**  
**(UNAUDITED)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2003</b>	<b>2004</b>
Revenues (Note 13).....	\$ 36,219	\$ 32,024
Operating expenses:		
Operations (Note 14).....	16,737	16,329
Sales and marketing.....	8,492	11,132
Technology.....	1,876	2,166
General and administrative.....	1,998	3,532
Total operating expenses.....	<u>29,103</u>	<u>33,159</u>
Income (loss) from operations.....	7,116	(1,135)
Other income, net.....	<u>31</u>	<u>15</u>
Income (loss) before taxes.....	7,147	(1,120)
Income taxes.....	(815)	--
Net income (loss).....	<u>\$ 6,332</u>	<u>\$ (1,120)</u>
Net income (loss) per share:		
Basic.....	<u>\$ 0.11</u>	<u>\$ (0.02)</u>
Diluted.....	<u>\$ 0.10</u>	<u>\$ (0.02)</u>
Weighted-average shares - basic.....	<u>59,598</u>	<u>62,325</u>
Weighted-average shares - diluted.....	<u>63,241</u>	<u>62,325</u>

The accompanying notes are an integral part of these financial statements.

**E-LOAN, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(IN THOUSANDS)**  
**(UNAUDITED)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2003</b>	<b>2004</b>
Cash flows from operating activities:		
Net income (loss).....	\$ 6,332	\$ (1,120)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization of fixed assets.....	1,024	1,306
Non-cash compensation expense.....	--	636
Changes in operating assets and liabilities:		
Loans held-for-sale.....	142,878	(30,680)
Retained interests in auto loans - trading.....	(2,509)	(1,720)
Accounts receivable, prepaids, and other assets.....	(8,440)	8,308
Accounts payable, accrued expenses and other payables.....	196	3,381
Net cash (used in) provided by operating activities.....	<u>139,481</u>	<u>(19,889)</u>
Cash flows from investing activities:		
Acquisition of fixed assets.....	(2,211)	(2,359)
Net cash used in investing activities	<u>(2,211)</u>	<u>(2,359)</u>
Cash flows from financing activities:		
Proceeds from issuance of common stock, net.....	314	352
Proceeds from warehouse and other lines payable.....	1,112,628	1,074,149
Repayments of warehouse and other lines payable.....	(1,252,578)	(1,040,667)
Payments on obligations under capital leases, net.....	(10)	--
Net cash (used in) provided by financing activities.....	<u>(139,646)</u>	<u>33,834</u>
Net (decrease) increase in cash.....	(2,376)	11,586
Unrestricted cash and cash equivalents, beginning of period.....	33,821	29,123
Change in restricted cash.....	--	2,500
Unrestricted cash and cash equivalents, end of period.....	31,445	43,209
Restricted cash and cash equivalents, end of period.....	2,500	2,350
Total cash and cash equivalents, end of period.....	<u>\$ 33,945</u>	<u>\$ 45,559</u>
Supplemental cash flow information:		
Cash paid for interest.....	<u>\$ 2,400</u>	<u>\$ 2,049</u>

The accompanying notes are an integral part of these financial statements.

**E-LOAN, INC.**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL**  
**STATEMENTS**

**1. THE COMPANY**

E-LOAN, Inc. (the "Company") was incorporated on August 26, 1996 and began marketing its services in June 1997. The Company is a consumer direct lender of first and second mortgage loans, home equity loans and home equity lines of credit and auto loans. The Company operates as a single operating segment.

**2. BASIS OF PRESENTATION**

**Interim Financial Information (unaudited)**

The accompanying financial statements as of March 31, 2003 and 2004 are unaudited. The unaudited interim financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly the Company's financial position, results of operations and cash flows as of March 31, 2003 and 2004. These financial statements and notes thereto are unaudited and should be read in conjunction with the Company's audited financial statements included in the Company's 10-K for the year ended December 31, 2003. The results for the three months ended March 31, 2004 are not necessarily indicative of the expected results for the year ending December 31, 2004.

**Principles of Consolidation**

These condensed consolidated financial statements include the accounts of E-LOAN and its wholly owned subsidiary, Escrow Closing Services, Inc. ("ECS"). ECS was incorporated on February 27, 2003 and began marketing its services in November 2003. All intercompany accounts and transactions have been eliminated in consolidation.

**Reclassification**

Certain amounts in the financial statements have been reclassified to conform to the 2004 presentation.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Use of Estimates in the Preparation of Financial Statements**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Cash and Cash Equivalents**

The Company considers all highly liquid monetary instruments with an original maturity of three months or less from the date of purchase, including documentary drafts, to be cash equivalents. The Company is required to maintain a minimum cash and cash equivalents balance of \$15 million related to its warehouse lines. The following summarizes cash and cash equivalents at December 31, 2003 and March 31, 2004 (dollars in thousands):

	December 31, 2003	March 31, 2004
Cash.....	\$ 28,179	\$ 41,130
Certificates of deposit, unrestricted.....	75	75
Documentary drafts.....	869	2,004
Restricted cash.....	4,850	2,350
	<u>\$ 33,973</u>	<u>\$ 45,559</u>

### **Documentary drafts**

The Company originates auto loans directly to consumers partially through the use of a documentary draft process. This process requires the borrower and the auto dealer to provide the Company with a series of supporting documents and vehicle information to complete the loan. For some borrowers, the vehicle also must meet certain model year and loan-to value restrictions.

Cash is allocated to satisfy documentary drafts presented by borrowers before the required supporting documents are reviewed by the Company to complete the loan. If the required documentation is not provided as agreed to by the borrower and auto dealer, then the allocation of cash is reversed and the cash balance is restored. The Company's documentary draft process allows for at least two business days to process the required supporting documentation prior to determining whether to reverse or honor the original presentment by the auto dealer.

### **Escrow deposits**

The Company administers escrow deposits as a service to its customers. Escrow deposits totaled \$5.8 million and \$13.0 million at December 31, 2003 and March 31, 2004, respectively, which were held at third party financial institutions. Escrow deposits are not considered assets of the Company and, therefore, are not included in the accompanying balance sheet. However, the Company remains contingently liable for the disposition of these deposits.

### **Restricted Cash**

In December 2003, the Company renegotiated its line of credit with Wells Fargo Bank, National Association. As part of the amendment, the Company was required to provide restricted cash in the amount of \$2.35 million as collateral for this line of credit. This restricted cash is being held in certificates of deposit which mature in less than 90 days and is classified as a current asset on the Company's accompanying condensed consolidated balance sheet. This line of credit is being utilized to support letters of credit related to the new Pleasanton, California facility as well as a letter of credit related to the Company's surety bonds.

In March 2004, the Company renegotiated its \$400 million warehouse line agreement with Greenwich Capital that required the Company to maintain a restriction of \$2.5 million in cash as additional collateral. As part of the amendment, the restriction of this cash was removed.

### **Derivative instruments**

On January 1, 2001, the Company adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative and Hedging Activities" ("SFAS 133"), as subsequently amended by Statement of Financial Accounting No. 138. In accounting for its derivative financial instruments, SFAS 133 requires an entity to recognize all derivative assets or liabilities in the statement of financial condition and measure those instruments at fair value. The accounting for changes in fair value of the derivative depends on the intended use of the derivative and the resulting designation. An entity that elects to apply hedge accounting is required to establish at the inception of the hedge, the method it will use in assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffectiveness of the hedge. These methods must be consistent with the entity's approach to

managing risk. The Company is a party to mortgage rate lock commitments to fund mortgage loans at interest rates previously agreed (locked) by both the Company and the borrower for specified periods of time. When the borrower locks their interest rate, the Company effectively extends a put option to the borrower, whereby the borrower is not obligated to enter into the loan agreement, but the Company must honor the interest rate for the specified time period. Under SFAS 133 mortgage interest rate locks are derivatives. The Company is exposed to interest rate risk during the accumulation of interest rate lock commitments and loans prior to sale. The Company utilizes either a best efforts sell forward commitment or a mandatory sell forward commitment to economically hedge the changes in fair value of the loan due to changes in market interest rates. Both best efforts and mandatory sell forward commitments are derivatives under SFAS 133. Throughout the lock period the changes in the market value of interest rate lock commitments, best efforts and mandatory sell forward commitments are recorded as unrealized gains and losses and are included in the statement of operations in mortgage revenue.

The Company's management has made complex judgments in their application of SFAS 133. The judgments include the identification of hedging instruments, hedged items, nature of the risk being hedged, and how the hedging instrument's effectiveness will be assessed. The Company designates forward delivery commitments, where the Company intends to deliver the underlying loan into the commitment, as a fair value SFAS 133 hedge at the commitment date. In addition, the Company designates all best efforts sell forward commitments as fair value SFAS 133 hedges for underlying loans at funding date. The Company does not designate mandatory sell forward agreements as SFAS 133 hedges but does utilize them to economically hedge the changes in fair value of rate lock commitments with borrowers for which a best effort sell forward commitment has not been obtained. The Company did not have a material gain or loss representing the amount of hedge ineffectiveness related to designated SFAS 133 hedges during the three months ended March 31, 2004. The effect on the Company's income statement from marking to market the locked pipeline and forward commitments was a \$1.5 million and \$0.7 million loss, included in mortgage revenues for the three months ended March 31, 2003 and 2004, respectively.

In September 2003, the Company began hedging its interest rate risk on auto loan approvals. When the Company issues an auto loan approval, the Company extends a put option to the borrower, whereby the borrower is not obligated to enter into the loan agreement, but the Company must honor the interest rate for up to a 45-day period. Under SFAS 133, auto loan approvals are not considered derivatives. However, the company is still exposed to interest rate risk from issuance of approval to loan sale. The Company enters into amortizing swap contracts to economically hedge the interest rate changes in auto loan approvals. These swap contracts are considered derivatives under SFAS 133. The Company marks-to-market any changes in the value of outstanding swap contracts, which are recorded as unrealized gains and losses and included in the statement of operations in auto revenue. The effect on the Company's income statement from applying SFAS 133 was a \$0.1 million gain, included in auto revenues in the three months ended March 31, 2004.

#### **Sale of auto loans to qualified special purpose entity**

On June 17, 2002, the Company entered into an arrangement to sell auto loan receivables to a qualified special purpose entity ("QSPE"), E-Loan Auto Fund One, LLC ("E-Loan Auto"). These transactions involve the Company surrendering control over these assets to assure that the sold assets have been isolated from the Company and its creditors. As E-Loan Auto has met the appropriate tests to be considered a QSPE, the assets and liabilities of E-Loan Auto are not consolidated in the financial statements of the Company. E-Loan Auto has obtained a secured borrowing facility from Merrill Lynch Bank USA to finance all purchases of loans from the Company. The Company recognizes a gain on the sale of auto loan receivables to E-Loan Auto in the period the sale occurs, which represents the difference between the sale proceeds to the Company and the Company's net carrying value of the receivables. The Company retains an interest in the future cash flows from the loans. Such cash flows are distributed to the Company by the QSPE monthly. The retained interest is recorded on the balance sheet at fair value as a trading asset, and is marked to market at each subsequent reporting period in accordance with Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS 115"). The fair value of the retained interest is based upon the net present value of the estimated future cash flows to be received by the Company over the life of the loans. The Company makes various assumptions in order to determine the fair value of the estimated future excess cash flows to be generated by the auto loans sold to the QSPE. The most significant assumptions are the cumulative credit losses to be incurred on the pool of auto loan receivables sold, prepayment rates of the auto loans and the rate at which the estimated future excess cash flows are discounted. The assumptions used represent the Company's best estimates, and the use of different assumptions



could produce different financial results. The Company will continue to monitor and may update its assumptions over time.

### Net Income (Loss) Per Share

The Company computes net income (loss) per share in accordance with SFAS No. 128, *Earnings per Share*. Under the provisions of SFAS No. 128 basic net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing the net income (loss) available to common stockholders for the period by the weighted average number of common and potential dilutive shares outstanding during the period, to the extent such potential dilutive shares are dilutive. Potential dilutive shares are composed of incremental common shares issuable upon the exercise of stock options and warrants. Anti-dilutive shares in the amounts of 10.8 million and 10.2 million were excluded from the dilutive shares outstanding for the periods ended March 31, 2003 and 2004, respectively.

The following table sets forth the computation of diluted net income (loss) per share for the periods indicated (dollars in thousands, except per share amounts):

	Three Months Ended March 31,	
	2003	2004
	(In Thousands)	
Numerator:		
Net income (loss).....	\$ 6,332	\$ (1,120)
Denominator:		
Weighted average shares, basic.....	59,598	62,325
Effect of potentially dilutive securities:		
Warrants.....	477	--
Employee Stock Option Plan.....	3,166	--
Weighted average number of shares assuming dilution.....	63,241	62,325
Diluted net income (loss) per share.....	\$ 0.10	\$ (0.02)

### Comprehensive Income

The Company adopted SFAS No. 130, *Reporting Comprehensive Income*, during 1998. The Company classifies items of "other comprehensive income" by their nature in the financial statements and displays the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet. To date, the Company has not had any transactions that are required to be reported in other comprehensive income.

### Recent Accounting Pronouncements

In January 2003, the FASB issued FIN 46, "Consolidation of Variable Interest Entities -- an interpretation of ARB No. 51" ("FIN 46"). The objective of this Interpretation is not to restrict the use of variable interest entities but to improve financial reporting by enterprises involved with variable interest entities. FIN 46 states that a business enterprise with a controlling financial interest in a variable interest entity should include the assets, liabilities, and results of the activities of the variable interest entity in consolidated financial statements with those of the business enterprise. FIN 46 applied immediately to variable interest entities created after January 31, 2003, and to variable

interest entities in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after December 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. The adoption of this interpretation has had no effect on the Company's financial statements.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("SFAS No. 149"). SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities. This Statement requires that contracts with comparable characteristics be accounted for consistently as either derivatives or hybrid instruments. This Statement is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. The adoption of this statement has had no effect on the Company's financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity". SFAS No. 150 changes the accounting for certain financial instruments that under previous guidance issuers could account for as equity. It requires that those instruments be classified as liabilities in balance sheets. The guidance in SFAS No. 150 is generally effective for all financial instruments entered into or modified after May 31, 2003, and otherwise is effective on July 1, 2003. The adoption of this statement has had no effect on the Company's financial statements.

In March 2004, Securities and Exchange Commission ("SEC") Staff Accounting Bulletin No. 105 was issued, which provides guidance regarding loan commitments that are accounted for as derivative instruments under FASB No. 133 (as amended), "Accounting for Derivative Instruments and Hedging Activities". In this Bulletin, the SEC ruled that the amount of the expected servicing rights should not be included when determining the fair value of derivative interest rate lock commitments. This guidance must be applied to rate locks initiated after March 31, 2004. Our current method used to estimate the fair value of interest rate lock commitments is consistent with SAB No. 105; therefore, SAB No. 105 will have no impact on the Company's financial condition or results of operations.

#### **4. STOCK-BASED COMPENSATION**

The Company accounts for stock-based employee compensation arrangements in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* and related interpretations, and complies with the disclosure requirements of SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting For Stock-Based Compensation -- Transition And Disclosure -- An Amendment Of SFAS No. 123*. Under APB No. 25, compensation expense is based on the excess of the estimated fair value of the Company's stock over the exercise price, if any, on the date of grant. The Company accounts for stock issued to non-employees in accordance with the provisions of SFAS No. 123 and the Emerging Issues Task Force Consensus in Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Non-Employees for Acquiring, or in Conjunction with Selling, Goods or Services*.

The following pro forma net income (loss) information has been prepared as if the Company had followed the provisions of SFAS No. 123 (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2003	2004
	(In Thousands)	
Reported net income (loss).....	\$ 6,332	\$ (1,120)
Add: Employee stock compensation expense included in reported net income (loss), net of taxes.....	--	667
Less: Employee stock based compensation expense determined under fair value based method for all employee stock option awards, net of tax.....	(1,269)	(1,029)
Pro forma net income (loss).....	<u>\$ 5,063</u>	<u>\$ (1,482)</u>
Reported basic net income (loss) per share.....	\$ 0.11	\$ (0.02)
Reported diluted net income (loss) per share.....	\$ 0.10	\$ (0.02)
Pro-forma basic net income (loss) per share.....	\$ 0.08	\$ (0.02)
Pro-forma diluted net income (loss) per share.....	\$ 0.08	\$ (0.02)
Risk free interest rate - stock options.....	2.9%	3.0%
Risk free interest rate - ESPP.....	2.5%	2.1%
Average expected life - stock options.....	5.0	5.0
Average expected life - ESPP.....	2.0	2.0
Dividend yield.....	--	--
Expected volatility - stock options.....	59.1%	64.7%
Expected volatility - ESPP.....	89.9%	76.6%

## 5. WARRANTS

On April 25, 2000, the Company issued two warrants to purchase up to 13.1 million shares of common stock to The Charles Schwab Corporation ("Schwab"), pursuant to a marketing agreement with Schwab. The first warrant to purchase 6,500,000 shares of common stock at an exercise price of \$3.75, had a three-year term and expired unexercised on April 25, 2003. The second warrant to purchase 6,600,000 shares of common stock at an exercise price of \$15.00, had a three and a quarter year term and an expiration date of July 25, 2003. On July 12, 2001 the Company exchanged the warrant to purchase 6,600,000 shares at \$15 per share for a new warrant to purchase 1,389,000 shares at \$5 per share. On June 27, 2003, this warrant was net exercised for 254,566 shares of common stock.

In February 2001, the Company issued a warrant to purchase 300,000 shares of common stock to Greenwich Capital in connection with a warehouse agreement at an exercise price of \$1.55 per share until February 23, 2006. In July 2003, Greenwich Capital assigned a portion of the warrant to an institutional investor in the amount of 150,000 common shares. At March 31, 2004, both warrants remain outstanding.

In June 2002, the Company issued a warrant to purchase 800,000 shares of common stock to Merrill Lynch Mortgage Capital, Inc. in connection with a line of credit agreement at an exercise price of \$1.22 per share until June 1, 2005. At March 31, 2004, this warrant remained outstanding.

## 6. LOANS HELD-FOR-SALE

The inventory of mortgage and home equity loans consists primarily of first and second trust deed mortgage loans and home equity lines of credit on residential properties located throughout the United States. All mortgage and home equity loans held-for-sale are pledged as collateral for borrowings at December 31, 2003 and March 31, 2004.

(see Note 10).

The inventory of auto loans consists primarily of loans against new and used automobiles located throughout the United States. All of the auto loans held-for-sale are pledged as collateral for borrowings at December 31, 2003 and March 31, 2004 (see Note 10). The following summarizes loans held-for-sale at December 31, 2003 and March 31, 2004 (dollars in thousands):

	<b>December 31, 2003</b>	<b>March 31, 2004</b>
Mortgage.....	\$ 32,811	\$ 66,665
Home equity.....	13,803	10,043
Auto.....	4,158	4,702
Net deferred origination revenue.....	102	144
	<u>\$ 50,874</u>	<u>\$ 81,554</u>

Included in loans held-for-sale is a SFAS 133 basis adjustment amount of \$0.1 million and \$0.1 million at December 31, 2003 and March 31, 2004, respectively. The basis adjustment amount represents the change in fair value from rate lock commitment date to funding of those loans held-for-sale. The total fair value of loans held-for-sale, including the expected embedded gain on those loans, is \$51.8 million and \$83.5 million at December 31, 2003 and March 31, 2004, respectively.

## 7. ACCOUNTS RECEIVABLE, PREPAIDS AND OTHER CURRENT ASSETS

The following summarizes accounts receivable, prepaids and other current assets at December 31, 2003 and March 31, 2004 (dollars in thousands):

	<b>December 31, 2003</b>	<b>March 31, 2004</b>
Prepaids.....	\$ 4,574	\$ 2,244
Accounts receivable.....	21,233	15,890
Interest receivable.....	1,541	1,043
Other current assets.....	939	802
	<u>\$ 28,287</u>	<u>\$ 19,979</u>

Included in prepaids at December 31, 2003 and March 31, 2004 are prepayments for sales and marketing in the amounts of \$2.3 million and \$1.0 million, respectively. Included in accounts receivable is the receivable due to the Company from sales of mortgage loans on its sale agreement with Greenwich Capital Financial Products, Inc. ("Greenwich Capital") in the amounts of \$15.5 million and \$11.9 million at December 31, 2003 and March 31, 2004, respectively (see Note 10). Included in other current assets is an amount related to the fair value of SFAS 133 derivatives of \$0.1 million at December 31, 2003. There was no amount included in other current assets related to the fair value of SFAS 133 derivatives at March 31, 2004.

## 8. RETAINED INTERESTS IN AUTO LOANS

In June 2002, the Company created a qualified special purpose entity, E-Loan Auto Fund One, LLC ("E-Loan Auto"), which purchases prime auto loans from the Company and then holds the loans. For the three months ended March 31, 2004, the Company sold \$120.0 million in auto loans to E-Loan Auto and recognized \$2.4 million in gain

on sale. In exchange for the loans sold, the Company received cash of \$119.4 million from E-Loan Auto and recorded a retained interest valued at \$3.0 million in the loans sold to E-Loan Auto. From inception through March 31, 2004, the Company has sold \$809.1 million in auto loans to E-Loan Auto and recognized \$12.5 million in gain on sale. For the three months ended March 31, 2004, the average loan characteristics on auto loans sold to E-Loan Auto were \$17,500 loan size, 720 credit score, 12.7% new versus used car, and an average APR of 5.79%. The retained interest represents the Company's portion of the net present value of the expected excess cash flows over the life of the loans, remaining after payment of interest, servicing fees and credit losses. Included in the retained interest is a contributed basis in the loans sold to E-Loan Auto of 0.5%. The contributed basis is the difference between the loan amount and the cash sale proceeds received from E-Loan Auto of 99.5% (of the unpaid principal balance), which represents over collateralization in those loans. Cash flows are to be distributed by E-Loan Auto in the following manner: first to the hedge counterparty, second to the servicer, custodian and administrator, third to the lender for interest expense, fourth to the lender for principal payments, fifth to the Company and the lender any remaining cash flows, to be distributed 85% and 15%, respectively, up to \$800 million in originations. After \$800 million in originations, all remaining cash flows will be paid directly to the Company. The servicing fee is passed through to a sub-servicer of the Company, and as such the Company does not capitalize a servicing asset for the loans sold to E-Loan Auto, since the cost to sub-service equals the servicing fee.

The following table provides a summary of activity in the retained interests in auto loans:

	<u>2002</u>	<u>2003</u>
Beginning Balance December 31,	\$ 3,969	\$ 11,658
Contributed basis in loans sold to E-Loan Auto	618	600
Non-cash gain on sale	1,662	2,410
Accretion of present value discount	229	339
Excess cash flows received	-	(1,584)
Fair value adjustment	<u>-</u>	<u>(45)</u>
Ending Balance March 31,	<u>\$ 6,478</u>	<u>\$ 13,378</u>

At March 31, 2004, key valuation assumptions used to value the retained interests and the sensitivity of those assumptions to immediate 10% and 25% adverse changes in those assumptions are as follows:

	<u>March 31, 2004</u> <u>(dollars in thousands)</u>
Balance sheet carrying value of retained interests - fair value	\$13,378
Weighted-average life (in months)	50.8
Prepayment speed assumptions (ABS)	1.3
Impact on fair value of 10% adverse change (1.43)	(\$381)
Impact on fair value of 25% adverse change (1.62)	(\$969)
Weighted Average Expected credit losses (life of loan loss rate)	61 bps
Impact on fair value of 10% adverse change (67 bps)	(\$328)
Impact on fair value of 25% adverse change (76 bps)	(\$826)

Residual cash flows discount rate (average annual rate)	12.0%
Impact on fair value of 10% adverse change (13.2%)	(\$210)
Impact on fair value of 25% adverse change (15.0%)	(\$514)

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value of the retained interests based on a variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also in the above table, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments but increased credit losses), which might magnify or counteract the sensitivities.

The discount rate was determined by assessing the risk related to the asset to account for the present value of the cash flows to be received over the life of the loans. As a result, the retained interest asset is an interest earning asset, with interest income accreted over time at the discount rate and included in Auto Revenues. The weighted average loss rate is based on actual loss experience to date from the seasoned portions of the portfolio. The prepayment speed projects prepayments on a monthly percentage of the original loan balance. All assumptions are monitored over time and are adjusted to reflect actual performance.

## **9. NOTES PAYABLE**

On June 30, 2003, the Company obtained a \$5 million line of credit from Wells Fargo Bank, National Association to support working capital needs. The interest rate charged on borrowings against these funds is based on LIBOR plus 2% and is payable monthly. The line of credit was originally scheduled to expire on June 30, 2004. However, on December 11, 2003, the agreement was amended to reduce the line of credit to \$2,350,000 and extend the expiration date to June 30, 2005. As part of the amendment, the Company was required to provide restricted cash as collateral for this line of credit (see Note 3). Currently, the line of credit is being utilized to support letters of credit related to the new Pleasanton, California facility as well as a letter of credit related to the Company's surety bonds. The Company was in compliance with all debt covenants for this agreement during the three months ended and at March 31, 2004. No balance was outstanding on this line as of March 31, 2004.

## **10. WAREHOUSE AND OTHER LINES PAYABLE**

The Company has a warehouse line of credit for borrowings of up to \$75 million for the interim financing of mortgage loans with GMAC Mortgage Corporation. The interest rate charged on borrowings against these funds is variable based on LIBOR plus various percentage points. This warehouse line requires the Company to pay GMAC a non-use fee when the average outstanding principal amount of borrowings is less than 50% of the total commitment at a rate of 0.25% per annum on the daily average unutilized commitment. Borrowings are collateralized by the related mortgage loans held-for-sale. This line of credit agreement generally requires the Company to comply with various financial and non-financial covenants. In particular, the Company must maintain a minimum cash balance of \$15.0 million. The Company was in compliance with these covenants during the three months ended and at March 31, 2004. The committed line of credit expires on March 31, 2005.

The Company has an agreement to finance up to \$400 million of mortgage loan inventory pending sale of these loans to the ultimate mortgage loan purchasers with Greenwich Capital. Of this amount, \$200 million is available in committed funds. This loan inventory financing is secured by the related mortgage loans. The interest rate charged on borrowings against these funds is based on LIBOR plus various percentage points. As part of this agreement the Company had to pay a commitment fee of \$1.0 million for the period March 31, 2003 through March 30, 2004. The commitment fee was reduced to \$750,000 for the period March 15, 2004 through March 14, 2005. This agreement includes various financial and non-financial covenants. In particular, the Company must maintain a minimum cash and cash equivalents balance of \$15 million. Prior to an amendment in March 2004, the Company was required to maintain a restriction of \$2.5 million in cash as additional collateral. Subsequent to the amendment, there is no restriction on cash related to this facility. The Company was in compliance with these covenants during

the three months ended and at March 31, 2004. The line will expire on March 14, 2005.

In addition, the Company has a mortgage loan purchase and sale agreement with Greenwich Capital. Under the terms of this agreement, mortgage loans which are allocated to a mandatory sell forward commitment between the Company and a loan purchaser, but have not yet been settled, may be sold to Greenwich Capital subject to the accompanying trade assignment. Revenue derived from sales under this agreement is included as a receivable on the balance sheet until the transaction is settled (see Note 7). The balance of loans sold related to these receivables was \$305.1 million and \$308.3 million as of December 31, 2003 and March 31, 2004, respectively.

The Company has a \$10 million line of credit facility with Merrill Lynch Mortgage Capital, Inc. to support the interim funding of auto loans prior to their sale to the ultimate auto loan purchaser. The interest rate charged on this line is based on LIBOR plus various percentage points. This facility requires the Company to pay an unused line fee equal to 0.50% per year on the average daily unused line balance. This facility expires on July 13, 2004. This line includes various financial and non-financial covenants. The Company was in compliance with the various covenants during the three months ended and at March 31, 2004.

On February 6, 2004, the Company entered into a new uncommitted warehouse line of credit agreement for borrowings of up to \$200 million for the interim financing of mortgage loans with Merrill Lynch Mortgage Capital Inc. The interest rate charged on borrowings against these funds is variable based on LIBOR plus various percentage points. Borrowings are collateralized by the related mortgage loans held-for-sale. The uncommitted line of credit expires on February 4, 2005. This line of credit agreement generally requires the Company to comply with various financial and non-financial covenants. In particular, the Company must maintain a minimum unrestricted cash balance of \$12.5 million. Failure to comply with these, or any other covenants, could result in the obligation to repay all amounts then outstanding. The Company was in compliance with these covenants during the period ended and at March 31, 2004.

The following summarizes warehouse and other lines payable at December 31, 2003 and March 31, 2004 (dollars in thousands):

	December 31, 2003	March 31, 2004
Warehouse lines - GMAC.....	\$ 8,066	\$ 23,022
Warehouse lines - Greenwich.....	31,462	46,889
Warehouse lines - Merrill (Mortgage).....	--	3,384
Line of credit - Merrill (Auto).....	4,755	4,470
	<u>\$ 44,283</u>	<u>\$ 77,765</u>

# **11. ACCOUNTS PAYABLE, ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

The following summarizes accounts payable, accrued expenses and other current liabilities at December 31, 2003 and March 31, 2004 (dollars in thousands):

	December 31, 2003	March 31, 2004
Accounts payable.....	\$ 4,614	\$ 6,468
Accrued compensation.....	1,987	3,217
Income tax payable.....	(614)	(614)
Other current liabilities.....	1,646	2,268
Reserves.....	2,386	2,200
Interest payable.....	347	208
	<u>\$ 10,366</u>	<u>\$ 13,747</u>

Included in other current liabilities is an amount related to the fair value of SFAS 133 derivatives of \$0.9 and \$1.4 million at December 31, 2003 and March 31, 2004, respectively.

Included in the accounts payable, accrued expenses and other current liabilities is an amount related to reserves the Company established for representation and warranties and premium repayment liability. The Company sells loans to loan purchasers on a servicing released basis without recourse. As such, the risk of loss or default by the borrower has generally been assumed by these purchasers. However, the Company is usually required by these purchasers to make certain representations relating to credit information, loan documentation and collateral. To the extent that the Company does not comply with such representations, or there are early payment defaults, the Company may be required to repurchase loans or indemnify these purchasers for any losses from borrower defaults. In connection with a majority of its loan sale agreements, the Company is also responsible for ensuring that the borrower makes a minimum number of payments to be made on each loan, or else the Company may be required to refund the premium paid to it by the loan purchaser. As such, the Company records reserves based on certain assumptions in anticipation of future losses as a result of current activity.

Loss reserves due to violations of representations and warranties are recorded based on a percentage of current month originations. The Company currently calculates this loss rate exposure based on its historical loss rates as well as similar lending portfolios. Once the Company has endured a complete economic cycle, the rate will be adjusted based on actual losses as a percentage of origination volume on a historical basis. Premium repayment reserves, generated through early loan prepayments related to loans sold to loan purchasers, are recorded based on a rate determined by calculating actual prepayments as a percentage of originations on a historical basis applied to current month originations. The following illustrates the changes in the reserve balance for the three months ended March 31, 2004 by product (in thousands):

	<b>Mortgage</b>	<b>Home Equity</b>	<b>Auto</b>	<b>Total</b>
Balance at 1/1/04.....	\$ 1,309	\$ 966	\$ 111	\$ 2,386
Increase to reserve.....	162	325	18	505
Losses incurred.....	(316)	(355)	(20)	(691)
Balance at 03/31/04.....	<u>\$ 1,155</u>	<u>\$ 936</u>	<u>\$ 109</u>	<u>\$ 2,200</u>

## 12. SEGMENT AND GEOGRAPHIC INFORMATION

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information", establishes standards for reporting information regarding operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports issued to stockholders. SFAS No. 131 also establishes standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision-maker, or decision-making group, in making decisions how to allocate resources and assess performance. The Company's chief decision-maker(s), as defined under SFAS No. 131, are the Chief Executive Officer and the executive team. The Company has determined that it operates in a single reportable operating segment: online consumer direct lending, specializing in mortgage, home equity and auto loans.

All of the Company's revenues are generated from transactions originating in the United States.

## 13. REVENUES AND OTHER INCOME, NET



The following table provides the components of revenues (in thousands):

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2003</b>	<b>2004</b>
Revenues:		
Mortgage.....	\$ 23,851	\$ 14,536
Interest income on mortgage loans.....	4,864	2,936
Home equity.....	3,939	9,250
Interest income on home equity loans.....	424	1,473
Auto.....	2,887	3,062
Closing services.....	--	451
Other.....	254	316
Total revenues.....	<u>\$ 36,219</u>	<u>\$ 32,024</u>

The following table provides the components of other income, net (in thousands):

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2003</b>	<b>2004</b>
Interest income on short-term investments.....	\$ 31	\$ 23
Interest expense on non-warehouse facility borrowings.....	--	(8)
	<u>\$ 31</u>	<u>\$ 15</u>

#### 14. OPERATING EXPENSES

The following table provides the components of operating expenses (in thousands):

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2003</b>	<b>2004</b>
Compensation and benefits.....	\$ 12,680	\$ 14,090
Processing costs.....	2,800	2,774
Advertising and marketing.....	7,265	9,936
Occupancy and administration.....	3,505	4,060
Interest expense on warehouse borrowings.....	2,853	2,299
Total operating expenses.....	<u>\$ 29,103</u>	<u>\$ 33,159</u>

Commissions and bonus compensation comprised 25% and 19% of total compensation and benefits in the three months ended March 31, 2003 and 2004. Net occupancy costs comprised 30% and 37% of total occupancy and administration in the three months ended March 31, 2003 and 2004, respectively. Included in compensation and benefits for the three months ended March 31, 2004 is a charge related to the resignation of the Company's prior President and Chief Operating Officer of approximately \$1.0 million.

The following table provides detail of the operations component of total operating expenses classified by the

following revenue-related categories (in thousands):

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2003</b>	<b>2004</b>
Mortgage .....	\$ 8,186	\$ 6,648
Interest expense on mortgage loans.....	2,398	1,404
Home equity.....	3,082	5,070
Interest expense on home equity loans.....	288	868
Auto.....	2,783	1,834
Closing services.....	--	505
T total operations.....	<u>\$ 16,737</u>	<u>\$ 16,329</u>

## 15. COMMITMENTS AND CONTINGENCIES

### Loan commitments and hedging activities

The Company originates mortgage loans and sells them primarily through whole loan sales. The market values of mortgage loans are sensitive to changes in market interest rates and product demand. If interest rates rise between the time the Company enters into a rate lock with the borrower, the subsequent funding of the loan and the time the mortgage loans are committed for sale, there may be a decline in the market value of the mortgage loans. To protect against such possible declines, the Company has adopted a macro economic hedging strategy.

Individual mortgage loan risks are aggregated by loan type and pipeline production status and matched, based on estimated duration, with the appropriate hedging instrument, thus mitigating basis risk until closing and delivery. The Company currently hedges its mortgage pipeline through mandatory forward sales of Fannie Mae mortgage-backed securities and both mandatory and best efforts forward sale agreements with the ultimate loan purchaser. The Company determines which alternative provides the best execution in the secondary market at the time of commitment.

The Company believes that it has implemented a cost-effective economic hedging program to provide a high level of protection against subsequent changes in the market value of rate-lock commitments. However, an effective hedging strategy is complex and no hedging strategy can completely insulate the Company against such changes.

At March 31, 2004, the Company had extended locks to originate mortgage and home equity loans amounting to approximately \$387.8 million (the "locked pipeline"). At March 31, 2004, the Company had entered into best efforts forward loan sale agreements amounting to approximately \$57.5 million. These forward loan sale agreements do not subject the Company to mandatory delivery and there is no penalty if the Company does not deliver into the commitment. The Company is exposed to counterparty risk, however, it is the Company's policy and practice to use well-established U.S. financial institutions to mitigate that risk; the Company does not require collateral to support these commitments, and there has been no failure on the part of the counterparties to meet the terms of these agreements to date.

At March 31, 2004, the Company had entered into mandatory sell forward commitments amounting to approximately \$185.7 million. The Company adjusts the amount of mandatory sell forward commitments held to offset changes in the locked pipeline and changes in the market value of unsold loans. At March 31, 2004, the Company had entered into \$55.6 million of commitments with loan purchasers to deliver loans related to funded loans held-for-sale.

The Company issues auto loan approvals on its prime loan production. Approved auto loan applicants are provided a guaranteed rate for up to a 45 day period. At March 31, 2004, the Company had entered into amortizing swap contracts in the amount of \$26.1 million, as an economic hedge of anticipated funded loans from auto loan approvals.

## **Future Commitments**

The Company has future payment commitments for operating leases and non-cancelable TV media aggregating \$6.1 million, \$2.7 million, \$2.7 million and \$2.7 million for the years 2004, 2005, 2006 and 2007, respectively. The Company has total commitments of \$6.6 million for the years 2008 and beyond.

The Company has an available line of credit in the amount \$2,350,000. The Company is required to provide restricted cash as collateral for this line of credit (see Note 3). Currently, the line of credit is being utilized to support letters of credit related to the new Pleasanton, California facility as well as a letter of credit related to the Company's surety bonds.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion of the financial condition and results of operations of the Company should be read in conjunction with the Financial Statements and the related Notes thereto included elsewhere in this Form 10-Q. This discussion contains, in addition to historical information, forward-looking statements that involve risks and uncertainties. The Company's actual results could differ materially from the results discussed in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed below, as well as those discussed below under "Factors Affecting Future Operating Results." The Company disclaims any obligation to update information contained in any forward-looking statement. See "Forward-Looking Statements."

### **OVERVIEW**

The Company is an online consumer direct lender, specializing in mortgage, home equity and auto loans. As a retail lender, the Company is heavily impacted by economic conditions (such as interest rates) and seasonal/cyclical factors. To help mitigate this, the Company has focused on its diversified revenue products, which consist of total revenues excluding prime refinance mortgage and its related interest income. Additionally, the Company strives to be a low-cost provider with a vision of driving overall prices lower, which creates marketing efficiency. The result is a virtuous cycle connecting efficiencies in capital markets, operations and customer acquisition.

### **RESULTS OF OPERATIONS**

The following table sets forth the unaudited results of operations from the Company's statements of operations as a percentage of total revenues for the periods indicated:

	Three Months Ended March 31,	
	2003	2004
Revenues .....	\$ 36,219	\$ 32,024
Operating expenses:		
Operations .....	16,737	16,329
Sales and marketing.....	8,492	11,132
Technology.....	1,876	2,166
General and administrative.....	1,998	3,532
Total operating expenses.....	29,103	33,159
Income (loss) from operations.....	7,116	(1,135)
Other income, net.....	31	15
Income (loss) before taxes.....	7,147	(1,120)
Income taxes.....	(815)	--
Net income (loss).....	\$ 6,332	\$ (1,120)
Net income (loss) per share:		
Basic.....	\$ 0.11	\$ (0.02)
Diluted.....	\$ 0.10	\$ (0.02)

**AS A PERCENTAGE OF REVENUES:**

Revenues .....	100 %	100 %
Operating expenses:		
Operations .....	46 %	51 %
Sales and marketing.....	23 %	35 %
Technology.....	5 %	7 %
General and administrative.....	6 %	11 %
Total operating expenses.....	80 %	104 %
Income (loss) from operations.....	20 %	(4)%
Other income, net.....	-- %	-- %
Income (loss) before taxes.....	20 %	(4)%
Income taxes.....	(3)%	-- %
Net income (loss).....	17 %	(4)%

**Revenues**

The Company is a consumer direct lender whose revenues are derived primarily from the gain on sale of mortgage, home equity and auto loans that it underwrites, funds and sells. The Company also earns interest income on mortgage and home equity loans during the brief time they are held pending sale.

The following table provides the components of revenue shown as a percentage of total revenues:

		<b>Three Months Ended</b>	
		<b>March 31,</b>	
		<b>2003</b>	<b>2004</b>
<b>Revenues:</b>			
Mortgage.....	\$	23,851	\$ 14,536
Interest income on mortgage loans.....		4,864	2,936
Home equity.....		3,939	9,250
Interest income on home equity loans.....		424	1,473
Auto.....		2,886	3,062
Closing services.....		--	451
Other.....		255	316
Total revenues.....	\$	<u>36,219</u>	<u>\$ 32,024</u>
Mortgage.....		66 %	45 %
Interest income on mortgage loans.....		13 %	9 %
Home equity.....		11 %	29 %
Interest income on home equity loans.....		1 %	5 %
Auto.....		8 %	10 %
Closing services.....		-- %	1 %
Other.....		1 %	2 %
Total revenues.....		<u>100 %</u>	<u>100 %</u>

The following table summarizes dollar volume of loans closed and sold and the revenue (excluding interest income) in both dollars and average basis points (“BPS”) (dollars in thousands except BPS):

		<b>Three Months Ended</b>	
		<b>March 31,</b>	
		<b>2003</b>	<b>2004</b>
<b>Mortgage</b>			
\$ Volume	\$	1,110,008	\$ 757,107
Revenue	\$	23,851	\$ 14,536
BPS		215	192
<b>Home Equity</b>			
\$ Volume	\$	167,789	\$ 302,250
Revenue	\$	3,939	\$ 9,250
BPS		235	306
<b>Auto</b>			
\$ Volume	\$	168,106	\$ 153,889
Revenue	\$	2,887	\$ 3,062
BPS		172	199

**Mortgage Revenues.** The Company's mortgage revenues are derived from the origination and sale of loans. Mortgage loans are funded through the Company's warehouse lines of credit and sold to mortgage loan purchasers typically within thirty days. Mortgage loan revenues consist of proceeds in excess of the carrying value of the loan, origination fees less certain direct origination costs and other processing costs. These revenues are recognized at the time the loan is sold. Mortgage revenues consist of refinance mortgage revenues and diversified mortgage revenues – which are comprised of purchase and non-prime mortgage loans. Mortgage revenues decreased \$9.3 million to

\$14.5 million for the three months ended March 31, 2004 from \$23.8 million for the three months ended March 31, 2003. Mortgage revenues benefited significantly from refinance revenues during the three months ended March 31, 2003. Refinance revenue experienced large declines in the three months ended March 31, 2004, compared to the same period the prior year as the overall mortgage market shifted away from refinance loans. Diversified mortgage revenue increased, largely as a function of increased revenue per loan, as the Company continued progress on its strategy to build diversified revenue in anticipation of the declining refinance market. The Company expects refinance activity to continue to decline in the remainder of 2004 and that while growth in diversified mortgage revenue is expected, we do not anticipate that it will completely offset the declining refinance volume, resulting in lower mortgage revenue amounts in 2004 as compared to 2003.

The following table summarizes dollar volume of mortgage loans sold and the revenue (excluding interest income) in both dollars and average basis points (“BPS”) (dollars in thousands except BPS):

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2003</b>	<b>2004</b>
<b>Refinance Mortgage</b>		
\$ Volume	\$ 755,489	\$ 409,902
Revenue	\$ 17,938	\$ 7,857
BPS	237	192
<b>Diversified Mortgage</b>		
\$ Volume	\$ 354,519	\$ 347,205
Revenue	\$ 5,913	\$ 6,679
BPS	167	192

The following table reflects the percentages of the Company’s mortgage closed loan volume from purchase and refinance loans as compared to the total market (according to Mortgage Bankers Association of America) through the first quarter of 2004. The Mortgage Bankers Association of America data for the first quarter of 2004 below represents its estimate as of April 14, 2004:

	<b>Q1 03</b>	<b>Q2 03</b>	<b>Q3 03</b>	<b>Q4 03</b>	<b>Q1 04</b>
<b>E-LOAN Mortgage*</b>					
Purchase	25%	32%	45%	45%	43%
Refinance	75%	68%	55%	55%	57%
<b>Total Market*</b>					
Purchase	29%	32%	32%	51%	47%
Refinance	71%	68%	68%	49%	53%

\* Excludes home equity and auto loan volume

**Interest Income on Mortgage and Home Equity Loans.** The Company generates revenues from interest income on mortgage and home equity loans. The revenues realized are based on the loan amount multiplied by the contractual interest rate from the time of funding by the Company through time of sale. These revenues are recognized as earned during the period from funding to sale. Interest income is highly correlated to the volume of loans funded. As such, interest income on mortgage decreased \$2.0 million to \$2.9 million for the three months ended March 31, 2004 from \$4.9 million for the three months ended March 31, 2003 and interest income on home equity loans increased \$1.1 million to \$1.5 million for the three months ended March 31, 2004 from \$0.4 million for the three months ended March 31, 2003. The Company anticipates that with relatively lower mortgage fundings in the

remainder of 2004, interest income on mortgages will be slightly lower. Home equity fundings are expected to increase in the remainder of 2004, as will interest income on home equity loans and lines of credit.

**Home Equity Revenues.** Home equity revenues are derived from the origination and sale of loans. Home equity loans are funded through the Company's warehouse lines of credit and sold to home equity loan purchasers in approximately forty days from funding. Home equity loan revenues consist of proceeds recorded at settlement in excess of the carrying value of the loan, origination fees less certain direct origination costs and other processing costs. These revenues are recognized at the time the loan is sold. Home equity revenues increased from \$5.8 million to \$9.7 million for the three months ended March 31, 2004 from \$3.9 million for the three months ended March 31, 2003. The significant increase in home equity revenue is due to increased volume of sold loans as well as increased revenue per loan. The Company expects that home equity revenues will continue to grow throughout 2004 as volumes continue to increase.

**Auto Revenues.** The Company funds prime auto loans using a line of credit and then sells them to a qualified special purpose entity (QSPE), which was created in July 2002. Revenues from these sales consist of the estimated future discounted cash flows net of interest, servicing fees and credit losses. Revenues on prime auto loan sales are recognized when the loan is sold to the QSPE. In addition, in exchange for the loans sold, the Company records a retained interest. A discount rate has been applied to the asset to account for the present value of the cash flows to be received over the life of the loans. The retained interest is an interest-earning asset. The difference between the estimated discounted cash flows and the actual cash flows received over time are accreted and included as auto revenue.

Prior to the third quarter of 2003, sub-prime auto loans were sold to sub-prime auto loan purchasers. The revenue on these loans consisted of the mark-up to the lending partner's loan price or a set origination fee. These revenues were recognized at the time the loan was sold. In the third quarter of 2003, the Company stopped processing and funding sub-prime auto loans and shifted this portion of the business to a referral based system. Presently loan applications that do not meet the prime auto lending criteria are referred out to other sub-prime lenders in exchange for a fee. This fee is recognized as revenue at the time of transfer to the sub-prime lender and paid to the Company monthly for the previous month's referrals. As expected, this transition resulted in a reduction in overall auto loan volume in the three months ended March 31, 2004 compared to the three months ended March 31, 2003.

Auto revenues increased \$0.2 million to \$3.1 million for the three months ended March 31, 2004 from \$2.8 million for the three months ended March 31, 2003. The slight increase is related to referral revenue and interest income on the interest-earning asset.

The Company anticipates modest growth in both auto volume and revenue in 2004 as compared to 2003.

**Closing Services Revenues.** In the fourth quarter of 2003, the Company formed Escrow Closing Services, Inc, a wholly-owned subsidiary, which provides mortgage closing services, including HUD1 and document preparation and signing, disbursement and recording services for a portion of our home equity business. For the three months ended March 31, 2004, closing services revenues were \$0.5 million. The Company expects that closing services revenue will continue to grow throughout 2004 as volume increases.

## Operating Expenses

**Total Operating Expenses.** Total operating expenses include operational costs associated with the origination of mortgage, home equity and auto loans, including interest expense on warehouse lines, as well as costs associated with marketing, technology and administrative.

The following table provides detail of the Company's total operating expenses classified by major types of expense, expressed as a percentage of total operating expenses:

	Three Months Ended	
	March 31,	
	2003	2004
Compensation & Benefits	43%	43%
Processing Costs	10%	8%
Advertising & Marketing	25%	30%
Occupancy & Administrative	12%	12%
Interest Expense on Warehouse	10%	7%

As almost half of the total operating expenses of the Company are compensation and benefit related, the following table shows full-time headcount (including temporary and contract employees) by function at the end of each respective quarter:

	Three Months Ended	
	March 31,	
	2003	2004
Mortgage	391	273
Home Equity	172	256
Auto	146	81
Closing Services	--	13
Sales & Marketing	28	26
Technology	57	62
General & Administrative	47	66
Total	841	777

**Operations.** Operations expense is comprised of both fixed and variable expenses, including employee compensation and expenses associated with the production and sale of loans and interest expense paid by the Company under the warehouse and line of credit facilities it uses to fund mortgage, home equity and auto loans held-for-sale.

The following table provides detail of the Company's operations expenses classified by the following revenue-related categories (dollars in thousands):

	Three Months Ended	
	March 31,	
	2003	2004
Mortgage .....	\$ 8,186	\$ 6,648
Interest expense on mortgage loans.....	2,398	1,404
Home equity.....	3,082	5,070
Interest expense on home equity loans.....	288	868
Auto.....	2,783	1,834
Closing services.....	--	505
Total operations.....	\$ 16,737	\$ 16,329

Operations expense decreased \$0.4 million to \$16.3 million for the three months ended March 31, 2004 from \$16.7 million for the three months ended March 31, 2003. However, operations expense increased as a percentage of revenue from 46% to 51% for the three months ended March 31, 2003 and 2004, respectively. The decrease in absolute dollars is due to decreases in mortgage and auto operations expenses, due to lower volumes, offset by an increase in home equity due to higher volumes.

The following table provides detail of the Company's total mortgage operations expenses (excluding interest expense) classified by major types of expense, expressed as a percentage of total mortgage operations expenses (excluding interest expense):



	Three Months Ended	
	March 31,	
	2003	2004
Mortgage Operations		
Headcount & Related	47%	47%
Commissions	23%	20%
Processing Costs	20%	20%
Facilities & Other	10%	13%

The following table provides detail of the Company's total home equity operations expenses (excluding interest expense) classified by major types of expense, expressed as a percentage of total home equity operations expenses (excluding interest expense):

	Three Months Ended	
	March 31,	
	2003	2004
Home Equity Operations		
Headcount & Related	64%	57%
Commissions	8%	11%
Processing Costs	18%	20%
Facilities & Other	10%	12%

The following table provides detail of the Company's total auto operations expenses (excluding interest expense) classified by major types of expense, expressed as a percentage of total auto operations expenses (excluding interest expense):

	Three Months Ended	
	March 31,	
	2003	2004
Auto Operations		
Headcount & Related	57%	68%
Commissions	--	--
Processing Costs	15%	13%
Facilities & Other	28%	19%

**Direct Margin.** Direct margin is defined as revenue minus operations expense, which includes variable and fixed expenses.

The following table provides detail of the Company's direct margin classified by the following revenue-related categories (dollars in thousands):

	Three Months Ended	
	March 31,	
	2003	2004
Mortgage.....	\$ 15,665	\$ 7,888
Mortgage interest margin.....	2,466	1,532
Home equity.....	857	4,180
Home equity interest margin.....	136	605
Auto.....	104	1,228
Closing services.....	--	(54)
Other.....	255	316
Total direct margin.....	<u>\$ 19,483</u>	<u>\$ 15,695</u>

Direct margin decreased \$3.8 million to \$15.7 million for the three months ended March 31, 2004 from \$19.5 million for the three months ended March 31, 2003. The decline in direct margin is primarily due to decreased mortgage revenue per loan and decreased mortgage volumes. This decrease was offset by increased home equity volumes and revenues as well as a positive spread of home equity interest income over interest expense. The Company anticipates that mortgage revenue per loan and the spread of interest income over interest expense will continue to decline in 2004 as compared to 2003, as the overall level of refinance activity declines and competitive pricing pressure increases. Auto direct margins increased significantly for the three months ended March 31, 2004 compared to the three months ended March 31, 2003 primarily due to the transition of auto operations from Florida to California which began during the three months ended March 31, 2003 driving auto direct margins down in that period. The Company expects auto direct margin to grow modestly throughout 2004.

**Sales and Marketing.** Sales and marketing expense is primarily comprised of expenses related to advertising, promotion and marketing agreements and employee compensation and other expenses related to marketing personnel. Sales and marketing expense increased \$2.6 million to \$11.1 million for the three months ended March 31, 2004 from \$8.5 million for the three months ended March 31, 2003. Sales and marketing expense increased as a direct result of increased spending in direct response television advertising as well as direct response mail advertising. Sales and marketing expense increased as a percentage of revenue from 23% to 35% for the three months ended March 31, 2003 and 2004, respectively. The increase in sales and marketing expense as a percentage of revenues was due to a combination of increased spending levels and the decreased volumes in revenue in the three months ended March 31, 2004 compared to the three months ended March 31, 2003. Sales and marketing expenses are expected to increase as a percentage of total revenues and absolute dollars throughout the remainder of 2004.

The following table provides detail of the Company's total sales and marketing expenses classified by major types of expense, expressed as a percentage of total sales and marketing expenses:

	Three Months Ended	
	March 31,	
	2003	2004
Direct Response TV	46%	54%
Direct Response Mail	11%	15%
Online Advertising	25%	19%
Other Advertising	3%	1%
Headcount & Administrative	15%	11%

**Technology.** Technology expense includes employee compensation, the introduction of new technologies and the support of E-LOAN's existing technological infrastructure. Technology expense increased \$0.3 million to \$2.2 million for the three months ended March 31, 2004 from \$1.9 million for the three months ended March 31, 2003. Technology expense increased as a percentage of revenue from 5% to 7% for the three months ended March 31, 2003 and 2004, respectively. The increase in technology expense as a percentage of revenues was primarily due to the decreased volumes in revenue in the three months ended March 31, 2004 compared to the three months ended March 31, 2003. The Company expects technology expense to be approximately 6% of total revenues throughout the remainder of 2004.

**General and Administrative.** General and administrative expense is primarily comprised of employee compensation and professional services. General and administrative expense increased \$1.5 million to \$3.5 million for the three months ended March 31, 2004 from \$2.0 million for the three months ended March 31, 2003. Included in general administrative expenses for the three months ended March 31, 2004 was a charge of approximately \$1.0 million as a result of the resignation of the Company's prior President and Chief Operating Officer. Excluding this charge, general and administrative expense increased \$0.6 million to \$2.6 million for the three months ended March 31, 2004 from \$2.0 million for the three months ended March 31, 2003. Excluding this one-time charge, general and administrative expense increased as a percentage of revenue from 6% to 8% for the three months ended March 31, 2003 and 2004, respectively. The increase in general and administrative expense as a percentage of revenues was

primarily due to the decreased volumes in revenue in the three months ended March 31, 2004 compared to the three months ended March 31, 2003. The Company expects general and administrative expense to be approximately 6% of total revenues throughout the remainder of 2004.

**Other Income, net.** Other income, net, is related to interest earned on cash equivalents offset by expense incurred on non-warehouse facility borrowings. Other income, net remained consistent at less than \$0.1 million for the three months ended March 31, 2004 and the three months ended March 31, 2003.

### **CRITICAL ACCOUNTING POLICIES**

The condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the U.S., which require the Company to make estimates and assumptions. The Company believes that of its significant accounting policies, the following may involve a higher degree of judgment and complexity.

**Revenue Recognition.** The Company's mortgage and home equity revenues are derived from the origination and sale of loans. Mortgage and home equity loans are funded through the Company's warehouse lines of credit and sold to loan purchasers typically within thirty days. Mortgage and home equity loan revenues consist of proceeds in excess of the carrying value of the loan, origination fees less certain direct origination costs and other processing costs. These revenues are recognized at the time the loan is sold. In addition, the Company generates revenues from interest income on mortgage and home equity loans. The revenues realized are based on the loan amount multiplied by the contractual interest rate from the time of funding by the Company through time of sale. These revenues are recognized as earned during the period from funding to sale. Also included in mortgage and home equity loan revenues are amounts recorded in connection with loans sold under a Sale Agreement with Greenwich Capital (see "Off-Balance Sheet Arrangements"). The Company sells all loans to loan purchasers on a servicing released basis without recourse, subject to certain representations and warranties. Additionally, the Company is responsible for a minimum number of payments to be made on these loans. As such, the Company records reserves as a contra-revenue at the time a loan is sold, based on certain assumptions in anticipation of future losses as a result of current activity.

The Company funds prime auto loans using a line of credit and then sells them to a qualified special purpose entity (QSPE), which was created in July 2002 (see "Off-Balance Sheet Arrangements"). Revenues from these sales consist of the estimated future discounted cash flows net of interest, servicing fees and credit losses recorded in the form of the residual interest. Revenues on prime auto loan sales are recognized when the loan is sold to the QSPE. In addition, in exchange for the loans sold, the Company receives cash and a retained interest. A market discount rate has been applied to the asset to account for the present value of the cash flows to be received over the life of the loans. As a result, the retained interest asset is an interest-earning asset, and the difference between the estimated discounted cash flows and the actual cash flows received over time are accreted and included as auto revenue. Effective in the fourth quarter of 2003, the Company adopted Financial Interpretation No. 46, "Consolidation of Variable Interest Entities", ("FIN 46"). FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. The Company had variable interests in its qualified special purposes entity ("QSPE"), which are exempt from the provisions of FIN 46. The Company reports the rights and obligations related to the QSPE according to the requirements of Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.

Prior to the third quarter of 2003, sub-prime auto loans were sold to sub-prime auto loan purchasers. The revenue on these loans consisted of the mark-up to the lending partner's loan price or a set origination fee. These revenues were recognized at the time the loan was sold. In the third quarter of 2003, the Company stopped processing and funding sub-prime auto loans and shifted this portion of the business to a referral based system. Loan applications that do not meet the prime auto lending criteria are referred out to other sub-prime lenders in exchange for a fee. This fee is recognized as revenue at the time of transfer to the sub-prime lender.

**Valuation of derivative instruments.** On January 1, 2001, the Company adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative and Hedging Activities" ("SFAS 133"), as subsequently amended by Statement of Financial Accounting No. 138 and No. 149. In accounting for its derivative financial instruments, SFAS 133 requires an entity to recognize all derivative assets or liabilities in the statement of financial condition and measure those instruments at fair value. The accounting for changes in fair value of the derivative depends on the

intended use of the derivative and the resulting designation. An entity that elects to apply hedge accounting is required to establish at the inception of the hedge the method it will use in assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffectiveness of the hedge. These methods must be consistent with the entity's approach to managing risk. The Company is a party to mortgage rate lock commitments to fund mortgage loans at interest rates previously agreed (locked) by both the Company and the borrower for specified periods of time. When the borrower locks their interest rate, the Company effectively extends a put option to the borrower, whereby the borrower is not obligated to enter into the loan agreement, but the Company must honor the interest rate for the specified time period. Under SFAS 133 mortgage interest rate locks are derivatives. The Company is exposed to interest rate risk during the accumulation of interest rate lock commitments and loans prior to sale. The Company utilizes either a best efforts sell forward commitment or a mandatory sell forward commitment to economically hedge the changes in fair value of the loan due to changes in market interest rates. Both best efforts and mandatory sell forward sale commitments are derivatives under SFAS 133. Throughout the lock period the changes in the market value of interest rate lock commitments, best efforts and mandatory forward sale commitments are recorded as unrealized gains and losses and are included in the statement of operations in mortgage revenue.

The Company's management has made complex judgments in their application of SFAS 133. The judgments include the identification of hedging instruments, hedged items, nature of the risk being hedged, and how the hedging instrument's effectiveness will be assessed. The Company designates forward delivery commitments, where the company intends to deliver the underlying loan into the commitment, as a fair value SFAS 133 hedge at the commitment date. In addition, the Company designates all best efforts sell forward commitments as fair value SFAS 133 hedges for underlying loans at funding date. The Company does not designate mandatory sell forward agreements as SFAS 133 hedges but does utilize them to economically hedge the changes in fair value of rate lock commitments with borrowers for which a best efforts sell forward commitment has not been obtained. The Company did not have a material gain or loss representing the amount of hedge ineffectiveness related to designated SFAS 133 hedges during the three months ended March 31, 2003 and 2004.

In September 2003, the Company began hedging its interest rate risk on auto loan approvals. When the Company issues an auto loan approval, the Company extends a put option to the borrower, whereby the borrower is not obligated to enter into the loan agreement, but the Company must honor the interest rate for up to a 45-day period. Under SFAS 133, auto loan approvals are not considered derivatives. However, the company is still exposed to interest rate risk from issuance of approval to loan sale. The Company enters into amortizing swap contracts to economically hedge the interest rate changes in auto loan approvals. These swap contracts are considered derivatives under SFAS 133. The Company marks-to-market any changes in the value of outstanding swap contracts, which are recorded as unrealized gains and losses and included in the statement of operations in auto revenue.

*Capitalized software.* In 1999, the Company adopted SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, which requires that the Company expense computer software costs as they are incurred in the preliminary project stage. Once the capitalization criteria of the SOP have been met, external direct costs of materials and services consumed in developing or obtaining internal-use computer software and payroll and payroll related costs for employees who are directly associated with and who devote time to the internal-use computer software are capitalized. Capitalized costs are generally amortized over one to three years on a straight-line basis.

*Reserves for loan originations.* The Company sells loans to loan purchasers on a servicing released basis without recourse. As such, the risk of loss or default by the borrower has generally been assumed by these purchasers. However, the Company is usually required by these purchasers to make certain representations relating to credit information, loan documentation and collateral. To the extent that the Company does not comply with such representations, or there are early payment defaults, the Company may be required to repurchase loans or indemnify these purchasers for any losses from borrower defaults. In connection with a majority of its loan sales agreements, the Company is also responsible for a minimum number of payments to be made on each loan, or else the Company may be required to refund the premium paid to it by the loan purchaser. As such, the Company records reserves based on certain assumptions in anticipation of future losses as a result of current activity.

Loan loss reserves due to potential violations of representations and warranties are recorded based on a percentage of current month originations. The Company currently calculates this loss rate exposure based on its historical loss rates as well as similar lending portfolios. Once the Company has endured a complete economic cycle, the rate will

be adjusted based on actual losses as a percentage of origination volume on a historical basis. Premium repayment reserves, generated through early loan prepayments related to loans sold to loan purchasers, are recorded based on a rate determined by calculating actual prepayments as a percentage of originations on a historical basis applied to current month originations.

*Stock-Based Compensation.* The Company accounts for stock-based employee compensation arrangements in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* and related interpretations, and complies with the disclosure requirements of SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting For Stock-Based Compensation -- Transition And Disclosure -- An Amendment Of SFAS No. 123*. Under APB No. 25, compensation expense is based on the excess of the estimated fair value of the Company's stock over the exercise price, if any, on the date of grant. The Company accounts for stock issued to non-employees in accordance with the provisions of SFAS No. 123 and the Emerging Issues Task Force Consensus in Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Non-Employees for Acquiring, or in Conjunction with Selling, Goods or Services*.

*Deferred Tax Asset.* The Company accounts for income taxes using the liability method in accordance with SFAS No. 109, *Accounting for Income Taxes*. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized. Management evaluates the recoverability of the deferred tax assets and the level of the valuation allowance. At such time as it is determined that it is more likely than not that the deferred tax asset will be realizable, the valuation allowance will be reduced. The Company's deferred tax asset arises principally from net operating loss carryforward (NOLs). There are significant judgments and estimates involved in projecting the recoverability of the deferred tax asset, particularly with respect to the existence of future taxable income sufficient to realize NOLs. The Company reported its first profitable year in 2002 and was again profitable in 2003. However, the sustained low interest rate environment created favorable operating conditions for the Company. During the fourth quarter of 2003 and the first quarter of 2004, the Company reported a loss from operations, largely as a result in declines in mortgage refinance volume. Management will continue to monitor projections of future taxable income and when it believes realization of the tax benefits associated with the NOLs is more likely than not, management will reduce the valuation allowance by recording a benefit through the income tax provision recorded in the statement of operations. Based upon the Company's performance throughout the remainder of the year it is possible that management would reduce the valuation allowance during 2004; however, management can provide no assurances as to the amount of such reduction, the period in which it might occur or if it will occur at all.

#### **OFF-BALANCE SHEET ARRANGEMENTS**

*Retained interest in auto loans.* On June 17, 2002, the Company entered into an arrangement to sell auto loan receivables to a qualified special purpose entity (QSPE), E-Loan Auto Fund One, LLC ("E-Loan Auto"), for the purpose of being able to recognize the gain on sale from these loans. These transactions involve the Company surrendering control over these assets to assure that the sold assets have been isolated from the Company and its creditors. As E-Loan Auto has met the appropriate tests to be considered a QSPE the assets and liabilities of E-Loan Auto are appropriately not consolidated in financial statements of the Company. In the event that the entity no longer qualifies as a QSPE and is required to be consolidated, the Company would no longer be in compliance with certain debt covenants related to its warehouse and other lines of credit, as currently structured. In particular, the Company's debt to tangible net worth covenants would be exceeded, however management believes that it would be able to renegotiate its existing warehouse related covenants to adequately accommodate the consolidation of this entity, if needed. E-Loan Auto has obtained a secured borrowing facility from Merrill Lynch Bank USA to finance all purchases of loans from the Company. The Company recognizes a gain on the sale of auto loan receivables to E-Loan Auto in the period in which the sale occurs, which represents the difference between the sale proceeds to the Company and the Company's net carrying value of the receivables. The Company retains an interest in the future cash flows from the loans. Such cash flows are distributed to the Company by the QSPE monthly. The fair value of the retained interest asset is based upon the net present value of the estimated future cash flows to be received by the Company over the life of the loans. These retained interest assets are recorded on the balance sheet at fair value as trading assets, and are adjusted to estimated fair value at each subsequent reporting period. Changes in the estimated fair value of the residual interests are recorded through the statement of operations. Estimates of future cash flows to be received by the Company reflect assumptions regarding the cumulative credit losses to be incurred on the pool of

auto loan receivables sold, prepayment rates of the auto loans and the rate at which the estimated future excess cash flows are discounted. The assumptions used represent the Company's best estimates, and the use of different assumptions could produce different financial results. The Company will continue to monitor and update its assumptions over time.

*Sale Agreement with Greenwich Capital.* The Company has a loan purchase and sale agreement with Greenwich Capital, for the purpose of controlling the timing associated with loan sales. Under the terms of this agreement, mortgage loans which are allocated to a mandatory sell forward commitment between the Company and a loan purchaser, but have not yet been settled, may be sold to Greenwich Capital with the accompanying trade assignment. Revenues from loans sold under this arrangement are included as a receivable on the balance sheet. All loans sold under this arrangement are already committed to another loan purchaser, and as such, hold little risk of being unsaleable. Therefore, in the event that the Company was unable to utilize this arrangement, the Company would experience a one-time impact to revenues in the period this arrangement was discontinued.

## ***LIQUIDITY AND CAPITAL RESOURCES***

The Company's sources of cash include cash from the sale of mortgage, home equity and auto loans, borrowings under warehouse lines of credit and other credit facilities, brokerage fees, interest income, credit card referrals and the sale of debt and equity securities in both private and public transactions. The Company's uses of cash include the funding of mortgage, home equity and auto loans, repayment of amounts borrowed under warehouse lines of credit, operating expenses, payment of interest, and capital expenditures primarily comprised of furniture, fixtures, computer equipment, software and leasehold improvements. Because the Company's loan origination operating activities are funded principally through its warehouse and other lines payable, the Company analyzes trends in operating cash flows by combining cash flows from operating activities with cash flows from certain financing activities (specifically cash flows from warehouse and other lines payable).

Cash provided by operating and financing activities related to its warehouse and other lines payable was \$13.6 million for the three months ended March 31, 2004. Specifically, the Company obtained cash from net income, excluding non-cash related items, of \$0.8 million for the three months ended March 31, 2004. In addition, the Company benefited from positive cash flow due to the reduction of other assets in the amount of \$8.3 million, specifically prepaid marketing expenses, and the reduction of receivables in connection with loan sales. Further, the Company benefited from positive cash flow as a result of loans held-for-sale net of warehouse payable decreasing which provided \$2.8 million in net cash, and the increase of accounts payables and other accrued expenses in the amount of \$3.4 million. However, these sources of cash were offset by the continued increase in the retained interest asset which grew another \$1.7 million as additional auto loans were sold to the QSPE in the three months ended March 31, 2004.

Cash used in operating and financing activities related to its warehouse and other lines payable, was \$0.5 million for the three months ended March 31, 2003. Specifically, The Company utilized cash as a result of an increase in receivables and other assets of \$8.4 million, which included an increase of \$7.1 million related to receivables in connection with loan sales. In addition, the Company utilized cash as a result of the continued increase of the retained interest asset of \$2.5 million as additional auto loans were sold to the QSPE in the three months ended March 31, 2003. These uses of cash were offset by a source of cash from net income, excluding non-cash related items, of \$7.4 million for the three months ended March 31, 2003. In addition, the Company benefited from positive cash flow as a result of loans held-for-sale net of warehouse payable decreasing and providing \$2.9 million in net cash.

Net cash used in investing activities was \$2.2 million and \$2.4 million for the three months ended March 31, 2003 and 2004, respectively. Net cash used during the three months ended March 31, 2003 was primarily due to the addition of infrastructure related to increased headcount and investment in new technology systems. In October 2003, the Company began relocating its corporate headquarters and consolidating its operational facilities to a larger, single facility in Pleasanton, California. Capital expenditures related to the new facility (net of tenant improvement allowances) were \$1.7 million for the three months ended March 31, 2004. The Company will complete the buildout of its new facility in the second quarter of 2004, and as a result expects to spend an additional \$0.4 million to complete the project. The remaining cash used on investing activities during the three months ended March 31, 2004 was related to capitalized development.

Cash provided by financing activities, net of cash used by its warehouse and other lines payable was \$0.3 million and \$0.4 million for the three months ended March 31, 2003 and 2004, respectively. The increase for both periods presented was due to the issuance of common stock from the exercise of stock options.

The Company has committed and uncommitted warehouse lines of credit that it uses to fund mortgage and home equity loans. A committed line is a firm commitment from the warehouse lender that funds will be available if requested through the specified termination date. The Company pays for these committed funds either in the form of pre-paid commitment fees charged as a percentage of the committed line available, or in the form of an unused line fee, which is assessed monthly based on a percentage of the unused amount during the previous month. Uncommitted funds are available to the Company at the warehouse lenders discretion, and could potentially not be accessible by the Company if the warehouse lender denied the funding request. The Company has not experienced such a denied funding request from any of its current or previous warehouse lenders.

The Company has a warehouse line of credit for borrowings of up to \$75 million for the interim financing of mortgage loans with GMAC Mortgage Corporation. The interest rate charged on borrowings against these funds is variable based on LIBOR plus various percentage points. This warehouse line requires the Company to pay GMAC a non-use fee when the average outstanding principal amount of borrowings is less than 50% of the total commitment at a rate of 0.25% per annum on the daily average unutilized commitment. Borrowings are collateralized by the related mortgage loans held-for-sale. The committed line of credit expires on March 31, 2005. Upon expiration, management believes it will either renew its existing line or obtain sufficient additional lines. This line of credit agreement generally requires the Company to comply with various financial and non-financial covenants. In particular, the Company must maintain a minimum cash balance of \$15.0 million in addition to the requirement that the Company maintain at least one other warehouse facility of no less than \$100 million. Failure to comply with these, or any other covenants, could result in the obligation to repay all amounts then outstanding. The Company was in compliance with all covenants for this agreement for the three months ended and at March 31, 2004.

The Company has an uncommitted warehouse line of credit for borrowings of up to \$200 million for the interim financing of mortgage loans with Merrill Lynch Mortgage Capital Inc. The interest rate charged on borrowings against these funds is variable based on LIBOR plus various percentage points. Borrowings are collateralized by the related mortgage loans held-for-sale. The uncommitted line of credit expires on February 4, 2005. Upon expiration, management believes it will either renew its existing line or obtain sufficient additional lines. This line of credit agreement generally requires the Company to comply with various financial and non-financial covenants. In particular, the Company must maintain a minimum cash balance of \$12.5 million. Failure to comply with these, or any other covenants, could result in the obligation to repay all amounts then outstanding. The Company was in compliance with all covenants for this agreement for the three months ended and at March 31, 2004.

The Company has an agreement to finance up to \$400 million of mortgage loan inventory pending sale of these loans to the ultimate mortgage loan purchasers with Greenwich Capital. Of this amount, \$200 million is available in committed funds. This loan inventory financing is secured by the related mortgage loans. The interest rate charged on borrowings against these funds is based on LIBOR plus various percentage points. As part of this agreement the Company had to pay a commitment fee of \$1.0 million for the period of March 31, 2003 through March 30, 2004. The commitment fee was reduced to \$750,000 for the period March 15, 2004 through March 14, 2005. The line requires the restriction of \$2.5 million in cash as additional collateral, however, in March 2004, the line was amended to remove this restriction. The line expires March 14, 2005. Upon expiration, management believes it will either renew its existing line or obtain sufficient additional lines. This agreement includes various financial and non-financial covenants. In particular, the Company must maintain a minimum cash and cash equivalents balance of \$15 million. Additionally, the Company is required to maintain at least one other warehouse facility of no less than \$75 million in committed funds. Failure to comply with these, or any other covenants, could result in the obligation to repay all amounts then outstanding. The Company was in compliance with all covenants for this agreement for the three months ended and at March 31, 2004.

The Company has a \$10 million line of credit facility with Merrill Lynch Mortgage Capital, Inc. to support the interim funding of auto loans prior to the sale to the ultimate auto loan purchaser. The interest rate charged on this line is based on LIBOR plus various percentage points. This facility requires the Company to pay an unused line fee equal to 0.50% per year on the average daily unused line balance. This facility expires on July 13, 2004. Upon expiration, management believes it will either renew its existing line or obtain sufficient additional lines. This

agreement includes various financial and non-financial covenants. In particular, the Company must maintain a minimum cash and cash equivalents balance of \$15 million (including Restricted Cash). Additionally, the Company is prohibited from obtaining or incurring any debt or contingent liability in excess of \$5 million without prior consent from the lender. Failure to comply with these, or any other covenants, could result in the obligation to repay all amounts then outstanding. The Company was in compliance with all covenants for this agreement for the three months ended and at March 31, 2004.

The following table summarizes the key terms of our current warehouse and other lines payable:

	<b>GMAC Mortgage \$75M</b>	<b>Greenwich Capital \$400M</b>	<b>Merrill Lynch \$200M</b>	<b>Merrill Lynch \$10M</b>
Cost of Funds				
Spread over LIBOR	1.25%-2.0%	0.75%-1.25%	0.75%-1.0%	1.0%-2.0%
Covenants				
Minimum Cash	\$15.0M	\$15.0M	\$12.5M	\$15.0M (1)
Minimum Tangible Net Worth	\$40.0M	\$60.0M	\$40.0M	\$25.0M
Debt to Tangible Net Worth	10:1	10:1	12:1	--
Profitability	--	--	Net Worth > 80% prior 2 qtrs	--
Current Ratio	1.0:1.0	--	--	1.0:1.0
Additional Facility	\$100.0M	\$75.0M	--	--
Advance Rates	95%-100%	96%-99%	96%-99%	92%-97%

(1) All minimum cash requirements include restricted cash, however restricted cash related to the Merrill Lynch \$10 million line may not exceed \$5 million

On June 30, 2003, the Company obtained a \$5 million line of credit from Wells Fargo Bank, National Association to support working capital needs. The interest rate charged on borrowings against these funds is based on LIBOR plus 2%, and is payable monthly. The line of credit expires on June 30, 2004. On December 11, 2003, the agreement was amended to reduce the line of credit to \$2,350,000 and extend the expiration date to June 30, 2005. As part of the amendment, the Company was required to provide restricted cash as collateral for this line of credit. Currently, the line of credit is being utilized to support letters of credit related to the new Pleasanton, California facility as well as a letter of credit related to the Company's surety bonds. The Company was in compliance with all covenants for this agreement for the three months ended and at March 31, 2004.

The adequacy of our liquidity depends on our ability to successfully generate positive cash flow from an appropriate combination of efficient operations and improvements therein, financing from third parties and access to capital markets. With \$45.6 million of cash on hand at March 31, 2004 and borrowing capacity under our warehouse and other lines of credit of \$687 million, we believe our liquidity (including operating and other cash flows that we expect to generate) will be sufficient to meet operating cash flow requirements as they occur for at least the next twelve months; however, our ability to maintain positive liquidity going forward depends on our ability to generate cash from operations and access to the financial markets, both of which are subject to general economic, financial, competitive, legislative, regulatory and other market factors that are beyond our control.

## FORWARD LOOKING STATEMENTS

The statements contained in this Report that are not historical facts are "forward-looking statements" (as such term is defined in Section 27A of the Securities Act of 1933 and section 21E of the Securities Exchange Act of 1934), which can be identified by the use of forward-looking terminology such as "estimated," "projects," "anticipated," "expects," "intends," "believes," or the negative thereof or other variations thereon or comparable terminology, or by



discussions of strategy that involve risks and uncertainties. These forward-looking statements, such as the Company's plans to increase the number of purchase loans, the relative importance of loans E-LOAN originates and sells and growth in the number of applications received, statements regarding development of E-LOAN's business, future operating results, anticipated capital expenditures, the expectations as to the use of capital resources and the availability of additional financing, and other statements contained in this Report regarding matters that are not historical facts, are only estimates or predictions and cannot be relied upon. No assurance can be given that future results will be achieved; actual events or results may differ materially as a result of risks facing the company or actual results differing from the assumption underlying such statements. Such risks and assumptions include, but are not limited to, E-LOAN's ability to access additional debt or equity financing in the future, secure replacement lines of credit for mortgage and auto loans, respond to increasing competition, secure additional loan purchasers, manage growth of E-LOAN's operations, as well as regulatory, legislative, and judicial developments that could cause actual results to vary materially from the future results indicated, expressed or implied in such forward-looking statements. All written and oral forward-looking statements made in connection with this Report which are attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by the "Factors Affecting Future Operating Results" and other cautionary statements included herein. The Company disclaims any obligation to update information contained in any forward-looking statement.

### **FACTORS AFFECTING FUTURE OPERATING RESULTS**

The following important factors, among others, could cause actual results to differ materially from those contained in forward-looking statements made in this report or presented elsewhere by management from time to time.

#### **While we achieved profitability during fiscal years 2002 and 2003, we recently incurred losses, and we may not be able to maintain profitability.**

While we achieved profitability during fiscal years 2002 and 2003, we have an accumulated deficit of \$184.7 million, as of March 31, 2004. In the fourth quarter of 2003, we experienced a pre-tax loss of \$1.5 million and in the first quarter of 2004, we experienced a loss of \$1.1 million and may not regain or increase profitability on a quarterly or annual basis in the future. If revenues grow more slowly than we anticipate, or if operating expenses exceed our expectations or cannot be adjusted accordingly, our business, results of operations and financial condition will be adversely affected.

#### **We have a limited operating history and consequently face significant risks and challenges in building our business.**

We were incorporated in August 1996, initiated our online mortgage operations in June 1997 and acquired our online auto operations in September 1999. We cannot assure that the Company will be able to operate successfully if a downturn in the mortgage or auto business occurs. As a result of our limited operating history, our recent growth and our reporting responsibilities as a public company, we may need to expand operational, financial and administrative systems and control procedures to enable us to further train and manage our employees and coordinate the efforts of our underwriting, accounting, finance, marketing, and operations departments.

#### **Our quarterly financial results are vulnerable to significant fluctuations and seasonality, which could adversely affect our stock price.**

Our revenues and operating results may vary significantly from quarter to quarter due to a number of social and economic factors. Certain months or quarters historically experience greater volumes of mortgage and auto loan applications and funded loans. Moreover, the level and direction of interest rates regulate the relative volatility of seasonal loan origination cycles. As a result, we believe that quarter-to-quarter comparisons of our operating results may not be a good indication of our future performance. It is possible that in some future periods our operating results may not meet the expectations of market analysts and investors. In this event, the price of our common stock may fall.

#### **Interest rate fluctuations could significantly reduce customers' incentive to refinance existing mortgage loans.**

Rising interest rates generally reduce the demand for mortgage loans. Due to the low interest rate environment for the last several years, a significant percentage of our mortgage customers used our services to refinance existing mortgage loans. As mortgage interest rates have risen, consumers' incentive to refinance has been greatly reduced and the number of refinance loans that we originated and the revenues generated from those loans declined significantly. In an environment of rising or high interest rates relative to the interest rates on existing loans,

refinance loan revenue could continue to decline. If we are unable to increase diversified product revenue to offset the decline in refinance loan activity, our business and results of operations may be adversely affected.

**Our ability to engage in profitable secondary sales of loans may also be adversely affected by increases in interest rates.**

The mortgage loan purchase commitments we obtain are contingent upon our delivery of the relevant loans to the purchasers within specified periods. To the extent that we are unable to deliver the loans within the specified periods and interest rates increase during those periods, we may experience no gain or even a loss on the sale of these loans. In addition, any increase in interest rates will increase the cost of maintaining our warehouse and repurchase lines of credit on which we depend to fund the loans we originate. The interest direct margin earned on loans held-for-sale significantly benefited from the spread between long-term and short-term interest rates starting in 2001 and continuing through the second quarter of 2003. Based on historical trends, we do not expect the same level of benefit from interest rate spreads in a normal market. We have implemented a hedging program to manage the risk of loss due to fluctuations in interest rates, but our hedging efforts may not be successful, and no hedging strategy can completely eliminate interest rate risk. A sharp decrease in interest rates over a short period may cause customers who have interest rates on mortgage loans committed through us to either delay closing their loans or refinance with another lender. If this occurs in significant numbers, it may have an adverse effect on our business or quarterly results of operations.

**Our hedging strategy may not succeed in reducing our exposure to losses caused by fluctuations in interest rates.**

We attempt to manage our interest rate risk exposure on mortgage loan interest rate locks through hedging transactions using a combination of forward sales of mortgage-backed securities and forward whole-loan sales to fix the sales price of loans we expect to fund. An effective hedging strategy is complex, and we have limited experience administering a hedging program. A successful hedging program depends in part on our ability to properly estimate the number of loans that will actually close and is subject to fluctuations in the prices of mortgage-backed securities, which do not necessarily move in tandem with the prices of loans we originate and close. To the extent that we implement a hedging strategy but are unable to effectively match our purchases and sales of mortgage-backed securities with the sale of the closed loans we have originated, our gains on sales of mortgage loans will be reduced, or we will experience a net loss on those sales. In addition, in September 2003, we began managing our interest rate exposure related to our auto loan approvals by entering into amortizing swap contracts. Approved auto loan applicants are provided a guaranteed rate for up to a 45 day period. To the extent that we implement a hedging strategy but are unable to effectively match our coverage with anticipated loan volume, it is possible that we could experience a net loss on those loan approvals. Finally, if we are unable to obtain the necessary liquidity to execute our hedging programs through multiple hedge counterparties, our hedging strategy may not succeed. We currently have one counter-party for auto hedging and 14 counterparties for mortgage hedging.

**Uncertainty with respect to the time it takes to close mortgage loans can lead to unpredictable revenue and profitability.**

The time between the date an application for a mortgage loan is received from a customer and the date the loan closes can be lengthy and unpredictable. The loan application and approval process is often delayed due to factors over which we have little or no control, including the timing of the customer's decision to commit to an available interest rate, the close of escrow date for purchase loans, the timeliness of appraisals and the adequacy of the customer's own disclosure documentation. Purchase mortgage loans generally take longer to close than refinance loans as they are tied to the close of the property sale escrow date. This uncertain timetable can have a direct impact on our revenue and profitability for any given period. We may expend substantial funds and resources supporting the loan fulfillment process and never generate revenue from closed loans. Therefore, our results of operations for a particular period may be adversely affected if the mortgage loans applied for during that period do not close in a timely manner or at all.

**The increasing number of federal, state and local “anti-predatory lending” laws may restrict our ability to originate certain mortgage loans, or increase our risk of liability or cost of doing business.**

The enactment of federal, state and local laws, rules and regulations intended to eliminate so-called “predatory” lending practices impose restrictions on loans on which certain points and fees or the annual percentage rate (“APR”) exceed specified thresholds. Our mortgage loan purchasers and warehouse lenders are willing to buy or finance only a very limited selection of such loans, and these loans are subject to greater risks for actual or perceived

non-compliance with such laws, rules and regulations, including demands for indemnification or loan repurchases from our loan purchasers, class action lawsuits, increased defenses to foreclosure of individual loans in default, individual claims for monetary damages, and administrative enforcement actions. The continued enactment of these laws, rules and regulations may prevent us from making certain loans and may cause us to reduce the APR or the points and fees on loans that we do make. In addition, the difficulty of managing the risks presented by these laws, rules and regulations may decrease the availability of warehouse financing and the overall demand for certain subprime loans, making it difficult to fund or sell such loans. The growing number of these laws, rules and regulations may increase our cost of doing business, as we are required to develop systems and procedures to ensure that we do not violate any aspect of these new requirements. Any of the foregoing could adversely affect our business and results of operations.

**We have recently experienced significant growth in our business, and if we are unable to manage this growth, our business will be adversely affected.** Over the past two years we have experienced significant growth, which has placed a strain on our resources and will continue to do so in the future. Failure to manage this growth effectively could adversely affect our business. We may not be successful in managing or expanding our operations or maintaining adequate management, financial and operating systems and controls.

**Our future success is dependent upon increased acceptance of the internet by consumers and lenders as a medium for lending.**

Our success will depend in large part on widespread consumer acceptance of obtaining mortgage and auto loans online. Increased consumer use of the Internet to provide for their lending needs is subject to uncertainty. The development of an online market for mortgage and auto loans has only recently begun, is rapidly evolving and likely will be characterized by an increasing number of market entrants. If consumer acceptance of the Internet as a source for mortgage, home equity and auto loans does not increase, our business, results of operations and financial condition will be adversely affected. A number of factors may inhibit Internet usage by consumers, including privacy and security concerns regarding their personal information. The adoption of online lending requires the acceptance of a new way of conducting business, exchanging information and applying for credit by consumers that have historically relied upon traditional lending methods. As a result, we cannot be sure that we will be able to compete effectively with traditional borrowing and lending methods.

**The termination of one or more of our mortgage funding sources would adversely affect our business.**

We depend on GMAC Mortgage Corporation, formerly GMAC Bank ("GMAC Mortgage"), Greenwich Capital Financial Products, Inc. ("Greenwich Capital") and Merrill Lynch Mortgage Capital Inc. ("Merrill Lynch") to finance our mortgage loan activities through the warehouse credit facilities they provide. If any of these warehouse credit facilities becomes unavailable, our business would be adversely affected. Under our agreements with each of these lenders, we make extensive representations, warranties and various operating and financial covenants. A material breach of these representations, warranties or covenants on any of our lines could result in the termination of our agreements and an obligation to repay all amounts outstanding at the time of termination. In the past, we have had to obtain waivers from our warehouse lenders as a result of our failure to comply with covenants regarding the issuance of capital stock, excess asset purchases and our failure to meet financial ratios. More recently, we obtained a waiver from one of our warehouse lenders due to a failure to meet a current ratio covenant for the months ended April 30 and May 31, 2003. Our agreement with Greenwich Capital expires on March 14, 2005, our agreement with GMAC Mortgage expires on March 31, 2005 and our agreement with Merrill Lynch expires on February 4, 2005. Upon expiration of these agreements, management believes it will either renew its existing warehouse credit facilities or obtain sufficient additional credit facilities. However, we cannot assure that these agreements will be renewed or extended past their current expiration dates, and additional sources of funding for our mortgage loans may not be available on favorable terms or at all.

**The termination of our auto line of credit would adversely affect our business.**

We have obtained a line of credit from Merrill Lynch Mortgage Capital Inc. to finance the funding of our auto loans, and this is our sole facility for auto loan fundings. If this credit facility becomes unavailable, our business could be adversely affected. Under our line of credit agreement, we make extensive representations, warranties and various operating and financial covenants. A material breach of these representations, warranties or covenants could result in the termination of the facility and an obligation to repay all amounts outstanding at the time of termination. In the past we have had to obtain waivers from our previous auto line of credit provider (Bank One, N.A.) as a result of our failure to comply with a covenant regarding a debt to tangible net worth ratio. Our line of credit with Merrill Lynch

Mortgage Capital Inc. expires July 13, 2004. Upon expiration, management believes it will either renew its existing line or obtain sufficient additional lines. However, we cannot assure you that this agreement will be renewed or extended past its current expiration date, and additional sources of funding for our auto loans may not be available on favorable terms or at all.

**We are primarily dependent on three loan purchasers for most of our home equity business**

For the quarter ended March 31, 2004, the majority of our home equity loans were purchased by Wells Fargo Bank, Citicorp and The Provident Bank pursuant to Home Equity Loan/Line purchase agreements. If any of these loan purchasers are unable or unwilling to purchase our home equity loans, we may experience delays in our ability to accept or process home equity loan applications until we are able to secure new sources of loan purchasers. Sufficient additional sources of loan purchasers for our home equity loans may not be available on favorable terms or at all.

**We are dependent on one loan purchaser for all of our auto loan business.**

We currently sell all of our prime auto loans to E-Loan Auto Fund One, LLC, a qualified special purpose entity (QSPE). The QSPE is dependent on Merrill Lynch Bank USA to provide the necessary financing to continue purchasing loans from us. If Merrill Lynch Bank USA is unable or unwilling to provide continuing financing to the QSPE, additional forms of financing may not be available on favorable terms or at all.

**We depend on the timely and competent services of various companies involved in the mortgage process; if these companies fail to timely and competently deliver these services, our business and reputation will be directly and adversely affected.**

We rely on other companies to perform services related to the loan underwriting process, including appraisals, credit reporting and title searches. Any interruptions or delays in the provision of these services may cause delays in the processing and closing of loans for our customers. If we are unsuccessful in managing the timely delivery of these services we will likely experience increased customer dissatisfaction and our business and reputation could be adversely affected.

**The loss of our relationship with any of our significant providers of automated underwriting would have an adverse effect on our business.**

We depend on automated underwriting and other services offered by government sponsored and other mortgage investors, including Fannie Mae and Freddie Mac ("Agencies"), to help ensure that our mortgage services can be offered efficiently and on a timely basis. We currently have an agreement with the Agencies that authorizes our use of their automated underwriting services and enables us to sell qualified first mortgages to these Agencies. We cannot assure that we will remain in good standing with the Agencies or that the Agencies will not terminate our relationship. We expect to continue to process a significant portion of our conforming mortgage loans using the Agencies' systems. Our agreement with the Agencies can be terminated by either party. The termination of our agreements with the Agencies would adversely affect our business by reducing our ability to streamline the mortgage origination process.

**Any outages, delays or other difficulties experienced internally or through internet service providers, online service providers or other website operators on which our users depend could adversely affect our business.**

Due to the complexities of providing effective and responsive internet based products and services to customers, our information technology business model could experience delays and outages caused by a number of factors. Our IT platform is an integration of complex technologies ranging from proprietary and open source technologies to commercially available licensed technologies from industry leaders such as Cisco Systems, Sun Microsystems and Oracle. Although our IT business systems are designed to minimize downtime in the normal course of business, we cannot assure our service levels can be maintained in all possible disaster scenarios. Moreover, our users depend on Internet service providers, online service providers and other website operators for access to our website. Many Internet users have experienced significant outages in the past, and could experience outages, delays and other difficulties due to component or system failures unrelated to our systems. Any of these problems could adversely affect our business.

**Our business will be adversely affected if we are unable to safeguard the security and privacy of our customers' financial data.**

Internet usage could decline if any well-publicized compromise of security occurred. We may incur significant costs to protect against the threat of security breaches or to alleviate problems caused by any breaches that occur. We also retain on our premises personal financial documents we receive from prospective borrowers in connection with their loan applications. These documents are highly sensitive and if a third party were to misappropriate our customers' personal information, customers could possibly bring legal claims against us. We cannot assure that our privacy policy will be deemed sufficient by our prospective customers or compliant with any federal or state laws governing privacy, which may be adopted in the future.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Interest rate movements significantly impact our volume of closed loans and represent the primary component of market risk to us. In a higher interest rate environment, consumer demand for mortgage loans, particularly refinancing of existing mortgages, declines. Interest rate movements affect the interest income earned on loans held for sale, interest expense on the warehouse lines payable, the value of mortgage loans held for sale and ultimately the gain on sale of mortgage and auto loans.

We attempt to minimize the interest rate risk associated with the time lag between when fixed rate mortgage loans are rate-locked and when they are committed for sale or exchanged in the secondary market, through our hedging activities. Individual mortgage loan risks are aggregated by loan type and stage in the pipeline, and are then matched, based on duration, with the appropriate hedging instrument, thus mitigating basis risk until closing and delivery. We currently hedge our mortgage pipeline through mandatory forward sales of Fannie Mae mortgage-backed securities in addition to both mandatory and best efforts forward loan sale agreements with the ultimate loan purchaser. We determine which alternative provides the best execution in the secondary market. In addition, we do not believe our net interest income would be materially affected as a result of concurrent changes in long-term and short-term interest rates due to the short duration of time loans are held on the balance sheet prior to being sold (typically under thirty days). We manage our interest rate exposure related to our auto loan approvals by entering into amortizing swap contracts.

We believe that we have implemented a cost-effective hedging program to provide a high level of protection against changes in the market value of rate-lock commitments. However, an effective strategy is complex and no hedging strategy can completely insulate the Company against such changes.

### **ITEM 4. CONTROLS AND PROCEDURES**

As of March 31, 2004, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) and Rule 15d-15(e)). Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective at a reasonable level in timely alerting them to material information relating to the Company that is required to be included in the Company's periodic filings with the Securities and Exchange Commission. There has been no change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that has materially affected or is reasonably likely to materially affect, the Company's internal control over financial reporting.

The Company's management, including the Chief Executive Officer and Chief Financial Officer, do not expect that the Company's disclosure controls or internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met due to numerous factors, ranging from errors to conscious acts of an individual, or individuals acting together. In addition, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in a cost-effective control system, misstatements due to error and/or fraud may occur and not be detected.

## **PART II OTHER INFORMATION**

### **Item 1. Legal Proceedings**

The Company is subject to various other legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business. While the outcome of these claims cannot be predicted with certainty, management does not believe that the outcome of any of these legal matters will have a material adverse effect on the Company's results of operations, financial position or liquidity.

Please refer to our Annual Report on Form 10-K for the fiscal year ended December 31, 2003, filed on March 12, 2004, which disclose claims which have been filed against the Company. There have been no material developments with respect to these claims since the previously filed Annual Report.

## **Item 2. Changes in Securities and Use of Proceeds**

None

## **Item 3. Defaults Upon Senior Securities**

None

## **Item 4. Submission of Matters to a Vote of Security Holders**

None

## **Item 5. Other Information**

None

## **Item 6. Exhibits and Reports on Form 8-K**

(a) Exhibits:

- 3.1 Restated Certificate of Incorporation of E-LOAN dated July 2, 1999 (1)
- 3.2 Corrected Certificate of Amendment of Restated Certificate of Incorporation of E-LOAN, Inc. dated February 15, 2001 (2)
- 3.3 Amended and Restated Bylaws of E-LOAN, Inc. dated March 16, 2001 (3)
- 10.1 Credit Agreement with Wells Fargo Bank, National Association dated June 30, 2003 (4)\*
- 10.2 Amendment Two to Marketing, Promotion, Distribution, and Related Services Agreement with zipRealty, Inc. dated August 22, 2003 (5)\*
- 10.3 Amendment Three to Marketing, Promotion, Distribution, and Related Services Agreement with zipRealty, Inc. dated December 23, 2003\*
- 10.4 Amendment Four to Marketing, Promotion, Distribution, and Related Services Agreement with zipRealty, Inc. dated March 29, 2004\*
- 10.5 Amendment Number Eleven to the Master Loan and Security Agreement with Greenwich Capital Financial Products, Inc. dated April 1, 2004
- 10.6 Indemnification Agreement with Scott McKinlay dated April 22, 2004

- 10.7 Indemnification Agreement with Eduardo Pretell dated April 23, 2004
- 31.1 Chief Executive Officer Certification of Periodic Financial Report Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002#
- 31.2 Chief Financial Officer Certification of Periodic Financial Report Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002#
- 32.1 Chief Executive Officer Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002+
- 32.2 Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002+

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- (1) Incorporated by reference to Exhibit 3.1 of the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2000, filed on August 14, 2000.
- (2) Incorporated by reference to Exhibit 3.2 of the Company's Amendment to its Annual Report on Form 10-K/A for the fiscal year ended December 31, 2000, filed on April 23, 2001.
- (3) Incorporated by reference to Exhibit 3.3 of the Company's Amendment to its Annual Report on Form 10-K/A for the fiscal year ended December 31, 2000, filed on April 23, 2001.
- (4) Incorporated by reference to Exhibit 10.14 of the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2003, filed on August 13, 2003.
- (5) Originally filed as Exhibit 10.25 of the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2003, filed on November 14, 2003.

\* Confidential Treatment Requested

# Filed herewith

+ Furnished herewith

(b) Reports on Form 8-K

The Company furnished to the Securities and Exchange Commission one report on Form 8-K during the three months ended March 31, 2004 on February 4, 2004 for the purpose of reporting under Item 12 thereof its fourth quarter and full year financial results.

## SIGNATURES

Pursuant to the requirement of the Security Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

E-LOAN, INC.

Dated: May 7, 2004

By: /s/ Matthew Roberts

Matthew Roberts

*Chief Financial Officer*

*(Principal Financial and Accounting Officer and Duly Authorized Officer)*