

# ACTION Sell

## Merrill Lynch & Co., Inc. (MER)

Return Potential: (16%)

### Adding to Americas Conviction Sell List with a \$22 price target

#### Source of opportunity

We downgrade Merrill Lynch to Sell and add it to our Conviction Sell List with a \$22 six month price target (16% downside). Merrill currently trades at the highest price to book multiple in our large cap brokerage universe, despite having some of the most significant exposures to troubled assets such as CDOs, mortgages and leveraged loans. With these markets still under pressure, we believe additional write-downs (in addition to write-downs assumed after the partial sale of CDOs to Lone Star) and book value deterioration will continue to plague the stock. As a result, we see no reason why the stock should be trading at such a premium.

#### Catalyst

- (1) Very weak 3Q2008 results from the investment banks as well as other financial services companies over the next two months should continue to pressure our sector.
- (2) Further deterioration in the credit markets, particularly in the mortgage markets, may result in additional write-downs in upcoming quarters.
- (3) Dislocations across many of the financial markets as well as additional deleveraging are resulting in a meaningful slowdown in overall corporate and institutional activity.

#### Valuation

Merrill currently trades at 1.3x our 3Q2008 book value estimate. Our new \$22 price target (from \$28.50) assumes MER will trade at 1.1x our book value estimate in six months. We are also lowering our 3Q and full year 2008 loss estimates to (\$5.75) and (\$11.55) from (\$4.75) and (\$10.25).

#### Key risks

Risks include a rebound in global capital markets activity, higher prices for mortgage assets, and book value multiple expansion across the brokerage universe.

#### INVESTMENT LIST MEMBERSHIP

Americas Sell List  
Americas Conviction Sell List  
Coverage View: Neutral

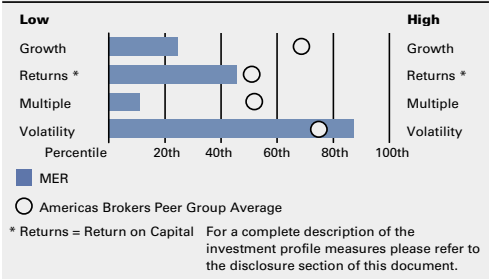
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#### Investment Profile: Merrill Lynch & Co., Inc.

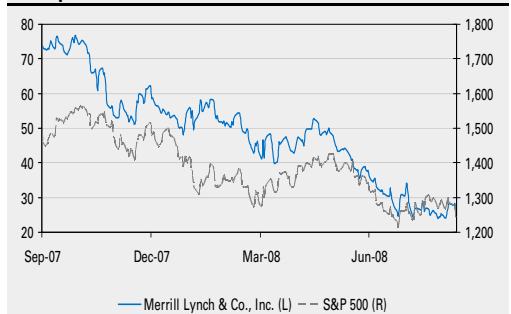


Key data	Current
Price (\$)	26.21
6 month price target (\$)	22.00
Market cap (\$ mn)	24,380.5

	12/07	12/08E	12/09E	12/10E
<b>Revenue (\$ mn) New</b>	<b>11,967.0</b>	<b>14,600.1</b>	<b>30,921.4</b>	<b>34,046.9</b>
Revenue (\$ mn) Old	11,967.0	16,580.3	30,936.7	34,102.7
<b>EPS (\$) New</b>	<b>(10.25)</b>	<b>(11.55)</b>	<b>2.50</b>	<b>2.90</b>
EPS (\$) Old	(10.25)	(10.25)	2.50	2.90
P/E (X)	NM	NM	10.5	9.1
P/B (X)	1.8	1.3	1.2	1.1
ROE (%)	(26.8)	(49.8)	13.5	14.5

	6/08	9/08E	12/08E	3/09E
EPS (\$)	(4.95)	(5.75)	0.53	0.63

#### Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	(35.7)	(47.4)	(65.2)
Rel. to S&P 500	(28.4)	(43.6)	(58.2)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 9/04/2008 close.

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# Merrill Lynch & Co., Inc.: Summary financials

Profit model (\$ mn)	12/07	12/08E	12/09E	12/10E	Balance sheet (\$ mn)	12/07	12/08E	12/09E	12/10E
Investment banking fees	5,600.0	1,496.5	4,523.7	4,936.8	Cash & equivalents	41,346.0	0.0	0.0	0.0
Commissions	7,267.0	1,699.3	7,655.4	8,511.7	Cash and securities for reg.	22,999.0	0.0	0.0	0.0
Principal transactions	(12,244.0)	1,248.2	9,128.1	10,895.0	Total securities	457,438.0	0.0	0.0	0.0
Asset management	5,602.0	719.0	4,522.0	5,107.0	Repos	354,757.0	0.0	0.0	0.0
Other	(117.0)	7,391.4	1,690.8	1,191.6	Securities borrowed	--	--	--	--
Net interest income	5,859.0	2,045.7	3,401.4	3,404.7	Broker receivables	--	--	--	--
Credit card fee	--	--	--	--	Customer receivables	--	--	--	--
Provision for consumer loans	--	--	--	--	Other receivables	126,849.0	0.0	0.0	0.0
<b>Net revenue</b>	<b>11,967.0</b>	<b>14,600.1</b>	<b>30,921.4</b>	<b>34,046.9</b>	Total receivables	126,849.0	0.0	0.0	0.0
Personnel/compensation	(15,977.0)	(14,710.7)	(15,460.7)	(17,023.5)	Property plant and equipment, net	3,127.0	0.0	0.0	0.0
Total non-interest expense	(24,234.0)	(26,221.2)	(24,252.7)	(26,423.7)	Intangibles	5,091.0	5,058.0	5,058.0	5,058.0
Income/(loss) from uncons. subs.	0.0	0.0	0.0	0.0	Other assets	--	--	--	--
Profit/loss on disposal of assets	0.0	0.0	0.0	0.0	<b>Total assets</b>	<b>1,020,050.0</b>	<b>990,070.6</b>	<b>1,039,574.2</b>	<b>1,091,552.9</b>
Total other net	0.0	0.0	0.0	0.0	Comm. paper and short-term debt	24,914.0	0.0	0.0	0.0
<b>Pretax profit</b>	<b>(12,267.0)</b>	<b>(11,621.1)</b>	<b>6,668.7</b>	<b>7,623.2</b>	Deposits	103,987.0	0.0	0.0	0.0
Provision for income taxes	4,001.0	5,013.0	(2,067.3)	(2,363.2)	Total securities sold	0.0	0.0	0.0	0.0
Minority interest	0.0	0.0	0.0	0.0	Repos	45,245.0	0.0	0.0	0.0
<b>Net income pre-pref. dividends</b>	<b>(8,241.0)</b>	<b>(6,608.0)</b>	<b>4,601.4</b>	<b>5,260.0</b>	Securities loaned	123,588.0	0.0	0.0	0.0
Preferred dividends	(270.0)	(3,190.0)	(460.0)	(460.0)	Other	291,631.0	0.0	0.0	0.0
<b>Net income pre-exceptionals</b>	<b>(8,511.0)</b>	<b>(14,298.0)</b>	<b>4,141.4</b>	<b>4,800.0</b>	Brokers payables	--	--	--	--
Post tax exceptionals	462.0	20.0	0.0	0.0	Customer payables	--	--	--	--
<b>Net income post tax exceptionals</b>	<b>(8,049.0)</b>	<b>(9,778.0)</b>	<b>4,141.4</b>	<b>4,800.0</b>	Total payables	132,626.0	0.0	0.0	0.0
					Accrued expenses & other liabs.	0.0	0.0	0.0	0.0
<b>EPS (diluted, pre-except) (\$)</b>	<b>(10.25)</b>	<b>(11.55)</b>	<b>2.50</b>	<b>2.90</b>	Total long-term debt	260,973.0	0.0	0.0	0.0
DPS (\$)	1.40	1.40	1.40	1.40	Other liabilities	0.0	0.0	0.0	0.0
BVPS (\$)	29.34	20.58	21.68	23.18	<b>Total liabilities</b>	<b>982,964.0</b>	<b>951,442.4</b>	<b>999,044.6</b>	<b>1,048,463.2</b>
Tangible BVPS (\$)	27.22	15.46	16.56	17.63	<b>Capital units &amp; pref securities</b>	<b>5,154.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
					Preferred stock	4,383.0	8,800.0	8,800.0	8,800.0
					Total common equity	27,549.0	29,828.2	31,729.6	34,289.7
					Minority interest	0.0	0.0	0.0	0.0
					<b>Total stockholders' equity</b>	<b>31,932.0</b>	<b>38,628.2</b>	<b>40,529.6</b>	<b>43,089.7</b>
					<b>Total liabilities &amp; equity</b>	<b>1,020,050.0</b>	<b>990,070.6</b>	<b>1,039,574.2</b>	<b>1,091,552.9</b>
<b>Growth &amp; margins (%)</b>	<b>12/07</b>	<b>12/08E</b>	<b>12/09E</b>	<b>12/10E</b>	<b>Ratios (%)</b>	<b>12/07</b>	<b>12/08E</b>	<b>12/09E</b>	<b>12/10E</b>
Net revenue growth	(65.5)	22.0	111.8	10.1	ROA	(0.9)	(1.4)	0.4	0.5
Net income growth	(231.2)	(21.5)	142.4	15.9	ROE	(24.0)	(40.5)	10.5	11.5
EPS growth	(233.5)	(12.7)	121.6	15.9					
Pretax margin	(102.5)	(79.6)	21.6	22.4					
After tax margin	(67.3)	(67.0)	13.4	14.1					

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

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## Behind our 3Q2008 estimate revision and current valuation

We are reducing our 3Q2008 EPS estimate by \$1.00 to a loss of \$5.75. Our revision is driven primarily by (1) higher expected gross write-downs, partially offset by higher gains on structured note liabilities as Merrill’s credit spreads have widened since we last revised our estimates; and (2) higher compensation expense as we believe Merrill will likely accrue 3Q compensation closer to 2Q levels. Additionally, we have factored in the \$125 mn fine that Merrill agreed to pay in its auction rate security settlement with New York Attorney General Andrew Cuomo. In 4Q2008, we have assumed that Merrill takes a 5% loss on the securities it buys back from clients.

### Exhibit 1: Key points behind our 3Q2008 estimate reduction

\$ in millions, except per-share data

Income statement items	old	new	change	% change
Equity underwriting	300	300	0	0%
Debt underwriting	315	305	(10)	(3%)
M&A	300	295	(5)	(2%)
FICC, ex write-downs	1,250	1,200	(50)	(4%)
Equity sales & trading, ex write-downs	1,200	1,100	(100)	(8%)
gross write-downs	(6,950)	(8,949)	(1,999)	29%
spread widening marks	600	900	300	50%
net write-downs	(6,350)	(8,049)	(1,699)	27%
compensation expense	3,038	3,500	462	15%
<b>EPS</b>	<b>(\$4.75)</b>	<b>(\$5.75)</b>	<b>(\$1.00)</b>	<b>21%</b>

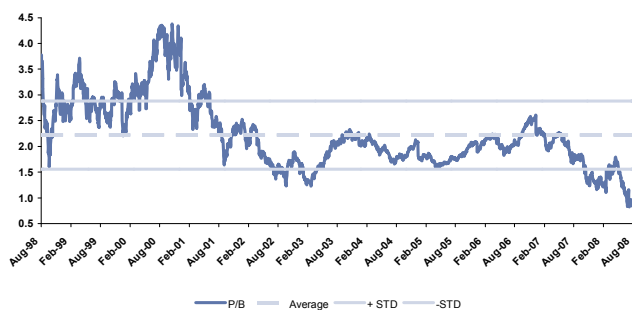
Source: Goldman Sachs Research, company data.

Valuation currently reflects too high of a premium, in our view. Merrill is currently trading at a multiple similar to Morgan Stanley, to whom it has historically traded at a 26% discount on a price-to-book basis. We expect Merrill’s multiple to compress over the coming weeks and months, as 3Q earnings will mark the fifth consecutive quarterly loss for the company, and its prospects for 4Q2008 are not promising enough to warrant this level of a premium to book value.

### Exhibit 2: Merrill Lynch’s historical multiples price-to-book

	Average P/B	+ STD	-STD	High	Low
10 - Year	2.2	2.9	1.6	4.4	0.8
5 - Year	1.9	2.2	1.6	2.6	0.8
3 - Year	1.9	2.3	1.5	2.6	0.8
1 - Year	1.4	1.7	1.1	1.8	0.8

Current P/B: 0.8

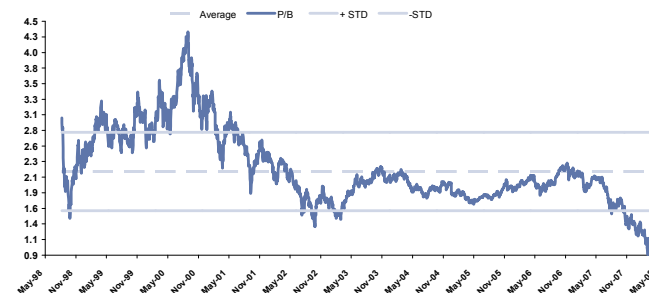


Source: FactSet

### Exhibit 3: Brokerage industry historical multiples price-to-book

	Average P/B	+ STD	-STD	High	Low
10 - Year	2.2	2.9	1.5	4.3	0.7
5 - Year	1.8	2.2	1.5	2.3	0.7
3 - Year	1.8	2.2	1.4	2.3	0.7
1 - Year	1.3	1.5	1.0	1.8	0.7

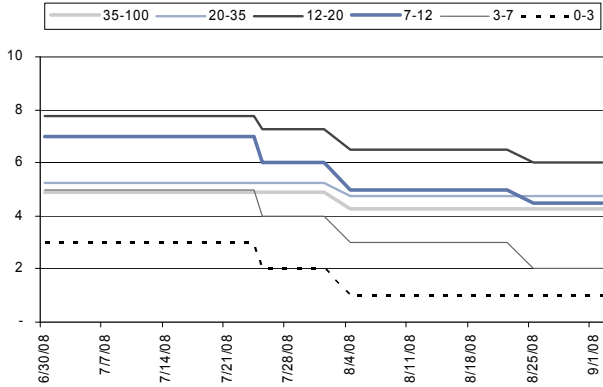
Current P/B: 0.8



Source: FactSet

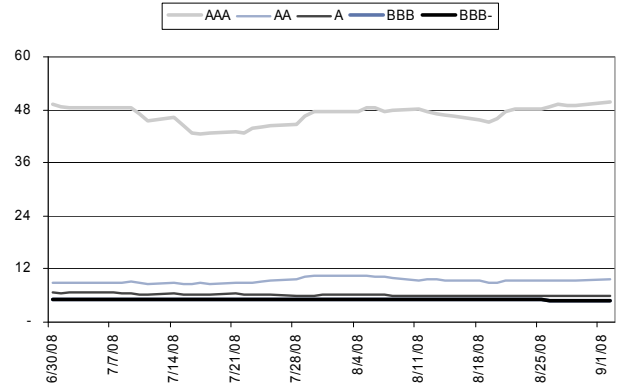
# Pricing for mortgage and leveraged loan assets has deteriorated since quarter-end

**Exhibit 4: TABX is down 35% on average since 2Q end**  
 TABX index 6-30-08 to 9-2-08



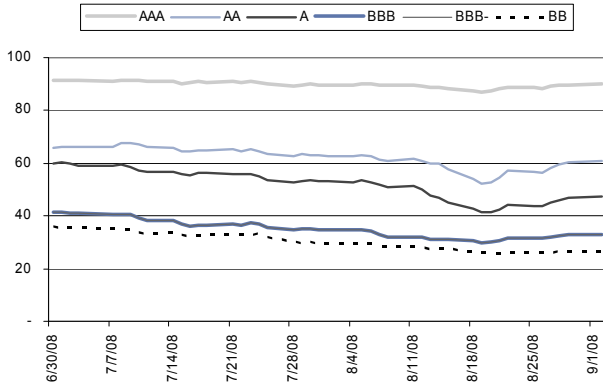
Source: Goldman Sachs Research

**Exhibit 5: ABX is down 2% on average since 2Q end**  
 ABX index 6-30-08 to 9-2-08



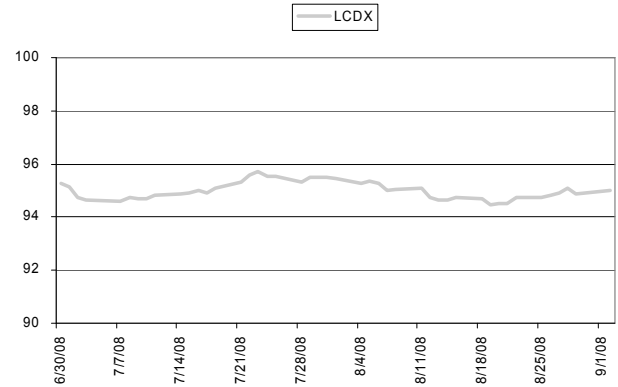
Source: Goldman Sachs Research

**Exhibit 6: CMBX is down 16% on average since 2Q end**  
 CMBX index 6-30-08 to 9-2-08



Source: Goldman Sachs Research

**Exhibit 7: LCDX is down 0.3% on average since 2Q end**  
 LCDX index 6-30-08 to 9-2-08



Source: Goldman Sachs Research

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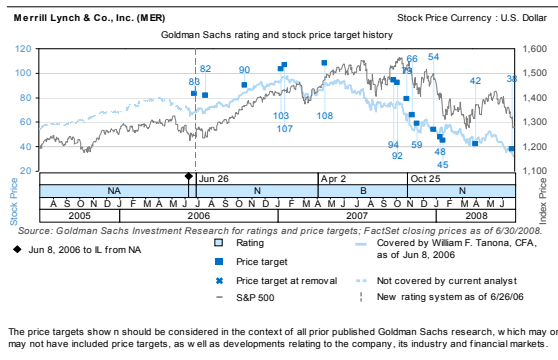
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## Price target and rating history chart(s)



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