

Merrill Lynch First Quarter 2007 Analyst Conference Call

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And with that I'll turn the call over to Jeff...

Thank you, Jonathan. And good morning to everyone. Welcome to our first quarter call. As in the past, unless otherwise indicated, I will exclude the impact of the one-time compensation expenses related to adopting FAS 123R in the first quarter of last year from comparisons to that period. I will also exclude the one-time net gain from the closing of the combination of Merrill Lynch Investment Managers, or MLIM, with BlackRock in the third quarter of last year from the determination of quarterly records. Full GAAP financials, which include the one-time compensation expenses, are available in the attachments to our earnings release, as are schedules reconciling those data to the numbers I will discuss.

This morning, Merrill Lynch reported another outstanding quarter.

Highlights include:

- Our highest quarterly revenues ever;
- Record earnings and earnings per share for a first quarter;
- A solid increase in ROE compared to the year ago quarter;
- Consistency in our results in each month despite varied market conditions;
- Very strong performances across both business segments, including record net revenues from Fixed Income Currencies and Commodities, or FICC, as well as from Equity Markets and Investment Banking;
- And our continued momentum evident in all global regions, as each major global region also achieved record revenues.

The record net revenues for the quarter were \$9.9 billion, up 24% from the prior-year period and 14% from the 2006 fourth quarter. This is the tenth consecutive quarter where we have generated year-on-year revenue growth. Excluding MLIM and BlackRock, the year-on-year revenue growth in our remaining businesses would have been even stronger, a little over 30%, which we think is more indicative of our growth trajectory.

In addition to the strong growth in revenues, we improved our operating leverage, as the pre-tax profit margin increased to 31.4%, up from 29.5% in last year's first quarter, reflecting both the growth in diversified sources of revenue and a continued focus on expense management.

This is the highest quarterly pre-tax margin we have ever recorded, other than in the 2006 fourth quarter, which benefited from a unusually low compensation expense ratio that reflected the finalization of full-year compensation expenses.

Net earnings per diluted share of \$2.26 were up 37% year-over-year and down 6% sequentially, while net earnings of \$2.2 billion were up 31% and down 8%, respectively, as our ongoing stock repurchases continue to enable EPS growth to surpass earnings growth.

Importantly, our annualized return on common equity of 23.3% increased by more than 4 points from the first quarter of 2006 as we continue to focus on this important measure of operating efficiency.

From a regional perspective, in the U.S. we grew revenues at double-digit rates both sequentially and year-over-year. But our growth outside the U.S. continued to be faster, at a rate more than ten percentage points higher than in the U.S. Non-U.S. net revenues comprised 39% of Merrill Lynch's total net revenues for the quarter, and 54% of net revenues in Global Markets and Investment Banking, or GMI. Both those proportions set new quarterly records.

We continue to believe that the profit pools in international markets will grow faster than those in the U.S. for the foreseeable future, and therefore, we continue to make investments necessary to build out our platforms broadly in these markets, complementing our strong presence in the U.S.

I want to stress the importance of the investments we have made to diversify and grow our businesses – not just geographically, but also across asset classes, products and clients. In key businesses in both GMI, and Global Wealth Management, or GWM, we continue to successfully execute our strategy to broaden and deepen our platform.

The benefits of this diversification become especially evident in quarters such as this one, where a clear dislocation in an individual market – the sub-prime mortgage space in the U.S. – did not impede the overall momentum of our franchise. As we have seen in other quarters in past years, it is not at all uncommon – and in fact it is a virtual certainty – that different markets will experience different periods of both strength and weakness at different times.

As we have built many sources of revenue growth into our portfolio of businesses, across many regions, we can continue to expand even as individual businesses experience slowdowns or corrections. This also allows us to maintain our strategic commitment to continue to build our capabilities in the areas experiencing tougher conditions, so that as the market turns we are even better-positioned than before.

And new initiatives that will drive future growth continue apace. During the first quarter we announced the acquisition of First Republic Bank,

which is on track for a third quarter closing. First Republic is a uniquely complementary platform to our GWM business as we look to expand in the high-growth private banking sector. We also opened new institutional offices in Turkey, Russia and Dubai.

The key long term drivers of our strategy – economic growth, wealth creation and globalization – remain in place and continue to give rise to substantial opportunities for us to grow and diversify revenues further.

Now I will provide a more detailed review of our first quarter performance by segment,

First GMI.

GMI turned in another record-setting performance as momentum accelerated across its expanding global portfolio of businesses, and investments for growth continued to pay off.

Net revenues of \$6.5 billion were 22% higher than the 2006 fourth quarter, and an even stronger 43% higher than the 2006 first quarter.

Pre-tax earnings for the quarter were \$2.3 billion, up 48% from the prior-year period on the strength of both the higher revenues and good operating leverage, driving the pre-tax margin to 35.8%. Sequentially, pre-tax earnings were down 10%, as the compensation ratio rose from the unusually low fourth quarter.

Now turning to FICC, which produced an outstanding first quarter performance.

Net revenues in FICC set a new record for the third consecutive quarter at \$2.8 billion, up 22% from the fourth quarter of 2006 and 36% from last year's first quarter.

The sequential increase was reflective of our enhanced positioning in a highly diversified set of asset classes, including record revenues from our credit, commercial real estate, rates, and currencies businesses, which substantially more than offset the impact of revenue declines from mortgages and commodities.

Compared with the first quarter of 2006, all major product lines, with the exception of mortgages, reported higher revenues.

I want to pause here to make a few comments about our U.S. sub-prime mortgage business, since I know it has been a topic of much discussion and speculation.

Let me put the business into context. As we noted in our earnings release, if you looked at both last year and the first quarter of this year and added up all of the origination, securitization, warehouse lending, trading and servicing revenues, both directly in our sub-prime business as well as our CDO activity involving sub-prime, including all the retained interests, you would see that revenues from sub-prime mortgage-related activities comprised less than one percent of our total net revenues for those five quarters.

And even if you were to incorporate, pro forma, the revenues of First Franklin as if it were a part of our firm for all of 2006, the aggregate contribution would still be less than two percent.

That said, this is an asset class that will continue to be significant, both in the U.S. and worldwide. And the strategic importance of the First Franklin acquisition was clearly evident this quarter, as having both origination and servicing capabilities enabled us to see trends emerge sooner and adjust underwriting standards and pricing more rapidly. I would also point out that our risk management capabilities are better than ever, and crucial to our success in navigating turbulent markets.

In fact, we have been capitalizing on the market dislocation by recruiting the best talent from competitors, and we fully expect to emerge from this cyclical downturn even better positioned.

At this point, we believe the issues in this narrow slice of the market remain contained and have not negatively impacted other sectors. Finally, it's important to understand that we manage our FICC businesses in aggregate as a portfolio — and that portfolio delivered record revenues for the quarter.

On a broader basis, most FICC markets experienced a continued favorable environment characterized by both high levels of client activity and opportunities for proprietary trading, enabling outstanding results as we continue to build out our capabilities in areas that are poised for growth. Let me give you some more color:

- We had a broad-based performance in our rates business, including strength in derivatives and exotics.
- In credit, we saw particular strength in trading distressed assets and emerging markets.
- In commercial real estate, we saw solid gains on our principal investments and in our CMBS conduit business.
- We had a very strong trading performance in commodities, especially in the core gas and power areas where we are a market leader both in Europe and the U.S.
- And regionally, we set revenue records in both the Pac Rim and EMEA regions, complementing strong double-digit growth in the U.S.

Next, I'll talk about Equity Markets.

Equity Markets net revenues increased very strongly as well, setting a new record at \$2.4 billion, up 35% from the fourth quarter and 50% from the year-ago quarter. Every major revenue category increased both sequentially and year-on-year, with the exception of private equity, which was down slightly from the fourth quarter. In particular:

- The equity-linked trading business showed the strongest absolute and relative growth among the trading areas, setting a new quarterly record, as client demand for derivative products continues to accelerate.
- In the cash trading business, growth was driven by improvements in electronic trading, demonstrating the impact of the investments we've been making, combined with favorable market conditions.

- The Strategic Risk Group, which is dedicated to proprietary trading, registered a record quarterly result for the second consecutive period as we continue to build out that unit.
- Revenues from the financing and services business, which includes prime brokerage, were also up, as this business continues to gain momentum, as evidenced by our recent ranking as the number two prime broker in Europe by *Global Custodian*.
- While down sequentially, revenues from private equity were still quite robust, and up significantly year-on-year, as our publicly traded investments continue to perform well.
- And from a regional perspective, EMEA was a clear standout. We believe EMEA now represents the largest and fastest-growing market within Equities, and we are extremely well-positioned, with EMEA contributing nearly a third of our global Equity Markets revenues.

Across our Global Markets businesses, our capabilities have never been stronger, and we are in a better position than ever to drive growth and manage risk across our global franchise.

Now to Investment Banking, which generated record net revenues for the second quarter in a row, at \$1.4 billion up 4% from the fourth quarter and 47% year on year.

This quarter's revenues were particularly strong in merger and acquisition advisory and leveraged finance, two core areas of focus for us, and were achieved despite the typical seasonal slowdown in broader market volumes. Regionally, EMEA stood out in terms of growth, also setting a quarterly record for Investment Banking revenues.

M&A Advisory revenues of \$399 million were the second-best ever for our firm, up 55% year on year and 40% sequentially. For the quarter, Merrill Lynch was number two in global completed M&A volume.

And debt origination revenues set a new record, up 38% from the prior-year period and 9% from the previous record set in the fourth quarter of 2006. Strength in this category was driven by leveraged finance, where we set a new revenue record as we ended the quarter number two in the global high yield league tables.

Equity origination was up 53% from the year-ago period, but down 24% from the particularly strong fourth quarter, as activity levels moderated around the globe. Our market share remained strong, as we finished the quarter in second place in the global equity and equity-linked league tables and were number one in IPO's.

Our increasing emphasis on providing multifaceted solutions for our clients was evidenced by the work we did for Freeport McMoran around its acquisition of Phelps Dodge creating the world's largest publicly traded copper company.

In this situation, we

- Advised Freeport McMoran on the transaction;
- Arranged \$17.5 billion in debt financings, which included the largest high yield note transaction ever at \$6 billion;
- And led \$5.8 billion in equity and equity-linked financings – setting a record for an already-public U.S. company

Our outstanding performance in investment banking underscores the progressively more powerful market position we have attained through key investments in personnel.

And beyond these strong results, our investment bankers are increasingly adding value to other areas of the firm, sourcing revenues in derivatives, commodities and principal investments, and introducing clients to our private wealth advisors. These “non-traditional” sources of revenue will continue to be a significant area of focus as we work to maximize the revenue potential from the high-quality relationships our investment bankers have with their clients.

The environment for investment banking remains constructive, particularly for large, multi-product transactions. Even after this strong first quarter, our pipeline closed the quarter at a new period-end record.

The sequential increase in the pipeline was driven primarily by debt and equity origination. The year-over-year increase was broader, across all three product areas and all three primary regions.

Subject to market conditions as always, we are optimistic about our ability to convert this pipeline into revenues.

Now, turning to GWM...

GWM comprises our Global Private Client and Global Investment Management businesses. The firm's share of the after-tax earnings of BlackRock are included in the GIM portion of GWM revenues for both the fourth quarter of last year and the first quarter of this year, but not the first quarter of 2006, when our asset management activities were reported in the former MLIM segment.

GWM generated solid revenue growth and strong pre-tax profits in the first quarter, driven by revenue growth in both GPC and GIM. Net revenues of \$3.4 billion were up 16% year on year and 4% sequentially. Pre-tax profits of \$842 million were up 31% and 11%, respectively. The pre-tax margin was 24.7%, higher than both prior periods.

GPC net revenues for the first quarter were \$3.1 billion, up a little over 2% sequentially and 11% from the prior-year quarter. These were GPC's second highest quarterly net revenues ever, short of the record set in the first quarter of 2000.

Sequentially, the overall revenue increase was driven by every major category. Transaction and origination revenues rose amidst a meaningful pickup in activity early in the quarter. Net interest and fee-based revenues also reached all-time highs.

Year-over-year, the overall GPC revenue increase also came across every revenue line, with fee-based revenues contributing the most. Transaction and origination revenues were driven higher by new issue origination activity in closed-end funds, and net interest increased meaningfully.

GPC continues to make progress on key growth initiatives, including:

- Private banking, where as I mentioned earlier, the First Republic acquisition will enhance our ability to grow in this attractive sector.

We believe that First Republic will be able to expand on a more rapid basis as a part of Merrill Lynch than as a standalone company. Once the acquisition is completed, together we will focus on intelligently building out the bank's footprint, as well as leveraging Merrill Lynch's wealth management expertise in tailoring products for First Republic's clientele.

- Also, expanding non-U.S. operations remains a priority. GPC again grew non-U.S. revenues at a faster sequential pace than the U.S. business, and is implementing a new business model focusing on ultra-high-net-worth clients.
- And we continue to invest in technology. In an increasingly competitive industry, the level and consistency of our revenues and earnings enables us to afford the substantial investments in technology required to empower FA's to deliver best-in-class client service, products and advice.

On to GIM, which recorded first quarter revenues of \$261 million up 24% sequentially and 151% from last year's first quarter. Sequentially, growth was driven by an increased contribution from our investments in BlackRock and other investment management companies.

Compared to the first quarter last year, most of the increase reflects the inclusion of BlackRock in the current quarter but not in the earlier period. However, other areas of GIM also generated revenue growth.

We continue to be extremely pleased with the successful integration of MLIM and BlackRock, and refer you to their earnings release this morning for a review of their outstanding progress.

For GWM as a whole, first quarter asset flows into private client accounts were strong. Net inflows into products that generate annuitized revenues were \$16 billion for the quarter. Total net new money into the firm was also \$16 billion, bringing total client assets to a new record level.

The GWM strategy remains consistent: investing in an industry-leading, global platform that attracts superior professionals and enables them to act as essential partners to their clients, providing best-in-class service, products and advice — and positioning the business for further growth.

That concludes my discussion of our segments.

I will now return to the income statement for the firm as a whole, beginning with expenses.

First, compensation.

The ratio of compensation expenses to net revenues for the first quarter was 49.6%, about 50 basis points lower than in the first quarter of 2006. The decline in this ratio reflects operating leverage to increased revenues, driven by our continued bottom-up discipline around compensation, even as we continue to hire aggressively around the world to enact our growth plans.

As usual, the quarterly progression of our compensation ratio will depend on how the environment evolves, both in terms of revenues and competitive trends in compensation.

Next, non-compensation costs...

Which in the first quarter totaled \$1.9 billion, up 15% from last year's first quarter, consistent with the growth of our business, but down 3% sequentially.

The ratio of non-compensation expenses to net revenues in the quarter reached a record low of 19.0%, down 1.4 points from the year-ago period, as we were able to deliver operating leverage despite the significant growth in activity levels and the inclusion of First Franklin, an expense-intensive business.

We will stay focused on non-compensation expenses even as we make further investments in infrastructure to drive growth.

Now, our effective tax rate,

Which for the first quarter was 30.3%, up 3 points from the full year 2006. At this point, we expect this rate to continue to increase modestly

as our earnings grow, but again, let me point out that both the rate for individual quarters and the full year rate can be impacted by various factors including changes in tax laws, settlements and business mix.

And finally, capital management.

We continued to execute aggressively on the share buyback front, repurchasing more than 22 million shares, \$2 billion worth, of our common stock during the first quarter.

Our plan is to remain active in repurchasing our stock, although as we seek approval from First Republic's shareholders for that acquisition, we will be required to withdraw from the market for a period of time. That may impact the absolute amount we buy back in the coming quarter.

We continue to effectively balance increasing our ROE while growing book value per share. Book value per share at the end of the quarter was \$41.95, up 13% from a year ago, and up 60 cents from year-end, despite the impact of share repurchases and our annual stock-based compensation grant.

And we also increased our ROE, which is up more than 4 points from the year-ago period, to 23.3%. This is a direct result of our efforts to grow revenues, drive higher margins and actively manage both our balance sheet and equity capital.

We are pleased with our continuing progress but remain focused on further improving this important metric. We are confident that, in similarly conducive markets, the successful execution of our growth strategy will allow us to drive our ROE higher, and to continue to increase both book value per share and, over time, dividends.

This wraps up my formal review of first quarter results.

Having produced our best revenues ever, we enter the second quarter with strong momentum and great optimism about our future. The market environment has been favorable for most of our businesses, but we are mindful that the markets can turn quickly. We also recognize that seasonally, the first quarter is often the strongest of the year, particularly for transaction-oriented businesses such as trading and parts of GPC.

But with each quarter, Merrill Lynch becomes stronger and more balanced across businesses, across regions and across asset classes. We have invested aggressively to build our platform, but we continue to see opportunities for further investment to drive future growth. We continue to successfully add and develop outstanding talent around the world, increasing our ability to deliver superior service to our growing client base.

As always, execution will be key, but our track record to date makes us confident we will deliver.

Now, I will be happy to take your questions...