

## Merrill Lynch 4Q06/FY06 Analyst Conference Call

### **Index 1: Entire Presentation**

Good morning, and welcome to Merrill Lynch's conference call to review 2006 fourth quarter and full year results. The following live broadcast by Jeff Edwards, Chief Financial Officer, is copyrighted to Merrill Lynch. Statements made today may contain forward-looking information about management's expectations, strategic objectives, growth opportunities, business prospects, investment banking backlogs, anticipated expense levels and financial results, anticipated results of litigation and regulatory proceedings, and other similar matters. Such forward looking statements are not statements of historical facts and represent only Merrill Lynch's beliefs regarding future performance, which is inherently uncertain. Investors are cautioned not to place undue reliance on forward-looking statements, which speak only to the date on which they are made, and may be impacted by a variety of factors that are beyond Merrill Lynch's control. Merrill Lynch does not undertake to update these statements to reflect the impact of subsequent circumstances or events. Investors should consult Merrill Lynch's reports filed with the SEC for any additional information. Investors should also read the information on the calculation of non-GAAP financial measures that is posted on Merrill Lynch's Investor Relations website, [www.ir.ml.com](http://www.ir.ml.com), where an on-line rebroadcast of this conference call will be available today at approximately 1:00 p.m. Eastern Time.

And now I'll turn the call over to Jeff...

### **Index 2: Second Quarter Results**

Thank you, Jonathan. First, let me also welcome everyone on this morning's call, wish you all a Happy New Year, and thank you for your interest in Merrill Lynch.

Throughout this call, unless I indicate otherwise, I will discuss only our operating performance; that is, I will exclude the impacts of both the one-time net gain from the closing of the MLIM-BlackRock combination in the third quarter, as well as the one-time compensation expenses related to adopting FAS 123R in the first quarter. Full GAAP financials which include these items are available in the attachments to our

earnings release, as are schedules reconciling the GAAP data to the numbers I will discuss.

This morning, I am delighted to report the strongest quarter and year ever for Merrill Lynch. Highlights for both the fourth quarter and full year include:

- Record revenues, earnings, and earnings per share;
- Significant improvement in return on equity while continuing to grow book value per share;
- Record results in Global Markets & Investment Banking (or GMI) driven by best-ever performances in Investment Banking and Fixed Income Currency and Commodities (or FICC), and a full year record in Equity Markets as well;
- Substantial growth in our newly formed Global Wealth Management segment, to be known as GWM; and
- Continued outperformance by our operations outside the United States with both Europe and Asia setting new full year records for both revenues and pre-tax earnings.

All these results demonstrate the breadth and depth we continue to add to our capabilities and positioning across business segments and regions, putting Merrill Lynch on its strongest competitive footing ever as we enter 2007.

In the fourth quarter, we generated our highest-ever quarterly operating revenues, at \$8.6 billion, up 27% from the fourth quarter of 2005 and 8% from the third quarter of 2006. With strong expense control, particularly over compensation costs, pre-tax earnings of \$3.4 billion were up 65% year-on-year and 42% sequentially. Record net earnings of \$2.3 billion were up 68% year-on-year and 21% sequentially, and earnings per share increased 71% and 21% over the comparable periods to a new high of \$2.41. The pre-tax operating profit margin of 39.0%, was the highest quarterly margin we have ever reported, up about 9 points over both prior periods, and our return on equity of 25.6% was the highest since the first quarter of 2000.

This strong fourth quarter performance topped off the record results for the full year. 2006 full year revenues of \$32.7 billion were up 26% over

2005, and significantly exceeded our previous revenue record set in 2000.

Pre-tax earnings of \$10.4 billion increased 44%; net earnings of \$7.6 billion were up 48%; and EPS of \$7.68 grew 49%. The pre-tax margin of 31.9% for the full year is up more than 4 points over 2005, and is the highest we have ever achieved. The full year 2006 return on equity of 21.6% is 5.6 points higher than the 2005 level and represents the first time this important measure has exceeded 20% for a full year since 2000.

Estimated book value per share at the end of the year was \$41.37, up 15% from the end of last year. That figure, of course, includes the net impact of the one-time items.

This strong performance in 2006 is a direct result of the successful execution of our strategy to invest in multiple growth initiatives across all businesses and regions, which enabled us to capitalize on the favorable market conditions we saw in the fourth quarter and throughout much of the year. We also continued to maintain tight discipline around expenses and managing our equity capital.

Let me highlight six key achievements in both the fourth quarter and full year 2006 which will pave the way for further growth in 2007 and beyond:

First, the execution and integration of strategic initiatives were both active and on schedule this quarter. The fourth quarter is, of course, the first full quarter that we are reporting results from our investment in BlackRock on the income statement. We remain very pleased with BlackRock's progress in integrating the former MLIM business—that is, Merrill Lynch Investment Managers—with BlackRock. Nonetheless, the true benefits of the combination have only begun to be realized, and we look forward to this industry-leading platform making substantial further progress in the quarters and years ahead. As you probably know, BlackRock is planning to release its results on Tuesday.

Since the fourth quarter began, we've closed two previously announced acquisitions: in December, Petrie Parkman, a specialized investment banking platform focused on the energy sector; and on the first day of the new fiscal year, First Franklin, a non-prime mortgage origination and

servicing franchise. So both these operations will contribute to our business in 2007.

Second, our Investment Banking business continued to make great strides, ranking number one for the quarter in the global equity and equity-linked underwriting league tables, and number one in 2006 in CDO issuance— for the third year in a row, as we continue to be an innovator in that space. For the year, we also ranked in the top five in global high yield origination for the first time since 1998, and this is the first year since 2003 that any non-commercial bank player has cracked the top five in this crucially important product category. This reflects the strides we have made with the financial sponsors client segment, as well as our role in M&A and private equity transactions. We have added substantially to our headcount of high-quality investment bankers over the past several years, and have dramatically improved the breadth and depth of our client franchise. We fully expect this group to deliver more growth in the years ahead, both in traditional and, increasingly, in non-traditional products such as private equity, derivatives and commodities.

Third, our strategy of adding to our Global Markets trading businesses through both organic and inorganic activity continued to drive growth. While virtually all major fixed income and equity businesses showed growth year-on-year, some of our strongest results came from focused investment areas including credit trading, commodities and foreign exchange within the FICC platform; and strategic trading, equity linked trading and financing and services in Equities. Despite the significant growth in many of these businesses, most remain less than full scale at this point, and we will continue to invest in them in 2007 to expand our product offerings and client base.

Fourth, our private equity business experienced two important events: the completion of the acquisition of HCA, which was announced during the third quarter, and the IPO of Hertz— although I should tell you that the majority of our revenues to date from the Hertz investment were recognized in prior quarters. While revenues from private equity will continue to be variable, we believe we can continue to grow this business over the long term, particularly as we engage our growing force of investment bankers in sourcing opportunities. Our private equity group is already off to a strong start in 2007, with the announcement two weeks ago of our investment in Aeolus, a Bermuda-based reinsurer.

Fifth, our private client business saw client flows accelerate, particularly in annuitized-revenue products, enabling client assets to reach an all-time high, reflecting our continued investments in technology and products, and our disciplined efforts to retain and attract exceptional Financial Advisors. In 2006, Merrill Lynch's FAs continued to deliver superior service and quality investment performance for our clients, driving industry-leading per capita productivity. We will continue to invest further in both our people and our platform to enhance our wealth management offering in 2007.

And last, but perhaps most important for our future positioning, is the substantially higher growth we continue to generate from our rapidly expanding international operations. For the full year, both GMI and GWM saw significant revenue and earnings growth from outside the U.S. In the case of GMI, non-U.S. revenues grew at almost double the rate of domestic revenues. For the firm as a whole, non-U.S. revenues reached 37% of the global total in 2006, the highest proportion in our history. We expect this important theme to continue as capital markets liberalize around the world, and as we continue to make investments to further the expansion of our non-US activities.

Our results in 2006 certainly benefited from the investments we have made over the last few years. However, it is important to note that many of our more recent investments, particularly those we have made in the past year, have not yet fully matured, and we expect them to drive future growth over and above what market trends may dictate.

Let me now review our financial performance for the fourth quarter and full year by segment,

### **Index 3: GMI**

#### **Starting with GMI...**

GMI had nothing short of an outstanding quarter across nearly all businesses and regions. With \$5.4 billion in revenues, GMI set a new quarterly record, up 21% sequentially and 55% year-on-year.

Pre-tax earnings for the quarter were \$2.6 billion, up 76% sequentially and 73% from the year-ago quarter. GMI's pre-tax margin of 48.4% was an all-time high, driven both by strong revenue growth and operating leverage achieved through discipline over compensation costs.

This record fourth quarter completed a record full year for GMI. Net revenues of \$18.9 billion were the highest ever, up 37% from 2005, with double-digit percentage increases coming from each division and each region. Pre-tax earnings growth was even stronger at 43%, to \$7.1 billion, as GMI achieved solid operating leverage even as significant investments continued to be made across the business. The full year pre-tax margin was 37.6%.

Looking at the revenue detail within GMI:

Fourth quarter FICC net revenues set another new record at \$2.3 billion, up 11% from the third quarter and 70% from last year's fourth quarter, as business activity remained strong across virtually every business. Commodities, credit trading and foreign exchange all set new quarterly revenue records on the strength of very strong client flows and solid proprietary results, while interest rate trading also generated strong revenue growth over both prior periods.

FICC also set a record for the full year with \$8.1 billion in net revenues, up 31% from 2005, achieving positive comparisons across every major line of business. Several businesses achieved full year records, including commodities, credit, foreign exchange, and structured finance.

Equity Markets net revenues of \$1.8 billion for the fourth quarter were up 16% sequentially and a strong 49% year-on-year. Compared to the 2006 third quarter, increases from private equity— which had its second-best quarter ever— and the strategic risk group— which had its best— more than offset seasonal declines in equity-linked trading. Relative to the fourth quarter of 2005, revenues from all equity businesses were up, with the exception of equity-linked trading, which faced low volatility during the quarter.

For the full year 2006, Equity Markets net revenues were up 54% to a record \$6.7 billion, with positive comparisons across every major line of business. Private equity, the strategic risk group, and equity financing and services all set revenue records.

Investment Banking also set a revenue record in the fourth quarter, with \$1.3 billion in net revenues, up 59% sequentially and 41% year-on-year.

Advisory revenues of \$286 million were up 10% from the third quarter, but down 18% from the particularly strong fourth quarter of 2005. However, revenues from both debt and equity origination set new quarterly records. Debt origination revenues of \$540 million were up 48% sequentially and 79% year-on-year, while equity origination revenues of \$475 million were up 146% and 77%, respectively, and finally eclipsed the previous quarterly record set back in 1999.

For the full year 2006, Investment Banking revenues also set a new record, at \$4.1 billion, up 24% from 2005. Debt origination revenues set a new record at \$1.7 billion, up 20%; advisory revenues of \$1.1 billion were up 25%, and equity origination revenues of \$1.2 billion were up 28%, in both cases the strongest results since 2001.

As we head into 2007, our dialogue with investment banking clients remains active and the pipeline strong. At the end of 2006, our pipeline stood at an all-time period-end record, up meaningfully from the end of both the third quarter and the end of last year.

## **Index 4: GWM**

### **Moving on to Global Wealth Management...**

The new GWM segment more explicitly delineates how we manage our private client and investment management businesses following the merger of MLIM with BlackRock. Under the GWM configuration, GPC net revenues reflect the preponderance of our traditional private client distribution activities, with the exception of the group that creates and manages hedge fund, fund-of-funds and other alternative investment products for private clients. That group is now included together with our investments in BlackRock and other investment management companies to form Global Investment Management, for which we provide a distinct revenue line. Revenues from GIM's constituent businesses are similar since they all arise from "manufacturing" activities within a broader wealth management context, and we expect the contribution of this group of businesses to GWM to grow over time.

You will recall that our investment in BlackRock is accounted for under the equity method, with our share of their after-tax earnings reported in revenues. We also record a small amount of expenses which are associated with carrying and managing the investment.

Since the investment in BlackRock was not completed until the end of the third quarter, there are no results from that investment in prior periods. Revenues from MLIM for prior periods are still reflected under the MLIM segment, which was discontinued at the time of the combination with BlackRock.

For comparability, we have made the small adjustments among the segments to conform results for prior periods to this methodology. I should note that GIM's revenues from ownership stakes in other investment management companies were previously reported in GMI.

Overall, GWM had a very strong quarter, generating net revenues of \$3.3 billion, up 17% from the third quarter of 2006 and 13% from the fourth quarter of 2005, reflecting growth in both GPC and the hedge fund business, as well as the inclusion of revenues from the BlackRock investment. Pre-tax earnings of \$759 million were up 27% sequentially and 19% from the prior year quarter, driven by those higher revenues, which were partially offset by increased compensation and litigation costs. The pre-tax margin was 23.1%, reflecting continued expense discipline within GPC and the very low expenses associated with the BlackRock investment.

For the full year, GWM's revenues, which largely reflect GPC, were \$12.1 billion, a robust 12% increase over 2005. Pre-tax earnings of \$2.7 billion were up 23% and the pre-tax margin was 22.5%.

Turning to the revenue detail in GWM...

GPC generated fourth quarter revenues of \$3.1 billion, up 13% sequentially and 10% year-on-year, with revenue gains across every major revenue category. Record fee-based revenues were driven by both increased asset values and continued strong net flows of client assets into annuitized products. Net interest income also increased. Transaction and origination revenue rebounded significantly from the third quarter, and origination revenues were also up strongly relative to last year's fourth quarter.

For the full year, GPC revenues of \$11.6 billion were up 11% from 2005, as revenues increased in every major revenue category.

GIM had fourth quarter revenues of \$211 million, up 143% from the third quarter of 2006 and 80% from the fourth quarter of 2005. As I noted earlier, this quarter represents the first time that revenues include an estimate of our share of the GAAP after-tax earnings of BlackRock.

GIM revenue growth was driven primarily by the initial contribution from BlackRock, but revenues from the alternative investments business and other ownership stakes also increased.

For the full year, GIM revenues of \$541 million were up 32% from 2005.

For GWM as a whole, fourth quarter client asset flows accelerated. Fourth quarter net flows into products that generate annuitized revenues were a record \$18 billion, bringing the full year total to a record \$48 billion, up 19% from 2005. Assets in annuitized-revenue products finished the year at \$613 billion, up 16% from 2005, driven by both market appreciation and those inflows. Total net new money was also strong in the fourth quarter, reaching \$22 billion. Full year net new money was \$61 billion, up 15% from 2005, and total client assets ended the year at a record \$1.6 trillion.

You should note that GWM net flows and client assets reflect only Merrill Lynch client accounts and activity; that is, they do not include BlackRock data for distribution channels other than Merrill Lynch.

For full year 2006, GPC added a net of 720 Financial Advisors, driven by continued low turnover of current FAs and recruitment of new FAs. We improved our FA recruiting performance relative to nearly all major competitors in 2006, adding FAs at a faster pace outside the U.S. than in the U.S.

Global Wealth Management's growth prospects are bright. We are committed to being an essential partner to our clients by providing them with outstanding service, superior products, world-class investment advice and cutting-edge technology. We continue to invest in our business, our people and our platform with the strong belief that it will allow us to attract new clients who will understand the benefits of having a relationship with a Merrill Lynch Financial Advisor.

That concludes my discussion of segment results. Since MLIM was discontinued on the last day of the third quarter, there are no fourth quarter results for that segment, and its full year results are identical to the year-to-date results I discussed on the third quarter call.

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

## Index 5: Expenses

### **First, compensation.**

The ratio of compensation expenses to net revenues ended the year at 46.2%, about 1.6 points lower than in 2005, despite compensation expenses increasing 21%. We believe these results demonstrate our success in striking a balance among three important goals: rewarding high-performing personnel with highly competitive pay; hiring talented individuals in key areas of investment to drive future growth; and delivering operating leverage to our shareholders as we grow revenues.

Looking ahead to 2007, we will continue to invest in people to further grow the business, which could produce a modestly higher full year ratio. That ratio, of course, will continue to depend on the business environment, competitive compensation and hiring trends, and the ultimate level of investment in personnel.

### **Turning to non-compensation costs...**

which in the fourth quarter totaled just under \$2 billion, up 9% sequentially and 6% from the fourth quarter of 2005. The ratio of non-comp expenses to revenues increased marginally on a sequential basis, as is typical in a fiscal fourth quarter, to 22.4%, but was down a substantial 4.5 points from last year's fourth quarter, demonstrating our strong operating leverage and continued discipline over fixed costs.

For the full year, non-comp expenses totaled \$7.2 billion, up 13% from 2005; however, the ratio of non-comp expenses to revenues fell 2.5 points to 21.9%, the lowest full year ratio we have ever recorded.

In 2007, we will remain diligent in maintaining our discipline over non-comp expenses, although we expect that, on an absolute basis, these expenses will rise as we continue to spend selectively, and in a targeted manner, to support our growth initiatives. However, we will maintain our focus on striking the right balance between investment spending and earnings growth.

**Now, our effective tax rate.**

The effective tax rate for the full year 2006 was 27.3%, down 1.9 points from 2005. That decrease primarily resulted from the tax benefit from carryback claims we reported in the third quarter of this year.

Preliminarily, we expect the effective tax rate for 2007 to rise somewhat from the 30.1% we recorded in the fourth quarter. I will add the usual caveat that both the rate for individual quarters, as well as the full year rate, can be impacted by various factors including tax settlements and the mix of business.

**Index 6: Capital Management**

**Lastly, Capital Management.**

We have previously articulated that we strive to balance a number of financial goals in delivering value to our shareholders, including increasing earnings and EPS, improving ROE, growing book value per share and increasing dividends. In 2006, we demonstrated strong progress on all these measures.

I want to start with ROE, because improving this crucial metric has been of particular importance to Merrill Lynch's management team over the past several quarters, and the results are clear.

To reiterate: Return on equity for the fourth quarter reached 25.6%, our highest quarterly ROE since 2000, and up 3.1 points sequentially and 8.7 points year-on-year. For the full year, ROE was 21.6%, up 5.6 points from 2005, and again was our best full year performance since 2000.

We are pleased with our absolute and relative improvements in ROE, but we acknowledge that we have more work to do going forward.

Importantly, our higher ROE did not come at the expense of growing book value per share. As I noted, we ended 2006 with book value per share of \$41.37, up over \$5 from 2005.

While we continue to invest capital in support of our growth initiatives, we have actively managed excess capital through share repurchases and dividends. In the fourth quarter, we repurchased 31 million shares for \$2.8 billion, a meaningful acceleration from both the third quarter of 2006 and the fourth quarter of 2005. For the full year, we repurchased 117 million shares for just over \$9 billion.

As a direct result of these repurchases, our period-end share count declined again, to 868 million shares, down 2% sequentially and 6% from the end of last year. For the fourth quarter, average diluted shares were 952 million, down 2% from the prior year, but up 1% sequentially due primarily to the impact of our significantly higher average stock price on employee stock option exercise activity and the calculation under the treasury stock method of accounting for unexercised options and convertible bonds. For the full year, however, our average diluted share count of 963 million was 2% lower than 2005.

As our stock-based compensation today is almost entirely comprised of actual restricted shares and units, as opposed to options, we anticipate the dilutive impact of options to diminish over time as more and more of the legacy options are converted into actual shares.

We expect 2007 to be another active year in terms of repurchasing our stock, although at this point we expect the pace to be somewhat slower than 2006. As you know, we grant our annual stock awards in January, so the first quarter period-end share counts will reflect that increase.

On the dividend front, I am pleased to report that the Board of Directors has approved a 40% increase in the quarterly dividend on our common stock, to \$0.35 per share, which represents our largest percentage increase, in the absence of a share split, in more than a decade.

We have more than doubled our dividends in just under three years' time. Dividends will remain an important focus for us, on a periodic basis, as we evaluate opportunities to continue to return excess capital to shareholders.

## Index 8: Closing

### **A few final comments before opening this call up to questions:**

We look back at 2006 as a year of exceptional growth and strategic progress at Merrill Lynch. Financial performance was very strong, and that is our primary scorecard. At the same time, we are also very encouraged by:

- the repositioning of our asset management franchise, which is now much better poised to deliver strong long-term growth;
- the accelerated pace of our investments, particularly outside the U.S., in markets that we expect to grow faster in the coming years;
- and the increasing recognition of our firm as a preferred platform for top-quality professionals across all of our businesses.

But 2006 is now in the rearview mirror, and we are firmly focused on the future. We enter 2007 with strong momentum and great confidence in our ability to capitalize on opportunities around the world to serve both individual and institutional clients. The long-term secular growth story of our businesses remains powerful, and most importantly, we have the enhanced breadth and depth of talent across our global enterprise to both execute on our growth initiatives and deliver on our strategy.

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