BernsteinResearch

Brad Hintz (Senior Analyst) • brad.hintz@bernstein.com • +1-212-756-4590
Michael Werner • michael.werner@bernstein.com • +1-212-756-4151
Vincent M. Curotto • vincent.curotto@bernstein.com • +1-212-756-1882

U.S. Securities Industry | 2008-09 M&A Outlook

			1/2/2008		YTD	EPS			P/E			
Ticker	Rating	CUR	Closing Price	Target Price	Rel. Perf.	2006A	2007E	2008E	2006A	2007E	2008E	Yield
BSC	M	USD	85.30	125.00	-1.9%	14.27	2.50	11.17	6.0	34.1	7.6	1.5%
GS	M	USD	207.60	235.00	-2.1%	19.69	24.73	20.50	10.5	8.4	10.1	0.7%
LEH	M	USD	62.19	78.00	-3.6%	6.81	7.26	7.44	9.1	8.6	8.4	1.0%
MER	M	USD	52.76	70.00	-0.3%	6.44	-2.78	6.15	8.2	NM	8.6	2.7%
MS	O	USD	50.95	68.00	-2.7%	7.10	2.37	6.54	7.2	21.5	7.8	2.1%
SPX			1447.16			86.75	91.05	97.00	16.7	15.9	14.9	2.0%

O – Outperform, M – Market-Perform, U – Underperform

Highlights

- Merger and acquisition activity has historically been correlated with favorable economic conditions. Rising corporate earnings, declining unemployment and benign equity and debt capital markets conditions have been harbingers of increasing advisory volumes. In such environments, corporate managements are more willing to accelerate company growth rates through M&A transactions and financial sponsors are able to use leverage to deploy equity into new investments.
- The first half of 2007 was an ideal operating environment for M&A activity, resulting in both strong financial sponsor and strategic corporate M&A activity. However, the global credit re-pricing events of H2:07 negatively changed the M&A market conditions and have served to slow both the domestic US and the EU economies. Overall, we expect M&A advisory revenues will decline about 20% annually in 2008.
  - The overhang of unplaced debt from 2007 transaction volumes, wider credit spreads and more conservative lending policies will limit announced 2008 global financial sponsor M&A activity. We expect financial sponsor volumes to decline 30% from this year's levels and an additional 22% in 2009.
  - In the corporate strategic sector of M&A, we expect volumes to fare better in 2008-09. Specifically, we expect European strategic M&A volumes to fall 4% in 2008 before rising 6% in 2009. For domestic strategic M&A, we expect a 10% decline in activity levels in 2008, followed by a 1% increase in 2009.
- M&A revenues accounted for 6.9% of Goldman Sachs' total net revenues in 2006. MS, LEH and BSC each generated about 5.0 to 5.5% of their 2006 net revenues from advisory fees. Merrill Lynch is the least exposed to M&A as just 3.4% of its 2006 net revenues came from M&A activities. We rate Merrill Lynch, Bear Stearns, Lehman Brothers and Goldman Sachs Market-Perform. We rate Morgan Stanley Outperform.

Investment Conclusion

The trend lines of several Wall Street's institutional businesses are beginning to point south. While M&A advisory engagements originated in 2007, continue to close, we note that Wall Street's strong year end backlog is being drawn down. This trend of slowing M&A activity will continue into 2008.

Brad Hintz • brad.hintz@bernstein.com • +1-212-756-4590

This will occur due to two factors – (1) an economic slowdown in the USA and the EU will reduce corporate earnings growth and limit the willingness of corporations to risk new acquisitions and (2) the overhang of $160 billion of unplaced deal paper, wider credit spreads in the debt market and tighter lending standards at syndicating banks will constrain financial sponsor demand. Overall, we expect M&A advisory revenues will decline about 20% annually in 2008 for the brokers as the decline of announced volumes in H2 '07 will result in an incremental sequential decline in completed M&A volumes (relative to announced volumes) in 2008. We expect announced 2008 global financial sponsor M&A activity will decline 30% from this year's levels and an additional 22% in 2009. In the corporate strategic sector of M&A, we expect volumes to fare better in 2008-09, with European strategic M&A volumes falling 4% in 2008 before rising 6% in 2009. For domestic strategic M&A, we expect a 10% decline in activity levels in 2008, followed by a 1% increase in 2009. Overall we expect the security industry group's advisory revenues to increase by about 9% in 2009 from 2008 levels.

Among the large U.S. security firms, Goldman generates the largest nominal dollar amount of advisory revenues while Morgan Stanley generates the second highest. Both GS and MS are perennial 'Top Three' global M&A advisors. Bear Stearns reported the weakest M&A advisory revneues. M&A revenues accounted for 6.9% of Goldman Sachs' total net revenues in 2006. MS, LEH and BSC each generated about 5.0 to5.5% of their 2006 net revenues from advisory fees. Merrill Lynch is the least exposed to M&A as just 3.4% of its 2006 net revenues came from M&A activities.

We rate Merrill Lynch, Bear Stearns, Lehman Brothers and Goldman Sachs Market-Perform. We rate Morgan Stanley Outperform.

Details

In this piece we use regression techniques to forecast both 2008 and 2009 U.S. and European announced M&A Activity. These two regions account for 75% of the global M&A market.

For each of these regions we forecast the financial sponsor-related activity and the corporate strategic M&A activity to derive our total forecasts. Our forecasts are based on regression analysis of past M&A announced volumes.

Exhibit 1 highlights our 2008-09 annual M&A activity forecast, by region and by type of M&A activity.

Exhibit 1
2008-09 Forecasted M&A Volume Growth/Declines

US M&A Announced Volumes

	Financial Sponsor Activity	Strategic M&A	Total M&A
2008	-32%	-10%	-17%
2009	-17%	1%	-4%

European M&A Announced Volumes

	Financial Sponsor Activity	Strategic M&A	Total M&A
2008	-28%	-4%	-9%
2009	-17%	6%	3%

Sources: Bernstein Analysis & Estimates

Brad Hintz • brad.hintz@bernstein.com • +1-212-756-4590

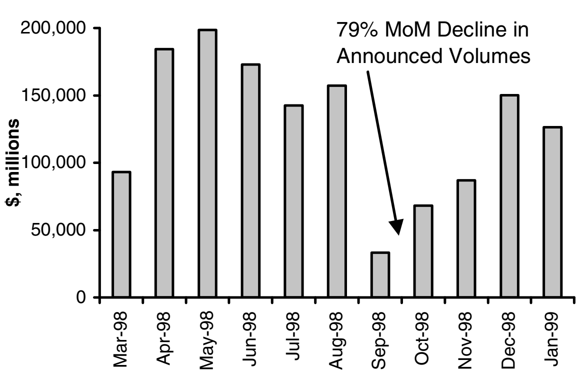
The Current Health of the M&A Market

Global M&A activity has not been immune to the recent credit repricing event. Newly announced financial sponsor deals have fallen drastically and corporate strategic deals have also declined. In the U.S., monthly announced M&A volumes have declined to their lowest levels in three years during September and October (see **Exhibit 3**).

As a consequence of recent credit market events, we expect financial sponsor driven activity will slow dramatically in 2008. Financing is more expensive and while private equity firms still have significant levels of un-invested capital, the number of LBO targets has been reduced by these higher financing costs. Looking ahead, leverage ratios will decline with the increased financing costs, committed financing guarantees will be tougher to obtain and debt investors will demand (and get) more covenants on their LBO financings. In addition, with still a large backlog of financing (high-yield debt and leveraged loans) related to LBO deals that still need to worked through the system, newly announced deals are virtually at a standstill.

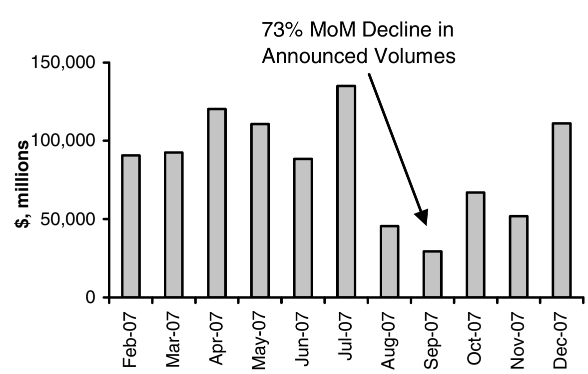
Nevertheless, we expect corporate strategic M&A deal volume will be better off than financial sponsor activity over 2008-09. While the recent credit re-pricing event had temporarily frozen the strategic M&A market, we expect activity should resume at a healthy pace. Following the 1998 Russian Default/LTCM credit event, corporate M&A volumes dropped off significantly, falling 79% on a month-over-month basis in September 1998. Nonetheless, M&A volumes rebounded by December 1998, recovering to 95% of the 6-month March-August 1998 average. Though we acknowledge that 2007 is not 1998, placing the current state of the overall global economy within the context of our analysis of historical M&A cycles, we believe the credit repricing event will slow down, but not halt the overall global M&A market.

Exhibit 2
1998 Domestic Corporate Announced M&A Volumes



Source: Dealogic, Bernstein Analysis

Exhibit 3
2007 Domestic Corporate Announced M&A Volumes



Source: Dealogic, Bernstein Analysis

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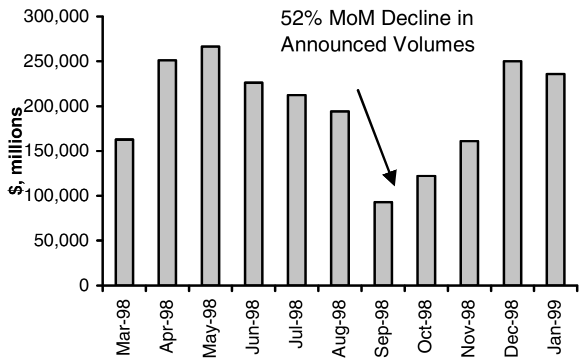
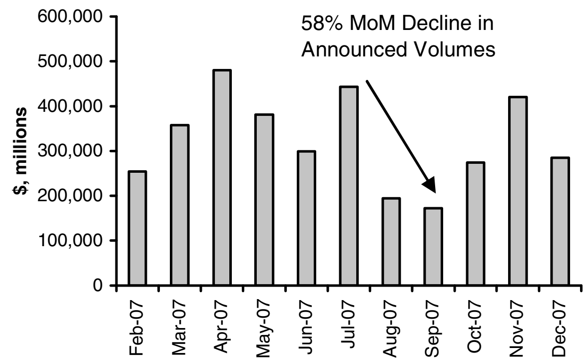
Brad Hintz • brad.hintz@bernstein.com • +1-212-756-4590

Exhibit 4
1998 Global Corporate Announced M&A Volumes



Source: Dealogic, Bernstein Analysis

Exhibit 5
2007 Global Corporate Announced M&A Volumes



Source: Dealogic, Bernstein Analysis

Mergers and Acquisitions – Where are We in the Current Cycle

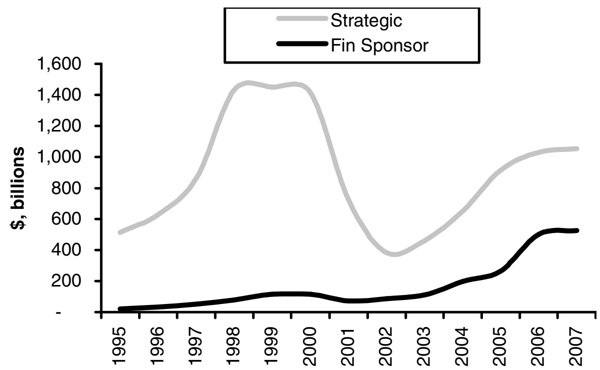
Strategic M&A activity tends to move with the economic cycle. In the economic downturn following the end of the technology, media and telecommunication bubble, corporate appetites for strategic M&A deals dropped sharply. M&A deal volumes collapsed to $470 billion in 2002 as declines in corporate earnings and uncertainty about the economic outlook resulted in the weakest M&A market since 1996. The ability of corporate acquirers to execute deals fell as equity market valuations devalued the acquiring companies' "currency."

Since the bottom of the cycle in 2002, total announced M&A activity in the U.S. has increased each consecutive year, growing from $470 billion in 2002 to $1.58 trillion in 2007, which was inline with 1998-00 average annual levels. The 200%+ increase in M&A volumes over 2002-07 was driven by both strength in strategic deals and even stronger growth in financial sponsor-related deals. Specifically, strategic M&A deals grew from $384 billion in 2002 to $1.05 trillion in 2006, a 185% increase, while financial sponsor-related M&A announced activity rose from $86 billion in 2002 to $525 billion in 2007, a 510% increase (see **Exhibit 6**).

As a result, financial sponsor activity, which accounted for just 7% of total domestic volumes during the last peak in the cycle (over 1998-00), made up 33% of total domestic volumes in 2006 and 2007 (see **Exhibit 7**).

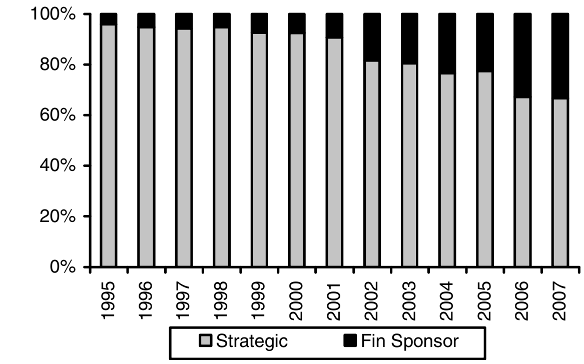
Brad Hintz • brad.hintz@bernstein.com • +1-212-756-4590

Exhibit 6
Domestic Strategic & Financial Sponsor Activity



Sources: Dealogic, Bernstein Analysis

Exhibit 7
Domestic Financial Sponsor Activity has Increased



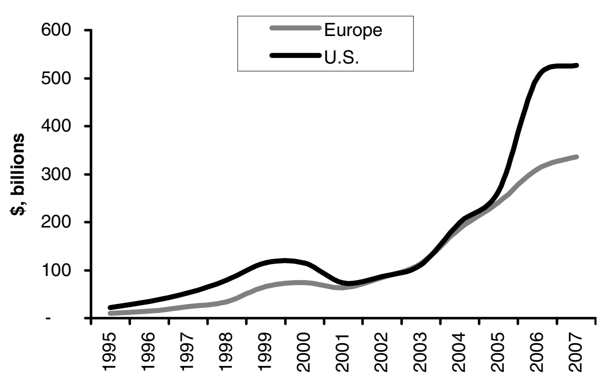
Sources: Dealogic, Bernstein Analysis

Financial Sponsor Activity

Unique to this M&A cycle has been the level of which financial sponsor activity has been driving announced M&A volumes. From 2001 to 2005, financial sponsor M&A activity accounted for $692 billion worth of deals in Europe, and $735 billion worth of deals in the U.S. Specifically, for both of these regions, financially sponsored deals accounted for approximately 20% of total announced M&A volumes during 2001-05.

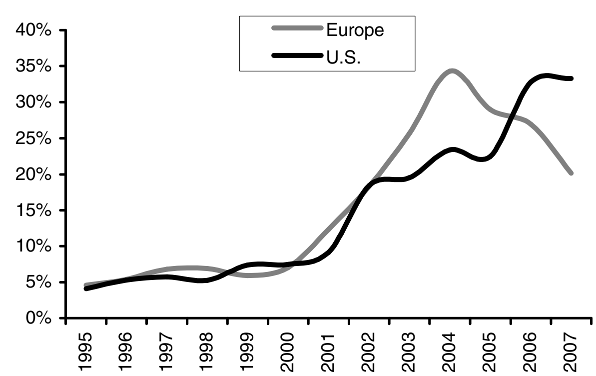
More recently (over 2006-07), financial sponsor activity in the U.S. increased significantly, while volumes from these types of deals plateaued in Europe. During these 2 years, financial sponsor announced M&A volumes totaled $1.03 trillion in the U.S. compared to just $650 billion in Europe (see **Exhibit 8**). As a % of total volumes, financial-sponsor deals were just 20% of total European volumes (in line with financial sponsor 2001-05 contribution to total European M&A volumes), while they were 33% of total volumes in the U.S.

Exhibit 8
Financial-Sponsor M&A Activity



Sources: Dealogic, Bernstein Analysis

Exhibit 9
Financial Sponsor Activity as a % of Total M&A



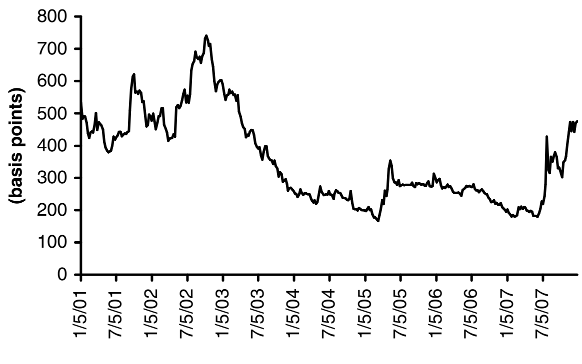
Sources: Dealogic, Bernstein Analysis

The growth in financial sponsor activity over 2001-06 was driven by a confluence of factors. The Leverage Buyout (LBO) boom was driven by, 1) four consecutive years of 20%+ returns over 2003-06 which resulted in record levels of fundraising (see **Exhibit 12** and **Exhibit 13**), 2) cheap financing (high yield credit spreads narrowed to near-all time lows- see **Exhibit 10**), 3) low equity market price-to-cash flow multiples

Brad Hintz • brad.hintz@bernstein.com • +1-212-756-4590

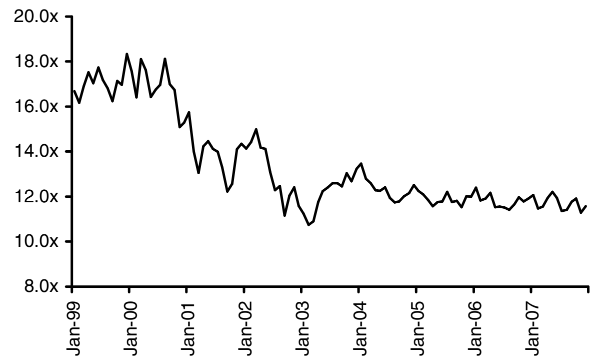
(see **Exhibit 11**), and 4) competition among investment banks that led to guaranteed acquisition financing commitments.

Exhibit 10
High-Yield Corporate Credit Spreads (Ba-Rated)



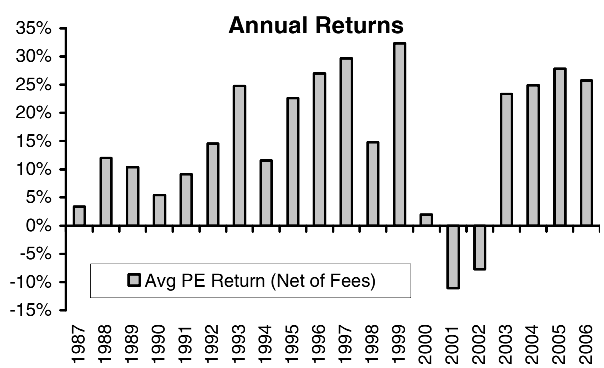
Sources: Lehman Fixed Income Research, Bernstein Analysis

Exhibit 11
U.S. Cap-Weighted Price-to-Cash Flow Multiples



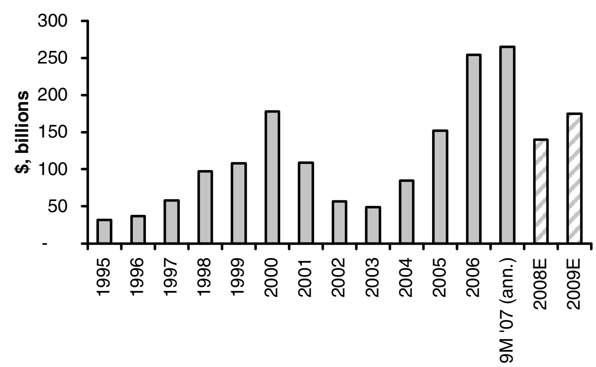
Sources: Bernstein Strategy Group, Bernstein Analysis

Exhibit 12
Annual Returns of Private Equity



Sources: Cambridge Associates, Bernstein Analysis

Exhibit 13
Private Equity Fundraising



Sources: Dow Jones Private Equity Analyst, Bernstein Analysis

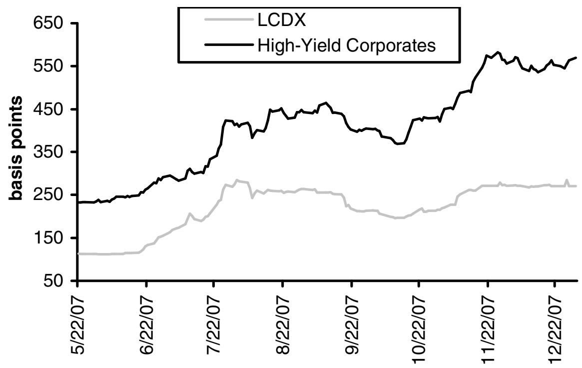
More Expensive Financing Going Forward

The recent credit re-pricing event has resulted in more expensive financing for financial sponsor firms. Credit spreads gapped out across all fixed income asset classes, but the largest increases occurred in the more risky areas of the fixed income market. As a result, credit spreads for high-yield corporates increased by 336 basis points from May through the year end while credit spreads in the LCDX (a leverage loan-based credit default swap index) increased 158 basis points over the same period (see **Exhibit 14**).

The increase in the cost of financing, coupled with the less favorable financing terms and covenants now attached to the deals will discourage the boom level of financial sponsor activity the market enjoyed over the past 5 years.

Brad Hintz • brad.hintz@bernstein.com • +1-212-756-4590

Exhibit 14
Credit Spreads since the start of the Credit Repricing Event



Sources: Corporate Reports, Bernstein Analysis

Financial Sponsor Activity Forecasts

Forecasting Financial Sponsor Activity is more difficult than predicting strategic M&A volumes. Based on our statistical analysis, we have found that financial sponsor activity is a function of private equity fund raising levels and the cash flow yield of the equity market less the nominal interest rates paid on high-yield debt.

The cash flow yield of the overall equity market provides a measure of how attractive, on aggregate, equity valuations are to a private equity firm. Because a PE firm often employs leverage when making an acquisition to enhance its ROE, a target firm with a high cash flow yield is an ideal investment. The high cash flow yield will help the acquiring private equity firm pay off the funds it borrowed (either in the form of high-yielding debt or leveraged financing) to make the acquisition.

Our forecast for 2008 and 2009 Financial Sponsor volumes hinges on our forecasts for the underlying input factors, most important of which is the expected level of PE fundraising in 2008-09. PE Fundraising levels have shown a cyclical tendency over time (see **Exhibit 13**). Annualizing 9M '07 fundraising data, we estimate full-year 2007 private equity capital raised to be $265 billion, which would beat the 2006 record of $250 billion. But we expect private equity fundraising efforts will decline in both 2008 and 2009 to $140 billion and $175 billion, respectively.

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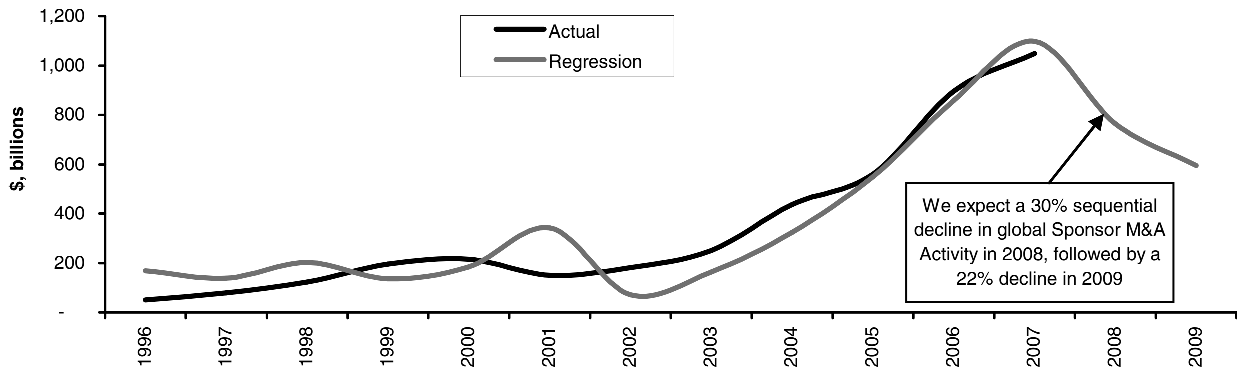
Exhibit 15
Global Financial Sponsor Activity – Actual vs. Regressed



Sources: Dealogic, Bernstein Analysis

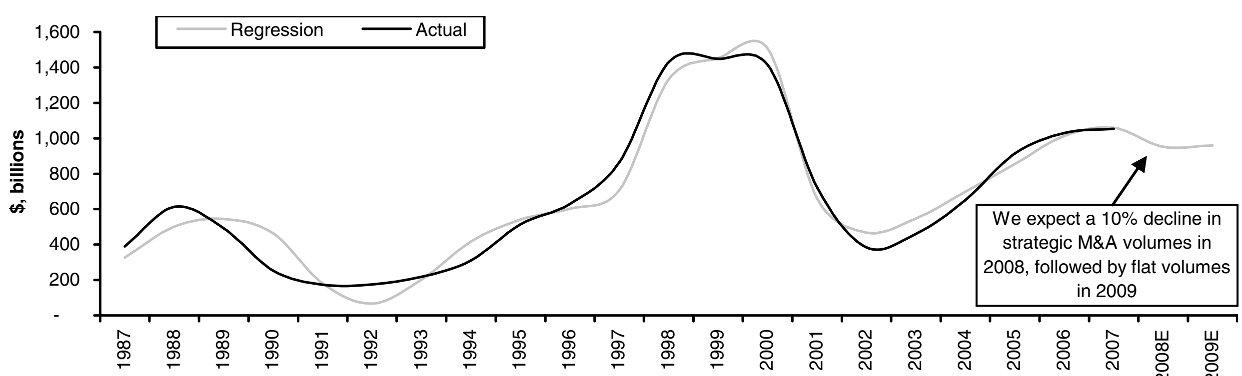
Based our the expectations of the input factors for our regression formula for financial-sponsor announced M&A volumes, we expect newly announced financial sponsor-related M&A activity will decline 30% in 2008 from 2007 levels and then fall an incremental 22% in 2009. Our forecast implies that newly announced financial sponsor-related volumes in 2009 on a global basis will be inline with 2005 levels (see **Exhibit 15**).

Domestic Strategic M&A Volumes

Historically, merger and acquisition activity has been correlated with rising corporate earnings, declining unemployment and benign equity and debt capital markets conditions. These factors indirectly measure corporate confidence in future business performance, and they also gauge the willingness of corporate executives to pursue strategic M&A transactions in the pursuit of growth.

We have developed a regression equation that explains more than 90% of the annual variation in domestic strategic M&A volume. The variables included in the U.S. regression model are corporate earnings of the S&P 500, domestic unemployment and a dummy variable related to the TMT Bubble period. The regression results in an R-squared of 94% and incorporates annual data from 1987-07.

Exhibit 16
Forecasted Domestic Strategic M&A Activity



Sources: Corporate Reports, Bernstein Analysis

Based on our M&A forecasting regression analysis, Bernstein's forecast of corporate S&P 500 earnings and Global Insight's expectations for domestic unemployment levels over the next 2 years, we believe that 2008

Brad Hintz • brad.hintz@bernstein.com • +1-212-756-4590

domestic strategic activity will decline 10% from 2007 annual levels. For 2009, our regression formula implies that domestic strategic M&A volumes will increase 1% from 2008 activity levels.

However, our regression analysis does not incorporate two major secular trends that we believe could drive incremental strategic volume growth in the U.S. to our forecasts:

– First, we expect the continuing decline of the US$ will make U.S. corporate targets more attractive to foreign acquirers. With the US$ having fallen 7% vs. the Euro in 2007, we can expect incremental cross currency acquisition volume growth above what our simple regression forecasts imply.

– Secondly, we believe there will be a positive substitution effect related to the 30% forecasted decline in financial sponsor deal activity next year. With financial sponsor M&A activity subsiding from recent record volume levels, this should result in less pricing competition for corporate strategic buyers and thus result in increased deal volume.

Exhibit 17
Euro/US$ Exchanges Rates

Sources: Bloomberg, Bernstein Analysis

U.S. Strategic M&A Volume Forecast: Sensitivity to a Recessionary Environment

Given that the main drivers of our M&A forecast are corporate earnings and unemployment, a domestic recession in the U.S. (in which unemployment rises and corporate earnings decline) would have a severe impact on the output of our regression formula. Given investor concern that the U.S. is entering a recession, we've examined the sensitivity of our U.S. strategic M&A activity forecasts to a recession scenario in 2008.

Assuming unemployment rises to 6.0% in the U.S. in 2008 (up from 4.7% currently) and corporate earnings fall short of current expectations by 15%, we would expect domestic strategic volumes to be about 30% below our current expectations. This would imply a 31% decline in volumes in 2008 from full-year 2007 levels (see **Exhibit 18**).

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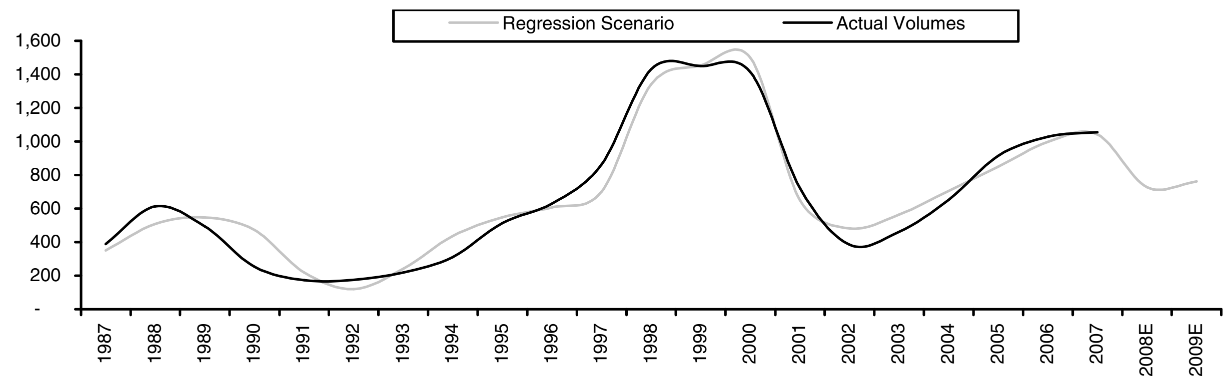
Exhibit 18

Recession Scenario: Implies a 31% Decline of Domestic Strategic M&A Volumes in 2008



Sources: Dealogic, Global Insight, Bernstein Analysis

Domestic M&A Activity as a % of Market Capitalization

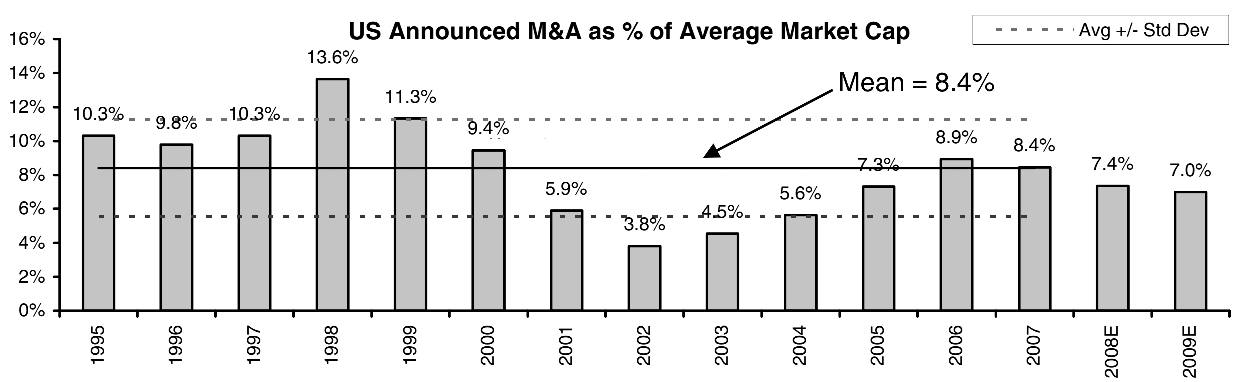
One of the more common metrics used by Wall Street to examine M&A activity over time is to look at announced M&A volumes as a percent of the region's market capitalization. Looking at the data for the US market, 2006 marked the 4th consecutive year of increasing M&A volumes as a % of market capitalization. 2007 announced M&A volumes represented 8.4% of the total domestic market cap, down from 2006 levels, but inline with the long-term 1984-06 average (see **Exhibit 19**).

In the prior cycle, domestic M&A as a percent of U.S. equity market capitalization peaked at 13.6% in 1998 before declining to 9.4% in 2000 and then troughing at 3.8% in 2002.

Incorporating our expectations for strategic and financial sponsor M&A activity in 2008-09, we expect total M&A activity as a % of domestic equity market capitalization to decline to 7.4% in 2008 and 7.0% in 2009.

Exhibit 19

The Domestic M&A Cycle



Sources: Dealogic, Strategy Group, Bernstein Analysis

European M&A Trends

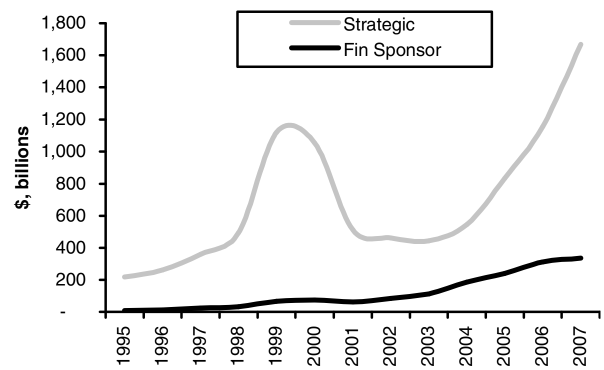
The trough of the current M&A cycle in Europe occurred in 2002 when announced M&A volumes were $547 billion. Since 2002, volumes have increased each consecutive year, growing to $2.00 trillion last year, 75% higher than 1999-00 volumes. The 265% increase in European M&A volumes over 2002-07 was driven by both higher strategic and financial sponsor-related deals. Strategic European M&A deals have

Brad Hintz • brad.hintz@bernstein.com • +1-212-756-4590

grown from $462 billion in 2002 to $1.67 trillion in 2006, a 260% increase. At the same time, financial sponsor-related M&A activity in Europe has risen from $85 billion in 2002 to $336 billion in 2006, a 300% increase (see **Exhibit 20**).

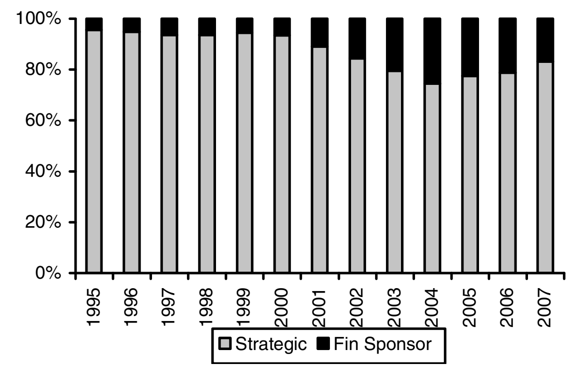
While there has been a significant increase in financial-sponsored activity in Europe, as discussed above, these types of deals accounted for just 20% of total European volumes during 2007. This compares to 33% in the U.S.

Exhibit 20
European Strategic & Financial Sponsor Activity



Sources: Dealogic, Bernstein Analysis

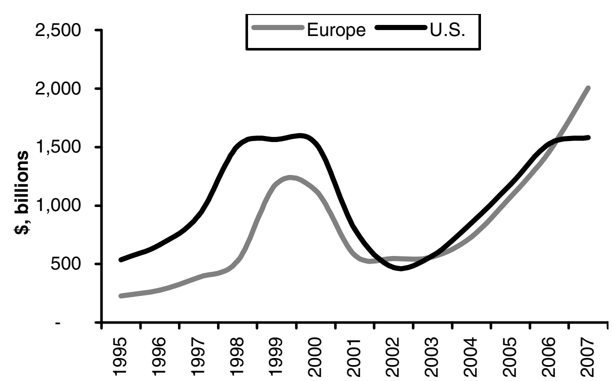
Exhibit 21
European Financial Sponsor Activity



Sources: Dealogic, Bernstein Analysis

Exhibit 22 shows the nominal values of announced M&A deals for the U.S. and Europe. European deals lagged the volume of deals announced in the U.S. over 1995-00, but over 2001-06, volumes in Europe and the U.S have grown at nearly the same pace.

Exhibit 22
Total Announced M&A Activity



Sources: Dealogic, Bernstein Analysis

European M&A Strategic Volumes

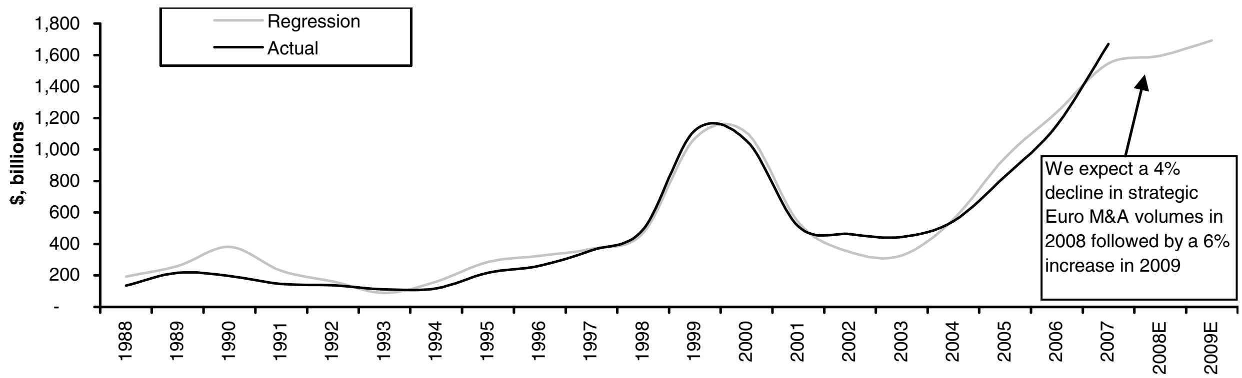
As with Strategic M&A volumes in the U.S. market, when corporate earnings in Europe increase as the economy expands, equity valuations tend to improve and volumes of strategic M&A transactions in the marketplace increase.

Brad Hintz • brad.hintz@bernstein.com • +1-212-756-4590

We developed a regression equation that explains 96% of the annual variation in Pan-European strategic M&A volumes. The variables we used in the regression model are corporate earnings (as defined by the earnings of the MSCI Europe Index[1]) and a dummy variable related to the TMT Bubble Period.

Based on our regression analysis and our Bernstein's forecast of European corporate earnings growth, we expect strategic European M&A volumes to decline 5% in 2008 before showing a 6% increase in 2009 (see **Exhibit 23**).

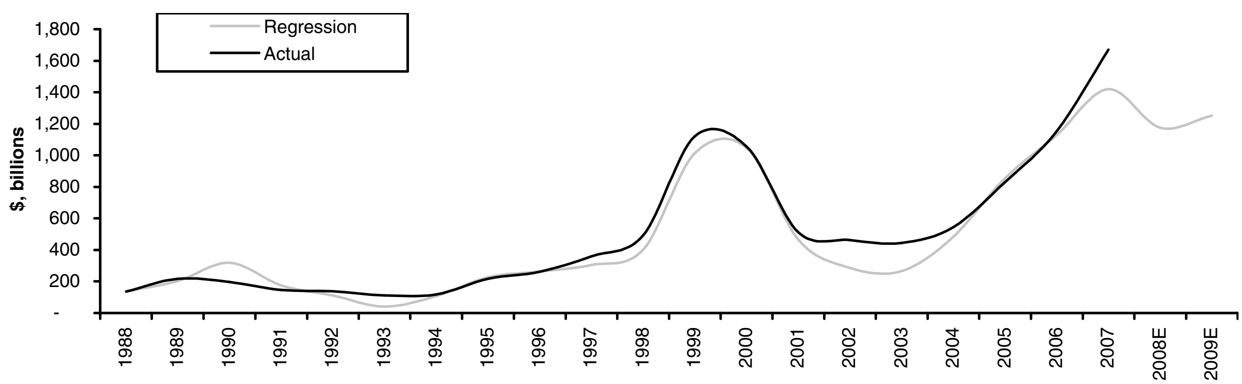
Exhibit 23
Forecasted European Strategic M&A Activity



Sources: Dealogic, Global Insight, Bernstein Analysis

While Europe currently appears more immune to a recession than the U.S., some investors are concerned that a domestic downturn driven by weakness in the housing market could have a contagion effect in Europe. Based on our recession scenario of a 15% decline in corporate earnings in 2008 and flat earnings in 2009, we forecast that a recession in Europe will lead to a 30% decline in strategic M&A volumes in 2008 followed by flat volumes in 2009 (see **Exhibit 24**).

Exhibit 24
Recession Scenario: Implies a 29% Decline of European Strategic M&A Volumes in 2008



Sources: Dealogic, Global Insight, Bernstein Analysis

[1] Note- we use European earnings denominated in US$ as our M&A volumes are similarly denominated in US$

Brad Hintz • brad.hintz@bernstein.com • +1-212-756-4590

The European M&A Cycle

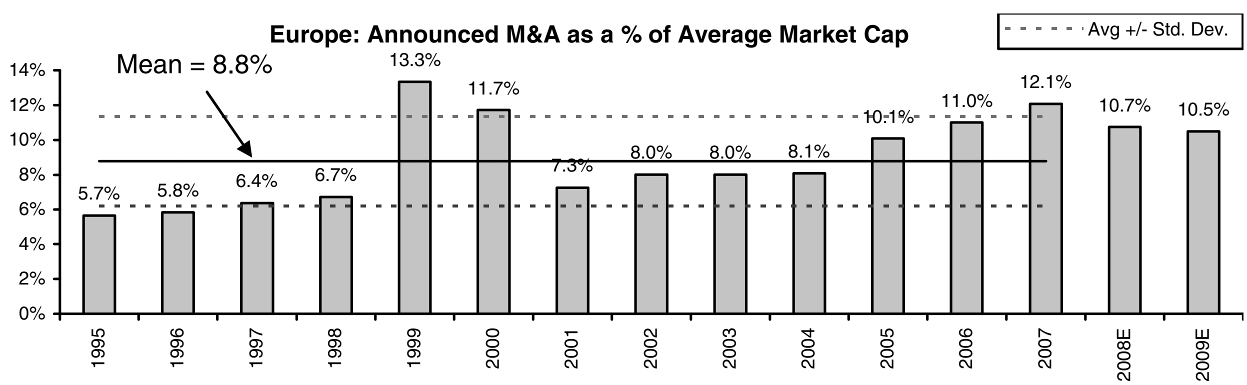
European M&A announced volumes have averaged 8.8% of European market capitalization since 1995, slightly above the U.S. mean of 8.4%. But European M&A activity has been significantly more robust than domestic activity since the formation of the Euro in 1999. The establishment of the Euro currency and the European Central Bank in 1998 helped to create a common framework across Europe which encouraged cross-border consolidation. So, while US M&A Activity (as a % of market capitalization) was more robust than Europe over 1995-98, European M&A activity has been more robust since 1999.

In terms of its M&A cycle, Europe experienced its sixth consecutive year of increasing M&A as a % of market capitalization in 2007 (see **Exhibit 25**). 2007 M&A activity in Europe was 12.1% of market capitalization, more than one standard deviation above its 1995-07 mean.

For European M&A, it is a bit more difficult to speak of cycles given the large structural change that occurred in the late 1990's – most importantly, the establishment of the European Central Bank and introduction of the Euro. This secular change resulted in the accelerated consolidation of many European corporations as cross-border operations were no longer hindered by different currencies, rules and regulations. We expect this secular trend towards cross-border consolidation will continue in Europe.

While we expect this year to represent a cyclical peak in terms of M&A volume we expect that volumes will outpace those of the U.S. for the next several years. Based on our forecast for financial sponsor activity and for corporate strategic M&A volumes, we expect announced M&A levels to be equivalent to about 10.5-10.7% of total European market capitalization in both 2008 and 2009.

Exhibit 25
The European M&A Cycle



Sources: Dealogic, Strategy Group, Bernstein Analysis

The Bottom Line on M&A

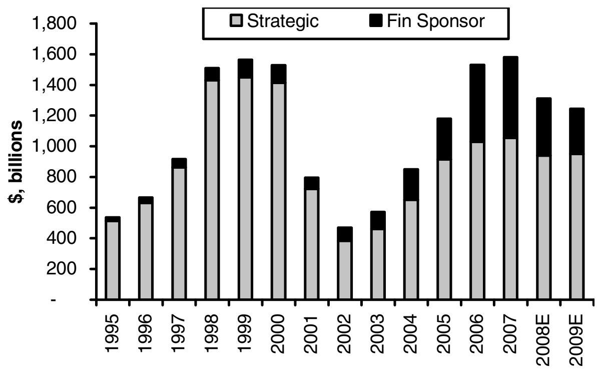
Combining our strategic and financial sponsor M&A activity forecasts for the U.S. and Europe gives us our 2008-09 forecasts for M&A volumes (see **Exhibit 26** and **Exhibit 27**).

We forecast total domestic announced M&A volumes will decline 17% in 2008 from 2007 levels as financial sponsor volumes decline 32% and corporate strategic M&A drops 10%. In 2009, we expect a more modest 4% drop in M&A volumes as we expect a 17% annual decline in financial sponsor activity will be mitigated by a 1% increase in strategic M&A.

For European M&A activity, we expect total volumes to fall 9% in 2008, driven by a 28% decline in financial sponsor M&A activity and a 4% decline in strategic M&A. In 2009 we expect European volumes to grow by 3%, as 6% strategic volume growth offsets a 17% decline in newly announced financial sponsor activity.

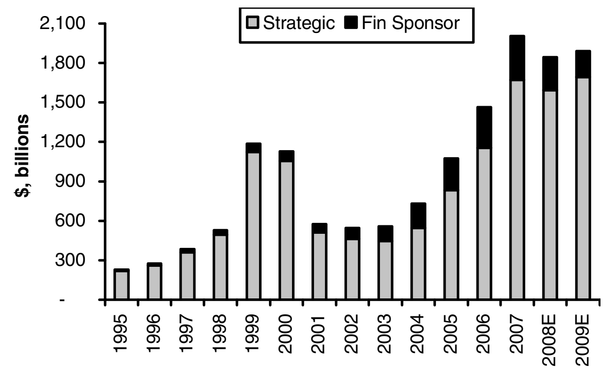
Brad Hintz • brad.hintz@bernstein.com • +1-212-756-4590

Exhibit 26
Domestic M&A Activity Expectations



Sources: Dealogic, Bernstein Analysis

Exhibit 27
European M&A Activity Expectations



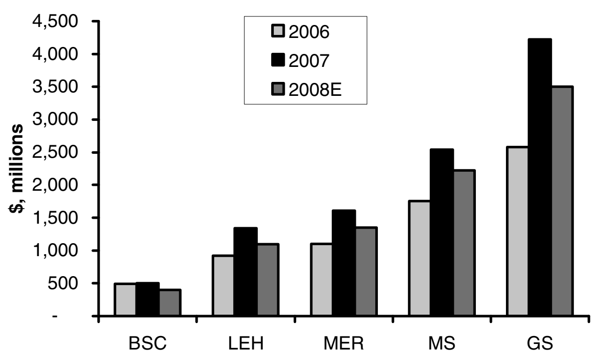
Sources: Dealogic, Bernstein Analysis

Our Coverage – Exposure to M&A

Among the large U.S. security firms, Goldman generates the highest level of M&A revenues while Morgan Stanley generates the second highest as both firms are perennial 'Top Three' global M&A advisors. Bear Stearns reported the weakest M&A advisory revenues both in 2006 and 9M '07 (see **Exhibit 28**).

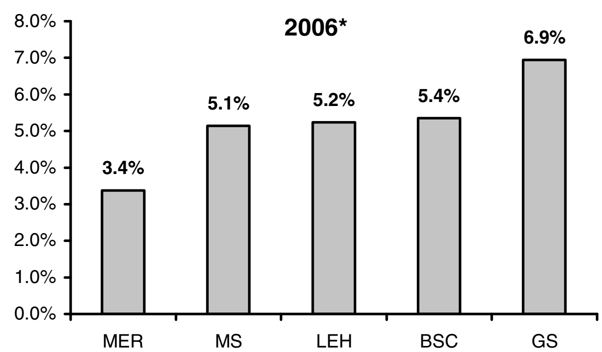
M&A revenues accounted for 6.9% of Goldman Sachs' total net revenues in 2006. MS, LEH and BSC each generated about 5.0-5.5% of their 2006 net revenues from advisory fees. Merrill Lynch is the least exposed to M&A as just 3.4% of its 2006 net revenues came from M&A activities.

Exhibit 28
Company Specific M&A Advisory Revenues



Sources: Corporate Reports, Bernstein Estimates

Exhibit 29
M&A Advisory Revenues as a % of Total Net Revenues



Sources: Corporate Reports, Bernstein Analysis

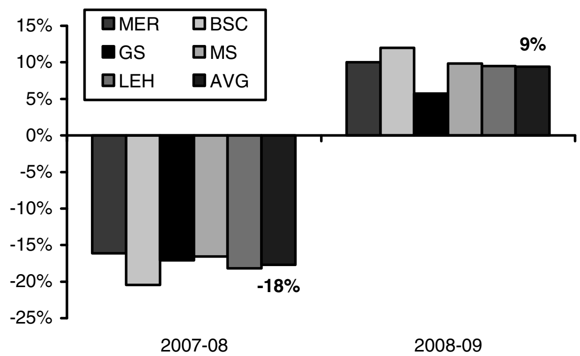
* Note – We examine M&A as a % of 2006 Results because of the large 2007 write-downs at many of the firms.

For 2008 we expect, on average, annual M&A revenues to decline by 18% for the five large capitalization security firms. We expect annual M&A revenues to grow by 10%, on average, for the group in 2009.

Brad Hintz • brad.hintz@bernstein.com • +1-212-756-4590

Exhibit 30

Annual M&A Advisory Revenue Growth, by Firm

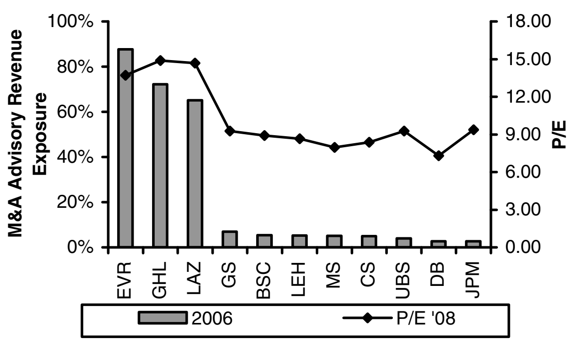


Sources: Corporate Reports, Bernstein Analysis

Exhibit 31 shows the exposure to M&A advisory revenues versus their forward P/E multiples (using 2008 EPS) of broad range of M&A players, including pure play advisors and large universal banks. Given the higher multiples at the pure play M&A firms (Evercore Partners, Greenhill & Co. and Lazard) versus the diversified players, it is clear that that the market assigns a high price-to-earnings valuation to this business.

Exhibit 31

M&A Advisory Revenue Exposure vs. 2008 P/E Multiples



Source: Corporate Reports, Bernstein Estimates

Valuation Methodology

We have found that the major brokerage firms' common stocks trade on a price-to-tangible book basis. Bernstein believes that the tangible book value of a securities firm is a "hard number" for these companies reflecting the industry's mark-to-market accounting discipline and the rapid turnover of brokerage firm balance-sheets. By comparison, forecasting the highly cyclical earnings is problematic and therefore price-to-earnings valuation ratios are not accurate or stable.

We derive our price targets based upon a valuation model that takes into account Return on Equity (ROE) versus K_e (the CAPM-based cost of equity), credit rating and a variable that differentiates between the 1999-2000 internet bubble period and all other periods of history. The formula is:

- **Target Price-to-Tangible Book Value = 5.33 + 0.77 * (Conditional Tangible ROE/Ke) – 0.62 * Credit Ratings + 0.90 * Internet Dummy Variable**

Brad Hintz • brad.hintz@bernstein.com • +1-212-756-4590

Regarding our valuation methodology, we should emphasize that our industry price-to-book valuation regression only explains 73% of the quarterly change in the price-to-book of a securities firm.

Exhibit 32
Bernstein's Securities Industry Valuation Model

	Current Tangible Book Value	Next 4 Qtrs Tang ROE	Beta	Ratings	Ke	Tangible ROE/Ke	10 Yr. Treasury	Internet Dummy Variable	Price-to-Tang Book Target	Price-to-Tang Book Current	Forecasted Tangible Book Value	Published Target Price	1/2/08 Current Price
BSC	$ 86.84	12.1%	2.00	7.00	12.8%	0.95	4.00%	0	1.43	0.98	$87.39	$125.00	$85.30
GS	78.88	26.3%	1.85	6.00	12.1%	2.17	4.00%	0	2.74	2.63	85.84	$235.00	$207.60
MER	33.88	18.3%	2.00	7.00	12.8%	1.43	4.00%	0	1.97	1.56	35.58	$70.00	$52.76
MS	25.29	23.6%	1.85	6.50	12.1%	1.94	4.00%	0	2.30	2.01	29.61	$68.00	$50.95
LEH	32.51	22.7%	1.85	7.00	12.1%	1.87	4.00%	0	2.13	1.91	36.62	$78.00	$62.19

Sources: Corporate Reports, Bloomberg, Bernstein Analysis

Risks

The biggest risk to our 12-month share price targets for the brokers is related to the US macro-economic cycle. Our forecast is based on the assumption that the US economy will continue to grow – albeit at a rate that is slower than that achieved in 2005-2006.

If the fixed income credit repricing we are currently experiencing worsens into a long-term credit crunch and leads to an US economic slowdown, the brokers will find high margin businesses such as M&A and IPO underwriting sharply declining. As unemployment rises retail brokerage activity will slow and new investment flows into asset management businesses and retail brokerage accounts typically shrinks. By contrast a sharp economic decline tends to enhance fixed income performance – but unfortunately fixed income is not a high ROE business given its capital intensity. In general an economic decline will lead to a decline of brokerage ROEs and the markets would probably penalize the firms by valuing the industry at a lower price-to-book value than our target prices implies.

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    Market-Perform: Stock will perform in line with the market index to within +/-15 pp in the year ahead.

    Underperform: Stock will trail the performance of the market index by more than 15 pp in the year ahead.
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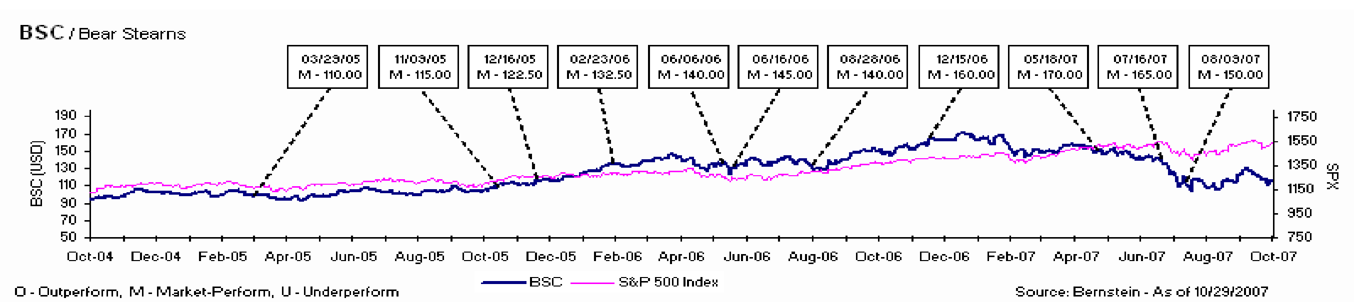
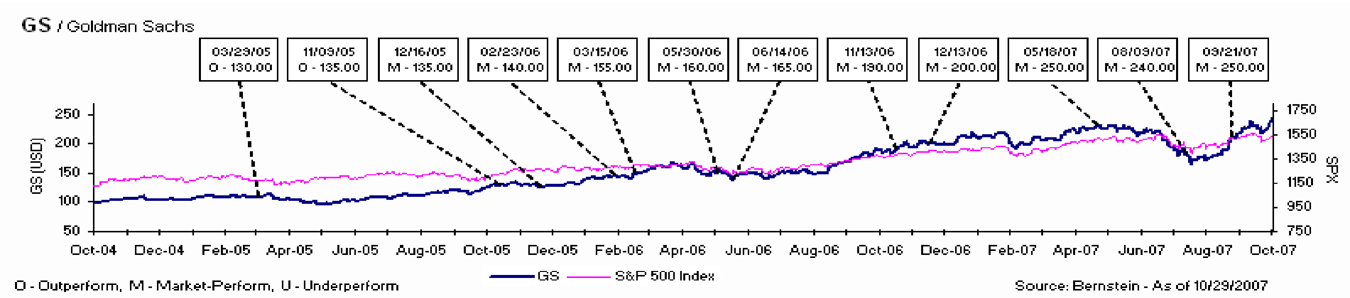
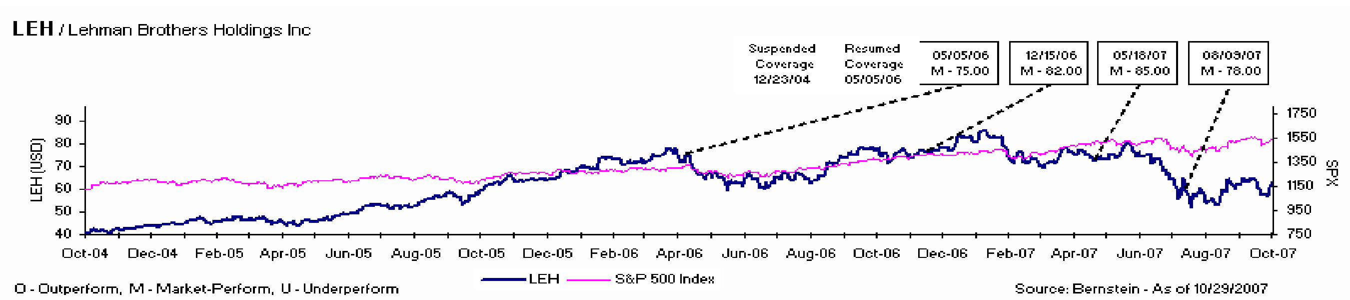
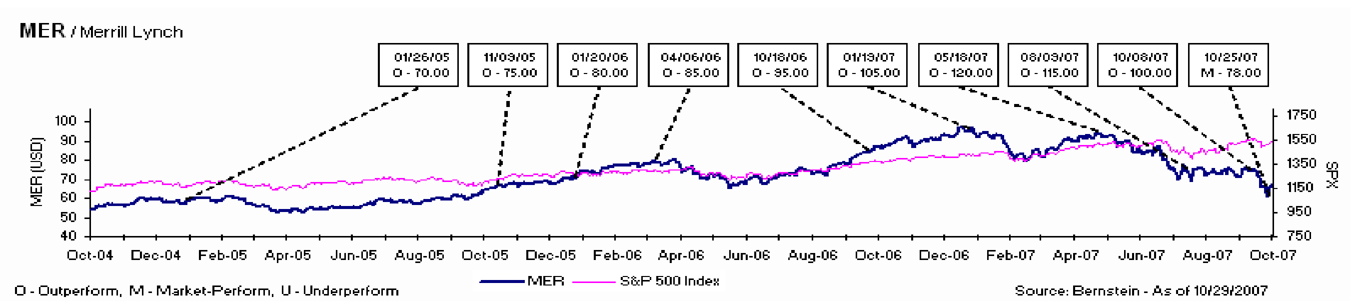
12-Month Rating History as of 01/02/2008

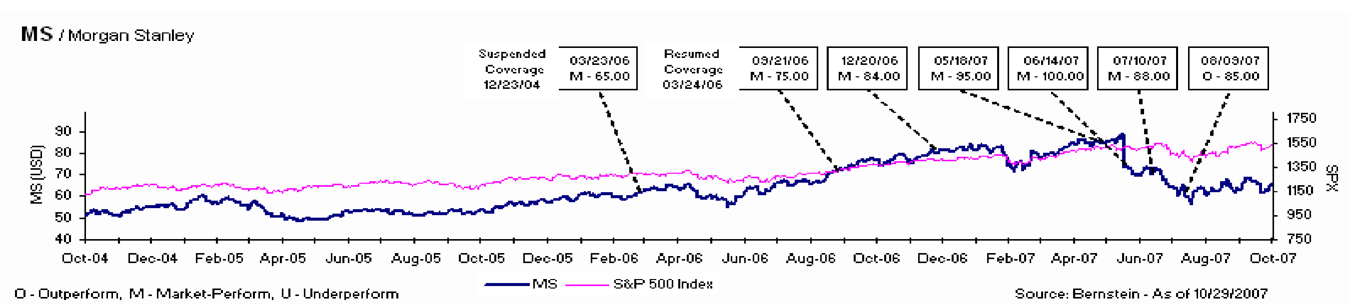
Ticker	Initiated Coverage	Rating
BSC	M - 09/11/01	
GS	O - 09/11/01	M - 12/16/05
LEH	M - 05/05/06	
MER	U - 09/11/01	M - 10/25/07
MS	M - 03/24/06	O - 08/09/07











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