

Deal or No Deal? Merrill Buy May Not Fly

By ANDREW BARY

Market's discount on B of A's acquisition of giant broker shows doubts about its consummation.

BANK OF AMERICA'S BLOCKBUSTER deal to buy Merrill Lynch, hailed by some as a strategic masterstroke, isn't looking like a sure thing, judging by the trading in the two companies' stocks today.

[Bank of America](#) (ticker: BAC) shares are down 7 to 26.74 in late trading while [Merrill Lynch](#) (MER) shares are up 1.83 to 18.88 after touching as high as 22.68 earlier today. Merrill now trades about four points below the current value of the Bank of America takeover offer, which is nearly \$23. Bank of America is offering 0.86 of its shares for each Merrill share.

One risk arbitrager said that no merger document has been issued yet and that Wall Street is expecting that eventual document will probably leave wiggle room for Bank of America to get out of the deal. The thinking is that Merrill didn't have a lot of negotiating power in the weekend talks. A weak merger document usually results in a wide arbitrage spread.

Investors in Merrill stand to earn a roughly 20% return, assuming the deal gets done. With the transaction expected to close in about six months, the annualized spread is 40%, versus a sub-10% return on a merger deal viewed as safe. There's concern that if the deal breaks, Merrill shares will drop, while Bank of America will rally, stinging anyone who is looking to buy Merrill now and to short Bank of America to lock in the arbitrage spread.

Bank of America, as Barron's Online noted earlier, is not a financial Fort Knox with a tangible common equity-to-assets ratio of 3%, half that of rival [Wells Fargo](#) (WFC). Bank of America might look to raise additional equity capital. It's also possible that Bank of America could see some resistance from its shareholders to the deal given the negative stock-market reaction today.

One positive note is that Bank of America's deal to buy Countrywide Financial last year generated similar fears that the transaction could fail but Bank of America, to the surprise of many on Wall Street, went ahead with the deal. Merrill is a far bigger and better prize, which probably increases Bank of America's willingness to get the deal done.

Buyers of Merrill at its current price can take some comfort that the company's market value is \$30 billion, roughly equal to value of Merrill's stake in Blackrock Financial of \$11 billion and a conservative estimate of \$20 billion on the firm's retail brokerage network. Sanford Bernstein brokerage analyst Brad Hintz valued the Merrill retail network at \$26.7 billion and came up with a sum-of-the-parts value of \$34.95 a share for Merrill stock, according to a note published today.

This suggests a margin of safety for Merrill holders now, but investors have learned to their chagrin lately that seemingly cheap financial stocks can get a lot cheaper in this market.