Countrywide Financial Corporation

Attractive Upside, but not without risk

Earnings Review **BUY**

Equity | United States | Mortgage Finance
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Merrill Lynch

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Near-term likely volatile; Heightened liquidity concerns

CFC shares likely to remain volatile and range bound for immediate future, as the market works through a period of heightened liquidity concerns in addition to the more fundamental challenges of rising credit-losses and a soft housing market. CFC shares already discount a fairly pessimistic view, in our opinion, so investors with longer-term investment horizons and generous risk-appetites could achieve an attractive total return for accepting higher levels of uncertainty and headline risks. We cannot rule out further downside in CFC shares, though we think the stock could witness robust appreciation, as investors sense some of the near-term pressure is abating. We maintain our 2008 and 2009 EPS estimates of $3.60 and $4.40 respectively. Our $36 target suggests 35% upside in 12-months.

Changing volatility risk rating to High from Medium

We are adjusting our volatility risk rating to High (C) from Medium (B), given poor visibility into near-term earnings trends, uncertainty surrounding the global financial markets and potential for liquidity issues to weigh further on CFC shares. We continue to think CFC shares have more upside opportunity than downside risk, however, the fluid situation in the capital markets increases investors exposure to heightened volatility for the foreseeable future.

Maintain 2008 & 2009 EPS estimates; H2'07 at risk

Near-term earnings likely to be influenced by poor depth of mortgage capital markets and liquidity-induced fears, suggesting unusually poor visibility in H2'07 EPS trends. We are maintaining a constructive view on the shares, because we think the market has largely discounted the near-term results plus additional uncertainty relating largely to liquidity.

Estimates (Dec)

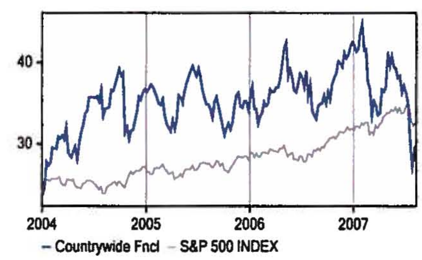
(US$)	2005A	2006A	2007E	2008E	2009E
EPS	4.11	4.30	2.95	3.60	4.40
GAAP EPS	4.11	4.30	2.95	3.60	4.40
EPS Change (YoY)	13.2%	4.6%	-31.4%	22.0%	22.2%
Consensus EPS (First Call: 10-aug-2007)			3.00	3.61	4.93
Dividend Rate	0.58	0.60	0.67	0.74	0.81

Valuation (Dec)

	2005A	2006A	2007E	2008E	2009E
P/E	6.5x	6.2x	9.0x	7.4x	6.0x
GAAP P/E	6.5x	6.2x	9.0x	7.4x	6.0x
Dividend Yield	2.2%	2.3%	2.5%	2.8%	3.0%

Stock Data

Price	US$26.61
Price Objective	US$36.00
Date Established	26-Jul-2007
Investment Opinion	B-1-7 to C-1-7
Volatility Risk	HIGH
52-Week Range	US$23.64-45.26
Mrkt Val / Shares Out (mn)	US$15,732 / 591.2
ML Symbol / Exchange	CFC / NYS
Bloomberg / Reuters	CFC US / CFC.N
ROE (2007E)	12.0%
Total Dbt to Cap (Jun-2007A)	92.8%
Est. 5-Yr EPS / DPS Growth	12.0% / 10.0%



Quarterly Earnings Estimates

	2006	2007
Q1	1.10A	0.72A
Q2	1.15A	0.81A
Q3	1.03A	0.70E
Q4	1.01A	0.71E

Refer to important disclosures on page 13 to 14. Analyst Certification on page 12. Price Objective Basis/Risk on page 11.

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Income Statement Data (Dec)

(US$ Millions)	2005A	2006A	2007E	2008E	2009E
Net Interest Income	2,324	2,922	2,977	3,093	3,496
% change	14.9%	25.8%	1.9%	3.9%	13.0%
Net Fee Income	4,781	5,535	6,739	7,819	8,548
Securities Gains / (Losses)	NA	NA	NA	NA	NA
Total Operating Income	12,397	14,697	14,382	16,567	18,095
Operating Expenses	(8,134)	(10,129)	(10,690)	(12,341)	(13,609)
% change	7.6%	24.5%	5.5%	15.4%	10.3%
Provisions Expense	(116)	(234)	(980)	(778)	(251)
% change	1,470.7%	102.1%	318.9%	-20.6%	-67.7%
Operating Pre-Tax Income	4,148	4,334	2,713	3,449	4,235
Operating Net Income to Comm S/Hold.	2,528	2,675	1,761	2,156	2,647
GAAP Net Income	2,528	2,675	1,761	2,156	2,647

Company Description

Countrywide Financial Corp.'s (CFC) primary business is mortgage banking, including the origination and purchase of residential mortgages via a multi-channel distribution network. Revenues are driven by mortgage origination and servicing, interest income on its portfolio, and fees from ancillary business.

Stock Data

Average Daily Volume	21,300,870
Brokers Covered (FirstCall)	0

Balance Sheet Data (Dec)

(US$ Millions)	2005A	2006A	2007E	2008E	2009E
Total Assets	175,085	199,946	220,078	246,354	271,501
Average Interest Earning Assets	NA	NA	NA	NA	NA
Total Gross Customer Loans	36,819	31,273	34,090	34,090	34,090
% change	-1.4%	-15.1%	9.0%	0%	0%
Total Customer Deposits	39,489	55,579	71,695	87,004	101,993
% change	97.3%	40.7%	29.0%	21.4%	17.2%
Tangible Equity	NA	NA	NA	NA	NA
Common Shareholders' Equity	12,816	14,318	15,132	17,053	19,421

Key Metrics (Dec)

(US$ Millions)	2005A	2006A	2007E	2008E	2009E
Net Interest Margin	NA	NA	NA	NA	NA
Effective Tax Rate	39.0%	38.3%	35.1%	37.5%	37.5%
Loan / Deposit Ratio	93.2%	56.3%	47.5%	39.2%	33.4%
Tangible Common Equity / Assets	0%	0%	0%	0%	0%
ROA	1.7%	1.4%	0.8%	0.9%	1.0%
ROE	21.9%	19.7%	12.0%	13.4%	14.5%
RoTE	NA	NA	NA	NA	NA
Dividend Payout Ratio	7.1%	6.2%	6.6%	6.4%	5.9%
Efficiency Ratio (Cost / Income Ratio)	65.6%	68.9%	74.3%	74.5%	75.2%

Quality of Earnings (Dec)

(US$ Millions)	2005A	2006A	2007E	2008E	2009E
Total Non-Interest Inc / Operating Inc	81.3%	80.1%	79.3%	81.3%	80.7%
NPLs plus Foreclosed Real Estate / Loans	0%	0%	0%	0%	0%
Loan Loss Reserves / NPLs	0%	0%	0%	0%	0%
Loan Loss Reserves / Total Loans	0%	0%	0%	0%	0%

Why Buy? Attractive franchise in very tough market

We think there is an attractive upside opportunity in CFC for those investors willing to endure the heightened headline risk, liquidity risk, credit risk and cyclical pressure, all of which are weighing on the stock currently. In our opinion, CFC shares currently discount a healthy-dose of the uncertainty in the housing, mortgage and capital markets, so a shift in sentiment or any good news that enters the market, should have a corresponding positive impact on CFC. Based on our 2009 EPS estimate of $4.40 and a recovery multiple of 10x EPS, which assume the mortgage sector is noticeably improving and the housing market is stable, we think the shares could produce 26% annualized return. CFC should be capable of withstanding a period of moderate illiquidity, in our view, so we are analyzing CFC as a going-concern. If the mortgage market benefits from higher-than-anticipated volume or margins recover more quickly, there is upside to our estimates and target.

Volatility risk rating change to High from Medium

We do not know when the mortgage or capital markets will improve and it seems easier to assume it gets worse before it gets better, however, we are optimistic that the capital markets will begin to stabilize with the additional liquidity that is being pumped into the system by multiple Federal Reserve banks globally. Case in point, the U.S. Fed added $38B in liquidity targeted at mortgage securities last Friday, which we think could ease concerns in the market that banks will stop lending against high-quality mortgage securities, otherwise known as repurchase agreements (repos).

Still, risk remains quite high in the current environment, so we are adjusting our volatility risk rating on CFC shares to High (C) from Medium (B), to reflect the higher likely volatility that we think will persist for the foreseeable future. CFC will probably remain in a wide range of $27-$33 until visibility into the housing, mortgage and capital markets improves and we do not eliminate the possibility that CFC re-tests its historical valuation trough of 1.0x BV, or $25, as it went modestly below that level intra-day on 8/10/07, after the media focused on cautionary commentary in CFC's Q2'07 10-Q filing document. In addition, near-term challenges will probably continue to weigh on sentiment. If the liquidity issues get worse, CFC shares could go lower. We analyze a few scenarios in this report to frame the downside risk.

Liquidity the most pressing concern; Shift to GSE model

The mortgage market is witnessing a severe contraction in liquidity across most every asset class, including the high-quality AAA sector, increasing the financial pressure on mortgage companies, including CFC. Most of the issues appear to be affecting lower-rated bonds and loans, both sub-prime and Alt-A, with lenders stating that margin calls are eroding capital and the poor depth of the market is leading to low dollar prices on asset sales. Most participants have said that little is actually moving outside of the GSE space. Lenders are nervous, with lower advance rates and higher rates likely over the immediate future. There have been companies, mostly mortgage REITs that have been unable to meet margin calls and credit facilities are being terminated.

The market is concerned that CFC could have difficulty with its credit facilities, which are critical to it operating in the near-term. CFC currently has about $185B in available credit facilities, though the concern is that these facilities could be terminated or the terms changed meaningfully, thus impacting CFC's ability to operate normally. We cannot understate the importance of liquidity for a specialty finance company like CFC. If enough financial pressure is placed on CFC or if the market loses confidence in its ability to function properly then the model can break, leading to an effective insolvency. If liquidations occur in a weak market, then it is possible for CFC to go bankrupt.

CFC appears stronger than many specialty finance companies, as the $186B in funding suggests about 1.6 quarters coverage for its mortgage operations that produce $115B per quarter on the Q2'07 pace. Should the secondary market remain congested, then we think CFC would reduce its exposure to many non-GSE products and we sense that this is happening throughout the industry already. We have seen Wells Fargo and Wachovia both back away from the Alt-A market, which we understand is very problematic. We have also heard anecdotal evidence that most product rate sheets are 10% of their previous size. CFC is about 70% GSE eligible, or about $80B per quarter, and loans with GSE-exits will probably be financed more readily than non-GSE eligible loans. Without a firm market to sell loans, warehouse facilities and asset-backed commercial paper conduits are at risk of being extended or terminated. CFC's bank will likely prove to be an important liquidity vehicle, should the secondary mortgage market remain dislocated, as it can post loan collateral to the FHLB for borrowing. CFC had $12B available at the FHLB at Q2'07 quarter-end and we think the bank will fund a higher percentage of loans, implying that additional FHLB borrowing cold occur over the near-term.

Table 1: Adjusted BV; Liquidate ST funded assets

Assets:	Carrying Value Q2'07	Adjustments	Adjusted Value Q2'07	
Cash	1,154	-	1,154	
Loans & MBS AFS	34,090	(1,023)	33,425	3% Discount
Trading Securities	22,793	(228)	22,645	1% Discount
REPO Securities	26,385	(264)	26,214	1% Discount
Loans HFI	74,057	-	74,057	
Investment in Financial Inst.	26,601	-	26,601	
MSR	20,087	-	20,087	
Other Assets	11,654	-	11,654	
Total Assets	216,822	(1,514)	215,837	
Liabilities:				
Mkt. Funding Sources	128,001	-	128,001	
Deposits	60,293	-	60,293	
Other Liabilities	14,142	-	14,142	
Total Liabilities	202,436	-	202,436	
Shareholder Equity	14,386		13,401	
Book Value, per share	$25.05	-$1.71	$23.34	
Share Count	574.2			

Source: Merrill Lynch estimates

The capital markets activity could be most impacted by a closed-down repo market, as most of CFC's short-term credit facilities are for financing securities inventory. Our repo liquidation scenario in Table 1 illustrates the potential book value adjustments that could occur, if CFC had to liquidate positions to pay-down borrowings, with a BV reduction to $23.30 from $25. We have assumed modest haircuts to the carrying value, as we think most of the securities are fairly liquid, even in this market. If this scenario were to occur, we think CFC shares could fall to $21, or roughly 0.90x adjusted BV, as we think investors would be concerned that other credit-facilities could be in jeopardy. Earnings would fall by about $1.70 per share, not factored into our estimates, though the charge would be behind CFC, so investors would likely look through the EPS impact.

Longer-term dislocation could alter strategy; Bank life rope

Investors are concerned that the capital markets could reduce exposure to the mortgage sector for an extended period, possibly reducing CFC's ability to roll-over its medium-term notes leading to its recently issued converts being put back at par. Should the secondary markets remain largely closed to CFC, then it clearly would have longer-term earnings challenges and would potentially need to consider strategic options to finance its operations with its bank. This would lead to a more aggressive move to integrate its lending operations with its bank, in our opinion, thus tapping the FHLB advance system more fully and the federally-insured deposit system. This type of environment would obviously be a stressful scenario for most financial institutions, though we think CFC has the operations in place to better leverage its banking assets.

We have analyzed one such scenario that assumes CFC reduces its reliance on medium-term note (MTN) borrowing, convertible debt and other short-term borrowings (See Tables 2-4 below): The majority of the balance sheet activity, including loan growth is completed through CFC's bank segment. The bank finances the growth through deposit growth and FHLB borrowing, requiring roughly $47B in deposit and FHLB borrowing to finance consolidated asset growth of $26B, implying delivering at the other various segments. The MTNs would fall from $22B to about $14B in our hypothetical scenario and non-bank borrowing would be down about $14B on a consolidated basis. We have also assumed junk-type spreads are applied to CFC's remaining MTNs, so we have factored in a meaningful earnings drag. Importantly, our analysis suggests CFC could effectively adjust its funding strategy to work-through a longer-term capital markets disruption and generate positive earnings of about $2 per share at its trough. Any quarter could have mark-to-market noise complicate results in a period, but earnings would likely grow nicely as the deferred earnings recognition of a hold-strategy would accelerate earnings growth in 2009, possibly complemented by improving credit costs to provide 50% EPS lift YoY. Our scenario suggests over $3 in EPS for 2009. If this outcome occurred, which is more conservative than our previous example, investors would likely witness CFC shares valued at around 6x EPS of $2-$3, or $12-$18, implying 45% downside from the current stock price of approximately $27. In our view, this is an unlikely scenario. It is not impossible, so we are not eliminating it as a potential outcome, however, we think CFC would remain a viable entity in this situation, which gives us some comfort.

Figure 1: Capacity coming out of sector

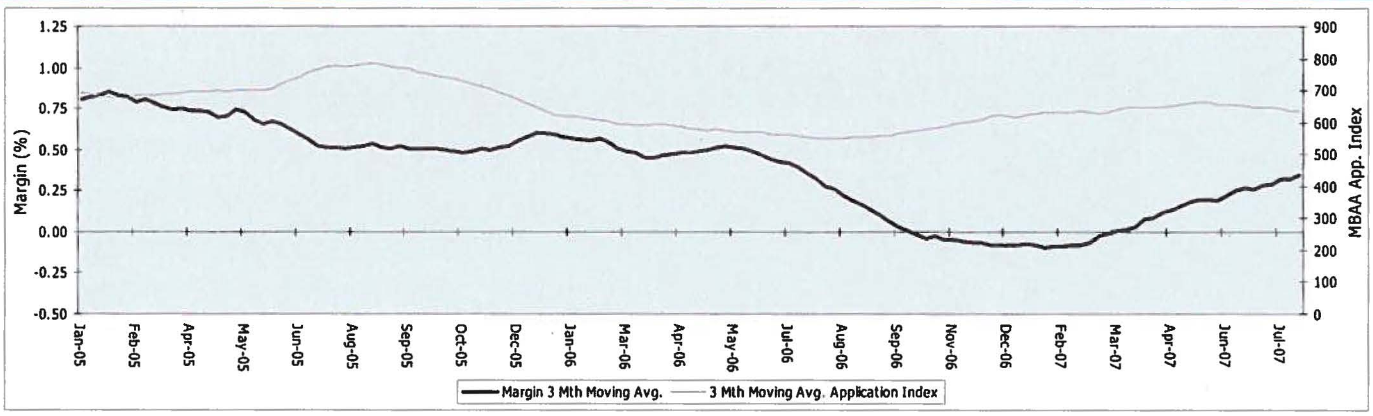
Source: Bureau of Labor Statistics

Bull case exists, even if blurred by headlines

The future remains bleak for a number of mortgage market participants, though we think CFC will prove to work through the current challenging situation and be better positioned to capitalize on an cyclical upturn. The quality of the loans will probably be better, property prices will likely reflect more conservative valuations, and margins will likely be meaningfully higher, as marginal players are likely to be out-of-business. Banks will likely be the major participants, though we would not be surprised if a major bank retreated from the sector, given the current backdrop. The market should be better structurally and competitively, which we think would be a great environment for CFC to generate robust operating and financial results.

CFC has to make it through the rough patch, of course, to benefit from any improvement. However, our relatively optimistic estimates for earnings in a more normal market environment in 2008 and 2009, suggest good upside in CFC shares, should the mortgage market nor the capital markets meltdown. Our 2008 EPS estimate of $3.60 and our 2009 estimate of $4.40 suggest possibly 60% upside, based on a 10x EPS multiple and our '09 forecast. We think the 10 multiple is quite reasonable because of the 50% earnings growth and improving sentiment that would follow a cyclical and credit upturn. Cash earnings would also be improving, as would ROE. Our forecast ROE is roughly 14% in 2009 and BV is roughly $31.50. Using what we consider to be a reasonable 1.4x BV multiple gets us to a similar $44 stock price in '09, as the market is looking at improving fundamentals. Our $36 target is a reasonable 12-month target, in our opinion, as we think the market will start pricing in improving fundamentals, once the backdrop stops getting worse.

Figure 2: Conforming fixed-rate still looks attractive relative to non-GSE sector



Source: Merrill Lynch estimates

The headline risk will likely remain heightened for the foreseeable future, as more companies will likely fail and credit will probably continue to deteriorate. That said, the discounting currently in the market seems more a function of the poor liquidity and unwinding of leveraged credit positions across a range of asset classes. This will probably keep the news focused on the sins of the past, until the quality of the late 2007 vintage loans demonstrates that it is safe for structured credit markets to finance mortgage collateral. Frankly, we hope the current friction in the system does not undermine the broader economy, as that could draw the cycle out and possibly lead to a deeper trough. The current market seems like it is bad enough, however, most are still trying to find a bottom, so we will be carefully assessing economic trends to gauge shifts in the important employment variables.

Cyclical improvements masked by liquidity and credit

Our internal models indicate a continuation of the cyclical improvement in the conforming fixed rate sector, though the credit issues and liquidity crisis is overwhelming the positive trends underlying the turbulent surface. We think the GSE market has largely remained out of the market's view due to the challenges most lenders face in the alternative sectors like Alt-A and sub-prime. However, our models continue to point to a modest recovery in the fixed-rate market. Capacity is coming out of the market and we think much of the downsizing is coming from higher touch/higher-cost alternative lending products. Given CFC scale and efficient operations, we think it can prosper in the conforming market, though consolidated margins will likely be weighed down in the near-term by market value adjustments on non-conforming loans and lower volumes, which had supported abnormally high production margins over the past few years. Still. Alt-A and pay-option margins will likely be under pressure for H2'07, so CFC margins will also remain under-pressure as the pipeline of the Alternative loans works its way through CFC's financial results later this year. We assume CFC will reduce its margin exposure to non-GSE sector by retaining some of the loans in its held-for-investment portfolio, if the current liquidity environment persists. However, we are still factoring in a secondary market execution into our formal estimates. Should the market for alternative loans remain closed, then our EPS forecasts could prove aggressive.

Table 2: Historical margins trends by product

	2005	Q1'06	Q2'06	Q3'06	Q4'06	2006	Q1'07	Q2'07	Q3'07 e	Q4'07 e	2007 e
Prime GOS Margin	0.82%	1.18%	1.23%	1.00%	0.93%	1.07%	0.97%	0.95%	0.95%	0.95%	0.95%
HELOC GOS Margin	2.92%	2.57%	2.30%	1.47%	2.36%	2.03%	2.11%	2.43%	0.75%	0.75%	1.67%
Sub-prime GOS Margin	1.90%	1.64%	2.02%	1.36%	2.42%	1.84%	-0.42%	3.54%	0.75%	0.75%	1.02%
Wtd. Margin	1.05%	1.29%	1.38%	1.09%	1.15%	1.22%	0.95%	1.10%	0.94%	0.94%	0.98%

Source: Company releases and ML estimates

Table 3: Scenario Analysis - Reduce market funding

	Calendar	2007				Calendar	2008				Calendar	Calendar
	2006	Q1 A	Q2 A	Q3 E	Q4 E	2007	Q1 E	Q2 E	Q3 E	Q4 E	2008	2009
Earnings Model												
Gain on Sale	4,263	1,234	1,493	1,031	876	4,634	980	1,194	1,160	1,191	4,525	4,541
Net Interest Income	2,922	579	435	342	130	1,486	211	168	177	244	800	2,023
Servicing Fees	3,636	1,387	1,421	1,609	1,658	6,076	1,713	1,754	1,794	1,829	7,091	7,622
Change in value due to CF	(3,194)	(925)	(1,007)	(1,098)	(1,137)	(4,167)	(1,095)	(1,165)	(1,195)	(1,224)	(4,679)	(5,285)
Impairment	148	(251)	1,059	0	0	809	0	0	0	(15)	(15)	(10)
Servicing Hedge Gains	(614)	(114)	(1,373)	(144)	(149)	(1,780)	(152)	(156)	(159)	(163)	(630)	(679)
Net Loan Servicing Fees	1,301	98	100	367	372	938	466	433	440	427	1,767	1,648
Net Insurance Premiums Earned	1,171	334	352	350	350	1,387	300	340	340	310	1,290	1,370
Commissions & Other Revenue	575	160	167	165	170	662	170	170	170	170	680	695
Total Revenue	10,232	2,406	2,548	2,254	1,898	9,107	2,127	2,305	2,287	2,343	9,062	10,277
Total non-interest expense	7,083	1,705	1,884	1,908	1,726	7,223	1,720	1,822	1,743	1,764	7,049	7,228
Earnings before Income Taxes	4,334	701	665	346	173	1,884	407	484	544	579	2,014	3,049
Provision for Income Taxes	1,659	267	180	130	65	641	153	181	204	217	755	1,144
Net Income to Common	**2,675**	**434**	**485**	**216**	**108**	**1,243**	**254**	**302**	**340**	**362**	**1,258**	**1,906**
EPS Data:												
Diluted	**$4.30**	**$0.72**	**$0.81**	**$0.36**	**$0.18**	**$2.08**	**$0.43**	**$0.50**	**$0.57**	**$0.60**	**$2.10**	**$3.17**
Book Value / Share (F.D.)	$24.50	$25.10	$25.10	$25.10	$25.10	**$25.10**	$25.20	$25.50	$25.80	$26.10	**$26.10**	**$28.20**
ROAA	1.4%	0.9%	0.9%	0.4%	0.2%	**0.6%**	0.5%	0.6%	0.6%	0.7%	**0.6%**	**0.8%**
ROAE	19.7%	11.9%	13.3%	6.0%	3.0%	**8.6%**	6.9%	8.1%	8.9%	9.3%	**8.3%**	**11.5%**
Avg. Leverage	13.8x	14.0x	14.5x	14.9x	14.8x	**14.4x**	14.8x	14.5x	14.2x	14.1x	**14.5x**	**14.1x**

Source: ML estimates

Table 4: Scenario Analysis - Reduce Market Funding

Balance Sheet	2006	Q1 A	Q2 A	Q3 E	Q4 E	2007	Q1 E	Q2 E	Q3 E	Q4 E	2008	2009
Cash	1,407	1,202	1,154	2,001	2,031	2,031	2,021	2,003	2,026	2,065	2,065	2,277
Loans - AFS	31,273	32,283	34,090	31,215	31,215	31,215	26,465	21,215	16,465	11,715	11,715	7,093
Trading Securities	21,502	21,634	22,793	19,000	18,000	18,000	17,000	16,000	16,000	17,000	17,000	18,000
REPO Securities	27,270	28,851	26,385	21,375	20,250	20,250	19,125	18,000	18,000	19,125	19,125	20,250
Loans HFI	78,086	75,177	74,057	79,935	84,327	84,327	89,496	94,342	100,740	106,675	106,675	129,302
Other Financial Assets	12,769	19,446	26,601	27,329	27,350	27,350	27,343	27,364	27,381	27,414	27,414	27,524
MSR Asset	16,172	17,442	20,087	21,254	21,952	21,952	22,623	23,418	23,997	24,554	24,554	25,577
PP&E & Other Assets	11,467	11,916	11,654	12,476	12,643	12,643	12,821	13,009	12,889	12,908	12,908	13,192
Total Assets	199,946	207,951	216,822	214,585	217,768	217,768	216,894	215,351	217,498	221,456	221,456	243,215

Source: Merrill Lynch estimates

Table 5: Scenario Analysis - Reduce Market Funding

Liabilities:	2006	Q1 A	Q2 A	Q3 E	Q4 E	2007	Q1 E	Q2 E	Q3 E	Q4 E	2008	2009
FHLB Bank Advances			28,825	25,649	27,289	27,289	29,155	30,885	33,179	35,306	35,306	43,042
Sub-total - MTN			22,412	23,638	22,046	22,046	21,931	21,862	20,271	15,885	15,885	14,163
Notes Payable	71,488	74,323	77,669	73,546	69,595	69,595	64,346	61,006	58,710	56,450	56,450	60,465
REPO & FFs	45,439	47,467	50,332	47,896	51,971	51,971	52,283	50,286	50,286	52,283	52,283	54,281
Deposits	55,579	57,525	60,293	63,629	66,728	66,728	69,983	73,110	77,000	80,577	80,577	93,414
Other Liabilities	13,123	13,818	14,142	14,960	14,861	14,861	15,463	15,876	16,138	16,468	16,468	17,669
Total Liabilities	185,628	193,132	202,436	200,031	203,155	203,155	202,075	200,279	202,134	205,778	205,778	225,828

Source: Merrill Lynch estimates

Table 6: Countrywide Financial - Earnings Model

	2005	Q1 A	Q2 A	Q3 A	Q4 A	2006	Q1 A	Q2 A	Q3 E	Q4 E	2007	Q1 E	Q2 E	Q3 E	Q4 E	2008	2009
Earnings Model																	
Gain on Sale	4,862	1,361	1,527	1,374	1,419	4,263	1,234	1,493	1,261	1,071	5,059	1,121	1,295	1,358	1,225	4,999	5,381
Net Interest Income	2,330	631	629	761	668	2,922	579	435	494	490	1,998	541	570	592	613	3,093	3,496
Servicing Fees	4,281	1,200	1,207	1,229	1,325	3,636	1,387	1,421	1,609	1,658	6,076	1,713	1,757	1,811	1,858	7,139	7,853
Amortization of MSRs	(2,288)	(739)	(768)	(807)	(880)	(3,194)	(925)	(1,007)	(1,098)	(1,134)	(4,164)	(1,083)	(1,160)	(1,202)	(1,231)	(4,675)	(5,417)
Impairment/Recovery	23	858	621	(1,209)	(121)	148	(251)	1,059	0	0	809	0	0	0	(15)	(15)	(10)
Servicing Hedge Gains	(523)	(886)	(621)	1,034	(141)	(614)	(114)	(1,373)	(144)	(149)	(1,780)	(152)	(156)	(161)	(165)	(634)	(700)
Net Loan Servicing Fees	1,493	433	438	246	183	1,301	98	100	367	375	941	479	441	448	447	1,815	1,726
Premiums Earned	954	280	284	301	307	1,171	334	352	350	350	1,387	300	340	340	310	1,290	1,370
Commissions	500	131	122	140	182	575	160	167	165	170	662	170	170	170	170	680	695
Total Revenue	10,139	2,836	3,000	2,822	2,758	10,232	2,406	2,548	2,637	2,456	10,047	2,611	2,816	2,908	2,765	11,877	12,668
Total non-interest expense	5,869	1,717	1,806	1,786	1,774	7,083	1,705	1,884	1,970	1,776	7,334	1,767	1,965	2,032	1,887	7,651	8,182
Earnings before Taxes	4,148	1,119	1,194	1,036	985	4,334	701	665	667	680	2,713	844	851	876	878	3,449	4,235
Provision for Income Taxes	1,620	436	472	389	363	1,659	267	180	250	255	952	316	319	329	329	1,293	1,588
Net Income to Common	**2,528**	**684**	**722**	**648**	**622**	**2,675**	**434**	**485**	**417**	**425**	**1,761**	**527**	**532**	**548**	**549**	**2,156**	**2,647**
Diluted EPS	**$4.11**	**$1.10**	**$1.15**	**$1.03**	**$1.01**	**$4.30**	**$0.72**	**$0.81**	**$0.70**	**$0.71**	**$2.95**	**$0.88**	**$0.89**	**$0.91**	**$0.91**	**$3.60**	**$4.40**
Book Value / Share (F.D.)	$21.40	$22.30	$23.40	$24.50	$24.50	$24.50	$25.10	$25.10	$25.50	$26.00	$26.00	$26.60	$27.20	$27.80	$28.40	$28.40	$31.60
ROAA	1.7%	1.6%	1.6%	1.3%	1.3%	1.4%	0.9%	0.9%	0.8%	0.8%	0.8%	0.9%	0.9%	0.9%	0.9%	0.9%	1.0%
ROAE	21.9%	20.8%	20.8%	17.6%	16.9%	19.7%	11.9%	13.3%	11.5%	11.4%	12.0%	13.7%	13.4%	13.4%	13.1%	13.4%	14.5%

Source: Countrywide Financial releases and Merrill Lynch estimates

Price objective basis & risk

Countrywide Financial (CFC)

Our $36 price objective on Countrywide Financial is based on a 10x multiple to our 2008 EPS estimate of $3.60, which does not take into consideration any mark-to-market adjustments that could factor into the GAAP results. Our target forward multiple is a blend between a mortgage-bank multiple of 8.0x and savings bank multiple of 12.0x, which we argue will be appropriate for CFC's hybrid mortgage-bank model. Assuming CFC retains a higher percentage of loans on its balance sheet, the quality of earnings should improve, providing investors better visibility and stability into sustainable earnings growth.

Considering book value, our target implies a 1.25x multiple to our '08 BV forecast of $28.40, which we think is substantiated by its improving ROE that we estimate to be 13% in 2008 and 14.5% in 2009. Should investors anticipate an aggressive mortgage recovery, due to a potential refinance cycle, then we think the ROE and valuation multiple have room to expand. Historically, the market has valued CFC shares at 1.75x BV on average, peaking at 4.0x and trough at 0.75x BV in the early 90's. It is instructive to consider the early-90's, in our opinion, because it is similar to today from a credit perspective. CFC was weighed down by flagging credit concerns and liquidity issues of the day, though the '92-'93 refinance wave provided a needed tonic for earnings relief and share gains.

Risk to CFC, the shares and our price target:

Interest rate volatility: A period of pronounced interest rate volatility could impair CFC's earnings and lead to negative mark-to-market adjustments. CFC utilizes complex hedging and derivative strategies to protect the financial value of its underlying assets, including the mortgage loan pipeline, its investment portfolio and the portfolio of mortgage servicing rights. Interest rate volatility increases the cost of its related hedging strategies and could lead to unintended consequences.

Disruption in Capital Markets: CFC could be negatively affected by a short or long-tem disruption in the secondary mortgage markets, or more broadly in the capital markets. CFC relies on efficient market funding mechanisms to price and transfer risk into the markets. Disruption in the financial system increases the costs of transferring risk and could lead to losses.

Liquidity risk: CFC requires healthy amounts of reasonably priced funds to operate effectively as an agent and investor in mortgage collateral in the primary and secondary mortgage markets. Reduced funding or unfavorable terms could prove to be a competitive disadvantage and reduce CFC earnings, possibly leading to poor financial trends and share price depreciation. In extreme case, CFC could be effectively put out of business.

Credit risk: CFC owns investments that incur substantial credit risk that could perform worse than CFC's expectations, leading to poor financial results and possibly increased costs and amounts of capital. Increased credit losses could undermine CFC's bank performance, introducing potential regulatory actions to protect consumer deposits.

Housing & Real Estate Markets: CFC's operations and investments relate mainly to the housing sector and other commercial real estate markets. Significant underperformance in either sector could pose additional risks to CFC's financial performance and increase operational risks.

Operational risks: CFC is a large and complex financial institution that requires highly experienced managers to operate effectively. Poor strategy or execution could undermine CFC's financial performance or otherwise increase the risk to shareholders from other risk factors outside the control of management.

Analyst Certification

I, Kenneth Bruce, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

*iQmethod*SM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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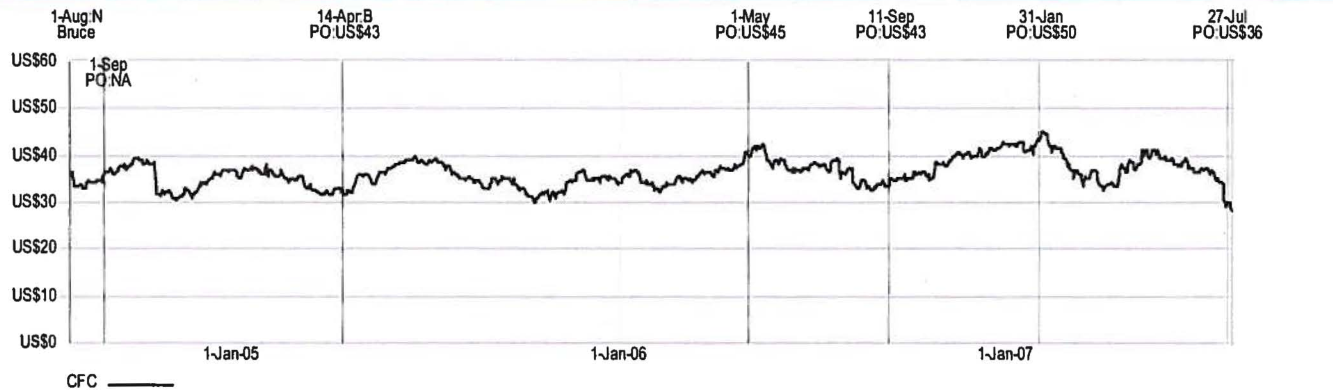
iQdatabase® is our real-time global research database that is sourced directly from our equity analysts' earnings models and includes forecasted as well as historical data for income statements, balance sheets, and cash flow statements for companies covered by Merrill Lynch.

Important Disclosures

CFC Price Chart



B : Buy, N : Neutral, S : Sell, PO : Price objective, NA : No longer valid

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of July 31, 2007 or such later date as indicated.

Investment Rating Distribution: Financial Services Group (as of 01 Jul 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	95	39.42%	Buy	47	52.81%
Neutral	138	57.26%	Neutral	66	50.38%
Sell	8	3.32%	Sell	0	0.00%

Investment Rating Distribution: Global Group (as of 01 Jul 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1675	47.16%	Buy	435	29.21%
Neutral	1633	45.97%	Neutral	438	29.67%
Sell	244	6.87%	Sell	47	21.66%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months.

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