



MS Completes the Hat Trick

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Morgan Stanley (MS) was met with a positive response today, completing a very positive trifecta of investment bank reports this week.

Partially, this was because the company reported better-than-expected results. I think that an even bigger reason was that, while the company had some write-offs, they were absorbed by the Morgan Stanley's other operations - for example, the company was able to shore up its balance sheet, reduce exposure and increase liquidity.

While Morgan Stanley and its peers are not yet out of the woods, clearly, this is a sign of improvement and perhaps the beginning of the end of the crisis as it impacts Morgan Stanley.

Morgan Stanley reported first-quarter 2008 EPS of \$1.45 on net revenue of \$8.3 billion. Return on common equity was 19.7% vs. 30.9% a year ago.

Global headcount declined by 2%, which yielded \$161 million of severance expenses. Compensation to net revenue was 47%, excluding the severance charges. Non-compensation expenses declined 6% sequentially.

For institutional securities, net revenue declined to \$6.2 billion from \$7.2 billion a year ago. M&A and underwriting volumes declined, but the pipelines were considered to be healthy. (Just as an aside, Morgan Stanley did not participate in today's big **Visa (V)** IPO.)

On a bright note, investment grade fixed income underwriting picked up 17% sequentially from fourth quarter 2007. Fixed-income sales and trading revenue declined 15% year over year, to \$2.9 billion. Morgan Stanley continues to incur losses in proprietary mortgage trading, but those losses have been reduced. Interest rate and commodity products performed well in the face of increased volatility, widening spreads and commodity demand.

Morgan Stanley took writedowns of \$910 million net of hedges on its lending businesses. Total investment grade loans declined sequentially from \$30.9 billion to \$26 billion. Of the \$26 billion, \$15.9 billion is attributable to leverage acquisition financing.

Currently, \$23.5 billion sits on the balance sheet, down from \$31.5 billion at the end of fourth quarter 2007. Net exposure has declined to \$11.6 billion from \$17.5 billion at the end of fourth quarter 2007. Non-subprime mortgages, including Alt-A loans, declined sequentially from \$16.5 billion to \$14.5 billion. Net exposure on mortgages declined sequentially to \$8.7 billion from \$10.9 billion, of which Alt-A exposure declined from \$4.6 billion to \$3.6 billion and total writedowns were \$600 million. U.S. subprime exposure remained at \$1.8 billion, which was flat with year-end levels. Residuals were written down by \$300 million. Aggregate direct exposure to monoline insurers was \$4.7 billion, up from \$3.7 billion at the end of 2007. This included \$1.3 billion of asset-backed securities and \$2.6 billion of municipal bonds.

In global wealth management, revenue declined 10% sequentially. Total client assets declined 5%. Asset management fees declined 14% sequentially due to poor performance and market declines.

Total structured investment vehicle exposure declined from \$8.2 billion at the end of fourth quarter 2007 to \$3.6 billion at the end of first quarter 2008, with the bulk of the decline coming from securities that have matured.

MS Preview: Will It Complete the Hat Trick?

Morgan Stanley (MS) is scheduled to report first-quarter 2008 results before the market opens on Wednesday and will conduct its quarterly conference call later that morning.

The big question: Will Morgan Stanley complete the hat trick of reporting better-than-expected results while quelling fears, as was already demonstrated by peers **Lehman Brothers** (LEH) and **Goldman Sachs** (GS) on Tuesday?

Morgan Stanley was able to participate in the financial sector snapback, thanks to Lehman and Goldman, rising nearly 18% on Tuesday.

What makes Morgan Stanley a little different than Lehman and Goldman is the big retail brokerage element that it brings to the table. Certainly, asset values have declined, which will have an impact, but, on the other hand, instructional volumes have been on the rise.

For the record, although I think these estimates have very little value, analysts expect Morgan Stanley to earn \$1.03 per share on net revenue of \$7.19 billion. In the year-ago quarter, Morgan earned \$2.17 per share on net revenue of \$9.99 billion.

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At the time of publication, Rothbort was long Goldman Sachs, although positions can change at any time.

Scott Rothbort has over 20 years of experience in the financial services industry. In 2002, Rothbort founded LakeView Asset Management, LLC, a registered investment advisor based in Millburn, N.J., which offers customized individually managed separate accounts, including proprietary long/short strategies to its high net worth clientele.

Immediately prior to that, Rothbort worked at Merrill Lynch for 10 years, where he was instrumental in building the global equity derivative business and managed the global equity swap business from its inception. Rothbort previously held international assignments in Tokyo, Hong Kong and London while working for Morgan Stanley and County NatWest Securities.

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For more information about Scott Rothbort and LakeView Asset Management, LLC, visit the company's Web site at www.lakeviewasset.com. Scott appreciates your feedback; [click here](#) to send him an email.

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