MSSB's margins still somewhat marginal

Brokerage generated 11% profit margin in Q1, still well below its stated goal; more work ahead

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(Photo: Bloomberg News)

Morgan Stanley, owner of the world's largest brokerage, reported first-quarter results that beat analysts' estimates as fixed-income trading revenue climbed more than at any other major U.S. bank. But the profit margin at the brokerage, **Morgan Stanley Smith Barney**, did not come close to hitting the company's stated goal.

The net loss of $94 million, or 6 cents a share, compared with profit of $968 million, or 50 cents, a year earlier, the New York-based company said today in a statement. Excluding accounting charges tied to the firm's own credit spreads, profit was 71 cents a share, topping the 44-cent average estimate of 17 analysts surveyed by Bloomberg.

“You had very favorable tailwinds in the fixed-income markets, and so trading revenues are very strong,” Charles Peabody, an analyst at Portales Partners LLC in New York, said in an interview on Bloomberg Radio. “The question is the sustainability.”

But Gorman, who took over at the beginning of 2010, trumpeted the results. "This quarter is further evidence that Morgan Stanley has rebounded from the financial crisis of 2008,” Gorman said in the statement.

The accounting charge is known as a debt valuation adjustment, or DVA. It stems from increases in the value of the company's debt, under the theory it would be more expensive to buy back the securities. Morgan Stanley booked $3.4 billion of gains in the third quarter of last year as its credit spreads widened.

Revenue at Morgan Stanley climbed to $8.91 billion from $7.76 billion a year earlier, excluding accounting adjustments. Book value per share dropped to $30.74 from $31.42 at the end of 2011.

Miss at MSSB

Global wealth management, overseen by Greg Fleming, posted pretax income of $387 million, up from $344 million a year earlier, as revenue climbed less than 1 percent to $3.41 billion. The division's pretax profit margin rose to 11 percent from 10 percent in the first quarter of 2011.

Asset management reported a pretax gain of $128 million, up from $125 million in the previous year's period.

Investors are looking for improvement in profitability at the Morgan Stanley Smith Barney brokerage, which had 17,649 advisers and $1.65 trillion in client assets as of Dec. 31. The unit posted a 10 percent pretax margin last year, below Gorman's target of more than 20 percent, and Greg Fleming, who runs the unit, vowed to raise the margin to the ‘mid-teens' by the middle of next year.

Morgan Stanley has the option to buy a 14 percent stake in the venture from Citigroup next month, increasing its ownership to 65 percent, and can buy the business outright over the next two years. Citigroup Chief Financial Officer John Gerspach indicated this week that the bank may be willing to sell the rest of its stake to Morgan Stanley this year.

Analysts have suggested that the purchase could undermine Morgan Stanley's credit rating. The company is already facing a potential three-level downgrade of its rating from Moody's Investors Service, which will take ratings actions on the largest global investment banks by the end of June. That would be the largest cut among U.S. banks and may force the firm to post more collateral on derivatives trades and pay more to borrow.

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