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Merrill beaten up over writedown

\$7.9B worth of credit deterioration leads to its worst quarterly loss

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Merrill Lynch's logo is a proud bull, the symbol of a booming stock market. But the Merrill longhorn was in full retreat yesterday, reigniting Wall Street's fears about the depth of the housing credit crisis.

The New York investment house took a \$7.9 billion writedown for its deteriorating portfolio of asset-backed bonds and less creditworthy mortgages -- substantially more than its peers, and some \$3.4 billion more than management had predicted just 20 days ago. The hefty charge led to Merrill Lynch's biggest quarterly loss since it was founded in 1914, and triggered a sharp slide in the Dow Jones industrial average until a late rally restored order.

PAGE 53 Merrill Lynch's unexpectedly large exposure to the "subprime" mortgage market represented a gamble that backfired badly for Chief Executive Stan O'Neal, who is under pressure to turn things around quickly. His remarks to investors were not encouraging, and shares fell almost 6 percent.

"We expect market conditions for subprime mortgage-related assets to continue to be uncertain and we are working to resolve the remaining impact from our positions," O'Neal said in a statement.

The major debt rating agencies quickly cut their estimates of Merrill Lynch's creditworthiness.

"It's troubling," said Scott Sprinzen, a credit analyst with Standard & Poor's. "The norm is that when companies preannounce bad results, they give themselves some leeway, and when the final results come out, they're a little better. Here, that's not the case."

Wall Street was further rattled by a glum report from the National Association of Realtors, which showed existing home sales fell 8 percent nationally in September, the largest drop since at least 1999. The Northeast region fared even worse, with a 10 percent drop.

"The housing market is unraveling," Mark Zandi, chief economist at Moody's Economy.com, told the Associated Press. "We are in a steep downturn and the prospects are that it is going to get worse before it gets better."

New Jersey's housing market has performed better than the region in recent months, but there are signs of increasing stress here, too. Home sales fell 17 percent in September, the worst performance of the year, according to Jeffrey Otteau of the Otteau Valuation Group, whose firm tracks pending sales contracts, not the actual closings reflected in the Realtors survey.

"The buying pace has slowed significantly," Otteau said.

Problems in the housing market have led to an increase in mortgage defaults and foreclosures. That's not good news for companies such as Merrill Lynch, which hold a considerable amount of collateral debt obligations, securities that are tied to assets such as housing.

Merrill Lynch is one of five major investment brokers in the United States, and the only one to report a loss this quarter. Its writedown related to the subprime market is also the largest of any financial institution so far, although Wachovia, JPMorgan Chase and UBS have all taken big charges, too.

In a report this week, Standard & Poor's said the just-concluded third quarter was the most difficult for investment brokers since 1998, and predicted a "long and likely painful readjustment period after the housing credit boom."

To some, that's not surprising. The U.S. housing market has been valued at \$22 trillion, so the downturn has wider implications than the bursting of the tech boom seven years ago, said David Kotok, chief investment officer of Cumberland Advisors, an \$800 million fund based in Vineland.

"You could see this coming for the last two years, unless you were a visitor from Mars," Kotok said. "You have to have corrections like this."

Merrill's correction came in the form of a \$2.3 billion loss for the quarter, or \$2.85 a share. Net sales were \$577 million, a drop of 94 percent from a year ago.

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