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Morgan Stanley's profits take a tumble
Earnings drop 57%, hurt by slower investment banking, fixed income activity; stock slumps.

By David Ellis

NEW YORK (CNNMoney.com) -- Earnings at Morgan Stanley fell by more than half last quarter, hurt by a decline in its investment banking and sales and trading businesses, the company reported Wednesday.

The No. 2 investment bank reported a 57% decline in profits from continuing operations to $1.026 billion, or 95 cents per share, down from $2.363 billion, or $2.24 per share, a year ago. The results, however, were better than expected on an earnings-per-share basis. Analysts had forecast the company would report a profit of 92 cents a share, according to earnings tracker Thomson Reuters.

Revenue at the firm suffered, falling well short of analysts' estimates. During the quarter, it dropped 38% to $6.5 billion from $10.52 billion a year ago. Analysts had expected sales of $7.05 billion. Investors were not comforted by the news. Morgan Stanley (MS, Fortune 500) shares fell nearly 4% in afternoon trade.

"Morgan Stanley's earnings today suggest that even the most well oiled sports cars face engine troubles from time to time," wrote David Easthope, senior analyst at independent research and consulting firm Celent LLC.
Morgan Stanley's chairman and CEO John Mack blamed tough market conditions and lower levels of client activity, which ended up hurting results in a number of different divisions.

Among the hardest hit was the company's asset management division, which posted a pre-tax loss of $227 million, hurt by losses on investments in real estate and private equity that had helped produce a $303 million profit just a year ago.

The company's fixed income business also got dinged, particularly in sales and trading as well as underwriting. Revenue at its institutional securities business sank to $3.6 billion, less than half of last year's levels of $7.4 billion. Investment banking revenues slipped as well, falling 49% to $875 million during the quarter. The company also booked a $519 million loss related to leveraged loans and noted that the performance of its commodities business was hurt by bad bets on electricity and oil.

Morgan Stanley management also took the earnings announcement as an opportunity to reveal that it suffered a $120 million loss after one of its London-based traders mismarked its books. Colm Kelleher, the company's chief financial officer, said during a conference call with analysts the individual was suspended and that the company was conducting a full internal review of the matter.

Offsetting those woes was a $1.43 billion pre-tax gain from asset sales, which included one of its Spanish wealth management businesses. But if Morgan Stanley management had a message to deliver Wednesday, it was that it was exercising caution, especially when it came to taking risks.

During the quarter, the company did just that, by shrinking its balance sheet and reducing its leverage. "We will continue to stay close to shore given the current market conditions and focus on our balance sheet and liquidity," Kelleher told analysts during the conference call. Wednesday's results, while troubling, are a far cry from where Morgan Stanley was just six months ago. In the fourth quarter, the company posted a $3.59 billion loss -- the first in the company's 72-year history.

But the horizon has looked dreary as of late for Wall Street. Some underwriting activity has slowed, investment banks are relying less on leverage to boost their returns and have been cutting jobs to deal with the credit crisis.
"There is a great deal of market skepticism building for many of these firms," said Dan Alpert, managing director of the boutique New York City-based investment bank Westwood Capital. "To replace their earnings and earnings growth in prior years is going to be incredibly difficult."

Morgan Stanley is the latest investment bank to report this week that its results have taken a hit due to the credit crunch. Lehman Brothers (LEH, Fortune 500) confirmed its previously announced $2.8 billion second-quarter loss on Monday while its management sought to ease concerns about the firm's underlying health.

And while Goldman Sachs (GS, Fortune 500) posted a much better-than-expected $2.1 billion quarterly profit on Tuesday, earnings were still lower than a year ago. Goldman also reported sluggish activity in its investment banking division and suffered a $500 million hedging loss.