REUTERS

July 29, 2008

Merrill to sell $8.5 b stock after big write-down

By Christian Plumb and Jonathan

New York: Merrill Lynch & Co said on Monday it will take a $5.7 billion third-quarter write-down as it unloads huge amounts of risky debt, and will raise $8.5 billion by selling new stock. The Wall Street investment bank and brokerage announced its plans less than two weeks after posting a $4.9 billion second quarter loss, hit by $9 billion of write-downs in that period.

In a sign of how toxic Merrill's debt holdings have become, it has agreed to sell $30.6 billion of collateralized debt obligations (CDOs), a kind of repackaged debt, to an affiliate of private equity fund Lone Star Funds, for just $6.7 billion, or about 22 cents on the dollar.

Merrill to sell Bloomberg stake for $4.5 b | Merrill nears deal to sell Bloomberg stake The fire sale nature of that deal will add to concerns that the global credit crisis, which has already led to more than $400 billion of write-downs and losses at major banks, still has a long way to run.

"What is happening to Merrill and others is death by a thousand cuts. It's painful to see it happen over and over again," said Daniel Alpert, managing director at investment bank Westwood Capital. Merrill said its stock sale, which includes a $3.4 billion purchase by Singapore's state-run Temasek Holdings, may grow to $9.8 billion. Management also plans to buy 750,000 shares, it said. Monday's write-down and plans to raise capital may raise further questions about the ability of John Thain, who only became Merrill's CEO in December following the ouster of Stanley O'Neal, to turn around the firm.

The company has lost $19.2 billion in the past year and suffered more than $40 billion of write-downs from subprime mortgages and other risky debt. Its shares sank 11.6 per cent in New York Stock Exchange trading ahead of the announcement and are now less than a third of their value a year ago.

The stock was little changed at $24.35 in after-hours electronic trading after dropping $3.19 to $24.33 in regular trading. "Are things that much worse than we were led to believe?" said James Ellman, president of Seacliff Capital in San Francisco. "If people were going to believe Thain when he said Merrill raised more capital than it needed to and had taken conservative marks on its securities book, I'm not sure they're going to believe him tomorrow morning."

On a July 17 conference call, Thain said: "Right now we believe we are in a very comfortable spot in terms of our capital." He has made a series of similar comments over the past seven months.

The most recent round of capital raising was particularly bruising because of provisions Merrill agreed to when it raised money in December and January. Essentially, the investment bank said it would give the investors in those raisings extra compensation if it later issued equity at a lower price.

That meant that in this offering, more than half the shares or share proceeds will go to prior investors, with $2.5 billion paid to compensate Temasek, and another $2.4 billion paid as additional dividends to investors in convertible securities.

Temasek agreed to invest the $2.5 billion in the new offering, as a large part of its purchase of $3.4 billion of common stock in this deal.

Prior sales

The Lone Star deal will result in a $4.4 billion write-down for Merrill and it will finance about 75 per cent of the purchase price, Merrill said.

Merrill also said it agreed to help bail out bond insurer Security Capital Assurance Ltd by agreeing to accept a $500 million cash payment in exchange for canceling some credit default swaps and ending related litigation.

Merrill said the settlement, together with the potential settlement of other CDO hedges, will result in a $1.3 billion write-down.

Earlier this month, Merrill completed the sale of its 20 per cent stake in Bloomberg LP, the news and financial data company, to Bloomberg Inc for $4.43 billion. Merrill also said then it was in talks to sell a controlling interest in a unit that provides services to mutual funds, in a deal that values the entire unit at $3.5 billion.

Assuming Merrill sells shares at its Monday closing price in the new offering, Temasek would have about 140 million new shares in Merrill. When combined with its prior holdings, it would have 226.645 million Merrill shares. If this new offering leaves Merrill with about 1.528 billion shares, Temasek would own about 15 per cent of Merrill, which may raise some concerns among US politicians about the level of foreign ownership at one of the nation's best-known banks.

Temasek previously informally agreed to refrain from owning more than 10 per cent of Merrill, according to a source familiar with the fund. A Temasek spokeswoman said on Tuesday that a portion of the deal is subject to regulatory approval.

Merrill declined to comment on specifics of the stock offering, such as the price. The company's market value was about $24 billion as of Monday's close, based on reported shares outstanding. Given that Merrill's retail brokerage business has been estimated by analysts to be worth at least $25 billion, while its near-50 per cent stake in asset management company BlackRock Inc is worth about $13 billion, its investment banking business has an implied negative value.

Write-downs

Merrill Lynch agreed in January to sell about $6.6 billion of mandatory convertible preferred securities. Investors in about $5.4 billion of those convertibles have agreed to exchange their securities for about 195 million shares of preferred shares, Merrill announced on Monday. The other investors agreed to exchange their securities into a new mandatory convertible preferred security.

In Seoul, Korea Investment Corp (KIC) said it converted $2 billion worth of preferred Merrill shares into common stock. Despite the latest write-downs, Merrill still has wide exposure to mortgage debt. As of June 27, it said it had exposures of $33.7 billion to U.S. prime mortgages, $1.01 billion to U.S. subprime mortgages, $1.54 billion to "Alt-A" mortgages and $7.45 billion to non- U.S. residential mortgages.

William Smith, president of Smith Asset Management Inc in New York, said Merrill fetched a "horrendous" price for the CDOs in the sale announced on Monday.

"The problem here is with Thain. You can throw him into the credibility problem camp now," Smith said. "It's tough to call the bottom on these things because it seems like it's never ending, but this could be viewed as the watershed."