

Moody's Largest Shareholder Casts Doubts on Rating Agencies' Futures

Value Investing

Moody's Feeling Credit Market Heat

By Morgan Housel April 25, 2008

It's been [a heck](#) of a year for **Moody's** (NYSE: [MCO](#)). After a vicious downturn in structured debt products that it had identified as top-notch sent firms such as **Ambac** (NYSE: [ABK](#)) and **MBIA** (NYSE: [MBI](#)) [heading south](#), its reputation as a formidable ratings firm has been left unquestionably tarnished.

New York-based Moody's reported first-quarter earnings of \$120.7 million, or \$0.48 a share, a plunge from the same period last year of around 31% and 23%, respectively. The poor performance came as no surprise to investors, who've seen shares sliced 45% in the past year. The results did, however, easily surpass analysts' expectations of \$0.35 a share in net income, giving shares a nice pop when announced Wednesday.

Revenue for the quarter took a 26% nosedive, coming in at \$430.7 million, thanks in part to a 57% drop in structured products that include collateralized debt obligations (CDOs) -- a persistent headache in the wake of a soured real estate market. Reacting to the slump in business, management announced plans in January to cut 7.5% of the headcount, and trimmed the incentive-based pay that some think caused a [conflict of interest](#) when rating products for lucrative customers.

With a multiyear boom in credit-related products that had paid handsome dividends to Moody's and rival S&P Ratings (part of **McGraw-Hill** (NYSE: [MHP](#))) now dormant, [the market for credit ratings will undoubtedly look starkly different in coming years](#). As I [mentioned](#) a few weeks back, Moody's has announced plans to radically overhaul its municipal bond credit rating system in what is likely an attempt at appeasing nerves after politicians began poking holes in [the ratings game](#).

Even one of Moody's largest shareholders, none other than **Berkshire Hathaway** (NYSE: [BRK-A](#)) (NYSE: [BRK-B](#)), has cast doubts on rating agencies' futures. In a recent interview with CNBC, Berkshire chief Warren Buffett said, "I don't think there's any question that the intrinsic business value of Moody's shrunk last year, just as McGraw-Hill owns S&P and the S&P component of McGraw-Hill ... they have less of a moat around them and they're going to be affected for a long time by the experience of the last couple years."

Article: <http://www.fool.com/investing/value/2008/04/25/moodys-feeling-credit-market-heat.aspx>