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Research Update:

MF Global Holdings' Rating Is Lowered To 'BBB-'; Outlook Stable

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Overview

- We believe that after a prolonged period of weak profitability and continued restructurings, U.S. futures and options broker MF Global Holdings' financial metrics are more supportive of a 'BBB-' rating.
- We are downgrading the long-term issuer credit rating to 'BBB-'. The outlook is now stable.
- We expect the firm to continue to maintain adequate capital and liquidity and for it to only modestly increase its credit and market risk as it continues management's planned evolution into a broker-dealer business model.

Rating Action

On Nov. 24, 2010, Standard & Poor's Ratings Services lowered its rating on MF Global Holdings Ltd. to 'BBB-' from 'BBB'. The outlook is now stable.

Rationale

We base our rating on MF Global, a broker specializing in futures and options, on its relatively good niche franchise, as well as its adequate financial profile and liquidity. Constraining the rating is the firm's profitability, which we believe is not commensurate with the size of its balance sheet, and revenue that largely depends on transaction volumes and interest rates.

The company is going through a prolonged period of weak operating performance due to lower volumes, low interest rates, and changes in operating strategy and client behavior. This, coupled with a string of large, one-time charges and write-downs, has resulted in GAAP losses through the September 2010 quarter and for every annual period going back to the firm's fiscal 2008. As a result, the firm has not been able to generate common equity through retention of earnings. In the company's fiscal second quarter 2010, the firm increased equity by issuing common stock and converting some hybrid capital. Even with this new common equity we consider capital to only be adequate as the firm has increased its securities inventory to support its expanding business activities. The firm's reduction in debt to a modest level and a very clean balance sheet have bolstered its financial profile. While we believe that liquidity is adequate, it suffers from the firm's reliance on wholesale funding and the resulting confidence sensitivity.

The company has been in a prolonged turn-around mode for the past two years, but we consider the most recent strategic plan of the new CEO Jon Corzine to be sound. This plan focuses on developing the firm's historic broker model into more of a broker-dealer model, which should eventually increase and diversify revenue and lead to better profitability. To this end, management has rationalized existing business lines, consolidated operations under a global management structure, pushed for a more sales-driven culture and incentives, and started to expand its higher-margin dealer activities like market making and principal trading. While we believe that over the longer term this should result in more diversified and better profitability, we also believe that over the near to medium term the implementation of this plan will incrementally increase the firm's risk profile, may disrupt the firm's producers, and will delay its return to profitability and credit metrics more supportive of the 'BBB' rating.

We believe that MF Global has demonstrated its resilience and good competitive niche position while facing considerable challenges and as a result it appears to be gaining clients and increasing client balances. We also believe that the company has sufficiently upgraded its risk management function to allow us to now consider its enterprise risk management (ERM) as adequate. That said, we still consider its ERM as a work in progress that needs to keep pace with the firm's planned expansion, particularly regarding the increased credit and market risk associated with its planned increase in principal and market-making activities.

Outlook

The stable outlook reflects our opinion that MF Global remains an investment-grade credit and is well positioned to weather continued weak profitability and challenging operating conditions. It also assumes that management will carefully implement its current strategic plan, and therefore it's unlikely to result in a return to healthy profitability metrics in the near term. If the company improved its profitability dynamics and demonstrated material improvement in operating profitability over a few quarters while maintaining a low risk profile, we could raise the ratings. Alternatively, ratings could come under pressure if the company suffers material principal losses or liquidity deteriorates or leverage increases.

Related Criteria And Research

- Securities Company Ratings Analysis Methodology Profile, April 29, 2004
- Franchise Stability, Confidence Sensitivity, And The Treatment Of Hybrid Securities In A Downturn, Dec. 1, 2008

Ratings List

Ratings Lowered

	To	From
MF Global Holdings Ltd.		
Counterparty Credit Rating	BBB-/Stable/--	BBB/Negative/--

Senior Unsecured	BBB-	BBB
Preference Stock	BB	BB+

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