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Goldman Sachs profit tops $3B on strong trading

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Goldman Sachs Group Inc.'s third-quarter earnings more than tripled from the depths of the financial crisis as income from the company's trading operations offset a drop in its investment banking business.

Goldman's stock fell 2.5 percent Thursday as investors reacted to the slide in investment banking revenue, the result of a general slowdown in takeover activity. Shares fell $4.71 to $187.57 in afternoon trading.

Some profit taking after the better-than-expected results also sent the stock falling, analysts said.

Goldman earned $3.03 billion, or $5.25 per share, easily beating analysts' expectations for a profit of $4.24 per share. The bank earned $810 million, or $1.81 per share during its fiscal third quarter last year, which ended in August. During the peak of the credit crisis last fall, Goldman became a bank holding company and changed to calendar quarterly reporting periods.

Goldman also had $5.35 billion in compensation expenses during this July-September period.

The company said bond, commodities and currency trading buoyed its profits for the second straight quarter.

"They're just good traders," said David Easthope, a senior analyst at consulting firm Celent. Trading and investment revenue nearly quadrupled from the third quarter last year and dipped 7 percent from record results in the second quarter.

But investment banking revenue, considered the foundation of the company's business, fell to $899 million in the third quarter. The results were 31 percent worse than the similar quarter last year as the credit crisis was worsening and 38 percent worse than the most recent quarter.

Goldman attributed the drop to a decline in bond underwriting as the still troubled credit markets limited the amount that companies could borrow to complete deals.

The weakness in Goldman's core business might have given investors pause, analysts said.

"Most people attach greater value to (investment banking) because its a fee-driven business," said John Jay, a senior analyst at financial consulting firm Aite Group.

Goldman, like other Wall Street banks, makes its money in investment banking by charging fees to underwrite bond sales or stock offers, or to manage mergers and acquisitions. Analysts like to see strength in that division because it is usually the most stable source of money for a Wall Street bank when the economy is strong.

It also is considered less risky than operations like trading, which are prone to wild market swings, and can cost a bank big if they make the wrong bets.

The investment banking business would have fared even worse were it not for strong stock underwriting activity. As the stock market has rebounded, Goldman was able to leverage its strong reputation to help companies issue new shares to take advantage of the rising market.

Lloyd Blankfein, the company's chairman and CEO, said Goldman is starting to see a rebound across many of its businesses even as the broader economy and consumers continue to struggle with rising unemployment and mounting loan losses.

"Although the world continues to face serious economic challenges, we are seeing improving conditions and evidence of stabilization, even growth, across a number of sectors," Blankfein said in a statement.

The company did note in its earnings statement that the backlog of investment banking business "increased significantly" in the third quarter, which means fourth-quarter results could be in line for a sharp uptick.

Goldman, which has outperformed other financial companies for years, has been the strongest bank throughout the financial crisis. It had less exposure to toxic mortgage-backed securities than other companies and also has been more aggressive in its trading.

As an investment bank, its exposure to traditional consumer loans, like mortgages and credit cards, that have plagued traditional banks like Citigroup Inc. and Bank of America Corp., is limited.

Its continued strength throughout the downturn allowed Goldman to quickly repay the $10 billion government bailout it received at the height of the credit crisis. That repayment was also done, in part, to rid the bank of restrictions on annual compensation that were attached to the loan. Goldman has been criticized for giving employees big paychecks despite the weak economy.

David Viniar, Goldman's chief financial officer, said during a call with reporters that the bank has made no decisions on year-end bonuses yet, and it will not make any determinations on how much to pay employees until the end of the year.

He said the bank is "very focused on the economic climate" and that will be taken into account when decisions are made.

The company said its compensation expenses during the third quarter amounted to 43.3 percent of net revenue. Goldman has now set aside $16.71 billion, or about 47 percent of net revenue, through the first nine months of the year for compensation, which includes salaries, bonuses and associated costs such as benefits and payroll taxes.

Viniar said during a separate call with analysts that the backlog of business was primarily in mergers activity and stock underwriting versus debt underwriting, though all were showing an increase. Revenue from equity underwriting will show up in quarterly results sooner than merger-related revenue, he added.

Goldman's image as one of the top players on Wall Street has helped it attract more business throughout the downturn, said Stephen Hagenbuckle, a managing principle of the private equity fund TerraCap Partners.

Goldman "continues to get increased market share," Hagenbuckle said. "Initially it was a lack of competitors, but more recently it's been their performance."