MORGAN-DEMPSEY
CAPITAL MANAGEMENT, LLC

Citigroup (C): Initiate Position 1.25% **January 2022**

Description

Citigroup is a global diversified financial services holding company whose businesses provide consumers, corporations, governments and institutions with a broad range of financial products and services. These include consumer banking and credit, corporate and investment-banking, securities brokerage, trading, securities services, and wealth management. It does business in more than 160 countries and jurisdictions. Citigroup generates almost half of its sales from North America.

Citigroup has two segments: Global Consumer Banking and Institutional Client Group

Global Consumer Banking (GCB)

GCB is a global leader in banking and wealth management and the world's largest credit card issuer. The GCB serves more than 110 million clients in the U.S., Mexico, and Asia and spans 19 markets. It currently is focused on three strategic priorities: growing wealth management, leading in consumer payments-lending and driving scale through digitalization and partnerships. GCB generated approximately 40% of 2020 revenues.

Institutional client Group (ICG)

ICG is Citi's international financial network that serves leading corporations, financial institutions and governments in countries and jurisdiction all over the world from offices in 96 countries. It services its clients by providing strategic, financing, and operational insight and by executing tailored product and service solutions both domestically and across borders. ICG includes six main business lines: Banking, Capital Markets and Advisory; Commercial Banking; Markets; Securities Services; Private Banking (part of Citi Wealth Management); and Treasury and Trade Solutions. ICG generated approximately 60% of 2020 revenues.

Investment Thesis

Citi's new CEO, Jane Nind Fraser, joined the company in 2004 and took over as CEO in March 2021. Her initial focus is on the completion of a transformation strategy as well as the initiation of a strategic refresh for the company.

The transformation strategy is designed to satisfy the requirements of the Fed's and the OCC's enforcement actions announced on October 7, 2020 that was the result of the firm not taking "prompt an effective actions to correct practice previously identified by the Board in the areas of compliance, risk management, data quality management and internal controls." The company was fined $400 million and required to get the OCC's approval for any acquisition and required to take "broad and comprehensive corrective actions to improve risk management, data governance and internal controls". Satisfaction of the consent decree will have the side effect of improving the company's data management, financial controls, and compliance. Although the cost of these investments is high, the result should be beneficial for bank operations and help to keep Citi in compliance in the future.

The initial stage of the strategic refresh is Citi's exit from underperforming businesses combined with investment into higher growth/higher profitability segments of the company. The company will begin by exiting consumer franchises in 13 Asian and emerging country markets and consolidating its consumer activities in Hong Kong, Singapore, the UAE and

London. Management particularly is interested in investing in growth opportunities in Wealth Management and Commercial Banking.

By exiting underperforming businesses and focusing investments in the more profitable segments of the business, Citi should be able to improve the profitability and efficiency of what has been a chronically underperforming bank. We expect this to be the first step in a transformational process that will be fleshed out more fully at the investor meeting in March 2022.

Positives

- Streamlining Citi's International consumer banking system in Europe and Asia and focusing on four hubs in Hong Kong, Singapore, the UAE and London should simplify operations and potentially improve profitability by exiting from smaller businesses with limited scale. The company currently has agreements to sell operations in Australia and the Philippines while deciding to wind down its operations in South Korea. The company has booked a loss for the Australian operations and will receive nothing for its South Korea operations. The sale of each operation should bring cash into the company. The sales and/or exit from all 13 operations also is expected to release approximately $7 billion of allocated tangible common equity over time. The other operations that are being sold or closed are in China, India, Indonesia, Malaysia, Taiwan, Thailand, Vietnam, Bahrain, Poland, and Russia. In 2020, the thirteen markets that Citi is exiting generated $4.2 Billion in revenues, $3.3 Billion of expenses (an efficiency ratio of 77%), earnings before tax of -0.1 Billion and net income of $0.0.
- Streamlining the international consumer banking system should improve the bank's efficiency and profitability.
- Citi's large credit card operation should benefit from higher loan balances as direct government payments begin to dissipate.
- CEO Fraser appears to be willing to aggressively make changes to the company. It will be interesting to see if she can change the culture as well.
- Shifting investments to growth areas like Wealth Management and Commercial Banking appears to be a reasonable strategy.
- The company is making good progress on the digital banking side of the business.
- The company currently is selling significantly below tangible book value. It is an inexpensive stock.

Risks

- The Fed's and OCC's consent decree are still in force and could result in tighter regulation and additional sanctions if either agency is dissatisfied with the speed and quality of the transformation program or if Citi has further violations.
- The transformation program has been adding about 2% per annum to expenses. It is difficult to determine how much of these expenses will remain embedded in the bank's cost structure.
- Strength in Investment Banking, Equity Markets and Securities Services have helped to offset weakness in traditional Consumer and Corporate Banking. A slowdown in capital markets business without accompanying improvement in traditional lending and credit cards could be a problem for the company.
- Loan growth has been stagnant, and the company has limited ability to produce significant loan loss reserve releases in the future.
- Citi's international exposure makes it more susceptible to negative impacts from economic weakness outside of the US. Any disruption in either the US or major non-US economies would limit the ability of Citi to meet its growth and profitability targets.
- The more detailed strategic refresh that will be announced in March 2022 could be underwhelming and/or difficult to execute.

Valuation

Citi stock has made little headway over the last two years. It is inexpensive using many valuation parameters, particularly P/E and Price to Tangible Book Value. While it does have the potential to be a value trap, we believe that the company's initial strategic refresh could provide the needed spark to get the stock price out of the doldrums.

Valuation Matric	Current	5-Year High	5-Year Low	Average
Price to Earnings (PE)	5.6	17.1	4.0	10.7
Forward PE	7.5	14.6	3.7	9.6
Price to Expected Growth (PEG)	.4	28.1	.3	1.1
Price to Book Value	.7	1.1	.4	.8
Price to Tangible Book Value	.8	1.3	.5	1.0
Dividend Yield	3.40%	6.0%	.50%	2.40%

Note:

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