Citigroup 25/08/2017 **FAT-USA-577**

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The next stage

In late July, Citigroup held in its first investor day since 2008 and management were upbeat about the banks' earnings prospects. Citi recently sailed through so-called stress tests and was given the Fed's blessing to double its quarterly dividend payment to 32 cents. This comes alongside its biggest ever common stock repurchase program of up to $15.6 billion.

At the investor day, Citigroup outlined an ambitious target of $9 in earnings per share by 2020, representing a large jump from the estimated $5.20 or so in earnings Wall Street has pencilled in for 2017. The target represents compound annual earnings growth of roughly 20%, which would likely be among the highest growth rates of any of the big banks if achieved. Citigroup's return on equity still has significant scope to increase and, combined with an undemanding current valuation, we continue to have a positive investment stance on Citigroup.

2Q17 snapshot

In the second quarter of 2017, Citigroup posted net income of $3.87 billion, or $1.28 per diluted share, on revenues of $17.9 billion. Net income was about 3% lower than a year earlier with a higher cost of credit and operating expenses, along with a higher effective tax rate, more than offset higher revenues. The effective tax rate was 31.6% in 2Q17 compared to 29.9% in the second quarter of 2017.

The earnings per share result was slightly better than the prior year quarter due to a lower share base. In 2Q16 Citigroup reported net income of $4.0 billion, or $1.24 per diluted share on the back of revenues of $17.5 billion. Diluted earnings per share growth received support from Citigroup's share buybacks, which resulted in the diluted share base shrinking by roughly 6% from a year ago.

Revenue increased approximately 2% year-on-year, driven by 6% growth in the Institutional Clients Group (ICG) and 5% increase in Global Consumer Banking (GCB). There was a 45% revenue decline in Corporate/Other as the bank continued to wind down legacy assets. Foreign exchange rates were also a slight headwind and holding currencies constant, Citigroup revenues increased 3%.

Citigroup's operating expenses were up marginally year-on-year at $10.5 billion versus $10.48 billion in 2Q16. In constant currency terms, operating expenses increased 2% as higher volume-related expenses, performance compensation and ongoing investments were partially offset by efficiency savings and the winding down of legacy assets. The efficiency ratio of 59% was effectively flat with a year ago.

Citigroup's cost of credit in 2Q17 was $1.7 billion, marking a 22% increase. This was due to a $94m increase in net credit losses and a net loan loss reserve release of just $16 million, compared to a much bigger net release of $256 million in the prior year quarter, mostly related to legacy assets. The provision for benefits and claims was $23 million in 2Q17 compared to $49 million in the second quarter of 2016.

Citigroup – Summary Financial Results

($MM, except EPS)

	2Q'17	1Q'17	%Δ	2Q'16	%Δ	1H'17	%Δ
Revenues	**$17,901**	$18,120	(1)%	$17,548	2%	**$36,021**	3%
Operating Expenses	**10,506**	10,477	0%	10,369	1%	**20,983**	0%
Efficiency Ratio	*59%*	*58%*		*59%*		*58%*	
Net Credit Losses	1,710	1,709	0%	1,616	6%	3,419	2%
Net LLR Build / (Release)[1]	(16)	(77)	79%	(256)	94%	(93)	NM
PB&C	23	30	(23)%	49	(53)%	53	(61)%
Cost of Credit	**1,717**	1,662	3%	1,409	22%	**3,379**	(2)%
EBT	**5,678**	5,981	(5)%	5,770	(2)%	**11,659**	8%
Income Taxes	**1,795**	1,863	(4)%	1,723	4%	**3,658**	14%
Effective Tax Rate	*32%*	*31%*		*30%*		*31%*	
Net Income	**$3,872**	$4,090	(5)%	$3,998	(3)%	**$7,962**	6%
Return on Assets	*0.83%*	*0.91%*		*0.89%*		*0.87%*	
Return on Tangible Common Equity[2]	*7.8%*	*8.5%*		*8.0%*		*8.2%*	
EPS	**$1.28**	$1.35	(5)%	$1.24	3%	**$2.63**	12%
Average Diluted Shares	*2,739*	*2,766*	*(1)%*	*2,916*	*(6)%*	*2,752*	*(6)%*
Average Assets ($B)	**$1,869**	$1,831	2%	$1,807	3%	**$1,850**	3%
EOP Assets (Constant $B)	**1,864**	1,841	1%	1,823	2%	**1,864**	2%
EOP Loans (Constant $B)	**645**	632	2%	635	2%	**645**	2%
EOP Deposits (Constant $B)	**959**	957	0%	939	2%	**959**	2%

9.7% RoTCE for 1H'17 excluding impact of disallowed DTA[2]

Source: Company presentation

Citigroup's credit quality is in good shape, with the allowance for loan losses at the end of the quarter reported at $12.0 billion, or 1.88% of total loans. This compares positively with $12.3 billion, or 1.96% of total loans at the end of the prior year quarter.

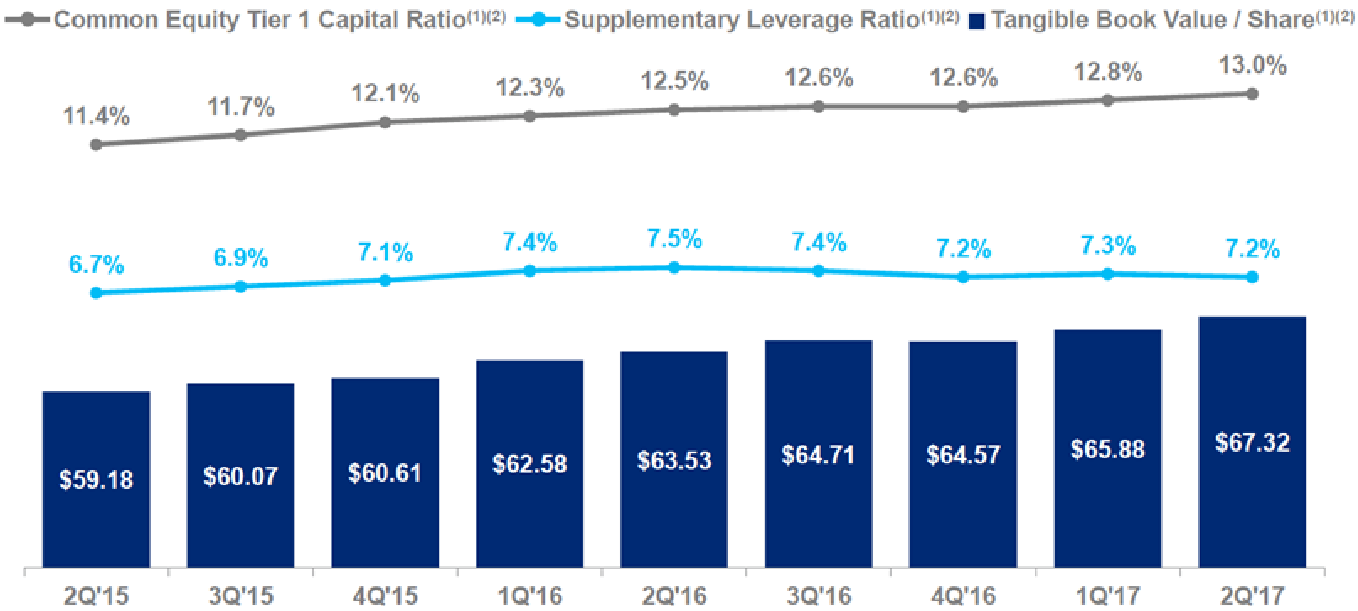
Total non-accrual assets declined 19% year-on-year to $5.1 billion. Corporate non-accrual loans decreased by 15% to $2.1 billion, while Consumer non-accrual loans declined 23% to $2.8 billion.

Citigroup's loan book of $645 billion was 2% higher year-on-year as growth in both the ICG and GCB segments more than offset the continued wind down of legacy assets in Corporate/Other.

Citigroup deposits were $959 billion at the end of 2Q17, up 2% as a 3% in both the ICG and BCG areas was partially offset by a decline in Corporate/Other.

Book value per share of $77.36 and tangible book value of $67.32 at the end of the quarter both increased 6% year-on-year. Citigroup's capital strength has improved markedly in recent years and the Common Equity Tier 1 (CET1) Capital Ratio stood at 13.0% at the end of 2Q17, up from 12.5% a year earlier.

Citigroup – Key Capital Metrics



	2Q'15	3Q'15	4Q'15	1Q'16	2Q'16	3Q'16	4Q'16	1Q'17	2Q'17
Risk-Weighted Assets (Basel III Advanced Approaches)	$1,279	$1,254	$1,216	$1,240	$1,233	$1,228	$1,190	$1,191	$1,184
Risk-Weighted Assets (Basel III Standardized Approach)	$1,212	$1,192	$1,163	$1,177	$1,181	$1,166	$1,148	$1,166	$1,189
Total Leverage Exposure	$2,386	$2,364	$2,318	$2,300	$2,327	$2,361	$2,345	$2,372	$2,418

Source: Company presentation

The 13.0 percent of Common Equity Tier 1 is well above the 11.5% management have deemed appropriate to prudently operate the business.

Summary

Citigroup's operating and financial performance over the past couple of years has shown that its transformation into a leaner, stronger banking machine is on track.

Citigroup has continued to improve the quality of its business and strengthen its capital ratios, while concurrently returning capital to shareholders again in 2017. There is plenty more to come given the scale of the buyback outlined.

Citigroup shares currently trade on circa 0.8 times the FY17 projected book value, while the FY17 forecast price to earnings multiple is 12.9 times, falling to 11.3 times the following year.

A valuation discount to peers with fewer legacy issues is warranted. However, we believe Citigroup's shares arguably have more upside potential given the fact that these legacy issues have faded and the core business is moving in the right direction.

This suggests to us that Citigroup's discount to peers on a book value multiple basis can narrow going forward. At the same time, we expect the broader sector to continue to positively re-rate due to a more favourable operating environment going forward.

Accordingly, Citigroup will remain held in the Fat Prophets portfolio. For Members without exposure and a medium-term investment horizon, we recommend the shares as a buy.

Disclosure: Citigroup is held in the US Managed Account Portfolio.

Snapshot C

Citigroup

Latest Closing Price: $67.69

Reuters: Citigroup is a global diversified financial services holding company. The Company provides consumers, corporations, governments and institutions with a range of financial products and services. As of December 31 2009, Citigroup had approximately 200 million customer accounts and did business in more than 140 countries. Citigroup operates through two primary business segments: Citicorp, consisting of its Regional Consumer Banking businesses and Institutional Clients Group, and Citi Holdings, consisting of its Brokerage and Asset Management, Local Consumer Lending and Special Asset Pool.

Market Capitalisation:$184.43B

	FY1	FY2
Price to Earnings	12.9	11.3
Dividend Yield (%)	1.4	2.2
Price to Book	0.8	0.8
Return on Equity (%)	6.8	7.4