Citigroup (C)

Updated July 15th, 2020 by Josh Arnold

Key Metrics

Current Price:	$50	**5 Year CAGR Estimate:**	15.5%	**Market Cap:**	$104 B
Fair Value Price:	$68	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	08/03/2020[1]
% Fair Value:	74%	**5 Year Valuation Multiple Estimate:**	6.1%	**Dividend Payment Date:**	08/24/2020[2]
Dividend Yield:	4.1%	**5 Year Price Target**	$90	**Years Of Dividend Growth:**	6
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	13.3%

Overview & Current Events

Citigroup was founded in 1812, when it was known as the City Bank of New York. In the past 200+ years, the bank has grown into a global juggernaut in credit cards, commercial banking, trading and a variety of other financial activities. It has thousands of branches, produces $74 billion in annual revenue, and has a market capitalization of $104 billion.

Citigroup reported second quarter earnings on July 14th, beating previously reduced expectations. Total revenue came in at $19.8 billion, up 5% year-over-year. Global Consumer Banking posted a net loss of -$396 million in Q2, an improvement from a -$754 million loss in the first quarter. Institutional Clients Group net income came to $1.9 billion, down from the $3.6 billion earned in Q1. Fixed Income Markets revenue soared 68% higher year-over-year to $5.6 billion, and up 17% from a very strong Q1. Equity Markets revenue was $770 million, down -3% year-over-year, but off -34% from Q1's robust number.

End of period loans were $685 billion, even with a year ago. Deposits at period end were $1.2 trillion, up 18% year-over-year. Citi's loan-to-deposit ratio, therefore, is just 57% as of the end of Q2, which is extremely low by any measure. This affords Citi an additional buffer should loans sour, as well as tremendous room for lending growth. It also means the bank is underutilizing the assets at its disposal, reducing profitability potential.

Citigroup built its credit loss reserve by a staggering $5.6 billion in Q2, up from $111 million in last year's Q2. It is clear the bank is worried about continued deterioration of credit quality from the COVID-19 crisis.

Earnings-per-share came in at 50 cents in Q1, down from $1.95 in the year-ago period, and reflecting the massive credit loss reserve build. We've left our estimate of earnings-per-share unchanged for this year at $3.30 but note that the conditions for bank earnings is ever-evolving in this climate.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$3.50	$3.59	$3.86	$4.26	$2.20	$5.44	$4.72	$5.33	$6.65	$8.04	***$3.30***	***$10.04***
DPS	---	$0.03	$0.04	$0.04	$0.04	$0.16	$0.42	$0.96	$1.54	$1.92	***$2.04***	***$3.00***
Shares[3]	2,906	2,924	3,029	3,029	3,024	2,954	2,772	2,570	2,369	2,114	***2,080***	***1,700***

Citi's earnings-per-share history is clouded by the immense struggles it endured following the Great Recession. However, years of hard work have paid off, and earnings have continued to move higher over time. We see Citi producing $7.50 per share on a normalized basis, and growth of 6% annually. This year's results will be much worse than that.

We believe Citi will continue to see higher revenue as its institutional and consumer businesses gather cheap deposits and lend them prudently, leading to reasonable loss rates and favorable margins. We believe Citi is pulling back on lending at the moment due to less than favorable spreads on loans, which was evident again in Q2. That is a headwind, at least temporarily, as it results in higher deposit costs without commensurate lending revenue, crimping top line and margin growth. In addition, the company's buybacks could be good for a mid-single-digit reduction in the share count

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[1] Estimated date

[2] Estimated date

[3] Share count in millions

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annually, although this is temporarily suspended. We note that even in the recent tumultuous interest rate environment, Citi is performing well. Citi is not as tied to traditional lending as most other banks, so the yield curve is not as critical, but the cost of deposits is important for its massive credit card business. Continued deposit growth that is outpacing lending growth is starting to weigh on margins. Losses to the credit card portfolio will be significant this year.

We're using normalized earnings power of $7.50 per share for our fair value and valuation calculations, which is where we believe Citi would have been without COVID-19 this year.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	11.4	10.4	8.4	11.4	22.8	9.8	9.7	12.3	10.4	8.4	***6.7***	***9.0***
Avg. Yld.	0.0%	0.1%	0.1%	0.1%	0.1%	0.3%	0.9%	1.5%	2.2%	2.8%	***4.1%***	***3.3%***

At just 6.7 times normalized earnings power, Citigroup's price-to-earnings ratio is well below its historical norms. We see a very strong tailwind to total returns from the valuation normalizing over the next five years. We expect the yield to fall over time from its very high level of 4.1% today, to just over 3%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	1%	2%	2%	9%	7%	9%	18%	25%	24%	***27%***	***30%***

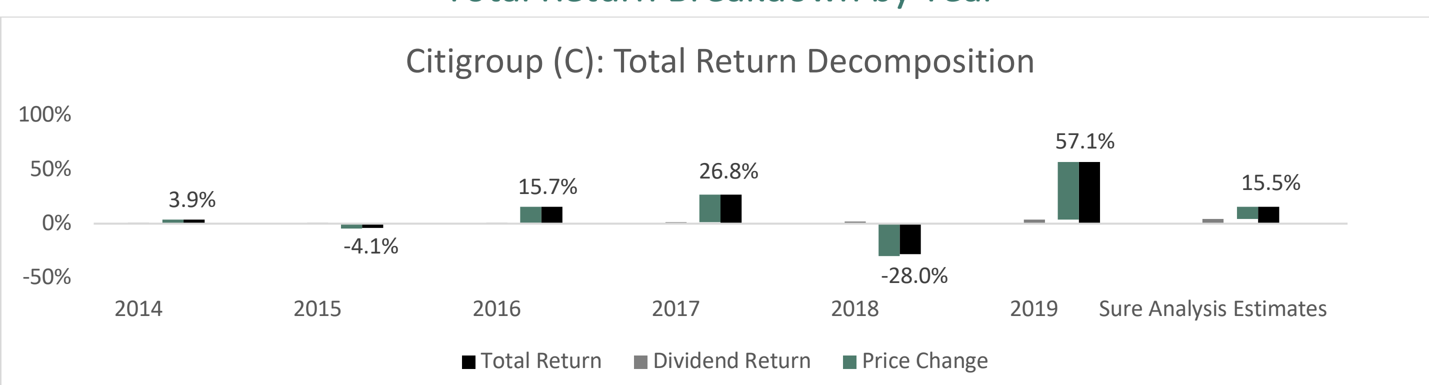
Citi's payout ratio is still just one-quarter of normalized earnings power, and we see it rising to near 30% in the coming years. Citi has spent the past several years trying to build its dividend back to a normalized level, and it is nearly in-line with competitors. Given strong normalized earnings, we see the dividend continuing to rise nicely in the coming years.

Citi's competitive advantage is in its global reach and its large position in the lucrative credit card business. Citi has differentiated itself from the other money center banks in these ways and it continues to serve the bank well. It is very susceptible to recessions as it nearly went out of business in 2008/2009. This downturn will likely not be kind to Citi, although we note that the bank is in much better shape than it was heading into the financial crisis from a balance sheet and business mix perspective. Still, earnings have already suffered materially in 2020.

Final Thoughts & Recommendation

In total, we see Citi as an underpriced security with a few levers to pull for growth. We are forecasting 15.5% total annual returns over the next five years, thanks primarily to its very low valuation. Citi has become an income stock once more and we see it as attractive for those seeking dividend growth, earnings growth potential and deep value. We note that 2020 will be challenging for Citi given its exposure to credit card losses, but the stock earns a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	86,601	77,331	69,190	76,724	77,219	76,354	70,797	72,444	72,854	74,286
SG&A Exp.	30,999	32,937	33,112	31,991	32,239	29,897	29,303	29,698	29,892	30,026
D&A Exp.	2,664	2,872	2,507	3,303	3,589	3,506	3,720	3,659	3,754	3905
Net Profit	10,602	11,067	7,541	13,659	7,310	17,242	14,912	-6,798	18,045	19,401
Net Margin	12.2%	14.3%	10.9%	17.8%	9.5%	22.6%	21.1%	-9.4%	24.8%	26.1%
Free Cash Flow	33,323	61,347	-13,966	59,754	42,957	36,539	50,977	-12,135	33,178	-18,170
Income Tax	2,233	3,575	7	6,186	7,197	7,440	6,444	29,388	5,357	4,430

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets ($B)	1,913	1,873	1,864	1,880	1,842	1,731	1,792	1,842	1,917	1,951
Cash & Eq. ($B)	190	184	138	198	160	133	160	180	188	193
Acc. Receivable	31	---	---	---	---	---	---	---	---	---
Goodwill & Int.	38.210	34.582	33.312	32.783	30.003	27.851	28.337	27.402	27.266	26.948
Total Liab ($B)	1,748	1,694	1,673	1,674	1,630	1,508	1,565	1,640	1,720	1,757
Accounts Payable	51.749	56.696	57.013	53.707	52.180	53.722	57.152	61.342	64.571	48.601
LT Debt ($B)	459	377	291	280	281	222	236	281	264	293
Total Equity ($B)	163	177	186	197	199	205	205	181	177	175
D/E Ratio	2.81	2.13	1.54	1.37	1.34	1.00	1.05	1.40	1.35	1.52

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	0.6%	0.6%	0.4%	0.7%	0.4%	1.0%	0.8%	-0.4%	1.0%	1.0%
Return on Equity	6.7%	6.5%	4.1%	7.1%	3.7%	8.5%	7.3%	-3.5%	10.0%	11.0%
ROIC	1.7%	1.9%	1.5%	2.8%	1.5%	3.7%	3.3%	-1.4%	3.8%	4.1%
Shares Out.	2,906	2,924	3,029	3,029	3,024	2,954	2,772	2,570	2,369	2,114
Revenue/Share	29.18	25.79	22.94	25.22	25.43	25.39	24.51	26.85	29.20	32.79
FCF/Share	11.23	20.46	(4.63)	19.65	14.14	12.15	17.65	(4.50)	13.30	-8.02

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.