Citigroup C.N C US

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Citi Is Different, but Macro Issues Driving

3Q11 Earnings Results

October 17, 2011

Relative rating Remains	**Buy**
Target price Reduced from 41.00	USD 38.00
Closing price October 17, 2011	USD 27.93
Potential upside	+36.1%

EPS of $1.23 ($0.84 ex CVA) vs. Our/Street Estimates of $0.75/$0.82

Revenues were down 8% q/q, with the capital markets businesses the big drag (we think credit and equity trading each was a swing of $500-900mm vs. 2Q11 and canceled out positive surprises such as the $1bn Lending gain); however, Citi showed solid growth in the international consumer businesses, total credit losses fell 12% q/q, the net interest margin was up 1bp, transaction services keep humming along, and operating expenses were down a bit. Meanwhile, capital levels improved and tangible book value grew at an okay 6% annualized clip. On the exposure front, Citi's loan-loss reserves remain healthy at 5.1% even after a $1.4bn reserve release, and the bank's European exposures appear reasonable on a relative and absolute basis. While not a stellar quarter (3Q11 won't be for anyone), we think Citi is managing through this tough environment pretty well.

Macro Outlook Remains Muted, but Citi Has Attractive Attributes

While we would expect consensus EPS for 2012E to come down—we trimmed our 2012 estimate by 5.5% and reduced our price target to $38 from $41—with the stock trading at 0.6x tangible book value, we think the market is overly discounting some of Citi's positive differentiating factors. In our view, these include 1) its international franchise, 2) more limited mortgage exposure (less private label put-back risk, smaller likely foreclosure settlement amount), 3) some potential expense flexibility (positive operating leverage outside the U.S. and YTD expense at the IB is up 3%), 4) more reserve releases to come with the allowance at 5.1%, 5) more limited exposure to the U.S. consumer banking regulatory headwinds, and 6) the potential for less NIM compression than U.S. peers.

Financials Remain Very "Underowned": A Potential Catalyst?

If and when some of the macro clouds lift, we think the meaningful underweight position in financials (in the note we show data as of June 30, and the trend likely intensified in 3Q11) could spark a financials rally as managers look to increase exposures closer to benchmark weightings.

December Year end	2011e		2012e		2013e	
Currency USD	Old	New	Old	New	Old	New
Revenue (m)	78,561	80,824	81,272	81,356	84,633	82,692
Net Income (m)	11,057	12,503	13,460	12,705	15,801	14,867
1Q EPS	1.00 A	1.00 A	1.03 E	0.99 E	1.21 E	1.18 E
2Q EPS	1.09 A	1.09 A	1.17 E	1.09 E	1.35 E	1.26 E
3Q EPS	0.75 E	1.23 E	1.10 E	1.03 E	1.35 E	1.24 E
4Q EPS	0.83 E	0.80 E	1.20 E	1.15 E	1.40 E	1.31 E
Annual EPS	3.65 E	4.13 E	4.50 E	4.25 E	5.30 E	5.00 E

Source: Company data, Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*

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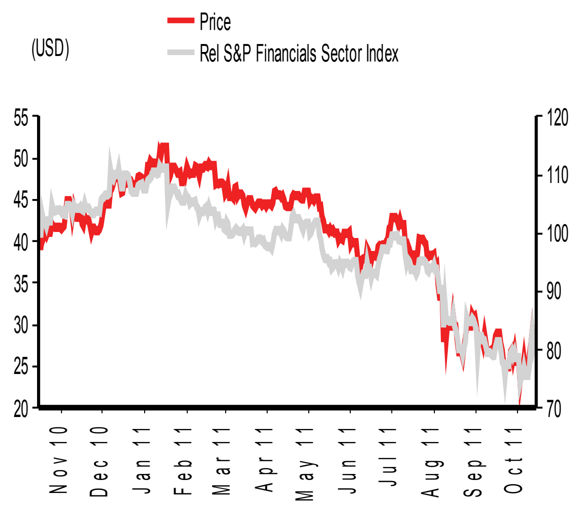
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Key data on Citigroup

Rating

Stock	Buy
Sector	Not rated

Relative performance chart



Source: ThomsonReuters, Nomura research

Performance

(%)	1M	3M	12M
Absolute	3.7	-27.2	-30.0
Relative to sector	3.3	-12.0	-16.6

Market data

Market cap (m)	82,869.8
Shares outstanding (m)	2,917.95

Source: ThomsonReuters, Nomura research

Citigroup

($ millions except per share)	2010	2011E	2012E	2013E
Business Revenues				
Total Regional Banking	32,442	32,855	35,786	38,033
Securities & Banking	23,084	23,159	20,299	18,613
Transaction Services	10,034	10,676	11,716	12,737
Total Citicorp	**65,560**	**66,689**	**67,801**	**69,383**
Brokerage & Asset Mgmt	609	389	600	600
Local Consumer Lending	15,826	12,088	11,356	11,359
Special Asset Pool	2,852	1,131	1,000	950
Total Citi Holdings	**19,287**	**13,608**	**12,956**	**12,909**
Corporate/Other	1,754	527	600	400
Total Managed Net Revs	**86,601**	**80,824**	**81,356**	**82,692**
Business Net Income				
Total Regional Banking	4,733	6,066	6,190	7,055
Securities & Banking	6,579	6,132	5,259	5,000
Transaction Services	3,674	3,579	4,152	4,471
Total Citicorp	**14,986**	**15,777**	**15,601**	**16,526**
Brokerage & Asset Mgmt	(190)	(222)	(35)	(23)
Local Consumer Lending	(4,988)	(2,622)	(2,698)	(1,133)
Special Asset Pool	1,173	738	150	0
Total Citi Holdings	**(4,005)**	**(2,106)**	**(2,583)**	**(1,155)**
Corporate/Other	(46)	(1,154)	(300)	(492)
Total Operating Income	**10,935**	**12,517**	**12,717**	**14,879**
Total Income Avail. To Commoı	**10,485**	**12,503**	**12,705**	**14,867**
Key P&L Metrics				
Earnings Per Share	$3.53	$4.13	$4.25	$5.00
Average Shares o/s	2,906	2,924	2,906	2,906
Common Dividends p/s	$0.00	$0.03	$0.12	$0.16
Dividend Payout Ratio	0.0%	0.7%	2.8%	3.2%
Other Key Metrics				
Estimated TCE	6.9%	7.8%	8.8%	10.0%
Book Value p/s	$56.15	$61.37	$66.01	$70.96
Tangible Book Value p/s	$44.57	$50.33	$54.89	$59.85
ROE	6.7%	7.2%	6.8%	7.5%
ROTE	8.5%	8.9%	8.3%	8.9%
Citi NCLs	30,859	21,347	19,778	17,235
Citi Provision Expense	25,194	13,779	19,278	17,235
Consumer NCO ratio	5.86%	4.43%	4.46%	4.11%
Corporate NCO ratio	1.30%	0.97%	0.66%	0.45%
Loans ($ Billions)	649	634	621	608
Assets ($ Billions)	1,915	1,917	1,841	1,769
Deposits ($ Billions)	845	860	899	945
Loan/Deposits	77%	74%	69%	64%

Source: Company reports and Nomura estimates.

Citi Is Different, but Macro Issues Driving

Citi reported 3Q11 EPS of $1.23 ($0.84 ex CVA) vs. our/Street estimates of $0.75/$0.82. While it wasn't a stellar quarter, we characterize it as "not bad all things considered." Revenues were down 8% q/q (the capital markets businesses were the big drag, with particular weakness in credit and equity trading; we think each was a swing of $500-900 million vs. 2Q11), Citi showed solid growth in the international consumer businesses, total credit losses fell 12% sequentially, the net interest margin (NIM) was actually up 1bp, transaction services keep humming along, and operating expenses were down a bit. Meanwhile, capital levels improved (Basel I Tier 1 common at 11.7%, and management reiterated its goal of 8-9% Basel 3 Tier 1 Common at the end of 2012), and tangible book value grew at an okay 6% annualized clip. On the exposure front, Citi's loan-loss reserves remain healthy at 5.1% even after a $1.4 billion reserve release and the bank's European exposures appear to be in reasonable shape (management even provided details on exposure to France and Belgium). While by no means a stellar quarter (3Q11 won't be for anyone), we think Citi is managing through this tough environment pretty well.

While we would expect consensus EPS for 2012E to come down, we think that investors need to be wary about taking out the positives from 3Q11 (like the positive $1 billion in Lending) without adjusting for some of the negatives (like negative marks in the credit businesses within FICC or the very weak showing in equity trading, which was 74% below Citi's 1Q09-2Q11 average). With the stock trading at 0.56x tangible book value, we think the market is overly discounting some of Citi's positive differentiating factors, which, in our view, include its international franchise, more limited mortgage exposure, and more limited exposure to the U.S. consumer banking regulatory headwinds. We think the stock could be a relative outperformer in the near term, and we reiterate our Buy rating.

Citi Has Some Key Differentiating Factors vs. U.S. Peers
We think Citi has a number of differentiating factors relative to other U.S. universal banks that we think are worth highlighting.

1) **International Loan Growth**. Unlike the anemic U.S. loan growth that is impeding U.S. banks' top lines, Citi continued to show positive international growth trends in 3Q11. As of the end of 3Q11, retail bank loans in Asia, LATAM, and EMEA were up 12%, 22%, and 1%, respectively, on a constant-dollar basis. In addition, while Citi is still investing for international growth, the firm was able to post positive operating leverage in Asia in 3Q11, and management expects positive operating leverage in LATAM in 4Q11.

2) **More Reserve Releases Given Elevated Allowance**. Similar to peers, credit quality continues to improve for Citi, although delinquencies ticked up a bit as portfolios outside the U.S. continued to grow. While we sensed some caution from management on credit costs and future reserve releases (Citi had a $1.4 billion reserve release in 3Q11). We think there is still more to come for Citi with its still-robust 5.1% allowance. With card credit quality continuing to improve, we anticipate that releases may persist for the next few quarters (this is a different tune than what JPM signaled last week).

3) **Less Mortgage Tail Risk**. Relative to its U.S. universal bank peers, Citi has much less private label mortgage-putback risk, is less exposed to a potential foreclosure settlement, and is less at risk for issues related to the FHA should they escalate. Per the 3Q11 disclosure, Citi's exposure includes its $421 billion third-party servicing portfolio, relatively modest $91 billion of private label RMBS issuance (2005-08), and 7% of industry FHA origination volume (2005-08). By any measure, these exposures are a fraction of those of other universal banks (especially Bank of America) individually or in aggregate.

4) **Potential Expense Flexibility**. We have the sense Citi management has increased its focus on managing expense creep, and we think it has some wiggle room to operate in the near term, particularly at the investment

bank (YTD expenses in Securities & Banking are up 3% vs. 2010) . YTD operating expenses are up 5%, but ex-FX, legal, and other episodic items, YTD expenses are up only 2.8%. The company reiterated that it expects to be toward the lower end of its previous guidance of $48-50 billion in annual expenses for 2011(ex-FX, legal, and episodic items). With less legacy mortgage exposure than peers, this should also help Citi avoid elevated servicing and litigation costs.

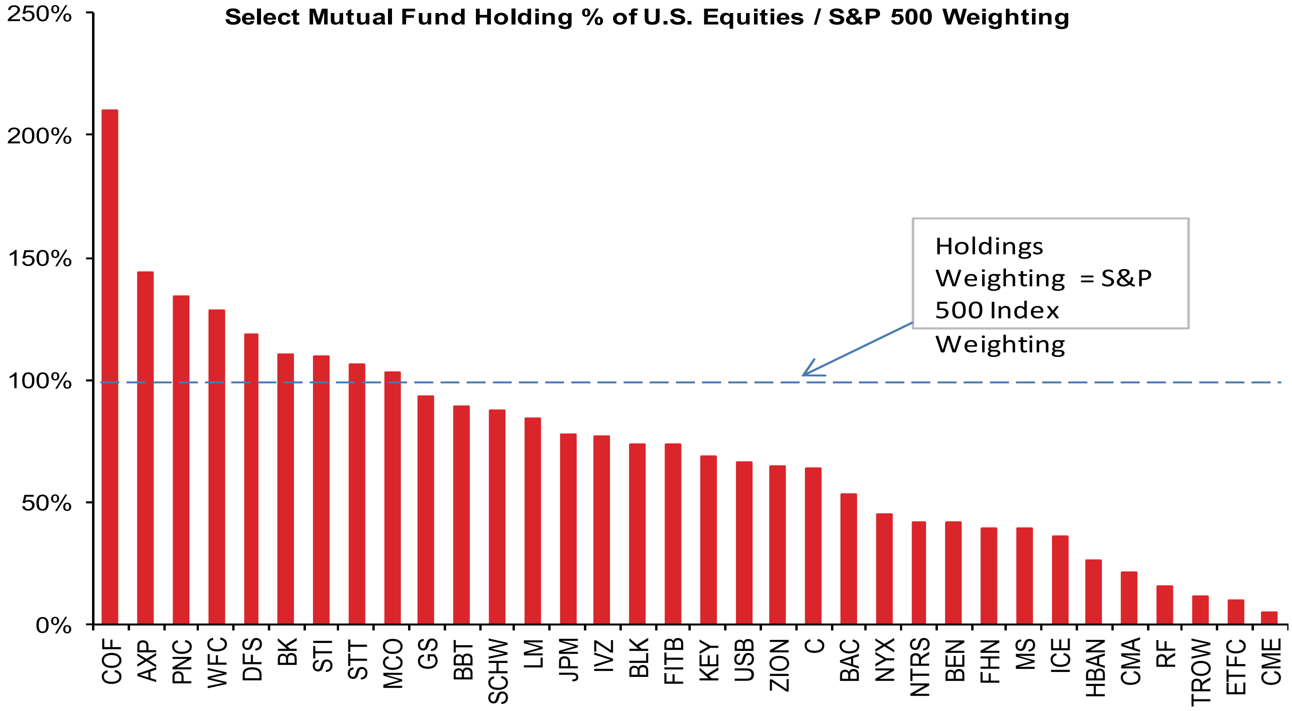
5) **More NIM Levers**. We think Citi defended its NIM, which actually increased 1bp q/q (up 4bp ex FDIC assessment). The company showed it is unafraid to continue to drop deposit rates, and expiring debt maturities (it believes none needs to be replaced, although it will maintain participation) give it some levers to pull to continue to support the margin. We think these factors plus Citi's ability to grow loans outside the U.S. could provide for more NIM stability relative to peers.

Attractive Attributes, and the Stock Is Cheap: Maintaining Buy Rating
We continue to view the stock as attractive, as international growth and credit improvement provide earnings and book growth. With smaller mortgage tail risk, reasonable capital, the potential for some expense flexibility, and greater ability to support NIM than its universal peers, we continue to view Citi as attractively priced. The stock trades at 0.6x TBV, and we continue to find it attractive (although we acknowledge that macro and European concerns may keep a lid on much multiple expansion in the near term). Given the still-difficult earnings backdrop, we reduced our 2012 EPS estimate to $4.25 from $4.50 and our 2013 EPS estimate to $5.00 from $5.30. Our price target goes to $38 from $41, based on 9x our 2012E of $4.25.

Macro and European Concerns May Keep Valuation Contained in the Near Term
Aside from capital markets revenue weakness, we think the high correlation with Citi's stock performance and the concerns regarding Europe will continue in the near term. Citi management provided additional color on the firm's $7.1 billion and $2.0 billion in net funded exposure to the GIIPS (Greece, Portugal, Ireland, Italy, and Spain) and France & Belgium, respectively. Citi noted that its exposure to the GIIPS sovereign entities was $1.5 billion and that it does not have sovereign exposure with France and Belgium. We think the additional disclosure should give investors some comfort, although it's probably impossible to provide a satisfactory answer on potential systemic risk. On a positive note, we think the leaders in the EU are moving closer to some solutions. While it may be a bumpy ride in the near term, we think the weight of the EU uncertainty could be reasonably reduced over the next six months (and, at a minimum, investors should feel good about Citi's exposure relative to its universal bank peers).

Financial Underownership Is Meaningful and Could Eventually Be a Catalyst
The choppy macro environment, mortgage tail risk, and systemic risk issues stemming from Europe have led to widespread underownership among a swath of financial companies. In Figure 1, we analyzed 30 of the largest active domestic equity funds for their financial stock ownership trends in comparison to the financial stocks' S&P 500 weighting. We believe that, post the swoon in financial stocks in 3Q11, the level of underownership that we show as of June 2011 has likely become more acute. If and when some of the macro clouds lift (such as a credible solution for the EU sovereign debt crisis), we think the meaningful underweight position in financials could spark a rally in the stocks as fund managers look to increase their exposures closer to benchmark weightings. While it may not happen in the near term, we do think this underweight trend could look very different 12 months from now.

Fig. 1: Ownership Analysis as of 6/30/11 (30 of the largest domestic actively managed funds)



Source: FactSet, Nomura research

Appendix A-1

Analyst Certification

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Mentioned companies

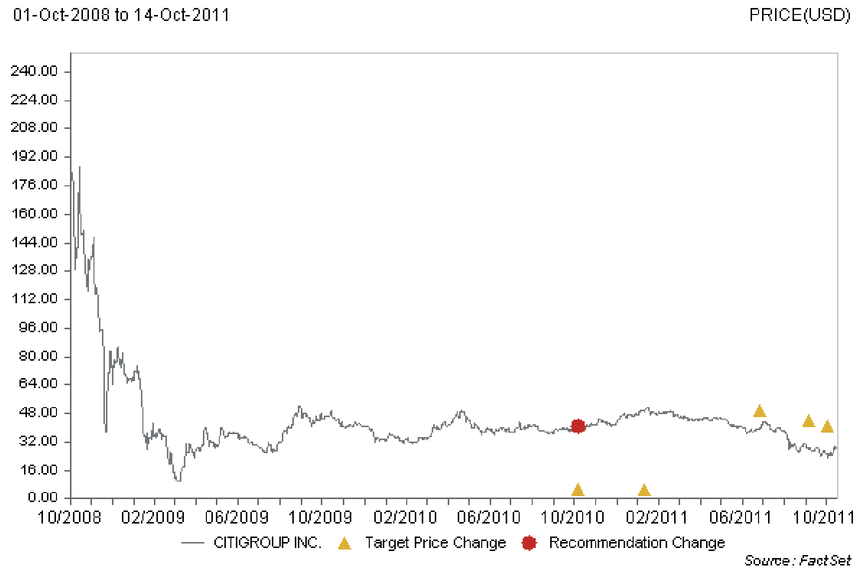
Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Citigroup	C US	USD 27.93	17-Oct-2011	Buy	Not rated	

Previous Rating

Issuer name	Previous Rating	Date of change
Citigroup	Not Rated	06-Oct-2010

Citigroup (C US) **USD 27.93 (17-Oct-2011)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
03-Oct-2011		41.00	23.11
06-Sep-2011		44.00	27.70
27-Jun-2011		50.00	39.99
11-Jan-2011		5.50	49.40
06-Oct-2010		5.00	41.00
06-Oct-2010	BUY		41.00

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our $38 price target for Citigroup is based on 9x our 2012 EPS estimate of $4.25, below Citi's historical average, as we expect ROEs to remain below historical levels in the near term. The benchmark for this stock is the S&P 500 Financials Index.

Risks that may impede the achievement of the target price Risks to our $38 price target for Citigroup include the following factors that could be below or worse than our expectations: regulatory risk, interest rate risk, general economic conditions that affect credit costs, changes in asset prices, availability of funding, credit spreads, capital market activity levels, litigation risk, and potential losses on sales of businesses in Citi Holdings.

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STOCKS

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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

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Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009 (and ratings in Europe, Middle East and Africa, US and Latin America published prior to 27 October 2008)

STOCKS

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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published prior to 30 October 2008

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