NASHVILLE NOTES

Citigroup Bora Bora

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The *Financial Times* reported last week that Citigroup Inc. was beginning the process of firing tens of thousands of workers as part of a restructuring effort codenamed Bora Bora. As of the end of the third quarter, the company had about 248,000 employees.

If there is a story about why the project is codenamed Bora Bora, I have not seen it. However, Wikipedia offers this perspective: "In ancient times the island was called *Pora pora mai te pora*, meaning 'created by the gods' in the local Tahitian language." Perhaps the name is an allusion to the magnitude of the project for a company that has struggled to become its best self since Travelers and Citicorp merged to form the current iteration of Citi in 1998.

Since Jane Fraser took over from Michael Corbat as CEO in early 2021, her team has been laying the groundwork for a significant restructuring of the company that has produced less than mediocre returns on equity since exiting the government intensive care unit after the financial crisis. Among the milestones is an exit from eight of the 14 targeted international consumer banking markets, as the "new" Citi will be focused more on corporate/investment banking, markets, cards/retail and wealth management.

Among the financial goals are a 4% to 5% compound annual growth rate in revenues, sub-60% efficiency ratio and 11% to 12% return on tangible common equity (ROTCE) "in the medium term." In the last 12-month (LTM) period ended Sept. 30, the company produced an efficiency ratio of 68% and ROTCE of 8%, according to S&P Global Market Intelligence data. The LTM ROTCE for competitors JPMorgan Chase & Co. and Bank of America Corp. was 23% and 16%, respectively. Ironically, investment banking and capital markets competitor Goldman Sachs Group Inc. also posted a dismal LTM ROTCE of 8%.

> ***Jane Fraser's team has been laying the groundwork for a significant restructuring of the company that has produced less than mediocre returns on equity since the aftermath of the financial crisis.***

It is rough math, but if Citigroup cuts 10% of its head count and thereby reduces compensation and benefit costs by 10% as well, then pretax income would increase by upwards of $3 billion based on $29 billion of compensation costs. The LTM efficiency ratio would improve to about 64% from 68%, ROTCE to 9% from 8%, and earnings per share to $7.50 from $6.31.

Of course, it is easy to make numbers work in Excel and PowerPoint. That said, Citigroup has made two notable reductions since the financial crisis.

One is head count. As of year-end 2007, the company had 410,000 employees. By year-end 2019, the number of employees declined to 211,000. Some reductions were attributable to businesses the company exited, such as manufacturing and trading subprime collateralized debt obligations. Nonetheless, the company produced a 58% efficiency ratio and a 12% ROTCE in 2019 — metrics that are aspirational today.

Since then, negative operating leverage has occurred, as the number of employees had climbed to about 248,000 by Sept. 30. Some of the increase was attributable to increased compliance requirements. In October 2020, Citigroup's primary banking subsidiary, Citibank NA, entered a consent order with the Office of the Comptroller of the Currency regarding deficiencies in "data governance, risk management, and internal controls that constitute unsafe or unsound practices and that contributed to violations of law or regulation."

My assumption has been that whatever regulatory and compliance issues existed at the company then, they were overshadowed by the August 2020 blunder that saw Citibank as administrative agent mistakenly wire $900 million of principal rather than the interest received from debt-laden Revlon to the syndicate lenders. Although Citigroup ultimately retrieved its funds through litigation, the regulatory penalty (assuming my premise is correct) has been high in the form of much greater compliance spending.

> ***Share repurchases set the stage for somewhat better performance over the last decade, but the absence of operating leverage in the last several years via a high efficiency ratio has lessened the positive impact.***

The other reduction is in outstanding common shares. Forgotten, I think, in the aftermath of the global financial crisis is that some banks incurred massive dilution through raising boatloads of common equity at very low prices. Citigroup's issuance was especially notable.

As of year-end 2007, the company had 499 million common shares outstanding. By the end of 2012, outstanding shares increased sixfold to 3.0 billion. Over the next decade, the number declined by about 37% to 1.9 billion. The repurchases set the stage for somewhat better performance over the last decade, but the absence of operating leverage in the last several years via a high efficiency ratio has lessened the positive impact of the much lower share count.

It is not hard to be a little bit cynical about Citigroup's current restructuring given the company's history, but it may prove to be successful, or mostly so, in time. If so, the stock could prove to be a great buy trading near 50% of tangible book value as of Nov. 20. If not, "value trap" may be the better descriptor.

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