

**Recommendation: SELL**

**NYSE: C**

**Fundamental Highlights**

- Stock failed to provide an adequate return for the past year.
- Lowest EBITDA Margin among Comps.
- Lowest Gross Margin Among Comps
- EPS Growth below industry average
- Scandal in Japan may hurt image.

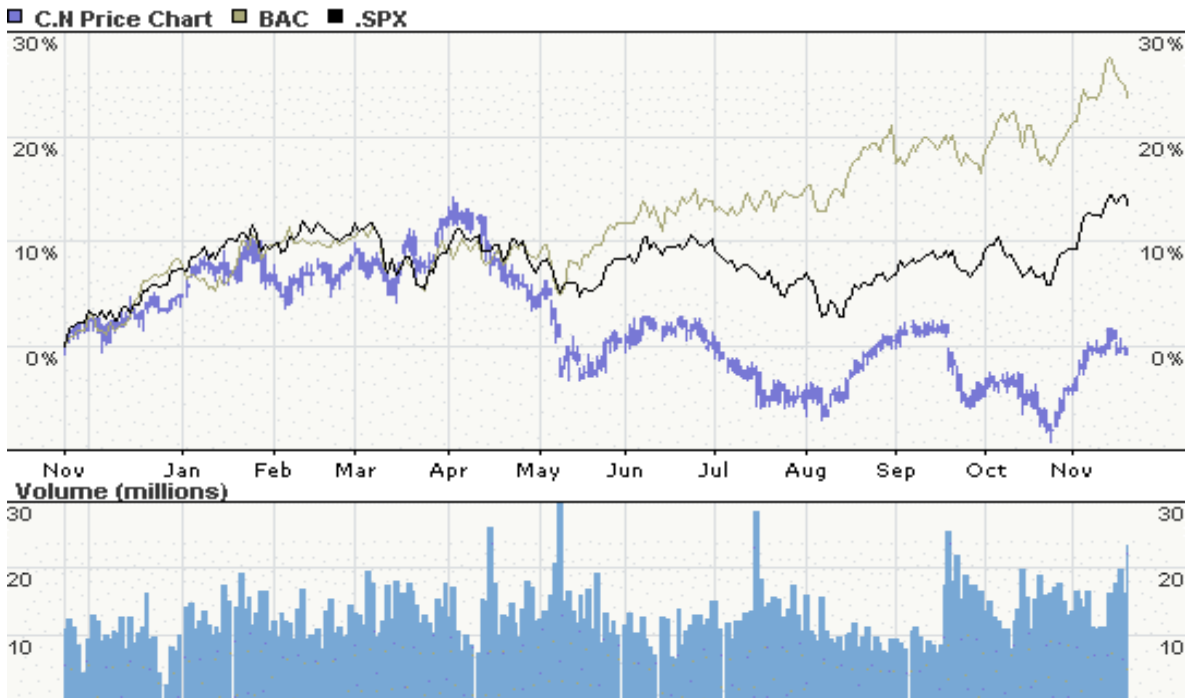
**Valuation Highlights**

- Overvalued on P/E terms
- Highest EV/EBITDA among Comps.
- Price expected to decline.
- Higher PEG than main competitor's.
- Slightly overvalued on a DCF basis.

**Key Financial Information**

Recent Price	\$45.15
52 Week High	\$52.88
52 Week Low	\$42.10
5yrE EPS Growth	
P/E (CFY)	14.93x
EPS (TTM)	\$3.15
PEG	1.89
2005E EPS	4.39
EV/ EBITDA (LTM)	12.4
EV/ EBITDA (NFY)	16.6

**Exhibit 1: Charting Citigroup against BAC and S&P 500**



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## ***Company Profile***

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Citigroup Inc., incorporated in 1988, is a diversified global financial services holding company whose businesses provide a range of financial services to some 200 million consumer and corporate customers in more than 100 countries. The Company's activities are conducted through the following business segments:

### Global Consumer

Global Consumer delivers an array of banking, lending, insurance and investment services through a network of local branches, offices and electronic delivery systems. Global Consumer includes Cards, Consumer Finance and Retail Banking.

### Global Corporate and Investment Bank

GCIB provides corporations, governments, institutions and investors in approximately 100 countries with a range of financial products and services. GCIB includes Capital Markets and Banking and Transaction Services. Capital Markets and Banking offers an array of investment and commercial banking services and products, including investment banking, debt and equity trading, institutional brokerage, advisory services, foreign exchange, structured products, derivatives and lending.

### Private Client Services

Private Client Services provides investment advice, financial planning and brokerage services to affluent individuals, small and mid-size companies, non-profits and large corporations primarily through a network of more than 12,200 Smith Barney Financial Consultants in more than 500 offices worldwide.

### Proprietary Investment Activities

Proprietary Investment Activities consists of Citigroup's proprietary Private Equity investments and Other Investment Activities, which includes its proprietary investments in hedge funds and real estate investments, investments in countries that refinanced debt under the 1989 Brady Plan or plans of a similar nature.

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## ***Investment Thesis Summary***

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Even though Citigroup is the world's largest financial services firm and has over \$1 trillion in assets, we feel that other companies in the money center banks sub-sector could add more to our portfolio's overall performance. This came to our attention when we began to analyze Citigroup's performance mainly over the last year that it has been held in the portfolio. Its performance over the past year has been poor, resulting in an almost negligible return excluding dividends. Comparing this to what the other comparable companies or banks were returning to their shareholders led us to our basic premise which is that Citigroup is not the best company to be held in this industry. After

evaluating the future prospects of various close competitors we concluded that the best course of action would be to trade Citigroup for Bank of America. We feel that it is important that this takes place as soon as possible because of the possible gains the portfolio as a whole is forgoing by continuing to hold a company that barely returned enough in the past year to keep pace with inflation. Our discounted cash flow (DCF) analysis across the different models resulted in pricing Citigroup remarkably close to what it is actually trading at the moment. This reinforces our suggestion that it is a good time to sell without having to take a loss. It also makes us feel confident that we are not foregoing a future positive price adjustment that would have resulted in profits had we decided to hold the stock. In the continuing analysis we will provide a thorough analysis of the points we took into consideration before reaching our conclusion.

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## *Comparable Company Analysis*

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### **Exhibit 2: Key Comparable Ratios**

	Citigroup	BAC
P/E (TTM)	14.3x	11.8x
LFY Gross Margin	81.80%	89.98%
LFY EBITDA Margin	30%	45.40%
ROE	16.10%	31.52%
ROA	5.70%	8.30%
Projected ROE	23.35%	34.12%
Dividend Yield	3.60%	4.15%
EV / EBIT	16.62%	13.96%
P/E / G	1.89	1.24

The ratios presented in the previous exhibit are the basis for our analysis. The first ratio is the P/E ratio that deals with the valuation of the company. Citigroup is trading at 14.3 times earnings, which basically means that we are paying \$14.3 in price for every dollar in earnings. Bank of America on the other hand is trading cheap relative to Citigroup at \$11.8x. Enterprise value, which is the actual economic value of a firm, divided by EBIT represents the value of the firm in relation to its earnings before interest and taxes. In other words the lower the ratio the cheaper the company is trading in relation to its EBIT. This again is favorable for Bank of America compared to Citigroup. The PEG ratio is sometimes a better indicator of how the firms are being valued because it takes into account future growth in earnings. This being so, it also concludes that BAC is undervalued in relation to Citigroup. Continuing with the profitability ratios we can see that BAC has a higher gross margin than does Citigroup (90% > 82%). This accounts for BAC being more effective and being able to retain more of total revenues after deducting the expenses directly related to the sales. The EBITDA margin shows an even greater discrepancy between the two companies. The difference of slightly more than 15 percentage points again represents how BAC is better able to control its expenses and in doing so increase overall profitability. BAC was able to generate a far greater return to its shareholders in terms of return on equity (ROE). Total ROE was an overwhelming

31.52% compared to Citigroup's 16.10%. This represents how much net income was generated as a percentage of the book value of equity. Projected ROE for 2005 also favors BAC by a difference of almost 10 points that represent the outlook that BAC will continue to outperform Citigroup well into the future. BAC also created a better return in terms of return on assets, which is measure of how effective management was at employing the company's total assets. The difference in ROA was approximately 3 points but nevertheless it continues to put BAC in a better position than is Citigroup. BAC's dividend yields 4.15% compared to Citi's 3.6%. This reinforces the notion of BAC being a better value company than is Citi. The difference could be misleading in the case that BAC's share price had fallen, hence resulting in a greater perceived yield. In fact, the exact opposite has occurred. BAC's share price has been advancing while Citi's has either decreased or remain constant in the past twelve months.

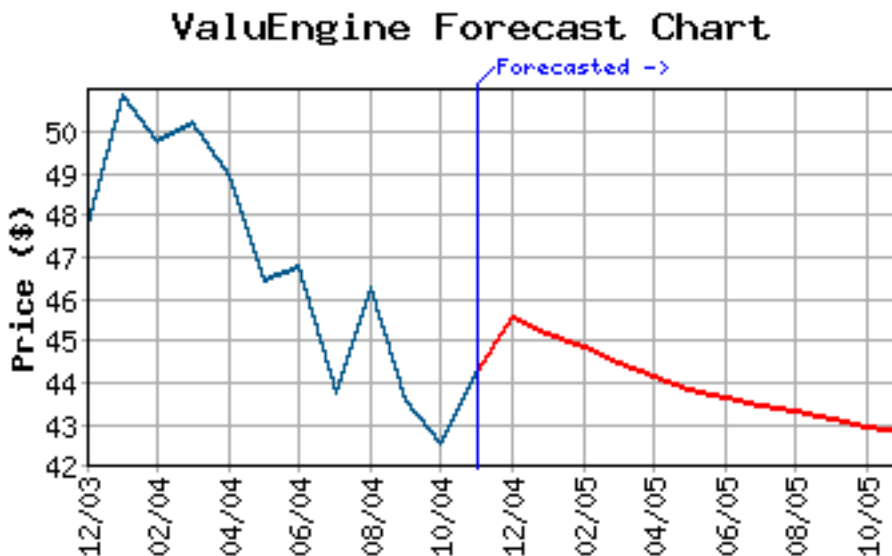
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### *DCF Valuation Analysis*

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The discounted cash flow analysis we performed on Citigroup resulted in a target price of \$45.77, which is almost identical to what the stock is currently trading at (\$45.15). The difference could be better attributed to a margin of error in the forecasts than the stock actually being undervalued. Our valuation leads us to believe that it is indeed trading at a fair price. The target price also makes us more confident in recommending a sell because it eliminates the possibility that the stock is undervalued and that the market has not yet adjusted for this. In other words we are not risking potential future capital gains by selling the stock at its current price. On the other hand, our research on BAC concludes that it is indeed undervalued, trading currently at \$45.85 and having a target price of approximately \$53.00. The following chart from Hoover's supports our goal of selling our holdings of Citigroup at the moment because not only will the stock not advance, it will most likely fall in the next year.

**Exhibit 3: Target Price Forecasts for Citigroup**



The previous exhibit not only reveals that the future for Citigroup does not appear favorable, but also shows that the estimates are in line with our intrinsic value from the DCF analysis. Hoover's highest price is forecasted to occur this coming December at around \$45.60. Our model resulted in valuing it at \$45.77 and we consider the difference to be negligible. The following exhibit is a forecast done by Hoover's of Citigroup's price movements for the near future:

**Exhibit 4: Estimated Target Prices for Citigroup**

Source: Hoover's	Target Price	Return
1 Months	44.83	-0.70%
3 Months	44.14	-2.25%
6 Months	43.07	-4.62%
1 Year	43.1	-6.75%
2 Years	41.72	-7.59%
3 Years	41.82	-7.37%

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***Conclusions***

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We feel confident in our sell recommendation because nothing in our research leads us to believe that there is a reason that Citigroup could contribute more to the portfolio than Bank of America. Every one of the ratios examined reinforces our suggestion, and makes BAC undoubtedly a better company to hold than Citigroup. Our DCF also leads to the same result concluding that Citigroup is currently fairly priced and that there are greater profit potentials in owning BAC.