TRANSCRIPT

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HOST
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SPEAKER
Mark Mason, Citi Chief Financial Officer

QUESTION AND ANSWER

GERARD CASSIDY: Good morning, everyone. This is Gerard Cassidy from RBC Capital Markets. Thank you for joining us. Our second fireside chat today is with Citigroup. We have Mark Mason, the Chief Financial Officer. Mark became the Chief Financial Officer back in February of 2019. And as we all know, Citigroup is one of our largest banks in the United States as well as the world with almost $2 trillion in assets. They've got a market cap of about $108 billion. And with us, as I mentioned, Mark Mason, CFO. Welcome, Mark.

MARK MASON: Thank you, Gerard. It's nice to be here. Thanks for having me.

GERARD CASSIDY: You're very welcome, and it's a real privilege and we're very lucky to have you with us, and again, thank you. Let's start off with maybe a macro question for you. There's been increasing concern about the possibility of a macroeconomic slowdown. And given your global presence, what are you seeing out there and what do you think are the biggest business risks faced by large universal banks like Citigroup?

MARK MASON: Sure. When I think about that question, I really have to think back to the way we ended the year. If you think about the way we ended 2019, there were concerns around trade, around the unrest in Hong Kong. We had just experienced three rate cuts in the back half of the year. And I sit here today, we sit here today and we're looking at a very different set of issues. I don't think any of us expected something of this nature to take hold when you think about the coronavirus as we've entered the year. And you can kind of just look back to just the difference between January and February and think about the headlines in terms of sentiment around growth. We were thinking and looking at GDP growth of 3% or so, and now we're hearing a sub-2% prospect of GDP growth. So things have changed very, very quickly. On top of that, we get a 50 basis point cut last week with the expectation of additional cuts as soon as next week. All of those things are meaningful.

And so as I sit here and think about it, I think the prospect of slower growth and an impact on growth more broadly is certain. And you can see it, when you look at – if you just look at Asia and you look at the manufacturing production numbers that are coming out of Asia, we can look at the purchase sale volumes coming out of Asia. We can look at corporates adjusting their expectations. Gerard, the simple fact that we're doing this conference call via virtual, we're doing this conference via virtually, is again evidence that there's going to be an impact from many of these macro factors that are out there.

The question is whether it's a delay or if it's a complete loss of business activity. And look, there are many unknowns that are still out there in terms of how the virus continues to spread and at what pace. We, as you would imagine, are doing everything that we need to do to protect the health and safety of our employees and our clients. We've done everything from restricted international travel to discouraged domestic travel. We have moved to split operations in order to ensure not only the health and safety, but that we can continue to service our clients, so we've taken a number of proactive efforts in that regard.

And then there's the other piece, which is how this plays out across the businesses. We obviously have operations in Asia. With Asia, it represents about 20% of our revenues. About half of that is institutional, about half of that is consumer revenues. If you think about the countries most impacted, China, Hong Kong, Japan, Korea, they represent about 8% of our revenues. And we've seen kind of mixed activity there. Activity obviously that involves direct consumer engagement has come to a halt. That said, activity that is geared around the investments we've made in digital capabilities, we've seen continued good activity there in terms of clients or consumer customers trading and what have you, things they can do online versus requiring direct engagement.

On the corporate side, we have a large corporate client base broadly, in and outside of Asia, and the impact there will vary depending on the sector. So certain sectors like hospitality and travel, we've seen the impact of that already. On the flip side, we've also seen a flight to quality as it relates to deposits. And you'd expect to see that I think in uncertain times, and we've certainly experienced that thus far. We've also seen market volatility. So think about the significant decline in equity valuations, the 10-year being meaningfully down. Those types of things are creating volatility, causing our clients to engage, to take positions. And it obviously creates opportunities for us to serve those clients, and that flows through as a benefit in our Markets revenues. And so there's a mix of things that are playing through, some puts and takes, as you would imagine.

One interesting fact, Gerard, if you think about the investments we've been making in digital capabilities, that actually is playing through in this type of environment as well. I mentioned it on the consumer side in our ability to continue to engage with clients. It's also true on the institutional side. The investments we've been making and our ability to onboard clients digitally in our TTS franchise as well as the digital investments we've been making in trade, which for example, has enabled us to kind of help different clients in Hong Kong to onboard their activity, but also to facilitate the trade that they need to do with their suppliers. And so lots of puts and takes, still early in terms of what the longer-term implications might be, but we're engaged with clients. We're actively trying to service them through the uncertain period of time, and we'll see how it plays out.

GERARD CASSIDY: That's very helpful, Mark. That was very broad-scoped. Thank you. Moving to the first quarter, if we turn to the operating environment so far this quarter, how are the equities and FICC trading revenues relative to a year-ago period? But also, how are the investment banking pipelines holding up, and are there any other updates you can give us on the quarter?

MARK MASON: Sure. As I mentioned earlier, we're seeing kind of macro factors, including the coronavirus, including the 50 basis point emergency cut, other central banks taking action, oil prices. All of those things are impacting the operating environment that we're in today. I think the more volatile market conditions and the large intra-day swings we've seen have resulted in higher trading revenues year over year across the franchise. Conversely, those same swings are having a dampening impact on investment banking activities. And so while the market has been volatile, based on our performance so far this quarter, we would expect Markets revenues to be up in the mid-single-digit range this quarter, maybe a little bit higher year-over-year. And assuming a continuation in the trends that we're seeing, we would expect investment banking revenues are likely to be down year-over-year in the first quarter, although we would expect to continue to take share. And we continue to have constructive dialogue with our clients, and the investment banking pipeline remains strong.

As I think about our accrual businesses like TTS, so far in the quarter we've seen good levels of activity, solid client engagement. I mentioned deposit volumes, but that's offset by the impact of a lower rate environment and some of the macro softness due to COVID-19 and particularly in parts of the world like Asia. So net-net, we could see flattish revenues in TTS this quarter, and I'd say we continue to expect or we would expect, I should say, revenues to be down slightly in Asia consumer just given the slowdown in activity that I referenced earlier.

And I guess finally, I would comment on the cost of credit. We'll see where we end up for the end of the quarter or for the end of March. But at this point, we would expect an increase in reserves this quarter just given the macro environment.

GERARD CASSIDY: Very good. Another topic that has received a lot of attention is the evolving rate environment that you've touched on. Can you talk a bit more about how the current interest rate environment impacts Citi and what you're expecting on a go-forward basis here in the US?

MARK MASON: Sure. I think the best way to describe it is the interest rate environment is obviously evolving and it's quite fluid. And again, we've seen the US move, we've seen other central banks move. We're all aware of the 50 basis point reduction we saw on March 3 and the prospect of another as soon as next week. That's a very different forward curve than we were talking about certainly on the fourth quarter earnings call. And so just it's difficult to predict the impact of this coronavirus and therefore difficult to predict the additional actions that the Fed or any of the other central banks, for that matter, may take.

But that said, we've previously discussed that we've been bringing down our interest rate exposure for more than a year now. And you can see that if you look at our 10-K as a reference point, and yes, there are all types of approximations that are involved in that. But based on the host of assumptions that are included in those estimates, I would expect that our current NIR sensitivity to lower rates is somewhat modest. You can just see the math there and you can see that it's somewhat modest.

And if I think about what all this means in terms of net interest revenue in the first quarter, as we sit here today, I'd say we would expect total firm net interest revenue to be down modestly year-over-year in the first quarter. So we will see an impact from lower rates, and that's going to obviously play through our accrual businesses, but I'd point back to the fact that we are seeing good client engagement, and that's what's really going to matter over time. And so obviously, I'll have more to say on that in April on the first quarter earnings call, but that's kind of what we're seeing thus far.

GERARD CASSIDY: Very good. And shifting over a bit, you mentioned this market volatility that we've been seeing, and one area that it's obviously been very volatile is the price of oil. It's come down significantly in the last several days. We recognize you don't have a very large energy portfolio, but what type of impact could this have on your energy loan portfolio?

MARK MASON: We have seen obviously a big drop in oil prices. I think if you look back at our fourth quarter disclosure, as of the fourth quarter we had corporate credit exposure to the energy sector clients of about $59 billion, and that would cover both funded and unfunded commitment. Consistent with what you've heard us say about our entire ICG portfolio, it is predominantly investment-grade, nearly 80%, which is really aligned with our target market strategy that you know well, Gerard, in terms of serving large multinational corporations.

And from a geographic point of view, that $59 billion, that energy sector client exposure, about three-quarters of it is in North America and Western Europe. In terms of the funded exposure, about $21 billion of it is funded or about 3% of our total loans. And 70% of that is investment-grade, as I kind of alluded to earlier.

Look, given the drop in oil prices, we are obviously intensely focused on that sector and on our exposure there. I'd say that when you look at the contours of the book, the size, the quality of the book, the regional concentration, it's been remarkably consistent over the past few years. And in fact, if you look back at the last oil patch crisis in 2015-2016, you would have seen us take additional reserves through the period, and that could potentially happen again this time around too. But if you think about last time, I think it would be important to note how we managed through that period and the work we did to mitigate losses before they occurred and ultimately resulting in the release of the bulk of those reserves. And so look, we're monitoring this very closely. But given our target client strategy and our risk appetite framework, we feel good about our ability to manage through as we've done in the past.

GERARD CASSIDY: That's very good. Speaking of credit more broadly, it appears largely benign around the world. The industry and yourselves have seen some great credit metrics over the last five years or so.

Given that, can you remind us what your outlook is for credit quality? What are some of the early warning signs that you guys are keeping your eyes on, and what loan areas do you think could be the problematic loan areas?

MARK MASON: Look, overall we feel good about the credit quality of our portfolio. Given the quickly evolving macro environment, where we're obviously monitoring it closely, similar to the comments I made on energy and we're looking for early signs of stress on the consumer side. Our target client strategy is geared around high-quality consumers. And you see that when you look at the NCL rates across the consumer business there. They're largely in line with the medium-term outlook that we gave back at Investor Day in 2017.

The delinquency and the loss statistics that we disclose are tracking very nicely. We obviously look at payment rates. We look at min pay and other factors in addition to the macro indicators to ensure that we are positioned to kind of pick up on any early signs of stress that may pop. And look, it goes without saying that there will be an impact, and we're looking for the potential impact from the coronavirus.

On the institutional side, the credit costs have continued to normalize, and they've grown modestly. Again, given current events, we're monitoring that exposure very, very closely. I mentioned the quality of that exposure, which I think is important in terms of the high percentage, the 80% being investment-grade. That being said, we take risks as part of our business. That's what we do, and we would not be immune to an overall economic slowdown. We are seeing some requests from our corporate clients for additional liquidity in all the sectors that you would expect in terms of hospitality, travel, cruise lines, et cetera, and we're working through that as appropriate to support their needs. But we're focused on it. We're prepared to take the appropriate actions to maintain credit performance if any of those indicators start to change in any meaningful way.

GERARD CASSIDY: Okay. Just speaking of risk, Citigroup is uniquely positioned with your global network here in the States. Can you share with us, do you think investors overstate the risks associated with your emerging markets exposure?

MARK MASON: It's a good question. I think people sometimes revert back to the Citi of 10 – 12 years ago. And we've simplified our business model and sharpened our focus pretty meaningfully versus 10 – 12 years ago to serve clients who really value the global capabilities that we bring, and those are the large multinational corporates, other multi-currency clients. And so when I think about our footprint, I think about our global model, it's really important that we also think about, talk about, be cognizant of the clients that we're covering and the quality of those clients and therefore the quality of our exposure that I referenced earlier.

So on the corporate side, loans to emerging market clients, they represent about 30% of the corporate loan book, $126 billion or so. Over the past 10 years, the average loss rate, the average annual loss rate has been 16 basis points. And again, I think that reflects the credit quality of those underlying VARs. It reflects the terms, the structures that we've put in place, but very, very low loss rates. It's also kind of important to note that in many of those countries where we operate in emerging markets, it's around ICG specifically, where our sole mandate is to serve the subsidiaries of these large multinational clients and to serve them with day-to-day cash management needs, with FX, with local funding needs. And so it's really important that we don't lose sight of the type of business we're doing and the clients that we're doing that business for.

I'd say on the consumer side, our global footprint is also driven by our target customer, again, high credit quality consumers. And here too, the loans to emerging market customers represent roughly 30% of our total consumer loans, so about $91 billion. Our average annual loss rate for this book has been roughly 200 basis points over the last 10 years. So while the market thinks of emerging markets and sometimes equates that to greater risk or volatility, we've actually had a uniquely stable, high-quality, efficient business with a high-quality client base and strong returns.

GERARD CASSIDY: That's very helpful. When we look at your global presence, can you discuss the benefits and the risks of having this presence across nearly 100 countries?

MARK MASON: The way I think about it is that our clients have business needs or opportunities in at least 100 countries. The clients that we're focused on have broad global needs. They're sometimes complicated needs, but they have needs across the globe. And we operate the largest proprietary financial network of any financial institution, and we've got direct connectivity to the banking systems in those countries. And this global platform and this strategy, we think of as a significant competitive advantage, allowing for us to serve the needs of those clients in those countries.

And you see it if you just think, for example, you see it in times like this. So last year, we saw a renewed focus among our clients in assessing their supply chains, especially as it related to China and new tariff structures, including evaluating options for how they move production facilities to other low-cost locations. And in some ways, that remains true today, just given the fluid and ongoing situation with regard to coronavirus and the potential disruption and realignment of trade flows and supply chains that could come out of that. And so the breadth of our global network, including relevant in this case our pan-regional presence across Asia-Pacific, we're uniquely positioned to advise clients on potential shifts and to service frankly their broader needs and their linkages outside of TTS and across the rest of our ICG platform that, again, creates unique opportunities for us.

GERARD CASSIDY: Thank you. It's that time of year for all the big banks to be doing their CCAR preparations. Obviously, Citi has been very consistent in the past three years in the amount of capital they've returned to their shareholders. Now that we've received these 2020 CCAR guidelines, including the adoption of the stress capital buffer or SCB as it's called, do you have any early thoughts on this front?

MARK MASON: Look, we're right in the middle of CCAR and the CCAR process right now. We're deeply entrenched in it, as you would imagine. Yes, the guidelines did come out about a week ago. We're still working through those. I'd say, Gerard, obviously the clarity as it relates to SCB is a positive. But we're working through the 2020 cycle right now, and we feel good about the CET1 target that we have, the 11.5%. And we'll share more of that as we kind of further assess the implications of the final rule that's come out. But there's really not a whole lot more to say at this point, we're working hard at it.

GERARD CASSIDY: Very good. We have about five minutes left, Mark. Maybe one question on technology, can you just walk us through some of the technology investment priorities that Citigroup has?

MARK MASON: Sure. So look, there are a couple of things on technology. So one, I think that if I think about the way the industry is emerging – or evolving, I should say, it's pretty apparent to us that technology is going to continue to be critically important. And frankly, it's the institutions that have scale and the ability to invest in technology that I think will be the ones that can continue to differentiate themselves as winners over time.

And we, as you know, make significant investment in technology. We spend roughly 20% of our total expense base on technology, so that equates to roughly about $8.5 billion or so. It's split equally between run the bank and build the bank. But in some ways, we think the real question is how technology and operation expenses work together. So even if you're spending more on technology, you can still bend the curve on our overall expense base. The investments we're making today in digital and technology are happening in parallel with existing operations, so call centers, data centers, branch infrastructure, et cetera. But as we continue to shift customers to digital and apply automation internally, we can take out even more of our operations cost.

When I think about the way we're spending on technology, look, we've shifted our investments to client-facing initiatives to improve the client experience on the consumer side and drive digital engagement. And you've seen that in 2019 as we've rolled out products like Flex Loan or products like Flex Pay as we've built out servicing centers that are multi-product so that they can handle the multi-relationship clients that we're growing on the consumer side.

On the institutional side, we've got an industry-leading digital banking platform. We're constantly looking to upgrade those capabilities for and with clients. You've heard me reference in the past the co-development of solutions for clients leveraging technology, developing that with clients, developing that with other FinTech players. And so technology, critical to our own operations, critical to the operations of our clients, critical to the solutions that we're developing to address their pain points. And again, I think scale plays to our benefit in terms of being able to develop those technologies in different parts of the world and leverage it across the many different clients that we have available to our franchise.

GERARD CASSIDY: We have time here for one last question, Mark. As we're sitting, as people are listening in to this call, and if you were sitting in the audience or if you were listening to the call as an institutional investor or an individual investor, what one question would you ask a CFO like yourself?

MARK MASON: I kind of alluded a little bit to it. I guess the question that I would ask is how they think about what differentiates them in terms of their ability to compete, just again, given the changes that we're seeing in the banking industry, driven by technology, driven by demographics. And as I think about that for Citi, I think we are well-positioned relative to the changes that are out there today.

If I think about – for us, I think about the path being our ability to leverage the assets that we have today, so the network, the client relationships and the partnerships that we have, as well as capitalizing on our capabilities and the investment in those capabilities at scale. When I think about those characteristics and those assets, many of which we've been demonstrating our ability to leverage, I think we're well-positioned to continue to win, to differentiate ourselves, to generate stable recurring revenue growth, and to capture embedded opportunities that exist with our clients, the clients we have today, which is frankly a lower risk growth strategy. So I think ultimately, this focus, leveraging those assets and capabilities should result in not just improving returns, but also continuing to improve the quality of our earnings over time.

And so the question would be differentiation. The answer would be that I think we have the characteristics of a differentiated franchise when you think about our network, our clients, our partnerships and the capabilities that we've invested in, and our ability to start to demonstrate that in 2019, and to continue to do so going forward.

GERARD CASSIDY: Mark, thank you so much. We’re really, really privileged and lucky to have you join us today, and the thoughtful answers I really appreciate, and thank you again.

MARK MASON: Thank you, Gerard. My pleasure, good to talk to you.

GERARD CASSIDY: Take care. Okay, bye-bye.

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