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## Citi May Book \$10 Billion Gain on Morgan Stanley Deal (Update2)

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By Bradley Keoun and Christine Harper



Jan. 12 (Bloomberg) -- **Citigroup Inc.** may book a gain of as much as \$10 billion by selling control of its brokerage to **Morgan Stanley**, helping to replenish capital depleted by the biggest losses in the bank's history, a person familiar with the talks said.

The pretax gain would come from writing up the value of Citigroup's Smith Barney unit to a new price set by the deal, said the person, who declined to be identified because the talks are confidential. The gain of \$5 billion to \$6 billion after taxes would flow into Citigroup's capital, a loan-loss cushion so eroded that the New York-based bank had to get \$45 billion of rescue funds

last year from the U.S. government.

"You're selling out the future to get through the crisis of the present, and unfortunately they don't have a lot of other choice," **David Trone**, an analyst at Fox-Pitt Kelton Cochran Caronia Waller in New York, said in a Jan. 9 interview.

The worst banking crisis since the Great Depression forced Citigroup Chief Executive Officer **Vikram Pandit**, 51, to abandon his pledge not to sell Smith Barney. For the past decade, the unit has been at the center of the bank's plan to provide bond- underwriting, savings accounts and investment advice under a single umbrella. Former U.S. Treasury Secretary Robert Rubin, 70, who joined the company in 1999 and had opposed calls to break it up, said Jan. 9 that he plans to quit the board.

Citigroup spokesman **Michael Hanretta** declined to comment. **Jim Wiggins**, a spokesman for Morgan Stanley, didn't return calls seeking comment. **Citigroup** fell 1 percent to \$6.68 in German trading today; **Morgan Stanley** rose 0.9 percent to \$19.24.

'Morgan Stanley Smith Barney'

Talks on the plan to combine Smith Barney with Morgan Stanley's brokerage in a \$20 billion joint venture progressed over the weekend, another person briefed on the talks said. The deal may be announced as soon as mid-week, this person said.

Under the plan being considered, Morgan Stanley would pay \$2 billion to \$3 billion to Citigroup to obtain 51 percent of a venture that would combine both firms' retail brokerage arms, people familiar with the plan said.

The new firm, tentatively named Morgan Stanley Smith Barney, would have about 22,000 brokers, exceeding the network created by Bank of America Corp.'s Jan. 1 takeover of Merrill Lynch & Co., which have about 20,000 brokers between them.

Citigroup posted \$10.4 billion of net losses in the first nine months of 2008, putting the bank on track to post its worst year since predecessor City Bank of New York was founded in 1812. Beleaguered by writedowns on mortgage-related bonds, losses on commercial real estate loans and costs related to the

bankruptcy of chemicals maker LyondellBasell Industries AF, Citigroup probably lost another \$5.82 billion in the fourth quarter, Sandler O'Neill & Partners analyst **Jeff Harte** estimated in a Jan. 9 report.

#### German Sale

That figure doesn't include a \$4 billion one-time gain that Citigroup expects from the sale, completed last month, of its retail banking operations in Germany. That unit was also sold by Pandit in an effort to free up capital.

Citigroup, which has 352,000 employees and 200 million customers and does business in more than 100 countries, was pieced together through acquisitions during a 17-year span by former Chairman Sanford "Sandy" Weill, who stepped down from a full-time role in October 2003.

Pandit, hired in December 2007 following the ouster of Weill's handpicked successor, Charles O. "Chuck" Prince, vowed to conduct a "dispassionate" review of Citigroup's business mix, and whether the company was too big to manage, as some analysts and investors contended. Pandit, who turns 52 this week, concluded that while cost cuts were needed and some assets should be sold, Smith Barney should remain united with the bank's other operations of branch banking, securities trading and underwriting and payment processing.

#### Government Help

Pandit told employees on a Nov. 21 conference call that he didn't plan to break up the company, singling out Smith Barney as a business he wanted to keep. Later that day, the bank's share price plunged to a 15-year-low of \$3.77, and Pandit spent the ensuing weekend huddled in talks with officials from the U.S. Treasury Department, Federal Reserve and Federal Deposit Insurance Corp. over a plan to receive \$20 billion of government bailout funds in addition to the \$25 billion it had already received, and \$306 billion of guarantees on troubled assets.

The decision to sell majority control of Smith Barney is an acknowledgement by Pandit that relinquishing responsibility for the unit may simplify the task of managing Citigroup's remaining businesses, one of the people familiar with the plan said.

Citigroup had the worst stock performance for two years in a row among large U.S. banks, as measured by the **KBW Bank Index**. The stock closed at \$6.75 on Jan. 9 in New York Stock Exchange composite trading.

#### 'Right-Sizing'

"There's a growing dissatisfaction with the slowness with which Citi seems to be dealing with its issues, particularly in terms of right-sizing the company," said **Bert Ely**, chief executive officer of banking industry consultant Ely & Co. in Alexandria, Virginia. That requires "not only substantial downsizing of the balance sheet, but also disposing of and selling off activities that are not crucial to its long-term strategy."

**Richard Parsons**, 60, Citigroup's lead outside director, told the Wall Street Journal that the board has confidence in Pandit's leadership. Parsons may be named later this month to replace board Chairman **Win Bischoff**, 67, the Journal reported yesterday, citing unidentified people familiar with the plans.

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