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## Citi-Morgan talks seen leading to wave of deals

**Published:** January 12, 2009 - 8:29 am

(AP) - Citigroup and Morgan Stanley may announce as early as Monday a deal to combine their brokerages, a move analysts say could trigger a fresh wave of consolidation in the troubled and thinning banking industry.

The potential deal between Citi and Morgan Stanley underscores the problems still facing the industry after a year in which several well-known financial firms toppled under the weight of rising losses tied to bad mortgages.

"This really shows the continued vulnerability of the banking system," said Keith Springer, president of Capital Financial Advisory Services.

Morgan Stanley is likely to pay Citigroup between \$2 billion and \$3 billion for a 51% stake in the brokerage Smith Barney, a person close to the negotiations said Saturday.

Morgan Stanley would then have the option to buy the rest of Smith Barney over the next three to five years, the person said. The person spoke on condition of anonymity because he was not authorized to speak about the ongoing talks.

A spokesman for Citigroup declined to comment on Sunday. Calls to Morgan Stanley were not immediately returned.

During the past several months of financial turmoil, many banks have had to overhaul their business models. Morgan Stanley and Goldman Sachs Group Inc. became bank holding companies shortly after rival Lehman Brothers Holdings Inc. filed for bankruptcy protection and Merrill Lynch & Co. was sold to Bank of America Corp. in an emergency sale initially valued at \$50 billion. Investors had grown concerned that stand-alone investment banks would no longer be viable amid continued weakness in the credit markets.

A deal to combine the brokerages of Citigroup and Morgan Stanley would not only give Citi much-needed cash, it would also give Morgan Stanley more manpower, analysts said.

"If Morgan and Citi get together, they would be able to put together a retail brokerage unit that is larger than Merrill's thundering herd, which could position them well in the marketplace," said Chris Probyn, chief economist at State Street Global Advisors. "This may be a way of staying competitive."

The move would also be beneficial to Morgan Stanley as it looks to build its less-risky, lower leveraged businesses after becoming a

bank holding company. The move would also provide Morgan Stanley a greater sales force to build its growing retail deposit based, which has been among the bank's top priorities in recent months, Lauren Smith, an analyst with Keefe, Bruyette & Woods Inc. wrote in a research note Monday.

Morgan Stanley has been able to hold up relatively better than other financial firms amid the ongoing credit market turmoil, though it did post a \$2.37 billion loss during its fiscal fourth quarter, which ended Nov. 30. Still, Morgan Stanley's woes have not been of the same magnitude as Citi's.

Citigroup has been hit particularly hard by the housing and credit crises. Though the bank has received \$45 billion in support from the government's \$700 billion financial rescue fund, its financial footing remains shaky.

Banking regulators are now pushing Citi to replace its chairman, Sir Win Bischoff, in an effort to restore confidence in the Manhattan-based bank after it needed billions of dollars in government support, according to a *New York Times* report. The *Times* and *The Wall Street Journal* said Monday that Richard Parsons, former CEO of Time Warner Inc. and a Citi director, is likely to succeed Mr. Bischoff.

Citi has reported four straight quarters of losses totaling \$20.2 billion through September 2008 and is expected to post yet another loss when it releases fourth-quarter results on Jan. 22.

Citi could report an operating loss as large as \$10 billion during the fourth quarter, according to the report in the *Journal*. About \$4 billion of the loss would be offset though by a gain from the bank's sale of its German retail banking operations in a deal that closed late last year, the newspaper said.

Citigroup couldn't immediately be reached Monday for a comment on the newspaper reports.

Analysts polled by Thomson Reuters, on average, forecast a loss of \$1.14 per share for the fourth quarter. Based on Citi's outstanding share count as of Sept. 30, that would equate to a loss of about \$6.21 billion. Analysts do not always include special one-time gains in their estimates.

A sale of Smith Barney could provide Citi needed cash to help further offset the mounting losses and help the bank streamline operations to reduce costs amid the ongoing credit crisis.

"It looks to me like they are rethinking the business model that Sandy Weill had, which was a one-stop shop model," said Mr. Probyn, referring to Citigroup's former chairman and chief executive. "Now they are thinking about maybe going back to a more streamlined division."

Mr. Weill built Citigroup into the conglomerate it is today through a series of mergers and acquisitions over the past couple decades before handing the reins to Charles Prince in 2003. The bank has been criticized for years that it had grown too big for its own good, with many investors clamoring for a break-up of its units.

But while Citigroup has struggled with its size, its competitors have gotten bigger. Rivals J.P. Morgan Chase & Co., Bank of America Corp. and Wells Fargo & Co. all made acquisitions in the last year to better diversify their businesses.

Bank of America bought Merrill Lynch & Co. and mortgage lender Countrywide Financial Corp. J.P. Morgan, meanwhile, scooped up storied investment bank, Bear Stearns Cos., in March, as well as the lucrative deposits of failed thrift Washington Mutual Inc. And Wells Fargo beat Citigroup in its pursuit of troubled Charlotte, N.C., bank Wachovia Corp.

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