BOCCONI STUDENTS INVESTMENT CLUB

Citigroup to spin off its historical branch OneMain Financial

Citigroup Inc.; market cap (as of 10/10/2014): $151.92bn

On October 8, 2014, Citigroup filed for a $50m initial public offering of its subprime consumer lending business OneMain Financial. The $50m offering is just a placeholder amount, a figure used to calculate registration fees, but if the transaction goes ahead the amount raised would likely raise considerably. The spinoff of OneMain, which makes personal loans often to consumers with damaged credit, comes five years after Citigroup first signaled that it intended to divest the business. The bank said OneMain no longer fits with its strategy of catering to more affluent consumers, but previous attempts to sell the business have fallen through. In order to complete the disposal within the targeted timeframe, Citigroup is pursuing a dual-track process with plans for the IPO moving ahead along with talks with potential investors for an outright sale. In fact, already in May 2014, Citi's chief executive Mike Corbat, said at an investor conference that the bank could dispose OneMain via a sale to private equity, a public share sale or a combination of both. According to the regulatory filing, it is not clear when the IPO might occur. However, people familiar with the matter indicated it could take place by year-end, as reported by the New York Times.

Citigroup's Citi Holdings division, of which OneMain Financial is a sizeable part, was created in 2009 to house all the poor-performing and non-core assets that the group planned to dispose of over time. Since then, the bank has made significant progresses in managing this division, as it cut down total assets from almost $900bn at the peak of the economic crisis (more than 40% of Citigroup's total assets) to $111bn by the end of Q2 2014 (around 6% of total assets).

OneMain Financial is one of the largest providers of installment loans in the US, handing out personal loans to people with below-average credit ratings for amounts between $3,000 and $15,000. The company, which came into existence in 1912 as Commercial Credit, acquired Primerica in 1988, forming the Primerica Corporation. Subsequently the group acquired the Travelers Corporation in 1993 and, following the merger of Travelers Group with Citicorp to form Citigroup in 1998, Commercial Credit was rebranded as CitiFinancial in 1999 and became the leading community-based lender in North America prior to the economic downturn of 2008.

This incredible sequence of mergers was conducted under the historical leadership of Sandy Weil, who later became Citi's CEO, and current JP Morgan's CEO Jamie Dimon. The two started from Commercial Credit and through the years were able to create the largest US-based financial conglomerate by assets back in 1999. The Travelers-Citicorp merger led to amendment of the Glass-Steagal Act by the Gramm-Leach-Bliley Act. But the recession and the subsequent focus on cutting down costs by exiting non-core operations saw Citigroup renaming the division OneMain Financial in 2011 and moving it under Citi Holdings. The unit was almost sold in late 2011 to a consortium that included Berkshire Hathaway, Centerbridge Partners and Leucadia National, but difficulty to secure financing for the deal forced Citigroup to delay its plans.

OneMain Financial suffered major losses in the financial crisis, but it has been profitable since 2012: earning $407mm in 2012, and $536mm in 2013. Citigroup as a whole earned $7.54bn and $13.67bn in those years, respectively. In 2013 alone, the subprime unit realized a return on assets of 5.4% and return on equity of 19.9%. For 2014 H1, the unit had net income of $287mm, representing a return on assets of 6.0% and a return on equity of 19.1%.

The IPO filing highlights OneMain Financial's regulatory disadvantage of being owned by a bank holding company. In fact, under Citi, the unit is subject to certain banking regulations, including oversight by the Federal Reserve Board and the Consumer Financial Protection Bureau. Such banking regulations limit the activities and the types of businesses that the unit is able to conduct, as the Federal Reserve Board has broad enforcement authority over bank holding companies and their subsidiaries. Thus, the spinoff could lead to potential growth for OneMain if the unit continues its business in a less regulated environment.

Analysts estimate that an outright sale of the entire company, which could be accomplished instead of the IPO, could bring in as much as $4bn in cash for Citigroup upon completion. More importantly, the disposal of OneMain Financial will reduce the total assets under Citi Holdings by roughly $9bn, thus marking an important step towards the eventual divestment of all of Citigroup's non-core operations. This would free up some capital also in light of the failure of the stress test exercise conducted by the Federal Reserve earlier this year. As one large Citi shareholder said, "It might be cleaner to just sell OneMain to a single buyer but if the unit gets IPOed there's still value to be recognized there" however, "It all fits within the construct of the umbrella of restructuring and reducing the asset size of Citi Holdings". Analysts and bankers have suggested Springleaf as a possible acquirer of the unit because of its similar business model. Also, while the regulatory environment may have deterred potential bank acquirers, the sale of OneMain to a non-bank also faces the hurdle of how to fund the company, which does not take deposits. However, this year OneMain securitized its loans, gaining access to one potential funding channel.

According to the regulatory filing, Citigroup is the sole book-runner for the IPO.

Tags: Bad bank, Berkshire Hathaway, Citi, consumer finance, IPO, Glass-Steagal Act, Gramm-Leach-Bliley Act, Jamie Dimon, OneMain, Sandy Weil, Spin off, subprime.