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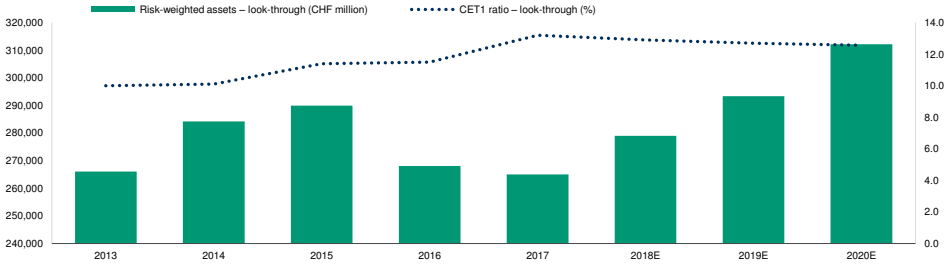
Credit Suisse Group AG

Earning its cost of capital and sustaining a modest distribution policy would be credit positive

On 12 December, Credit Suisse Group AG (CS, Baa2 stable), the parent of Credit Suisse AG (A1/A1 stable, baa2[1]), reiterated that it aims to generate a net return on tangible equity of 10%-11% in 2019 and 11%-12% in 2020, equivalent to a cumulative net profit of CHF9-CHF10 billion, up from a reported net profit of CHF1.8 billion for the first nine months of 2018. CS expects to reach the lower end of its 2019 target even without revenue growth, solely benefitting from significant post-restructuring tailwinds adding approximately CHF2 billion to 2019 profits.

Modest share buyback and dividend program is credit positive. CS aims to operate with a fully phased-in Common Equity Tier 1 (CET1) capital ratio of above 12.5% during the 2019-21 period, compared with a reported 12.9% as of 30 September 2018. The CET1 ratio target incorporates the expectation that the significant uptick in targeted net income generation in 2019 and 2020 will be partially used to digest additional risk-weighted assets of approximately CHF16 billion from upcoming regulatory tightening. Moreover, CS confirmed that it aims to increase returns to shareholders and distribute at least 50% of its net income through dividends or share buybacks[2] starting in 2019. The remainder of free capital generated will be reinvested into growth, provided market conditions allow. While this distribution strategy constrains an accelerated capital buildup, it allows retaining at least CHF4-5 billion of core capital over the next two to three years, thereby building further buffers that could help to mitigate more volatile market conditions, as well as help to cover regulatory changes and other contingencies.

Exhibit 1
Credit Suisse Group's capital buildup is somewhat constrained by upcoming regulatory tightening and higher payouts to shareholders

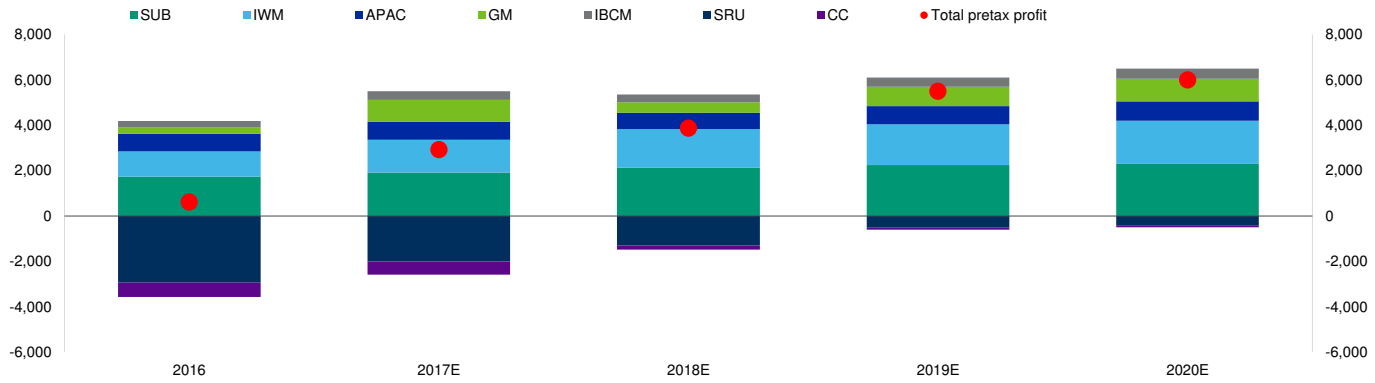


Note: Assumes 50% of net earnings being retained, adding to capital one year thereafter. Includes 3% RWA inflation from business growth and CHF16 billion from further regulatory tightening in 2019E and 2020E. RWAs are expected to become the binding constraint from 1 January 2022 onwards, when further regulatory tightening (e.g., FRTB) is expected to inflate RWAs by another CHF25-30 billion.
Sources: Credit Suisse Group and Moody's Investors Service estimates

Meaningfully lower restructuring as well as funding costs and a further trimming of expenses will help CS reach financial targets. From 2019 onward, the group's profitability will increasingly benefit from significantly lower costs off-loading non-core assets[3], lower funding costs as more expensive legacy capital instruments have been redeemed and only partially replaced with lower-cost funding, and the absence of meaningful restructuring costs (see Exhibit 2). Any revenue growth in 2019 or 2020 as well as a stronger-than-anticipated performance of capital markets divisions would add to the group's profitability.

Exhibit 2

Credit Suisse Group's de-risking and restructuring progress support profitability



SUB = Swiss Universal Bank, IWM = International Wealth Management, APAC = Asia Pacific, WM&C = Wealth Management and Connected, GM = Global Markets, IBCM = Investment Banking and Capital Markets, SRU = Strategic Resolution Unit, CC = Corporate Center

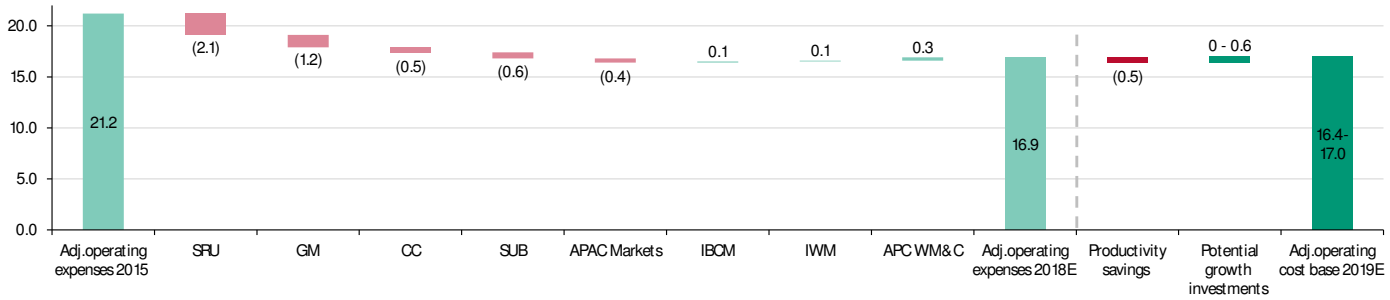
Sources: Credit Suisse Group and Moody's Investors Service estimates

Cost control will continue. For 2018, CS expects total operating expenses to decline by approximately CHF1 billion year over year to just below CHF17 billion (see Exhibit 3), largely stemming from the SRU and the Corporate Center. In 2019, CS expects costs to remain virtually flat at between CHF16.4-CHF17.0 billion, confirming that it will continue to balance needed investment for growth and improved systems and controls, subject to market conditions.

Exhibit 3

Credit Suisse Group total adjusted operating expenses waterfall by segment

The bank is successfully managing down total expenses, with further reductions planned in 2019



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Sources: Credit Suisse Group and Moody's Investors Service estimates

Digital and technology investment will support improved operating performance. Supporting operating efficiency, CS spent about CHF2.8 billion on technology in 2018 to support strategic business initiatives, half of which was invested into change-the-bank projects. We expect these investments to continue at the same level going forward, comprising further change-the-bank initiatives, such as decommissioning and modernizing the group's platforms; optimizing computing capabilities through greater use of cloud technologies; integrating processes for the benefit of relationship managers and clients; as well as enhancing compliance and other control capabilities by leveraging on new technologies. If well executed, this will support reducing Credit Suisse's run-the-bank costs as well as accelerate its digital transformation.

Albeit stabilized and partially de-risked, the group's share of capital market business versus other global investment banks remains relatively high. Excluding the SRU and the Corporate Center, we estimate that the group's capital market divisions – Investment Banking and Capital Markets, Global Markets and Asia Pacific Markets – combined will continue to consume 40% of group risk-weighted assets and 50% of leverage exposures over the next two to three years. This compares with an estimated 30% share of the group's pre-tax income, constraining return on (regulatory) capital at group level, in particular if considering CS's capital-light and high-return wealth and asset management, as well as its Swiss universal bank businesses.

Endnotes

1 The ratings shown are Credit Suisse AG's deposit rating, senior unsecured debt rating, together with their corresponding outlook; and its Baseline Credit Assessment (BCA).

2 CS announced a CHF1.5 billion share buyback program for 2019, of which it aims to execute at least CHF1.0 billion. Management aims to maintain this into 2020, subject to market conditions and regulatory approvals.

3 Credit Suisse's Strategic Restructuring Unit (SRU) is forecasted to produce a $500 million pre-tax loss during 2019, down significantly from approximately CHF1.3 billion in 2018.

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