FITCH: CREDIT SUISSE CAPITAL INCREASE POSITIVE, CHALLENGES REMAIN

Fitch Ratings-London-27 April 2017: Credit Suisse Group AG (Credit Suisse) reported a sharp improvement in 1Q17 results compared with an historically weak 1Q16 and a subdued 4Q16, largely by capitalising on improving market conditions for credit, especially in the U.S., says Fitch Ratings. Nonetheless, the group's results remain under pressure from its Strategic Resolution Unit (SRU), which was set up to reduce non-core assets. Although losses from SRU decreased during the quarter, 1Q17 return on tangible equity was an only acceptable 6.5%, partly reflecting the ongoing SRU pre-tax drag.

Alongside its 1Q17 results, the bank announced a firmly underwritten capital increase with plans to raise around CHF4 billion to fund business growth and restructuring costs. The announcement addresses the outstanding part of the bank's capital strategy as announced in October 2015 and replaces previous plans to sell a minority stake in Credit Suisse Schweiz AG (A/F1/a/Stable), the group's Swiss operating bank.

The capital raise is intended to address further material profitability drag from the SRU (expected by the bank to be around USD1.4 billion in pre-tax losses in 2018, when the remaining risk-weighted assets of around CHF30 billion will be reintegrated in the business, one year earlier than planned), as well as other execution, restructuring and conduct challenges. The raise also considers the setback from the bank's 4Q16 RMBS settlement with the U.S. Department of Justice. Fitch expects the businesses included in SRU to remain a drag on reported results at least until 2019. While Fitch views the capital increase positively, we would expect a longer record of sound internal capital generation based on strong earnings and demonstration of a stabilised sales and trading franchise for this improvement to be reflected in a rating upgrade, particularly as we believe that the bank's business strategy also exposes it to possible volatility in Asia Pacific (APAC).

Credit Suisse generated CHF655 million of pre-tax profit in 1Q17, adjusted for non-recurring gains, which compares with a CHF428 million pre-tax loss in 1Q16. The latter included the impact of significant mark-to-market losses in credit products, notably distressed debt, and industry-wide subdued revenues. Results show continued progress on taking down operating expenses, which the bank expects to reduce to under CHF18.5 billion for this year.

The bank's Swiss Universal Bank (SUB) division remains the largest contributor to pre-tax profit (CHF404 million in 1Q17). Cost discipline was an important contributor to the division's strong performance as revenues were broadly unchanged yoy. This resulted in broadly resilient net margins on assets under management (AuM) at 43bp for 1Q17 while gross AuM margins fell by 9bp to 146bp. The latter reflected strong 4% annualised net new money growth in the quarter and lower transactional revenue, partly offset by improved mandate penetration. The bank reiterated that it expects around CHF3 billion in gross client outflows from tax regularisation and the optimisation of its external asset manager client base.

The first quarter also marked strong net new money growth across all of Credit Suisse's wealth management-oriented businesses, totalling CHF12bn in 1Q17. Pre-tax profit in International Wealth Management (IWM) fell 3% yoy to CHF291 million due to CHF36 million restructuring charges booked in 1Q17, but underlying performance was sound, reflecting contained operating expense growth and higher revenues as commission and fee income rose. Net new assets grew at a strong 6% annualised rate, which only led to modest net AuM margin erosion. The asset

management business booked in IWM benefitted from increased performance and management fees, partly offset by lower private equity gains, and posted unchanged pre-tax profit excluding higher restructuring costs.

Diverging momentum across the trading and wealth management business within the APAC division led to a 44% fall in pre-tax income to CHF147 million for 1Q17, which also included a yoy higher CHF19 million restructuring charge. The revenue fall in APAC was largely driven by a 74% yoy fall in fixed income sales and trading revenue, reflecting lower client activity in rates and foreign exchange. This was compounded by lower equity trading revenues led by lower equity derivatives results. As a result, the sales and trading part of the APAC business posted a quarterly pre-tax loss (CHF54 million), for a second consecutive quarter. Revenues (and to a lesser degree costs) from private banking, underwriting and advisory rose sharply qoq and led to a 67% yoy pre-tax profit increase from these activities at CHF205 million. Momentum in private banking was underpinned by strong net new asset growth, together with improved gross and net margins.

Global Markets (GM) returned to acceptable levels of profitability in 1Q17, generating CHF317 million pre-tax profit. The improvement was led by credit activities (57% of revenues in 1Q17), whose higher yoy revenue also reflects mark-to-market losses booked in 1Q16. Higher asset prices and lower volatility in credit assets supported the bank's securitised products and credit franchise. This was partly offset by 13% yoy lower equity revenues and 24% lower solutions revenues, partly reflecting lower activity in macro and derivative products and lower structured note issuance. The bank will need to sustain 1Q17 performance but appeared on track to meet its CHF1.2bn divisional annual pre-tax profit target.

Continued momentum in debt underwriting (up 64% yoy), which accounted for around half of revenues in Investment Banking & Capital Markets (IB&CM), contributed to another sound 1Q17, as revenue rose by 56% yoy from a very muted 1Q16. Pre-tax income of CHF149 million was unchanged qoq and an improvement on the small 1Q16 pre-tax loss.

Credit Suisse's fully-loaded CET1 ratio rose 20bp to 11.7% at end-1Q17 as risk-weighted assets fell by 2% qoq, primarily reflecting continued deleveraging in SRU, while CET1 capital remained broadly unchanged qoq. Adding the announced CHF4 billion capital increase, the pro forma ratio would have stood at around 13.4% at end-1Q17. The bank targets a CET1 capital ratio of around 13% before there is more clarity on the ultimate impact of regulatory revisions around risk-weighted asset calculations, which would place Credit Suisse's capitalisation in the upper-end of the range for global trading and universal bank peers.

The capital increase will also allow the bank to meet the 5% leverage exposure-based going concern too-big-to-fail capital requirement in 2017, well ahead of the 2020 deadline. At end-1Q17, the bank's fully-loaded CET1 leverage and Tier 1 leverage stood at 3.3% and 4.6% respectively, and the capital increase would have added around 50bp to each ratio. We expect further AT1 issuance will help maintain regulatory compliance while providing flexibility to fund leverage exposure growth, notably in wealth management businesses.

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