FITCH: CREDIT SUISSE'S 4Q17 SHOWS SOUND WEALTH MANAGEMENT; WEAKER EQUITIES TRADING

Fitch Ratings-London-15 February 2018: Credit Suisse Group AG's (Credit Suisse) 4Q17 results show a sound franchise in global wealth management as well as progress in cost reduction, says Fitch Ratings. However, the performance of the sales and trading operations in global markets (GM) and Asia Pacific (APAC), in our opinion, remains weak.

The bank generated CHF141 million pre-tax profit in 4Q17, a figure which continues to be dampened by restructuring expenses and litigation, which together amounted to CHF392 million in the quarter. Pre-tax profit for 2017 was CHF1.8 billion, a material improvement from the previous two years of pre-tax losses. The operating return on risk-weighted assets (RWAs) was modest, at around 0.7% for 2017, but would have been close to a more adequate 1.5% excluding the Strategic Resolution Unit (SRU). We expect earnings to converge with the group's underlying capacity in 2018 and particularly in 2019, as the drag from the SRU subsides and the well-implemented cost reductions continue to improve operating leverage.

The wealth management businesses have seen higher net margins on assets under management (AuM), highlighting the bank's well-performing franchises. Pre-tax profit for 4Q17 in the international wealth management (IWM) division (asset management and private banking outside of Switzerland and APAC) rose by a third yoy to CHF368 million, excluding real estate gains and losses on business sales. Strong net new money growth of 5% in 4Q17 for private banking underpinned sound revenue growth which, together with cost control, helped profitability. Higher AuM in asset management contributed to a 24% yoy increase in 4Q17 management fees, and asset management's pre-tax profit rose 28% yoy (excluding losses on sale), despite higher compensation expenses weighing on costs.

The Swiss Universal Bank remained the group's profit engine, generating CHF433 million pre-tax profit in 4Q17, 20% higher yoy excluding real estate gains in 4Q16. The growth was achieved despite lower transaction-based fees and, to a lesser extent, net interest income, and reflects mainly the impact of cost reduction in private banking. We believe that a renewed focus on costs has enabled the bank to offset the net impact of gross AuM margin pressure. The lower transaction-based revenue reflected lower revenue from an internal joint venture with investment banking businesses. We expect continued cost efficiency to be important in sustaining the bank's performance, while material revenue growth in a mature market is more challenging absent higher interest rates.

Trading operations booked in GM posted a 4Q17 pre-tax loss of CHF195 million, largely due to low revenue. Revenue was hampered by underperformance in equity sales and trading, down 18% yoy for the full-year and 25% yoy in 4Q17 on a US dollar basis, which despite a weak quarter was a worse performance than most European global trading and universal bank peers. Further hires, particularly in equity derivatives, and investments should help the bank strengthen revenue in this area. Fixed income sales and trading revenue fell 2% yoy in 4Q17 on a US dollar basis, partly reflecting lower revenue from credit amid low market volatility and client activity. The yoy decline was less pronounced than other GTUBs, reflecting Credit Suisse's strength in credit and securitised products, which were less affected by the particularly challenging environment for foreign exchange and rates trading. The bank stated it could seize revenue upside from higher market volatility in 1Q18 from higher capital velocity, notably in securitised products, despite GM being at the internal ceilings for RWAs and leverage exposure.

Low market volatility helped improve underwriting revenue, largely in investment banking & capital markets (IBCM); however, the benefit was more than offset by lower advisory revenue and divisional revenue fell 2% yoy. IBCM reported CHF107 million pre-tax profit for the quarter. Credit Suisse stated that the lower corporate tax rate in the US has strengthened its deal pipeline, although higher market volatility could delay deal execution.

APAC generated CHF176 million pre-tax profit in 4Q17 (CHF103 million in 4Q16), mainly reflecting 12% higher revenue in wealth management-related activities, including advisory, underwriting and financing revenue. Underlying revenue was broadly unchanged yoy, excluding a CHF64 million gain on a pre-IPO financing. The quarter also included a CHF50 million positive fair value adjustment on an impaired loan. Despite a 14% reduction in operating expenses, market activities in APAC posted a quarterly pre-tax loss of CHF53 million, bringing the full year loss in APAC Markets to CHF70 million, due to a 14% yoy trading revenue fall, notably in fixed income from low foreign exchange activity but also in equities. We believe that APAC Markets will continue to remain strategic as it helps Credit Suisse's franchise, notably with entrepreneurs. The pre-tax loss highlights further cost adjustments may be necessary to accommodate low levels of client activity.

The bank reported a CHF2.7 billion tax charge related to US deferred tax assets write-downs, a fairly large amount reflecting the bank's large US operations. This was caused by the implementation of the US Tax Cuts and Jobs Act, which lowered the US federal corporate tax rate to 21% from 35%. This resulted in a net loss of CHF2.1 billion for 4Q17 and CHF948 million for 2017. The bank currently expects not to become subject to the Base Erosion and Anti-Abuse Tax (BEAT) provision, which could increase its tax liability in respect of certain payments from US affiliates.

Credit Suisse's fully-loaded Basel III CET1 ratio fell 40bp qoq to 12.8% at end-2017, above the group's target of above 12.5%. The ratio, which compares well with other European GTUBs, was driven lower by higher RWAs, mainly in respect of operational risk as the bank's model incorporated the impact of litigation settlements on past RMBS practices with the National Credit Union Administration. The going concern CET1 (3.8%) and Tier 1 (5.2%) leverage ratios remained unchanged qoq and above 2020 regulatory requirements. Credit Suisse expects a further CHF8 billion in RWA inflation in 2018, of which it expects to incur CHF2 billion in 1Q18, in relation to credit multipliers.

The bank has reduced its estimate of the impact of the finalisation of Basel III rules to CHF35 billion - CHF40 billion (from its previous estimate of CHF45 billion- CHF50 billion), which adds some flexibility to its plans to pay 50% of net income in dividends from 2019, leaving 20% for wealth management-focused business growth and 30% for regulatory contingencies.

Contact:

Claudia Nelson
Senior Director
+44 20 3530 1191
Fitch Ratings Limited
30 North Colonnade
London E14 5GN

Luis Garrido, CFA
Associate Director
+44 20 3530 1631

Media Relations: Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email: peter.fitzpatrick@fitchratings.com.

Additional information is available on www.fitchratings.com