FITCH: CREDIT SUISSE'S 2Q18 SHOWS REVENUE MOMENTUM AND COST DISCIPLINE

Fitch Ratings-London-31 July 2018: Credit Suisse Group AG's wealth management-focused and domestic universal banking businesses continued to perform well in 2Q18, driving the group's gradual earnings improvement and underpinning the group's Positive Outlooks, Fitch Ratings says. The bank reached its end-2018 risk-weighted asset (RWA) and leverage exposure targets for the non-core Strategic Resolution Unit (SRU), whose shrinking losses are also sustaining earnings upside. Geopolitical uncertainty has translated into a more subdued appetite for Lombard lending, particularly in Asia Pacific, which in our view highlights the importance of a diversified product suite.

Credit Suisse generated CHF1.1 billion pre-tax profit in 2Q18, 81% higher yoy, which we estimate translates to a sound operating profit/RWAs ratio of 1.5%. The improvement was attributable to higher pre-tax profits across the wealth management-focused divisions, which more than offset lower pre-tax profit in the Global Markets (GM) division, and to lower non-core losses from the SRU. The group's 7.2% return on tangible equity in 1H18 showed some progress (5.0% in 1H17) towards the 10%-11% target for 2019. We expect that continued cost discipline and business growth should enable the group to make further progress towards this target.

The Swiss Universal Bank (SUB) division's pre-tax profit of CHF553 million (10% higher yoy and 38% of the group excluding the SRU and the corporate centre) largely reflected the continued benefit of cost reductions. The reported divisional cost/income ratio fell 3ppts yoy to a sound 59%. We expect performance to remain strong, despite challenges in generating strong revenue growth in a mature market. In 2Q18, higher net interest income from higher loan balances and margins, along with higher commissions, particularly in the corporate and institutional clients segment, offset weakness in transactional revenue. The quarter highlighted increased demand and revenue from wealth structuring solutions, which mitigated lower brokerage activity included in transaction income.

Sound 6% net new asset growth, broad-based revenue growth and good cost control underpinned results in International Wealth Management (IWM), as pre-tax profit rose 19% yoy to CHF433 million. Revenue growth of 7% included increases in commission and fee income on higher assets under management, higher net interest income on the back of considerable loan growth (13% yoy) and higher transactional revenue, notably from greater structured product issuance, in part related to a joint venture ("ITS") with the group's GM division.

Pre-tax profit in the Asia Pacific (APAC) division grew 15% yoy to CHF217 million. The 8% revenue improvement was largely led by markets-related revenue, reflecting higher equity derivatives trading revenue and a pickup in client demand for structured products and emerging market rates. Loan balances fell slightly qoq, as geopolitical uncertainty led certain private banking clients to de-lever their portfolios. The wealth management segment was affected by lower net interest income despite the higher (yoy) average loan balances and lower transaction-based fees. Together with litigation expenses linked to the settlement of the US authorities' investigation into hiring practices before 2013, this put pressure on the reported net AuM margin (29bp in 2Q18, down 4bp yoy).

Sales and trading operations booked in the GM division saw a subdued 2Q18, as a 6% revenue decline led to a 42% yoy pre-tax profit fall to CHF148 million. Fixed-income sales and trading revenue was marginally down yoy (6% in US dollar terms), reflecting the non-recurrence of a strong 2Q17 in securitised products, despite a solid 2Q18 in leveraged finance. Equity trading

revenue fell marginally yoy, as lower cash equities revenue more than offset stronger equity derivatives trading revenue, in part related to higher structured product client activity from the joint venture with the wealth management businesses. We believe the transfer of CHF12 billion leverage exposure to wealth management-focused divisions from GM in relation to ITS could free up some resources to generate revenue, as leverage exposure of USD268 billion at end-2Q18 was substantially below the divisional USD290 billion ceiling. However, divisional RWAs of USD59 billion were at end-2Q18 close to the USD60 billion RWA ceiling. We believe the division will continue to operate at a high cost/income ratio (85% in 1H18), as the USD6 billion revenue aspiration and USD4.8 billion cost targets, even if reached, would translate to a still high 80%.

A significant 60% yoy increase in advisory revenue boosted the Investment Banking & Capital Markets division's pre-tax profit, which rose 41% yoy to CHF110 million in 2Q18.

Credit Suisse's Basel III CET1 ratio fell 10bp qoq to a sound 12.8% at end-2Q18, as methodology and foreign exchange-driven increases in RWAs outpaced CET1 capital accretion. We expect the group's Tier 1 leverage ratio to fall below its current 5.2% level, as CHF6.3 billion additional Tier 1 instruments are called in 3Q18. The group has issued USD2 billion additional Tier 1 instruments in 3Q18 and expects the Tier 1 leverage ratio to rise back to above 5% by end-2018.

The bank's regulatory liquidity coverage ratio (LCR) was a strong 226% at end-2Q18 and we expect it to remain structurally elevated, as the group manages its liquidity to its "internal barometer" measure, which takes into account local liquidity requirements. In June 2018, FINMA lowered the group's minimum LCR requirement to 100% from 110%.

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