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Credit Suisse Group AG

Q2 2018 results: Strong investment banking and wealth management drive credit-positive results

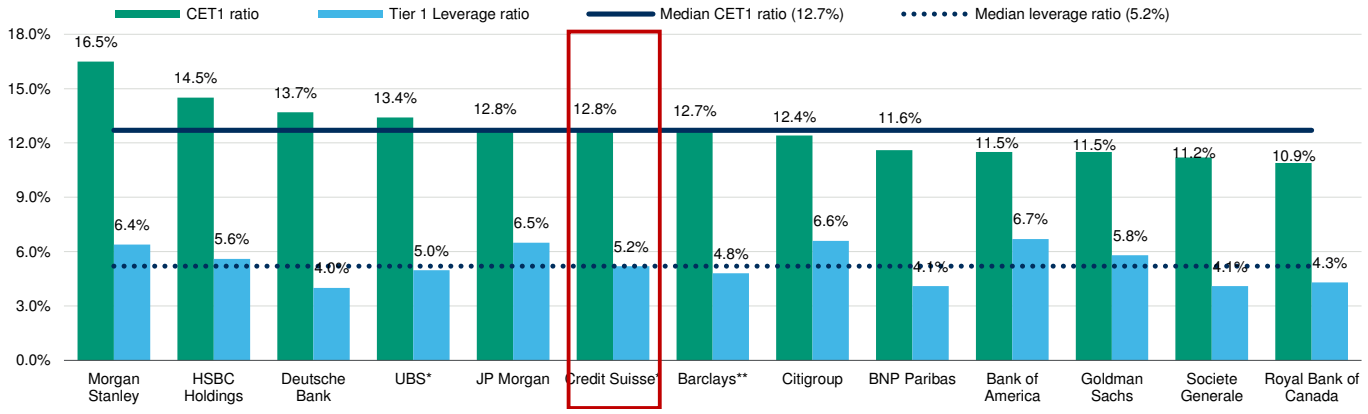
In Q2 2018[1], Credit Suisse Group AG (CS, Baa2 stable[2]), the parent holding company of Credit Suisse AG (A1 stable/A1 stable, baa2[3]) reported[4] consolidated (unadjusted) pre-tax profits of CHF1.1 billion and a net profit of CHF647 million, up 81% and 114% year-over-year, respectively. These strong results were supported by strong International Wealth Management (IWM) revenues on the back of record AuM[5], significantly higher advisory revenues as well as a solid performance of the group's equity and fixed income sales and trading businesses[6] within its Asia Pacific (APAC) segment. This helped offset some weakness in the group's Global Markets (GM) segment where sales and trading revenues slightly declined year-over-year. At group level, continued strong cost control supported strongly positive operating leverage, with total operating expenses down 5% year-over-year, whilst revenues increased 7%. Excluding expected losses in the group's Strategic Resolution Unit (SRU), adjusted core pre-tax profits stood at CHF1.6 billion, up 33% year-over-year. Assuming a 30% tax rate, this corresponds to an underlying annualised net return on tangible equity and a net return on equity of 11.7% and 10.3%, respectively (Moody's calculation), compared to 8.8% and 7.7%, respectively, a year ago.

Sustained solid capital metrics. CS reported a Swiss fully-applied common equity Tier 1 (CET1) capital ratio of 12.8% in the quarter, virtually unchanged from 12.9% in Q1 2018 and down from 13.3.% as of 30 June 2017 (see Exhibit 1). The year-over-year decline was largely owing to a 7% increase in RWAs[7] following business growth. Retained earnings supported underlying capital and the stabilisation of the CET1 ratio above the group's 12.5% target. CS further reported a slightly improved 3.9% CET1 leverage ratio and a 5.2% Tier 1 leverage ratio as of 30 June 2018.

Positive operating leverage in all but one segment. Q2 2018 was the eighth consecutive quarter where CS generated positive operating leverage, underlining the progress it has made in right-sizing the bank since it announced its restructuring program in late 2015. The only exception during the quarter was Global Markets, where revenues declined 6% and costs remained flat. Investment Banking and & Capital Markets (IBCM) revenues grew 26%, driven by very strong advisory (+60% year-over-year) as well as solid debt underwriting (+6%) revenues, whilst costs in the segment increased by 19%. Asia Pacific Markets saw combined equity and fixed income sales and trading revenues increase 21% year-over-year, whereas costs only grew 1%. International Wealth Management (IWM; 6% revenue growth and flat costs) as well as the Swiss Universal Bank (SUB; 1% revenue growth, 7% cost reduction) further contributed to the group's solid second quarter results.

Exhibit 1

Common Equity Tier 1 (CET1) ratios and Tier 1 leverage ratios for Global Investment Banks, as of 30 June 2018



Notes: (1) As of Q1 2018 for HSBC Holdings, Barclays, BNP Paribas and Societe Generale. RBC's second quarter ended in April 2018; Q2 2018 for the rest; (2) Basel III fully phased in advanced approach for all US banks. Citi has only reported CET1 ratio under the standardized approach (12.1% for Q2 2018) which is the binding constraint. The CET1 ratio under the advanced approach shown in the chart is Moody's estimate; (3) Tier 1 leverage ratio for US banks is the supplemental leverage ratio (SLR).
*UBS and CS leverage ratio reflect Common Equity Tier plus Low Trigger Additional Tier 1 and High-Trigger Additional Tier 1 securities.
**Barclays leverage is reflective of the spot UK leverage ratio.
Sources: Companies' results presentations and financials, Moody's Investors Service

Detailed considerations

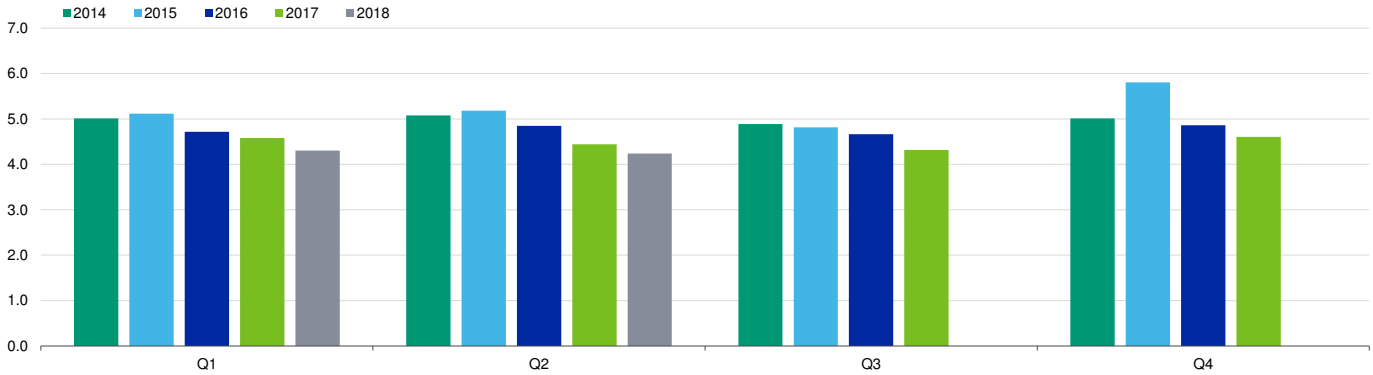
Positive operating leverage in the quarter supported by continued cost cutting, but revenue outlook remains uncertain

Credit Suisse achieved another CHF200 million of net cost savings, resulting in the lowest quarterly expenses since 2014 (see Exhibit 2[8]). We continue to believe the group's significantly reduced operating expense base is credit positive and demonstrates CS's progress in executing on its promises. In 2019 and 2020, CS expects costs to remain flat at CHF16.5 to CHF17.0 billion. If Credit Suisse achieves its strategic plan and medium-term earnings targets on a sustainable basis, the improved loss-absorption capacity will be positive for its creditors.

Exhibit 2

Lowest quarterly operating cost base supported profitability

Adjusted operating expenses, CHF billion



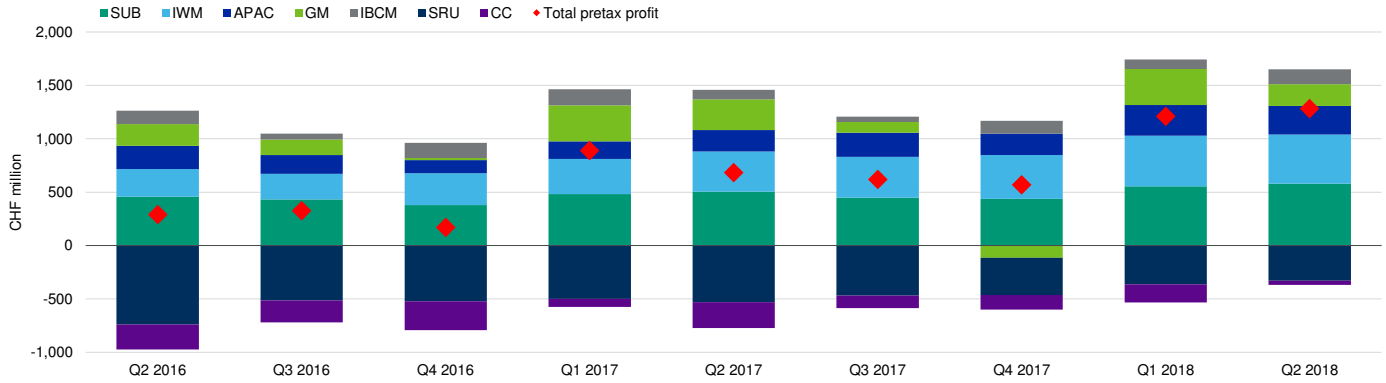
Note: CS total adjusted operating expenses, excluding restructuring and litigation expenses
Sources: Company financials, Moody's Investors Service

Despite the visible progress in maintaining positive operating leverage post right-sizing, we believe CS's positive operating leverage may fade as it enters 2019, in particular as the positive effects from efficiency gains and cost savings run off. Whilst the group's profitability will continue to benefit from lower projected losses from the SRU in 2019 and 2020[9], we believe the group will have difficulty maintaining a sizeable positive revenue-cost gap in the medium-term excluding this effect.

During the second quarter of 2018, the benefits of lower operating expenses, coupled with solid wealth management and universal banking revenues, as well as a strong advisory result, drove the underlying increase in profitability. The second quarter even outpaced the (usually) seasonally stronger first quarter, leading to the highest second-quarter pre-tax profit since CS announced its restructuring in late 2015 (Exhibit 3).

Exhibit 3

Credit Suisse Group's adjusted profit before tax by segment, CHF million



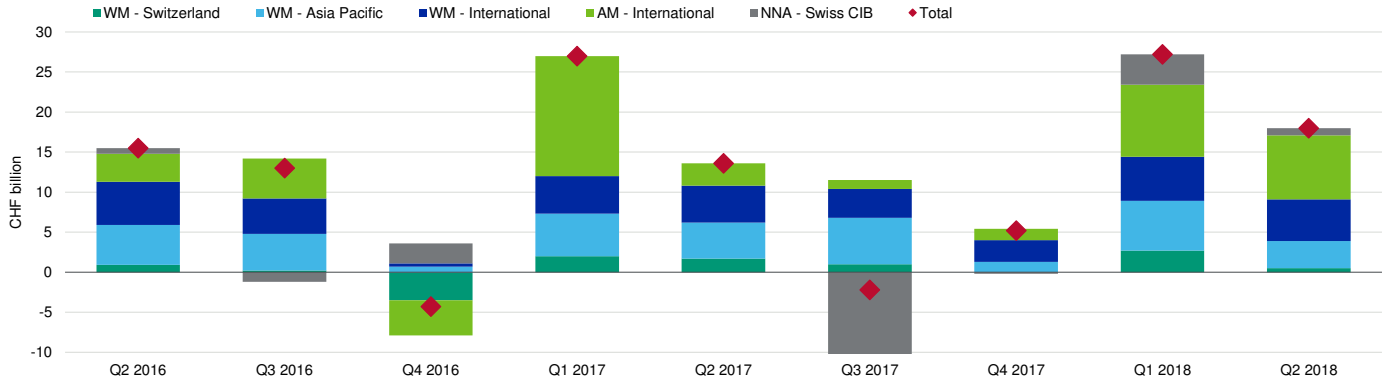
Notes: SUB: Swiss Universal Bank, IWM: International Wealth Management, APAC: Asia Pacific, GM: Global Markets; IBCM: Investment Banking and Capital Markets, SRU: Strategic Resolution Unit, CC: Corporate Center.

Sources: Company results presentations and financials, Moody's Investors Service

CS's wealth and asset management businesses further benefitted from industry-leading net new money inflows (see Exhibit 4), even outpacing the strong performance of Q2 2017. During the second quarter of 2018, CS's wealth and asset management businesses combined recorded net new money inflows of CHF15.4 billion, equivalent to a 4.4% annualised growth rate over year-end 2017 total AuM. Invested assets maintained their highest-ever levels since 2013, supporting future recurring revenue generation.

Exhibit 4

Net New Assets (NNA) by region, CHF billion



Notes: Excluding Strategic Resolution Unit and not adjusted for assets managed across businesses (double-counting). WM: Wealth Management (Private Banking), AM: Asset Management, Swiss CIB: Swiss Corporate and Institutional Banking

Sources: Company financials, Moody's Investors Service

Segmental results commentary

Swiss Universal Bank (SUB) reported adjusted pre-tax profits of CHF580 million, up 15% year-over-year. With adjusted net revenues up 1% year-over-year, SUB managed to improve its year-over-year pre-tax profit, strongly supported by a 7% decrease in adjusted operating expenses. Assets under management (AuM) across SUB increased slightly during the quarter to CHF564 billion, largely reflective of market performance.

International Wealth Management (IWM) reported adjusted pre-tax profits of CHF461 million for the quarter, up 22% from a year ago. Within IWM, Private Banking adjusted pre-tax income in the quarter was up 21% to CHF372 million, with positive contributions from net interest and recurring fee income. The resulting revenue growth in the segment (+6%) clearly offset only flat operating expenses.

IWM saw solid net new asset (NNA) inflows of CHF5.2 billion in Private Banking and CHF8.0 billion in Asset Management during the quarter. With record invested assets of CHF371 billion in Private Banking and CHF401 billion in Asset Management, future fee generation will support recurring revenues.

Asia Pacific (APAC) reported adjusted pre-tax profits of CHF266 million in the quarter, up 34% year-over-year. APAC Markets performance recovered amid continued reshuffling and re-alignment, whilst stable revenues in APAC Wealth Management and Connected (WM&C) supported the segment's pre-tax profits.

APAC WM&C saw adjusted pre-tax profits increase 5% to CHF208 million, as significantly higher year-over-year recurring fee-based revenues (+19%) more than offset the decline in net interest income (-2%) and lower transaction-based revenues (-5%). Advisory, underwriting and financing revenues also slightly reduced (-1%). Operating expenses declined 3% if adjusted for litigation provisions and restructuring expenses (CS settled on its hiring practice investigation in Asia during Q2 2018).

Global Markets (GM) reported a 29% decline in adjusted pre-tax profits to CHF204 million in Q2 2018. Net revenues declined 6% while operating expenses fell 0.5%. Within the business, smaller revenue declines from equity as well as fixed income sales and trading could not be offset by solid underwriting (flat year-over-year). CS's equities business benefitted from significant increases in equity derivative revenues. Within fixed income, higher results in leveraged finance trading and in structured credit and financing were offset by lower securitized products.

Investment Banking and Capital Markets (IBCM) reported adjusted pre-tax income of CHF141 million, a 60% year-over-year increase relative to the prior year. The strong result was driven by very strong advisory revenues (up 60% year-over-year) reflecting several larger M&A closings, as well as continued solid leveraged finance and equity capital markets revenues.

The **Strategic Resolution Unit (SRU)** reported an (unadjusted) pre-tax loss of CHF368 million versus CHF563 million in Q2 2017. CS continued reducing its non-core exposures, recording a CHF1.8 billion quarter-on-quarter reduction (-8%) in RWAs to CHF20.4 billion, supported by a corresponding CHF4.5 billion reduction in leverage exposures (-10% quarter-on-quarter) to CHF38.7 billion. The decline in RWAs and leverage exposures was largely driven by reductions in derivative exposures reflecting further unwinding, clearing, and portfolio hedging as well as further reductions in loan and financing exposures, largely in emerging markets. CS therefore remains well on track to achieving its SRU targets on RWA and leverage exposures, and the remaining SRU portfolio is expected to be folded back into the core businesses by year-end 2018.

The **Corporate Centre** reported a significantly reduced pre-tax loss of CHF41 million in the quarter relative to a loss of CHF243 million in the in the same period last year.

Moody's related publications

Credit Opinion

» Credit Suisse Group AG, April 2018

Issuer Comments

» Deutsche Bank AG: Q2 2018: Maintaining balance sheet strength while reengineering, July 2018

» JPMorgan Chase & Co.: Broad-based credit-positive performance in 2Q18, tempered by substantial shareholder distributions, July 2018

» Bank of America Corporation: Q2 2018 results: Positive operating leverage and a lower tax rate continues to boost performance, July 2018

» The Goldman Sachs Group, Inc.: Q2 2018 results: Strong performance and continued cost discipline are credit positive, July 2018

» Citigroup Inc.: Credit-positive operating performance in 2Q18, tempered by substantial shareholder distribution plans, July 2018

Issuer In-Depth

» UBS Group AG and Credit Suisse Group AG: Review of UBS's ratings for upgrade reflects its lower capital markets risk and more predictable earnings, April 2018

» Global Investment Banks - Europe: Q4 2017 Update: Weak capital markets results constrain revenue, but lower charges provide lift, February 2018

» Global Investment Banks - 2018 Outlook, December 2017

» Global Investment Banks: Legacy litigation risks recede, July 2017

» Global Investment Banks: Indicators of Capital Markets Risk for the Moody's GIB Peer Group, June 2017

» Credit Suisse and UBS: Swiss TLAC Regulation Drives Issuance of Loss-Absorbing Debt, Increasing Protection for Senior Creditors, December 2016

Rating Action

» Moody's places UBS Group AG's ratings on review for upgrade, maintains stable outlook on Credit Suisse Group AG, April 2018

Rating Methodology

» Banks, 16 July 2018

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Endnotes

1 All figures in this report relate to Q2 2018 and comparisons are made to Q2 2017, unless otherwise indicated.

2 The rating shown is Credit Suisse Group AG's long-term senior unsecured debt rating and outlook.

3 The ratings shown are Credit Suisse AG's long-term deposit rating and outlook, its long-term senior unsecured debt rating and outlook and its Baseline Credit Assessment (BCA).

4 Unless indicated otherwise, figures displayed in this report are on a Credit Suisse Group AG adjusted basis. Our adjustments do not take into account restructuring and litigation expenses whereas Credit Suisse's adjusted figures take out restructuring and major litigation expenses.

5 AuM = Assets under management.

6 Combined view of Asia Pacific Markets and Global Markets revenue lines.

7 RWAs = Risk-weighted assets.

8 CS continues to expect a 5% year-over-year decline in 2018 total operating expenses to below CHF17 billion from CHF21.2 billion in 2015 (and CHF18.0 billion in 2017), when it started its three-year restructuring program.

9 CS expects the SRU to be less of a drag on earnings in 2019, once the remainder of the unit is re-integrated into the group's core divisions. CS forecasts that the segment will produce a $500 million pre-tax loss during 2019, down significantly from around CHF1.85 billion in 2017 and CHF1.4 billion forecasted for 2018.

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