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# Credit Suisse Group AG

## Q1 2017 Results: Revenue growth and cost reductions support improved results; capital raise announced

## Summary

In Q1 2017, Credit Suisse Group AG[1] reported a CHF 670 million pre-tax profit relative to a loss of CHF 484 million last year. On a Moody's adjusted basis[2], pre-tax net income was CHF 655 million, excluding CHF 15 million in gains from business sales. While the capital raise is welcome, these results are credit neutral, reflecting our expectation that Credit Suisse's profitability, while improving, will continue to be weak in 2017, as it carries through with remaining restructuring exercises and absorbs further non-core losses.

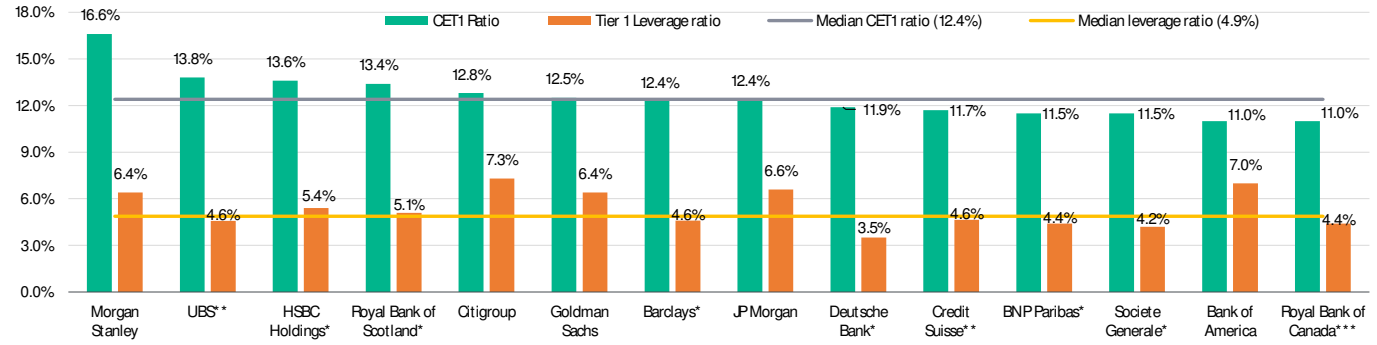
**Higher revenues and lower operating expenses drove improved result.** Revenue improvements were notable in the group's two main capital markets units. Lower operating expenses (-3%) also drove improved results, as the group achieved CHF 250 million in cost reductions in the quarter and stated it is on track to meet its 2017 cost reduction target of CHF 900 million. Apart from Asia Pacific, all main business divisions reported improved pretax profit in 1Q17 and all divisions apart from the Asia Pacific and the Swiss Universal Bank reported improved revenues in comparison to 1Q16. In particular, fixed income related revenues were up in CS's two global capital markets divisions, however prior period results included inventory write-downs of an unspecified amount rendering a direct comparison difficult. Asia Pacific Markets continued to perform poorly as a sharp decline in equity and fixed income revenues led to a decline in the pre-tax profit for the overall Asia Pacific division, despite a much improved Asia Pacific Wealth Management & Connected result. During the earnings call, management announced that it would right-size the equity and fixed income business in the Asian Markets business.

**Credit Suisse announced a CHF 4 billion rights offering** to improve its capitalisation and flexibility to invest capital. The rights offering replaces the previously planned minority IPO of CS's Swiss legal entity and will generate circa 170 basis points (bps) of capital. CS reported a 20 bps improvement in its BIS fully-applied common equity tier 1 (CET1) ratio to 11.7% in the quarter (see Exhibit 1). The increase in CET1 ratio reflected profit for the period less dividend accruals and a 2% reduction in risk-weighted assets (RWA) to CHF264 billion, driven by RWA reductions in the group's noncore unit. The planned capital raise in June will bring CS' CET1 ratio to a proforma 13.4%. CS's CET1 ratio would thus move from being below the median of global investment peers to be slightly above the peer median (Exhibit 1). Unlike some peers, CS has settled its RMBS litigation with the US Department of Justice, helping to reduce tail-risk for the business. The rights offering is credit positive as it underpins CS's capital strength and leverage position. Going forward we expect continued improvement in profitability beyond 2017 will help reinforce this key development for the rating.

Including the capital raise, CS has confirmed it would be in early compliance with end-state (1 January 2020) Swiss capital requirements of a 3.5% CET1 leverage ratio and a 5.0% Tier 1 leverage ratio. With a proforma CET1 leverage ratio of 3.8% at end 1Q17, CS will have a modest buffer above the Swiss capital requirements. Excluding this capital raise, at end-March 2017 these ratios stood at 3.3% and 4.6%, respectively. CS's total TLAC leverage ratio stood at 7.8% at the same period, relative to the end-state requirement of 10.0%. We expect CS to meet this requirement by further issuance of senior holding company debt, retained profits and through the contribution of this capital raise.

Exhibit 1

**Common Equity Tier 1 (CET1) ratio and Tier 1 Leverage Ratio for Global Investment Banks, End-March 2017**

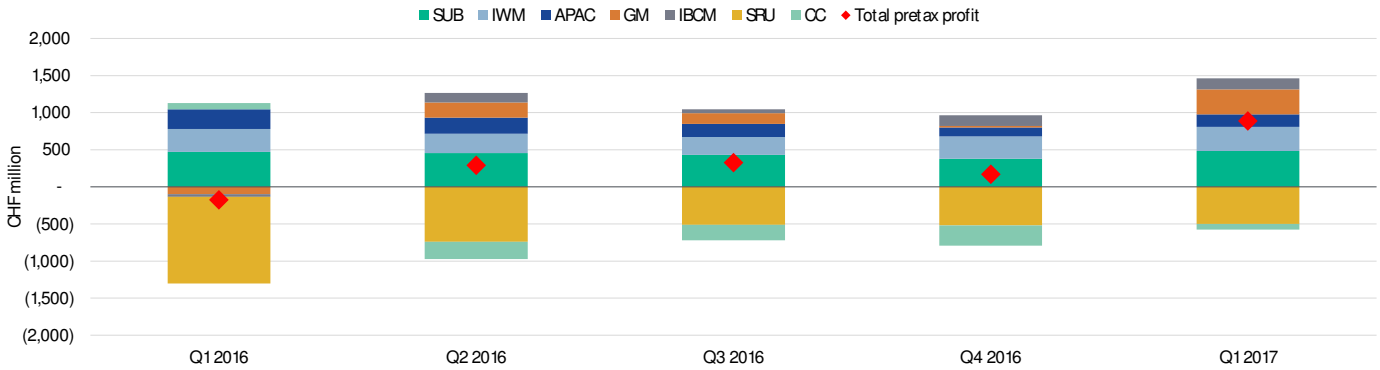



*End-December 2016, **Tier 1 leverage ratio for UBS and Credit Suisse reflects CET1 plus Low-Trigger Additional Tier 1 and High-Trigger Additional Tier 1. CET1 ratio and Leverage ratio on a look-through/fully-loaded basis. ***End-January 2017.
*Source: Company results presentations and financials, Moody's*

Within the business segments, key operating and financial trends were as follows:

Exhibit 2

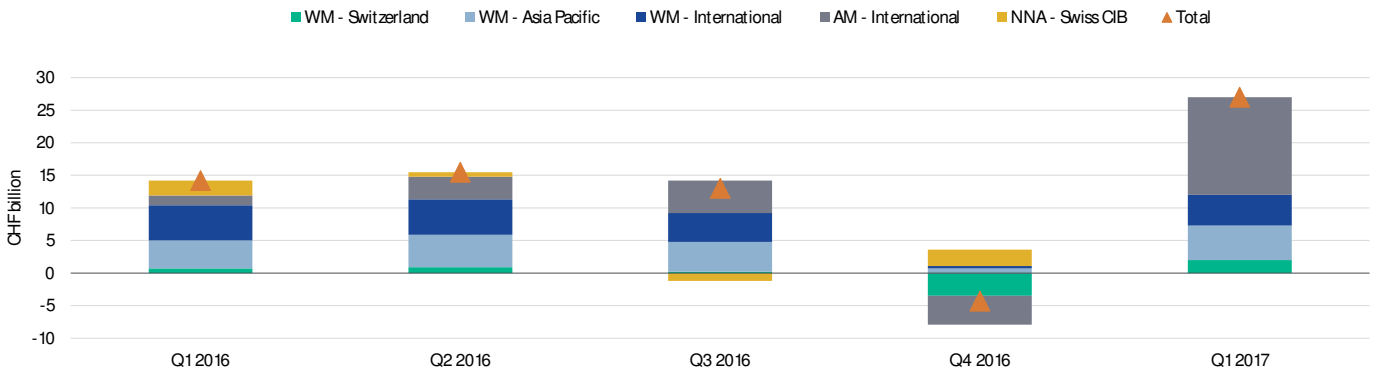
**Credit Suisse Adjusted Profit Before Tax by Segment**




*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
*Source: Company results presentations and financials, Moody's*

Exhibit 3

**Net New Assets (NNA) by Region**



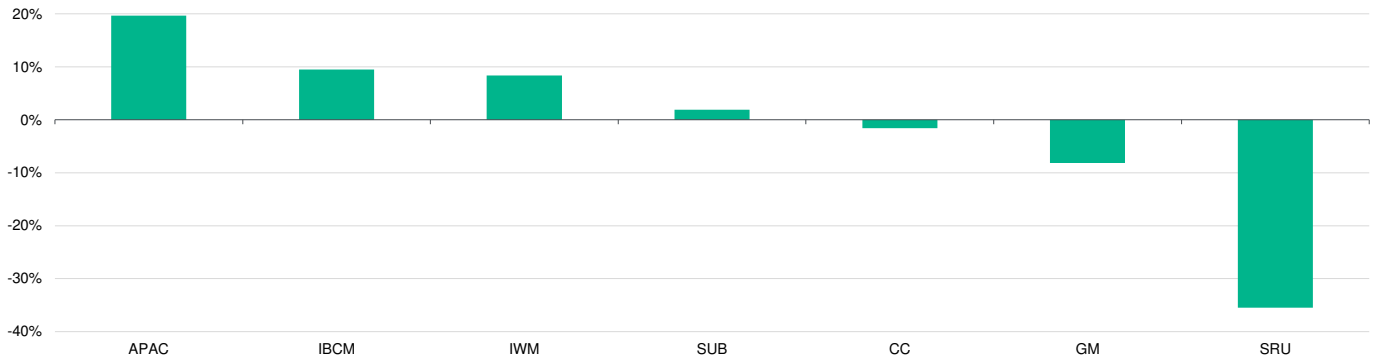

Note: excluding Strategic Resolution Unit and not adjusted for assets managed across businesses, WM: Wealth Management (Private Banking), AM: Asset Management, NNA - Swiss CIB: Net New Assets Swiss Corporate and Institutional Banking

*Source: Company financials, Moody's*

Exhibit 4

**Credit Suisse has re-deployed RWAs freed up from non-core operations and Global Markets into its Asia Pacific, International Wealth Management and Investment Banking and Capital Markets divisions**

**Percentage Change in RWAs Q1 2017 vs Q1 2016**




*Source: Company financials, Moody's*

**Swiss Universal Bank ("SUB")** reported adjusted pre-tax profits of CHF 483 million, up 2% versus the same quarter a year ago due to expense reductions of 2% while revenues remained broadly stable. The Swiss Private Client (PC) segment adjusted net margin reduced 1 basis point (bps) to 43 bps. These results underscore the continued progress the bank has made in reducing its cost base to boost profitability under the backdrop of the continued headwinds in Switzerland from negative interest rates and subdued client activity. For the last five quarters, SUB has consistently reported improved year-over-year pre-tax profits. Assets under management (AUM) across SUB increased in the quarter by 3% to CHF 547 billion, reflecting net new asset (NNA) inflows in both PC and Corporate and Institutional Banking (CIB).

**International Wealth Management ("IWM")** reported adjusted pre-tax profits of CHF 327 million for the quarter, up 6% from a year ago. Within IWM, Asset Management reported flat pre-tax profits of CHF 65 million as higher revenues (+6%) were offset largely by higher allocated costs from group functions. Private Banking adjusted pre-tax income in the quarter was up 8% to CHF262 million as higher net interest income (+5%) and higher recurring commissions and fees (+5%) offset lower transaction and performance based revenues (-2%) and higher operating expenses (+1%). The rise in IWM PB net interest income reflected higher loan and deposit margins on both higher loan and deposit volumes. IWM saw strong NNA inflows of CHF 19.7 billion during the quarter, mainly reflecting inflows from emerging markets and traditional and alternative investments. Across IWM, the division manages a total CHF 703 billion in assets under management, an increase of 9% versus 4Q16 reflecting largely the strong NNA inflow. Risk-weighted assets increased by 1.5% in the quarter to CHF35.8 billion.

**Asia Pacific ("APAC")** reported adjusted pre-tax profits of CHF 166 million in the quarter, a 37% decline compared to the prior year. Continued weak performance in APAC Markets overshadowed improved results in APAC Wealth Management and Connected (WM&C). The decline in APAC Markets profits was driven primarily by a continued decline in fixed income sales and trading (-74%), as client activity in rates and foreign exchange products was subdued, and a decline in equity sales and trading (-16%). Operating expenses in Asia Markets reduced by 8%, reflecting lower compensation and also the transition of the systematic market making business to IWM AM, which more than offset higher prime services and marketing expenses. APAC WM&C on the other hand reported a strongly improved performance with adjusted pre-tax profits up 67% as net interest income (+25%), recurring fees and commissions (+11%) and transactional based revenues (+27%) increased, more than offsetting higher operating expenses (+25%). Operating expenses were higher reflecting higher headcount and compensation and higher allocated corporate function costs. Risk-weighted assets decreased by 4.4% in the quarter to CHF33.1 billion.

**Global Markets ("GM")** reported an adjusted pretax profit of $337 million for the quarter relative to a loss of $98 million in the same period last year. 1Q16 results included inventory write-downs of an unspecified amount, which makes direct comparison difficult. GM has now reported four consecutive quarters of adjusted pretax profit after recording pretax losses in 4Q15 and 1Q16 when it booked write-downs on inventory and CS subsequently announced a further de-risking and accelerated restructuring of the division. Within the business, Credit improved 133% versus the prior year which more than offset continued declines in Equities (-14%) and Solutions (-23%). Performance in Credit reflected favourable markets, asset prices and, lower volatility in the quarter, which were supportive for client activity. CS made further progress in cost reduction initiatives as operating expenses reduced 4% to $1.3 billion, reflecting a lower allocation of group corporate function costs which more than offset higher compensation and benefits paid. RWAs and leverage exposure rose in the quarter by 3% to $52 billion and $287 billion, respectively. Global Markets is now operating close to CS's leverage exposure cap of $290 billion for the division, however short of its RWA ceiling of $60 billion. We would expect the announced capital raise would help underwrite growth in RWAs in Global Markets, opportunity dependent.

**Investment Banking and Capital Markets ("IBCM")** reported adjusted pre-tax income of $151 million, relative to a pre-tax loss of $32 million for the prior year. The strong improvement in results reflected higher revenues (+54%) which more than offset higher operating expenses (+14%), bringing the cost-income ratio down to 74% from 75% in Q4 2016. Within revenues, the firm benefited from higher equity underwriting revenues (+129%), debt underwriting revenues (+62%) which more than offset lower advisory and other fees (-6%). The debt underwriting results reflected higher leveraged finance and investment grade underwriting revenues and the comparison with 1Q16 which included inventory write-downs. Total operating expenses increased 14% and reflected higher compensation accrued due to the improved business line performance.

The **Strategic Resolution Unit ("SRU")** reported a (unadjusted) pre-tax loss of CHF 539 million in the quarter relative a pre-tax loss of CHF 1.25 billion for the same period last year. In the quarter, CS continued to make good progress in reducing its non-core exposures recording a CHF4 billion reduction (-9%) in risk-weighted assets in the quarter and a corresponding reduction in leverage exposures of CHF 23 billion (-22%). These reductions reflect the sale of some loan portfolios to external parties and further unwinds and compressions across its legacy investment banking portfolio and credit derivative products. Credit Suisse guided that it continues to expect the disposal cost per unit of risk-weighted assets to increase as it seeks to reduce its relatively more leverage-intensive exposures. CS also brought forward its 2019 RWA target of CHF30 billion to end-2018 when the remaining SRU portfolio is expected to be folded back in to the core business. It is expected that CHF 30 billion of RWAs will be shifted back to core, of which CHF 19 billion is in operational risk.

**Corporate Centre** reported a pre-tax loss of CHF 99 million in the quarter, relative to a pre-tax profit of CHF 33 million (excluding fair value changes in own debt, which Credit Suisse reports in Other Comprehensive Income) in the same period last year. 1Q16 benefitted from a reduced fair value on deferred compensation plans.

## Endnotes

1 Credit Suisse Group AG (LT senior unsecured Baa2 stable) is the parent holding company of Credit Suisse AG (LT deposits A1 stable, LT senior unsecured A1 stable, baa2 BCA). BCA: Baseline Credit Assessment

2 Unless indicated otherwise, figures are on a Credit Suisse adjusted basis. Moody's does not adjust for restructuring and litigation expenses whereas Credit Suisse's adjusted figures take out restructuring expenses and major litigation expenses.

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