Credit Suisse AG
Executing on Strategy

In October 2015, Credit Suisse detailed its strategy to be a leading private bank and wealth manager with strong investment banking capabilities that could grow profitably and generate capital through the cycle. Over the last eighteen months, we have seen management adapt as conditions demanded and make solid progress in execution. To date, it appears that the group's business and market standing have withstood the challenges. The transformation, nevertheless, is not complete with profitability still needing to improve.

Credit Suisse AG's long-and short-term ratings are A+ and S-1, respectively, both with Stable Outlook.

Focus on profitability and capital

As presented at the investor day in October 2015, Credit Suisse would improve its ability to generate capital internally by (a) right-sizing the investment banking business, (b) disciplined capital allocation, (c) lowering fixed costs and (d) reducing non-core assets. This would be in addition to a CHF 6bn rights issue.

With difficult operating conditions persisting in the early part of 2016, management announced further actions in March 2016 to accelerate the pace of restructuring. In particular, the gross savings target was increased to CHF 4.3bn from CHF 3.5bn and a new RWA target of CHF 60bn was set for the Global Markets business, about 30% lower than previously.

At the subsequent investor day in December 2016, management communicated revised financial targets. These included lowering the target operating cost base for 2018 to below CHF 17bn from below CHF 18bn and adjusting downwards the pre-tax income targets for certain businesses most impacted by reduced trading flows and lower levels of market activity.

Clear progress has been made

Full-year 2016 results show that Credit Suisse has met its cost and capital targets. In 2016, the group achieved CHF 1.9bn in net cost savings, exceeding the target of greater than CHF 1.4bn and brought total adjusted operating expenses (at constant FX rates) to CHF 19.4bn. The Basel III fully loaded CET1 capital ratio was 11.6%, within the target range of 11-12% (pre significant litigation expenses). Excluding the USD 5.3bn DOJ RMBS settlement, the CET1 capital ratio would have been 12.5% and the CET1 leverage ratio 3.5%.

Further, the Global Markets business is being de-risked and right-sized. Management has assessed the portfolio of businesses against three criteria: client connectivity, capital and funding resource usage, and earnings quality. Consequently, certain businesses have been rationalised or exited. Examples include material reductions in illiquid credit inventories of distressed credit and US CLO secondary exposures, rationalisation of the EMEA footprint and the consolidation of derivative activities. As of end-2016, the RWAs and leverage exposure of the Global Markets business had reduced to USD 51bn and USD 278bn, respectively; below the 2016 target ceilings of USD 60bn and USD 290bn, respectively.

Progress in reducing the legacy and non-core portfolio has also been made with the Strategic Resolution Unit's (SRU) RWAs and leverage exposure falling by almost 40% during the year to USD 44bn and USD 103bn, respectively.

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Related Research

Focus on wealth management: Tax transparency and cross-border activity
September 2016

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Encouraging resilience in the business franchise

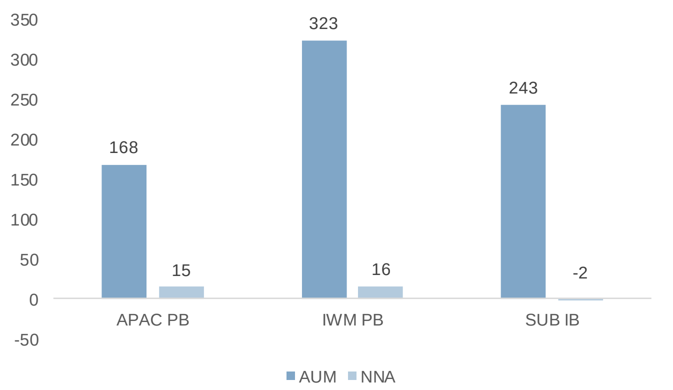
We note that throughout this period of restructuring and right-sizing the group has continued to emphasise the strength of its investment banking business franchise. During the 2016 investor day, management highlighted that the group has improved or maintained its market position across key products as of 9M 2016, including:

- **Announced M&A**. Ranked #5 with 19% market share vs 2013-2015 average of #9 with 13.8% market share
- **Equity capital markets**. Ranked #5 with 5.5% market share vs 2013-2015 average of #7 with 5.5% market share
- **Leveraged finance**. Ranked #3 with 7.6% market share vs 2013-2015 average of #4 with 7.2% market share
- **US securitisations**. Ranked #1 with 13.2% market share vs 2013-2015 average of #1 with 13.1% market share

This resilience can be seen in the performance of the investment banking business during 2016. Over the year, global advisory and underwriting revenues across all divisions increased 9% to USD 3.8bn, with the group outperforming the market; equity underwriting was down 14% vs -25% for the market, debt underwriting was up 16% vs 5% for the market and advisory was up 20% vs -2% for the market.

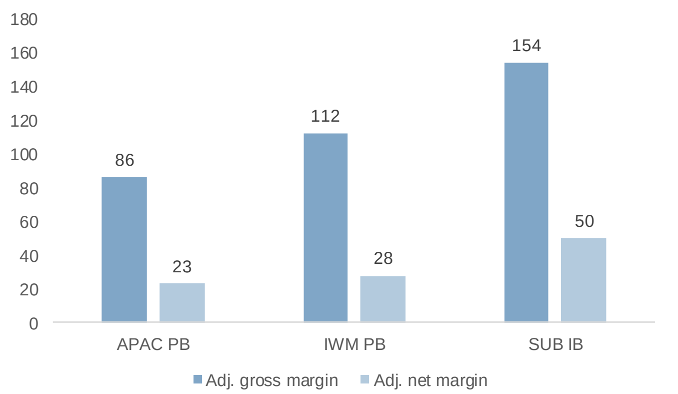
The group's wealth management businesses which sit within the Swiss Universal Bank (SUB), International Wealth Management (IWM) and Asia Pacific (APAC) have also developed positively, with assets under management, net new assets and margins all growing. In 2016, net new assets increased by nearly 60% to CHF 28.5bn, including the impact of CHF 12bn in outflows related to regularisation[1] and selected exits in the external asset manager business. Management has guided to another CHF 9bn in regularisation outflows for 2017. Meanwhile, the adjusted net margin on assets under management increased 2bps to 30bps.

Figure 1: Assets under management (AUM) and net new assets (NNA) (CHF bn)



Source: Company data, Scope Ratings

Figure 2: Adjusted gross and net margins (bps)



Source: Company data, Scope Ratings

[1] Due to increased international cooperation on tax matters and tax transparency, clients are increasingly declaring their assets to tax authorities. This leads to cross-border outflows as clients repatriate their assets or withdraw funds to pay taxes.

Still more to accomplish to ensure future success

Having met its 2016 targets, management is now focused on achieving 2018 and 2019 targets. The year 2016 had been flagged as a "peak transformational year" and there has been good progress made in reshaping the group's business model and in reducing costs. Nevertheless, more needs to be done to improve profitability in the various businesses and to reduce the drag from the SRU. The targets appear demanding and achieving them will depend to some extent on market conditions (Figure 3). Management has indicated that the start to 2017 has been encouraging, underpinned by better client activity levels across capital markets and trading as well as positive inflows in the various wealth management businesses.

Figure 3: Selected key objectives

	2016	2018 target	2019 target
APAC pre-tax income	CHF 0.8bn	CHF 1.6bn	
IWM pre-tax income	CHF 1.1bn	CHF 1.8bn	
SUB pre-tax income	CHF 1.7bn	CHF 2.3bn	
Global Markets return on regulatory capital	2%	10-15%	
IBCM return on regulatory capital	12%	15-20%	
SRU pre-tax loss	CHF 2.9bn	~USD 1.4bn	~USD 0.8bn

Notes: The above targets were presented at the December 2016 investor day. The targets and 2016 figures are on an adjusted basis. With the release of end-2016 results, management indicated that exit costs over the lifetime of the SRU were being revised downwards to below 3% of the total portfolio on a RWA basis.
Source: Company data, Scope Ratings

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