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Credit Suisse Group AG

Q4 2022: Restructuring dampens revenue across divisions, while liquidity marginally improves from October lows

Figures displayed in this report are on a CS reported basis and refer to Q4 2022; comparisons are made versus Q4 2021, unless otherwise indicated.

In Q4 2022[1], Credit Suisse Group AG (CS, Baa2 negative[2]) reported a net loss of CHF1.4 billion. The adjusted[3] net return on tangible equity (ROTE) stood at -7.3%, while the adjusted annualized return on assets (RoA) and risk-weighted assets (RWAs) stood at -0.39% and -1.22%, respectively (Q4 2021 adjusted: 0.13% and 0.36%, respectively). CS's results are credit negative and highlight the current strategic and financial challenges the firm is facing. As previously stated, we expect the plan will entail further substantial losses in 2023, due to reduced revenue streams and elevated restructuring costs, moderate losses in 2024 and a return to modest profitability in 2025.

Revenue slump across all divisions. Group revenue decreased 33%, driven by a 74% decline in Investment Bank (IB) revenue in USD terms; a 17% decline in Wealth Management (WM) revenue, a 28% reduction in Asset Management (AM) revenue, and a 20% decrease in Swiss Bank (SB) revenue. Operating expenses of CHF 4.3 billion decreased 31% as Q4 2021 reported CHF 1.6 billion goodwill impairment charge and high litigation provisions year on year. Adjusted operating expenses of CHF 4.0 billion were down 3% year on year.

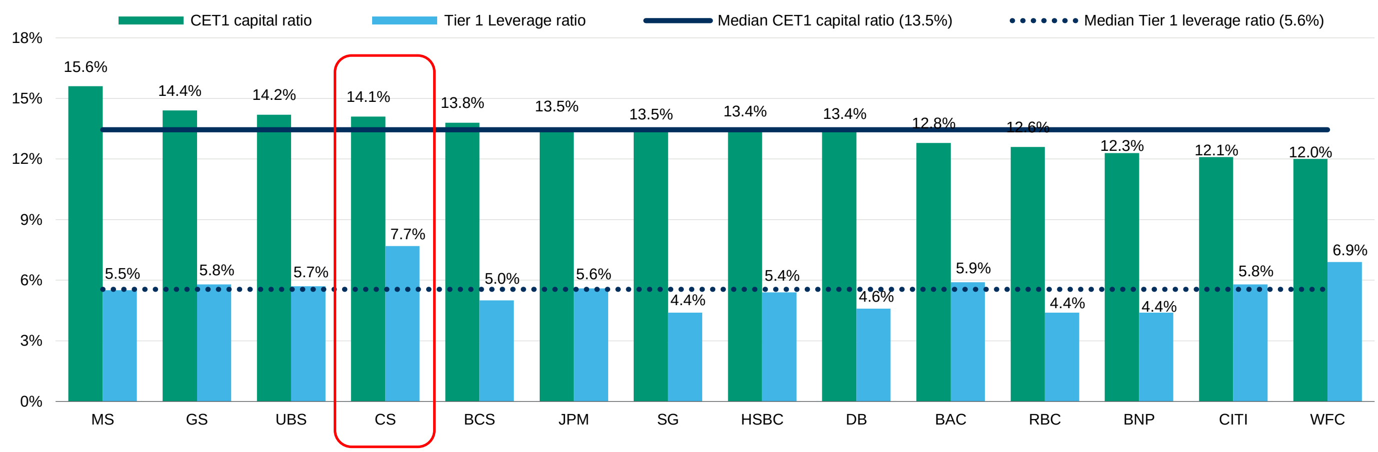
Deposit outflow poses additional challenges. During the quarter, CS's wealth and asset management businesses combined recorded outflows of CHF111 billion, 85% of which occurred in October and November, following media rumours on the financial health of the bank. Outflows were CHF93 billion in the WM division, CHF12 billion in the AM division and CHF8 billion the SB division. Management said the group reported small deposit inflows in January. Firmwide assets under management decreased by 8% in the quarter to CHF1.3 trillion, driven by net outflows and FX impact. For 2022 full-year, net asset outflow was CHF 123 billion, compared to net new assets (NNA) of CHF31 billion in 2021.

For 2022 full-year, CS reported a net loss of CHF 7.3 billion. Revenue of CHF14.9 billion decreased by 34% year on year, driven by a 55% decline in IB revenue in USD terms, a 30% decline in WM revenue, a 14% decrease in AM revenue and a 5% decrease in SB revenue; revenue included CHF 368 million real estate gains and CHF 586 million valuation loss on the Allfunds Group investment. Operating costs of CHF 18.2 billion decreased 5% year on year, which included CHF 1.3 billion litigation provisions and CHF 533 million restructuring expenses. CS's adjusted operating costs of CHF 16.2 billion were below previous guidance of CHF ~16.5-17.0 billion, and up 1% year-on-year. Impairment of deferred tax assets were large, at CHF 3.7 billion.

Liquidity recovered from the October dip but remains below internal appetite. CS average LCR ratio improved to 144% from the lower levels in the quarter supported by deleveraging, a CHF4 billion capital raise, a CHF7 billion of capital market and other funding and client outreach program. CS expects substantial liquidity release through 2023 supported by strategic transformation from Non-Core Unit and Securitized Products. Maintaining solid liquidity is very important to CS because of its sizeable global wealth management and capital markets franchises: the deposits and short-term market and high net worth Individual (HNWI) clients funding are more confidence-sensitive than for traditional banks, exposing CS to a greater risk of funding stress.

Capital and leverage metrics improved. CS reported a CET1 capital ratio of 14.1% (see Exhibit 1), up from 12.6% in the previous quarter. The increase in CET1 ratio was supported by a CHF4 billion of capital raise (+147 basis points) as well as RWAs reduction (+80 basis points) that was partly offset by the loss in the quarter (-53 basis points). The first stage of the disposal of CS's securitised products business to Apollo will boost the CET1 ratio by 30 basis points in 1Q 2023; the managed exit from the securitised products business is anticipated to eventually decrease operational risk-weighted assets (RWAs) associated with CS's historical RMBS activity. Both the CET1 leverage ratio of 5.4% and Tier 1 leverage ratio of 7.7% improved when compared with Q3 2022 (4.1% and 6.0%, respectively). The leverage exposure decreased to CHF651 billion due to reduced activity.

Exhibit 1
The regulatory capital position improved
Common Equity Tier 1 (CET1) ratios and Tier 1 leverage ratios for Global Investment Banks, as of end - December 2022



As of Q4 2022 for BAC, Citi, GS, JPM, MS, RBC, WFC, UBS, BNP,DB, SG, CS and Q3 2022 for all others; 2) The Tier 1 leverage ratios of UK and European banks are calculated as per the Capital Requirement Regulations, and they exclude certain central bank balances as temporarily allowed; for US banks we show the supplemental leverage ratio (SLR). 3) The CET1 ratio for US banks is calculated under the advanced approach.
Source: Company reports

Some progress in the carve-out of CS First Boston. CS announced the $175 million acquisition of The Klein Group LLC, which will be integrated into CS First Boston. CS will retain control of the new CS First Boston, including options to attract third-party capital. CS appointed Michael Klein as CEO of Banking and of the Americas as well as CEO designate of CS First Boston. Executing the carve-out of CS First Boston as an independent advisory and capital markets business will be a large endeavour, due to deteriorating markets and macroeconomic environment and challenges they will face in retaining and attracting human capital despite monetary incentives.

The complex and lengthy restructuring goes ahead. CS announced that the first stage of the deal to sell its securitised products business to Apollo is to be completed in the first half of this year; with a CET1 ratio benefit of 30 basis points to be booked in 1Q 2023. The execution of the strategic plan announced in November[4] entails substantial execution risk due to its breadth and complexity: although the plan could be positive in the long run and lead to a substantially de-risked, more efficient and simplified bank, with materially lower leverage and dependence on the more volatile capital markets and investment banking earnings, the associated complexity will require a lengthy timeline and lead to high talent and client attrition risk.

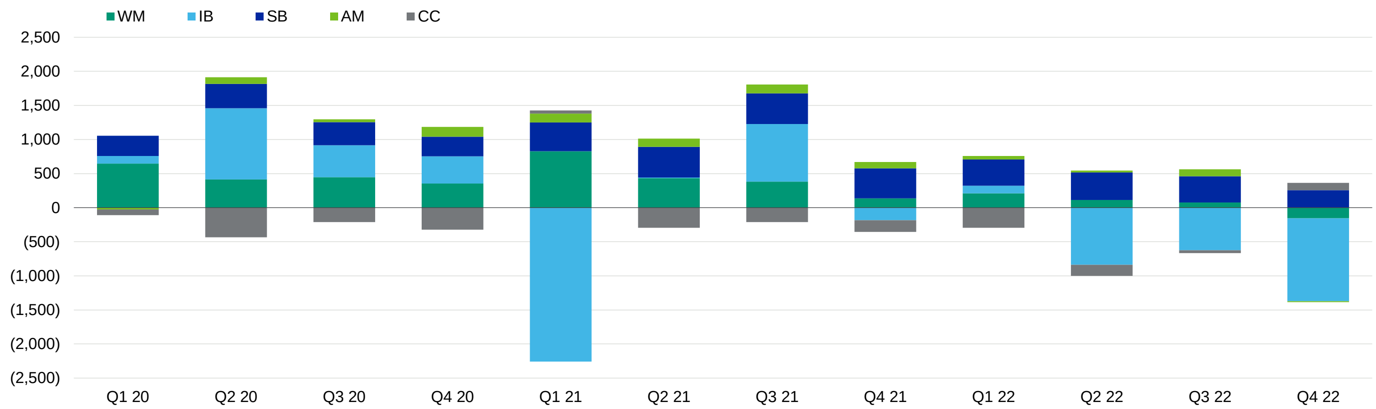
Segment results commentary

Unless indicated otherwise, figures displayed below are on a CS adjusted basis excluding significant items and comparisons are made versus Q4 2021.

Exhibit 2

Underlying performance further weakened in the quarter

Division pre-tax profits, CHF million



Adjusted pre-tax income including Archegos impact.

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

Wealth Management (WM) reported adjusted pretax loss of CHF155 million, down from CHF138 million profit last year, driven by lower adjusted revenue (-18%) and higher adjusted operating expenses (5%). Net interest income decreased 17% reflecting lower deposit and loan volumes and higher funding costs that were only partly offset by higher deposit margins. Fee and commission income decreased 17% due to lower assets under management. Transaction-based revenue declined 20% due to lower client activity, lower corporate advisory fees. Adjusted operating expenses increased 5% due to a higher general and administrative expenses. WM faced net new assets outflow of CHF92.7 billion (Q3 2022: outflow of CHF6.4 billion). The majority of outflows materialized in October 2022, with 60% of net assets outflows driven by deposit outflows. Asset under management decreased to CHF540 billion compared to CHF635 billion in Q3 2022, driven by lower net assets outflows in all regions.

Investment Bank (IB) reported an adjusted pretax loss CHF1208 million compared with pretax loss of CHF169 million.[5]. Adjusted revenue decreased 74% (in USD terms) reflecting weaker revenue across all business lines. FICC revenue declined 84%, reflecting a decline in Global Credit Products. Equity Sales & Trading revenue declined 96% also reflecting the exit from prime services and cash equities as well as reduced client activity. CS's FICC and Equity revenue trend was significantly worse than at its US peers, driven by both an unfavourable business mix and by franchise impairment. Advisory revenue declined 47% and capital market revenue decreased 66%, reflecting lower primary issuance and weaker market conditions. Adjusted operating expenses were down 15% due to lower compensation and benefits costs.

Swiss Bank (SB) reported adjusted pretax profits CHF259 million compared with CHF438 million last year. Adjusted revenue decreased 10% due to lower net interest income (-11%), fee and commission income (-10%) due to lower AuM and a 18% decline in transaction-based revenue, mainly driven by equity investments (excluding those transaction-based revenue were down 8%). Adjusted operating expenses were up 6% due to higher compensation expenses. Net new assets outflow was CHF8.3 billion, driven mainly by outflows of private clients.

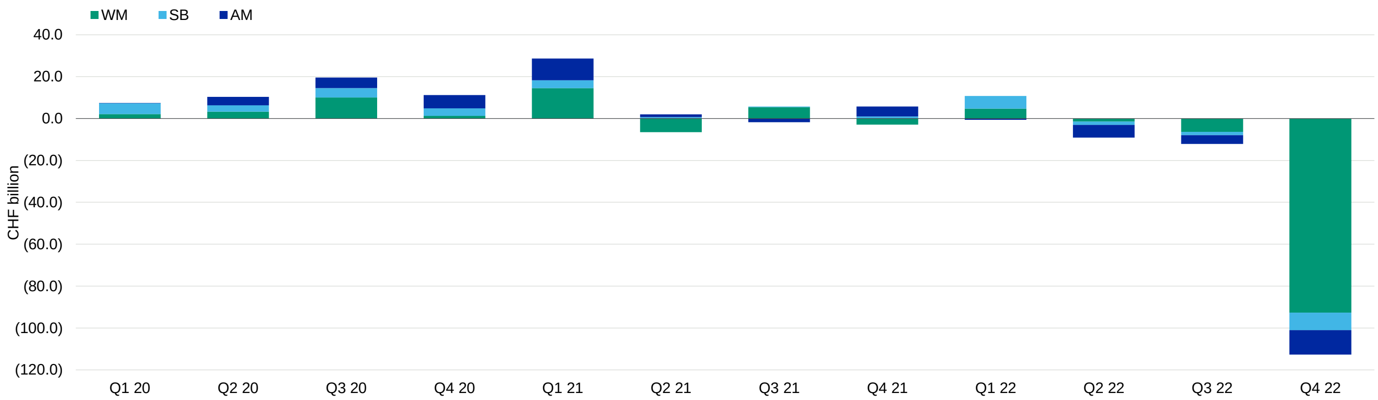
Asset Management (AM) reported adjusted pretax loss CHF15 million compared with CHF93 million profit last year. Revenue decreased 28% due to reduced performance, transaction and placement revenue (-68%) and lower management fees (-19%), mainly reflecting a 16% in AuM. Adjusted operating expenses were down 3% supported by lower expenses related to the supply chain finance funds matter and reduced commission expenses. Net new asset outflow was CHF 11.7 billion across traditional and alternative investments. Assets under management decreased by 16% year on-year and 2% sequentially.

Corporate Center reported an adjusted pre-tax profit of CHF104 million compared to a loss of CHF172 million. Adjusted net revenue increased to CHF186 million due to improved Treasury performance. Adjusted operating expenses decreased 23%.

Exhibit 3

New new assets continued negative trend in the quarter

Net New Assets (NNA) by divisions, CHF billion



Source: Company financials, Moody's Investors Service

Ratings Considerations

We assign Baa2 senior unsecured debt ratings to Credit Suisse Group AG and A3/P-2 senior unsecured debt and deposit ratings to its principal bank subsidiary, Credit Suisse AG. Credit Suisse Group AG's senior unsecured debt rating reflect (1) the bank's ba1 Baseline Credit Assessment (BCA)(2) the result of our Advanced Loss Given Failure (LGF) analysis, providing two notches of uplift and (3) zero notches of rating uplift stemming from government support. The outlook is negative.

Moody's related publications

Credit Opinion

» Credit Suisse Group AG, November 2022

Issuer Comments and In-Depth Reports

» CS 2025 plan: breadth and complexity of restructuring entail significant execution risks, November 2022

» Risk management and governance issues may undermine franchise and earnings stability, July 2021

» IBOR phaseout 15 months away, but hurdles could stretch beyond finish line, September 2020

» Biggest banks are better set to withstand COVID-19 stress than banks as a whole, September 2020

» Stable wealth-management arms of largest Swiss and US banks are a credit positive offset to COVID-19 disruption, September 2020

» Global investment banks' strong liquidity helps insulate creditors, May 2020

» Global Investment Banks: Estimated profit hit in coronavirus shock scenario should not take toll on capital, April 2020

» Fintech - Global Investment Banks: GIBs can keep pace with fintechs, but retail banking is most at risk of a digital divide, February 2020

Rating Action

» Moody's affirms Credit Suisse Group's AG senior unsecured debt at Baa2 and downgrades Credit Suisse AG's senior unsecured debt to A3 and deposits to A3/Prime-2; outlook negative, 1 November 2022

Rating Methodology

» Banks Methodology, July 2021

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Endnotes

1 All figures in this report relate to Q4 2022 and comparisons are made to Q2 2021, unless otherwise indicated.

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

3 We take Adjusted income/(loss) from CS disclosure and include Archegos impact and assume a normalized 25% tax rate.

4 The strategic plan includes: (1) finalizing and executing the transfer of the majority of the assets of the securitized products group to investment vehicles managed by affiliates of Apollo and PIMCO, (2) setting-up a non-core unit holding mostly Investment Bank assets, (3) carving out and attracting new external capital for a simplified independent investment bank, headquartered in New York, under the brand CS First Boston, and (4) aligning and streamlining the bank's remaining businesses which will focus primarily on banking in its domestic Swiss market, global Wealth and Asset Management, while retaining a much smaller ancillary markets footprint.

5 Adjusted pre-tax income as in CS disclosure excluding significant items and Archegos impact

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