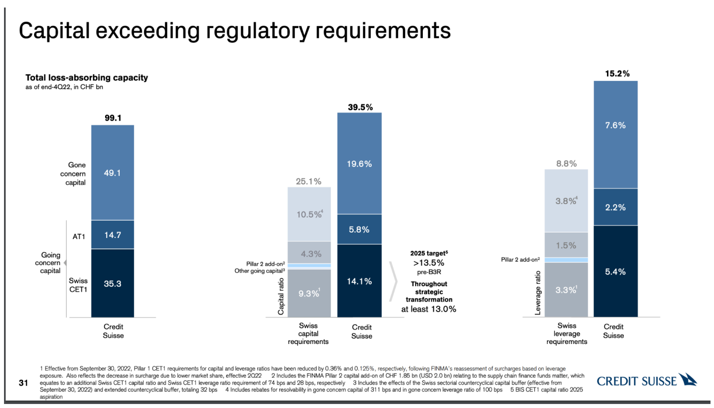
Deutsche & Credit Suisse Debt

GTSF Investments Committee | Feb 02, 2023

Jake Sherwood, Macro Senior Analyst

Credit Suisse Business Struggles

Credit Suisse recently reported their 4th quarter earnings for 2023 and reported their worst annual loss since the 2008 financial crisis. The bank reported a (17.6%) return on tangible equity, 74% decline in adjusted net revenue, and net outflows comprising 8% of 3Q22 AUM. Sales & Trading, a significant portion of the bank's operations, saw steep declines, with equities trading revenues down 96% YoY and Fixed Income revenues down 84% YoY. Credit Suisse's business mix leans on capital-light wealth management and an investment bank that is facing many headwinds. Due to the Archegos Capital debacle, the bank was forced to retreat from the Prime Finance business, and areas of strength in leveraged finance, M&A, and SPAC deal activity are muted. The investment bank's colossal risk management lapses are driving up funding costs and causing key executives to leave. The management team must restructure and downsize the investment bank quickly, which is a long, costly, and risky exercise that may require significant capital raising. Retaining key staff, competing with US banks, and enhancing control infrastructure will also be significant challenges.

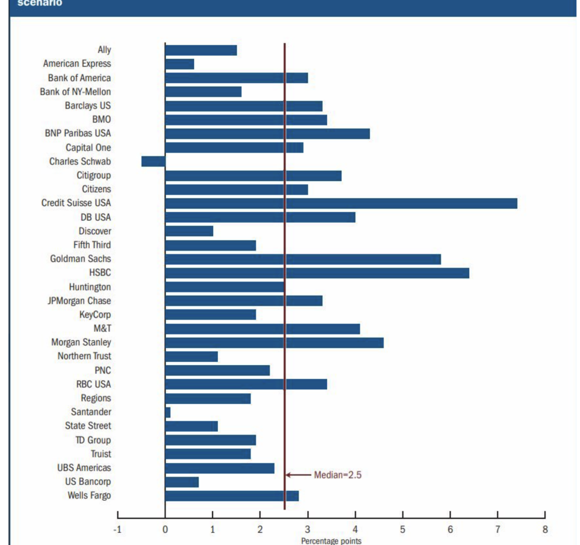


Credit Suisse Deleveraging

In spite of the looming struggles in their Investment Banking segment, Credit Suisse has been effectively de-risking their loan book, reporting a strong increase in their tier 1 capital ratio. This increase in the capital ratio indicates that the bank has a solid foundation to support its operations and to withstand potential financial stress.

Additionally, the bank reported a Liquidity Recovery Ratio of 144%, and a tier 1 leverage ratio of 7.7%. This is a positive development for the bank and demonstrates their commitment to maintaining financial stability and reducing risk. However, without a recovery in their core business, and significant cuts to operating expenses, it is likely Credit Suisse would raise equity and dilute shareholders to pay off debt.

Figure 3. Change from 2021:Q4 to minimum common equity tier 1 capital ratio in the severely adverse scenario



Note: Estimates of minimum common equity tier 1 capital as a percent of risk-weighted assets are for the nine-quarter period from 2022:Q1 to 2024:Q1.

Contact Information

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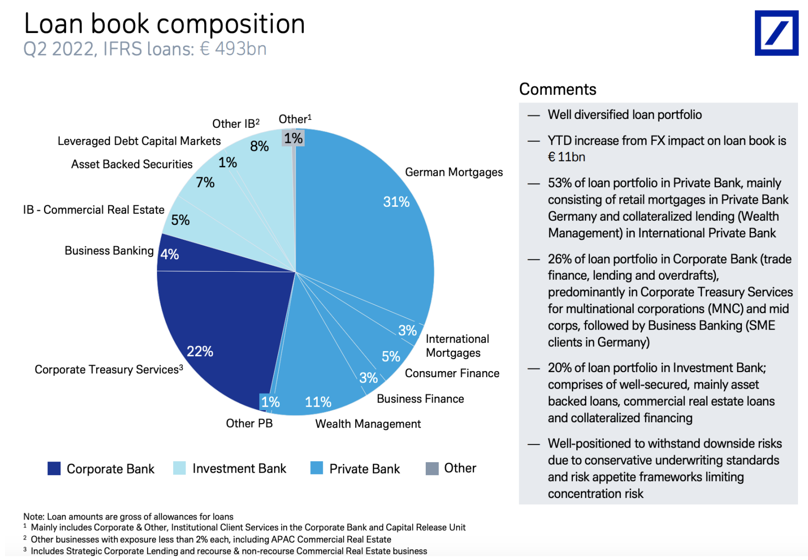
Deutsche Bank

Deutsche Bank's latest financial report showed strong earnings growth and delivery on key financial targets. Management has successfully launched their restructuring process and have significantly cut operating expenses. Deutsche Bank also continues to steal market share in their Investment Bank division, while completely exiting their Equities Trading business, which saw major losses for Credit Suisse. Further, rising interest rates are proving to be a major tailwind for earnings, as they reported an additional 700 million EUR in net interest income in 2022. Their Capital Release Unit also delivered on their de-leveraging initiatives, reducing leverage exposure by 43% YoY. Looking at their loan book composition to the right, you can see that management takes a conservative approach to lending, with a well diversified loan portfolio.



5YR Bond Analysis

5YR Treasury Yield = 3.90%

Credit Suisse Group

1. CS 7.5% 02/15/2028

   → YTM = 6.43%

2. CS Default Risk Premium

   = 6.43% - 3.90% = 2.53%

3. CDS/DRP Ratio = 1.27

Deutsche Bank

1. DB 0.3% 05/25/2028

   → YTM = 4.61%

2. DB Default Risk Premium

   = 4.61% - 3.90% = 0.71%

3. CDS/DRP Ratio = 1.31

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