Issuer Profile:
Neutral (3)

Ticker:
UBS

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UBS Group AG ("UBS")

Potential New Issue

- UBS Group AG ("UBS") is reportedly looking to issue a **SGD Perpetual non-call 5yrs Additional Tier 1 instrument.** No initial price guidance has been provided yet and any new deal remains subject to market conditions.
- This would be UBS's second capital instrument issue in the SGD space after the SGD700mn UBS 5.875% PERPc23s issued in November 2018.
- Initial indications are that the structure of this deal will be similar to the UBS 5.875% PERPc23s with the instrument subject to write down at the point of non-viability or if its CET1 ratio falls below 7.0%.

Pricing Indication

- While the economic outlook is more clouded since the prior issue, the technical environment has shifted considerably with positive sentiment for bank capital instruments given the dovish rates outlook. This, along with solid market liquidity, has driven strong demand for duration and structural high yield instruments in the SGD space.
- The UBS 5.875% PERPc23s was issued at an initial spread of 3.605% and currently trades at a yield of ~4.66% or 314bps above swaps. The more recently issued Credit Suisse Group AG SGD750mn CS 5.625% PERPc24s (reset SDSW5 + 3.767%) is currently trading at a yield of 5.26% or a spread of 374bps. We presently rate Credit Suisse Group AG at a Neutral (4) under our framework while UBS is rated a notch higher at Neutral (3).
- Considering these inputs, we expect any initial price talk for a proposed new issue to be around the 5% handle. This assumes a spread of ~350bps based on current 5-year swaps of 1.52%. However, we would not be surprised if technicals eventually grind this deal tighter by around 20bps.
- At these levels, **a proposed initial spread of ~330bps** would (1) be around 30bps tighter than initial spread for the UBS 5.875% PERPc23s; but (2) somewhat reflect the longer duration against current trading levels for the UBS 5.875% PERPc23s; and (3) be around 40bps tighter than current levels for the CS 5.625% PERPc24s.
- We would not chase this deal any tighter than those levels which already reflect the stronger influence on technicals as opposed to fundamentals.

Relative Value:

Comparative AT1s	CET1 Ratio	Call date	Reset Spread	Ask Price	Ask Yield	Spread
UBS 5.875% PERPc23	13.3%	28/11/23	3.605%	104.60	4.66%	313bps
CS 5.625% PERPc24	12.5%	06/06/24	3.767%	101.50	5.26%	374bps
SOCGEN 6.125% PERPc24	12.0%	16/04/24	4.207%	102.20	5.58%	405bps
STANLN 5.375 PERPc24	13.5%	03/10/24	3.683%	101.50	5.04%	352bps
HSBC 5.0% PERPc23	14.3%	24/09/23	2.665%	102.45	4.33%	280bps
BAERVX 5.9% PERPc20	13.1%	18/11/20	3.320%	102.88	3.48%	185bps
BAERVX 5.75% PERPc22	13.1%	20/04/22	3.915%	103.65	4.27%	272bps
UOBSP 3.58% PERPc'26	13.9%	17/07/26	1.795%	100.45	3.50%	194bps

Indicative prices as at 27 August 2019 Source: Bloomberg
CET1 capital ratios based on latest available quarter

Background

- UBS Group AG ("UBS") is the world's largest wealth manager by assets under management. Based in Zurich and operating across 50 countries, UBS also provides Personal & Corporate Banking, Asset Management and Investment Banking.
- As at 30 June 2019, it had total invested assets of USD3,381bn. There is no major shareholder of UBS with shareholdings widely spread across institutional investors with BlackRock Inc. and GIC amongst the 5 largest institutional investors.
- While business fundamentals are sound, earnings and capital ratios will continue to be in focus due to high shareholder returns, rising costs and potential litigation impacts

Comments on 2Q2019 and 1H2019 results

- **Weaker top line performance:** UBS reported its 2Q2019 and 1H2019 results with operating profit before tax of USD3.31bn down 13.2% y/y for 1H2019. This was driven by a larger fall in first half operating income (-6.7% y/y) than the fall in operating expenses (-4.7% y/y). Operating income performance was dragged by both weaker net interest income (-18.6% y/y due to changes in deposit mix from demand deposits into money market funds and certificates of deposit and loan repricing) and lower net fee and commission income (-6.1% y/y from lower net brokerage fees in Global Wealth Management and the Investment Bank as well as lower investment fund fees and fees for portfolio management and related services mostly in Global Wealth Management).

- **Operating expenses didn't compensate for the half but better in the quarter:** Lower operating expenses were driven mostly by lower general and administrative expenses (-22.6% y/y from a reduction in outsourcing costs, litigation, regulatory and similar costs, professional fees and a reallocation of rent expenses following adoption of IFRS16) and a fall in personnel expenses (-1.9% y/y from lower variable and financial advisor compensation and contractor costs that was offset to an extent by higher pension costs). The reported cost to income ratio for 1H2019 of 77.4% weakened from 75.7% as at 1H2018. q/q performance was better with the reported cost to income ratio of 76.5% in 2Q2019 improved from 78.4% in 1Q2019.

- **Wealth Management still the propeller, Investment Bank the anchor:** By segment, overall y/y operating income performance was impacted mostly by weak performance in the Investment Bank (-16.2% y/y from weaker client activity levels and lower transaction fees in Equity and Debt Capital Markets amongst others) and Global Wealth Management (-6.0% y/y from lower recurring, transaction and net interest income). On the flipside, Corporate Center operating income was marginally positive in 1H2019 (USD17mn) against a USD174mn operating loss in 1H2018. This performance fed through to reported operating profit before tax with the Investment Bank (-42.9% y/y) and Global Wealth Management (-15.8% y/y) driving the 13.2% y/y fall in overall operating profit before tax. Otherwise, other segments most notably the Corporate Center (+79.1% y/y on better net treasury income and lower operating expenses) but also Personal & Corporate Banking (+3.1% y/y on better transaction income, loan growth and credit loss recoveries) and Asset Management (+12.9% y/y on stable operating income and lower operating expenses) improved in 1H2019. Overall, Global Wealth Management continues to contribute more than half (52.6%) of UBS's total 1H2019 operating profit before tax followed by Personal & Corporate Banking (23.5%) and the Investment Bank (19.2%)

- **But capital position keeping things afloat:** UBS's capital position improved h/h as a result of capital growth and a reduction in risk weighted assets from changes in the asset mix as well as methodology and policy changes and lower regulatory add-ons. Its CET1 ratio as at 30 June 2019 was 13.3%, up from 12.9% as at 31 December 2018 and 13.0% as at 31 March 2019. These remain above its capital guidance of around 13.0% and minimum CET1 capital ratio requirements of 10.3% (including countercyclical buffer) as at 1 January 2020 for UBS which are stringent due to both higher obligations for systemically important banks under Swiss legislation (minimums include both going concern and gone concern requirements), its dominant domestic market position as well as its classification as a global systemically important bank. Its Total Loss- Absorbing Capacity as at 30 June 2019 of 33.3% is also above its minimum requirement of 25.0%. UBS is also subject to Swiss leverage ratio requirements for systemically relevant banks with a minimum going concern requirement of 5.0% and minimum total loss-absorbing capacity leverage ratio requirement of 8.8%. As at 30 June 2019, UBS was above these requirements at 5.5% and 9.6% respectively.

Recent Reports on UBS Group AG from OCBC Credit Research

- Asian Credit Daily (24 July 2019)
- Singapore Mid-Year 2019 Credit Outlook (05 Jul 2019)

Explanation of Issuer Profile Rating / Issuer Profile Score

Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings into a 7 point Issuer Profile Score scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Please note that Bond Recommendations are dependent on a bond's price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer's credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.

Explanation of Bond Recommendation

Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

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