Swiss Banks, Asset and Wealth Managers

Impact of negative interest rates and a strong Swiss franc – Upgrade JB, EFG, VZ and PGHN to Buy

Equities

Switzerland
Banks, Ex-S&L

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Strong Swiss franc mainly impacts Swiss private banks, but less than thought

Profits in 2015 are pressured by a negative currency translation but more importantly a negative transaction impact. That said, the impact could be less severe than we originally thought because of: 1) a recently weaker Swiss franc resulting in higher average assets under management 2015E, 2) significantly lower assumed negative side-effects and 3) material mitigating (cost) measures (eg, Julius Baer). We upgrade both Julius Baer and EFG Int. to Buy. Both offer: 1) double-digit EPS growth beyond 2015, 2) (underestimated) cash returns, 3) optionality due to excess capital and 4) the likelihood of legacy topics being resolved soon.

Negative interest rates could have material negative impact on regional banks

The Swiss swap curve is in negative territory. Over the coming years, we think this could have material implications on both the banks' asset and liability side in terms of spreads and client behaviour. Additionally, hedging is costly and could further erode margins. A deteriorating macro environment could additionally increase risk costs and lower loan growth. Due to expected negative net profit growth in 2015, too high consensus expectations and too high valuations, we reiterate our Sell on BCV and downgrade SGKB to Sell. That said, decent dividend yields could offer some protection for both.

Double-digit growth and visibility have high value – upgrade VZ, PGHN to Buy

VZ and PGHN have visible, annuity-type revenues that are growing double-digit due to structural drivers. Both should offer mid-teens profit growth for several years thanks to double digit inflow levels. PGHN could further benefit from asset allocation shifts to private markets given the low (or even negative) yield. VZ will continue to benefit from an ageing population seeking high-quality advice in many areas (old age saving, independent portfolio management, housing etc). We think Leonteq is trading on high multiples based on high (consensus) forecasts. We see a risk for a disappointment (eg, profits, volumes) with H1 2015 results.

Figure 1: Our preferences (grey shaded indicates rating change made in this report)

Most preferred	In the middle	Least preferred
Julius Baer (Buy)	Credit Suisse (Neutral)	Banque Cantonale Vaudoise (Sell)
EFG International (Buy)	Vontobel (Neutral)	St. Galler Kantonalbank (Sell)
GAM Holding (Buy)		Leonteq (Neutral)
Partners Group (Buy)		
VZ Holding (Buy)		

Source: UBS research. NB For details of all rating, price target and estimate changes, please see Figure 4 and Figure 5.

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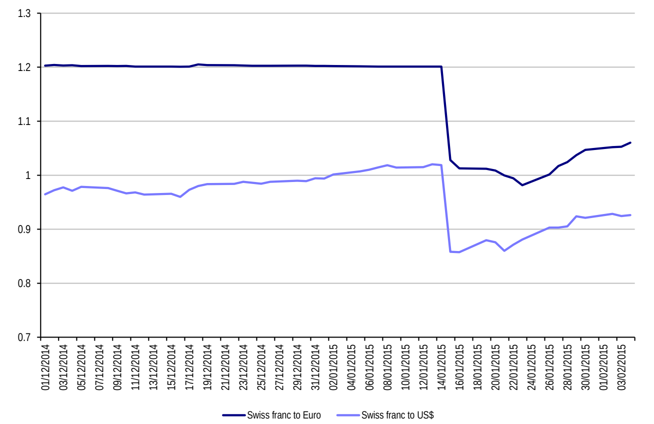
Taking stock

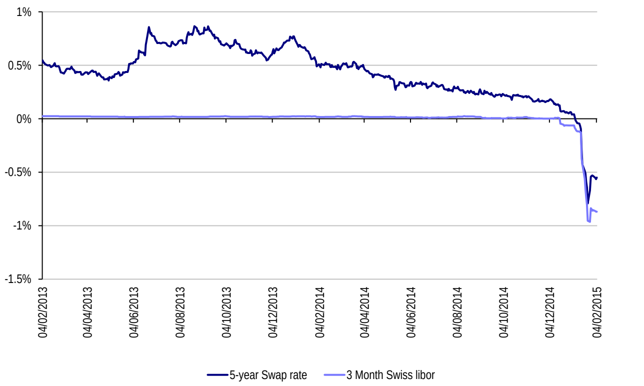
We still think that the sudden Swiss franc strengthening and the extreme moves on the interest rate side are a non-linear, unexpected and material shock for the economy and banks with potentially profound short-, medium- and long-term impacts.

Figure 2: Swiss franc against euro and dollar



Source: Datastream

Figure 3: Extreme interest rate moves



Source: Datastream

More than three weeks after the SNB decided to remove the 1.20 EURCHF floor, we revise and update our initial views.

We think the currency moves are a manageable profit headwind over the coming six to eighteen months for the banks under our coverage but we think it could have a more severe impact for some non-listed, smaller banks which could speed up consolidation.

In contrast to this, we now see the more relevant and underestimated, medium- to long-term negative implications coming from the extreme interest rate moves: The key reason for our negative stance on St. Galler Kantonalbank and BCV.

In this report, we update our views on both areas – currency and interest rate moves. Also, we make the following changes to recommendations, price target and EPS. We are upgrading Julius Baer, EFG Int., Partners Group and VZ Holding to Buy and we downgrade St. Galler Kantonalbank to Sell.

Figure 4: Changes to ratings and price targets

	Julius Baer	EFG Int.	SGKB	BCV	PGHN	VZ
Old recommendation	Neutral	Neutral	Neutral	Sell	Neutral	Neutral
New recommendation	Buy	Buy	Sell	Sell	Buy	Buy
Old price target	35	10	360	430	220	153
New price target	46	13	300	400	300	222
change (%)	*31%*	*30%*	*-17%*	*-7%*	*36%*	*45%*

Source: UBS research

Figure 5: EPS changes

EPS changes	Julius Baer	EFG Int.	SGKB	BCV	PGHN	VZ
2015E	27%	40%	-7%	-7%	10%	3%
2016E	19%	10%	-13%	-10%	8%	3%
2017E	11%	11%	-12%	-10%	9%	3%

Source: UBS research

The below table shows PE valuation levels both at current and price-target-share price levels.

Figure 6: PE valuation levels

	Credit Suisse	Julius Baer	EFG Int.	Vontobel	Cembra	SGKB	BCV	PGHN	GAM	Leonteq	VZ
Share price 6 February 2015 (CHF)	20.2	41.9	10.3	32.7	56.8	357.5	558.0	262.3	16.7	218.2	167.2
Target price (CHF)	20	46	13	31	60	300	400	300	18.1	200	222
EPS 2015	1.9	2.6	0.9	1.9	4.7	24.4	30.6	13.4	1.1	6.6	10.4
EPS 2016	2.4	2.9	1.0	2.5	4.9	23.7	29.9	16.1	1.4	10.2	11.9
PE 2015E	10.7x	16.2x	11.8x	17.0x	12.2x	14.7x	18.2x	19.5x	14.8x	33.0x	16.1x
PE 2016E	8.3x	14.5x	10.8x	12.8x	11.5x	15.1x	18.7x	16.3x	11.6x	21.3x	14.0x
PE 2015E at target price	10.6x	17.8x	14.9x	16.1x	12.9x	12.3x	13.1x	22.3x	16.0x	30.3x	21.4x
PE 2016E at target price	8.3x	15.9x	13.7x	12.2x	12.1x	12.6x	13.4x	18.7x	12.6x	19.5x	18.6x

Source: UBS estimates

Investment cases in short

Julius Baer (Buy; PT CHF46): We like the investment case for three reasons: 1) Decent net new money, some positive market performance and at least stable gross margin should translate into mid- to high-single digit top-line growth. Gross margin trends in IWM are promising and bode well for 2015 too. 2) Working down legacy topics: the legalisation of the back-book should largely be accomplished in 2015 and the US tax dispute should be solved too, potentially resulting in a multiple expansion. 3) Excess capital of more than CHF600m at the of end-2015 (that's including a US tax dispute charge) offers strategic flexibility and the opportunity to further increase the dividend payout ratio or to announce a share buyback programme or to make EPS accretive acquisitions (similar to eg, Bank Leumi).

EFG International (Buy; PT CHF13): We like the investment case for three reasons: 1) Various forward-looking indicators like (gross) hiring remain strong in our opinion and they should translate into profit growth over the coming three years. 2) We see a rising dividend both in absolute terms and in terms of pay-out ratio. 3) Excess capital of some CHF300m at end-2016 offers strategic flexibility and the opportunity to further increase the dividend payout ratio or to announce a share buyback programme or to make EPS accretive acquisitions.

Partners Group (Buy; PT CHF300): Partners Group, a provider of private markets investment solution (private equity, debt, real estate and infrastructure), is well

positioned to benefit from ongoing and emerging structural trends globally. Pension funds allocating a higher part of their assets to private markets should translate into more than ample client demand, which provides strong support for management fees. For timing reasons and supported by an improved exit environment for earlier investment programs, performance fees could grow very rapidly in the next 2-3 years. With active hiring and expansion of the investment platform, Partners Group intends to increase its ability to deploy committed funds in a value-enhancing manner. Over time, higher earnings mean that Partners Group could pay meaningfully higher dividends as well.

GAM (Buy; PT CHF18.1): We think GAM Holding has the potential to grow AuM, its top line and net profits by at least a 10% CAGR for a few more years to come. For 2014, however, we predict zero operating profit growth and even a 2% decline in terms of net profit. GAM offers several known positive features: (1) Its cash yield of 8% is strong (90-100% of net profit redistributed to shareholders via dividends and share buybacks); (2) excess capital of up to cCHF300 million provides ample strategic flexibility (seed money, M&A); and (3) the broad range of products and distribution channels should translate into decent inflow levels over time. Our CI ratio and net new money forecasts remain at the upper/lower (ie, conservative) end of the target ranges.

VZ Holding (Buy; PT CHF222): VZ's investment case offers a well-functioning, transparent, high-quality and fast-growing business model. After a period dominated by investment into the business, we see a return to solid double-digit earnings growth for several years to come. This is fuelled by mid-teens net new money growth, four times the Swiss private banks peer group average. The roll-out of second pillar pension solutions to SMEs and the increasing popularity of rule-based portfolio management services add to natural growth driven by consistent net hiring of front-end staff.

Cembra Money Bank (Buy; PT CHF60): Cembra Money Bank is characterised by a stable and predictable business model, which generates sustainable economic profit (RoE > CoE) and offers a 6% (and rising) net dividend yield (assuming payout ratios in the 65-70% range). Management is committed to strict cost control and, compared with peers, the cost line is generally less exposed to exogenous factors. The well-diversified receivables (including loans, leases and credit cards) portfolio, high net interest margin and long-term fixed-rate funding (along with fixed-rate lending) serve as a competitive advantage in times of macro difficulties. Moreover, Cembra's excess capital provides the group with strategic optionality. We think an extraordinary dividend could be distributed (on top of the 6% net dividend yield) in the next two years.

Banque Cantonale Vaudoise (Sell; PT CHF400): We would avoid Banque Cantonale Vaudoise for valuation reasons. Revenues, operating profit and net profit were down in 2013 and remained flattish year on year in H1 14. Mortgages grew only 1% in H1 14. We expect negative net profit growth in 2015, driven by negative interest rates hurting net interest income and further deteriorating loan growth. BCV continued to suffer outflows from offshore private banking – a trend that looks set to continue for some time, management believes (but onshore inflows were very strong). The announced dividend policy until 2017 of paying CHF22-27 plus a CHF10 extra dividend per share is a consequence of this excess capital position, and translates into an almost 100% payout ratio.

St. Galler Kantonalbank (Sell; PT CHF300): SGKB, in our view, a well-run company when it comes to its core business, retail and corporate banking. The risk

policy is conservative and the asset quality is well managed. Nevertheless, SGKB is not immune to various adverse sector headwinds. In fact, we think, negative interest rates in Switzerland have profound negative implications on SGKB's mortgage business, hurting profitability as well as potentially leading to higher risk costs and lower loan growth. Due to negative net profit growth in 2015E, too high consensus expectations and too high valuations, we consider SGKB overvalued at current levels.

Credit Suisse (Neutral; PT CHF20): We think a P/TNAV '14E of 1.1x for a ROTE '14E of c10% (c12% in '15E) offers little upside. Uncertainties around regulatory demands (RWA calculations, leverage ratio, TLAC, TBTF and its impact on various areas) remain significant, in our opinion. We think CS's Tier 1 leverage ratio target of 3.7% could be too low in light of the likely regulatory tightening. Target leverage exposure reductions and earnings could lift the CET 1 leverage ratio by cCHF6.8bn to c3.3% in 2016E. Further cCHF6.9bn high- and low-trigger capital issuance (P&L costs?) could lift the tier 1 leverage ratio to 4.3% (total capital to c5.6%). Dividend futures imply a 2014 dividend of around CHF0.48 per share. Given regulatory uncertainty, we see little benefit in sending out a confident signal by paying a (too) high cash dividend.

Vontobel (Neutral; PT CHF31): Vontobel has, over the past few years, implemented various efficiency and growth initiatives. Compared with our previous expectations, these measures have not only had a more meaningful positive impact on financials, but have also taken effect earlier than expected. We think the results have been particularly visible in private banking, while asset management has continued its successful growth path. The 2014 targets were recently replaced with new 2017 targets. Vontobel no longer has revenue and AuM targets. It aims for a >12% ROE (up from 10% previously; we think mainly due to the Raiffeisen transaction), a <75% CI ratio and a >12% CET 1 ratio (>16% total capital ratio). The dividend payout ratio will be >50%. For 2017E we assume a CI ratio of 78.5%, ROE of 10.2%, a payout ratio of more than 80%, and a CET 1 ratio of 17%.

Strong Swiss franc mainly impacts Swiss private banks, but less than originally thought

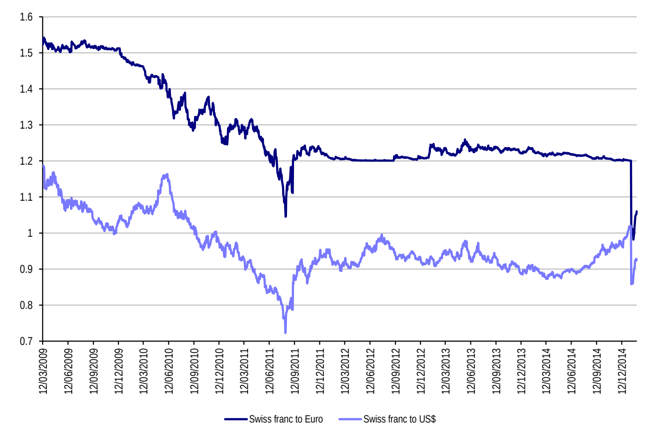
Profits in 2015 are pressured by a negative currency translation but more importantly a negative transaction impact. For the banks under our coverage this negative currency transaction effect typically lifts CI ratios by two to four percentage points. For some smaller, purer offshore private banks with most of the revenues in non-Swiss franc currencies and most of the costs in Swiss francs, this impact could be much more significant. Because of this and other drivers consolidation looks set to pick up in Switzerland as discussed in previous research (eg, 5 Sept 2014 Swiss banks report).

We recently published an interactive model where you can see the profit impact coming from potential Swiss franc moves. The banks are impacted the most by a strong Swiss franc among all Swiss stocks:

https://neo.ubs.com/shared/d1I5YECprS7PxKu

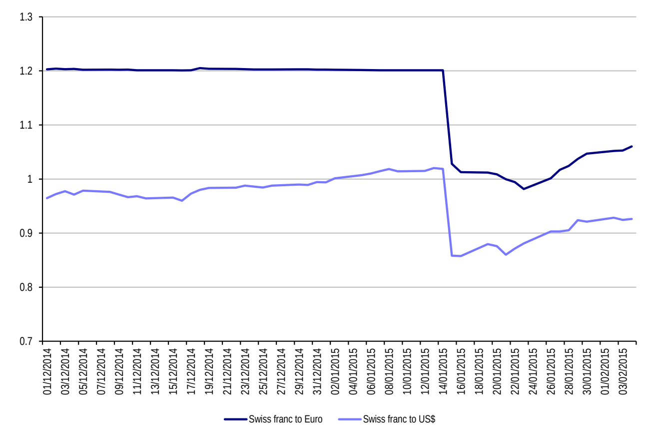
We still think that the sudden Swiss franc strengthening is a non-linear, unexpected and material shock for the economy and banks with potentially profound short-, medium- and long-term impacts.

Figure 7: Swiss franc against euro and dollar – long-term



Source: Datastream

Figure 8: Swiss franc against euro and dollar – short-term

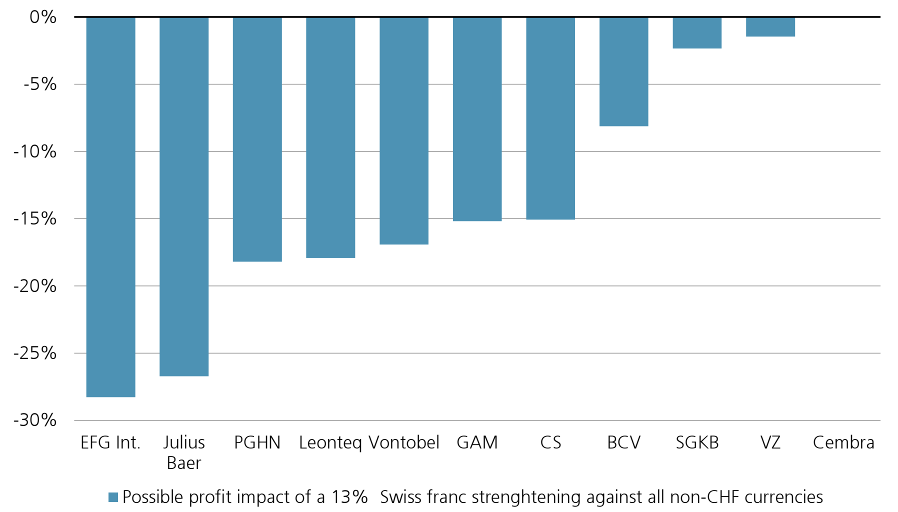


Source: Datastream

We recently reduced our earnings forecasts materially for most banks. The reductions came from the negative transaction effect, translation effect and negative ripple effects. The negative transaction and translation effect was discussed and derived in our 15 January 2015 note *FX impact of the SNB scrapping the EURCHF floor*[1].

[1] https://neo.ubs.com/r/?id=o22d28a,14afa39,14b1304&ap_oid=21695128

Figure 9: Possible profit impact of a 13% Swiss franc strengthening against all non-CHF currencies



Source: UBS estimates

Our previous estimates regarding the YTD negative impact on assets under management were too conservative and fears that the EURCHF could stay even below parity for longer have so far not materialised. Also recent press articles (eg, *Tages-Anzeiger*) suggest that the SNB is willing to stabilise the EURCHF exchange rate at around 1.05 to 1.1.

Negative side-effects smaller than feared

As mentioned in our 20 January 2015 report, we decided to use cautious forecasts to show that a negative stance on Swiss private banks is not warranted in our view given 2016 PE ratios.

We now believe that our cautious forecasts were even too cautious and we now only factor in very small negative ripple effects into the banks' revenues for 2015 and beyond.

Also, the Swiss franc strengthening topic seems mainly a Swiss domestic theme and the uncertainty, if any, seems limited to the Swiss domestic client base we think (eg, some negative impact on certain structured products, lower treasury results, some deleveraging). For foreign clients, we no longer think that there will be any meaningful negative revenue impact – on the contrary, some increased forex volatility and renewed demand for certain products (eg, structured products and (discretionary) mandates) could even result in some revenue opportunities.

Overall, we now expect gross margins to decrease slightly in 2015. This trend assumes a low single digit basis point headwind from lower net interest income and some higher gross margin legalisation outflows largely being compensated by higher client activity levels (eg, FX) and increasing penetration of higher margin products (eg, discretionary mandates).

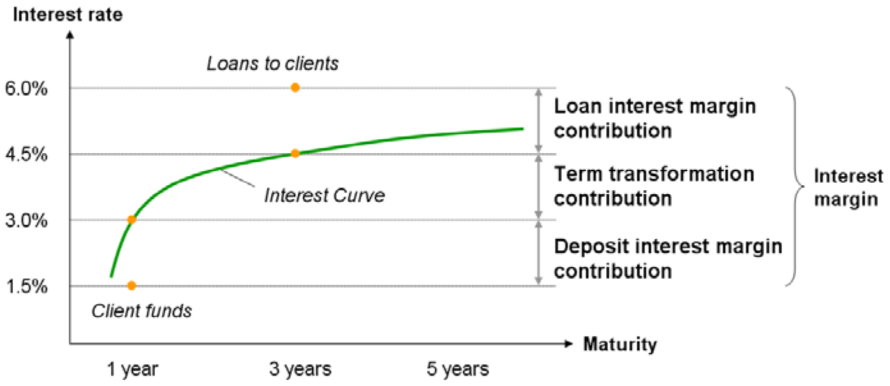
Negative interest rates could have material negative impact on regional banks

The Swiss swap curve is in negative territory. Over the coming years, we think this could have material implications on both the banks' asset and liability side in terms of spreads and client behaviour. A flat yield curve and the inability/unwillingness to charge interest rates on deposits and a limited re-pricing possibility on the asset side could put pressure on net interest income. Additionally, hedging is costly and could further erode margins. A deteriorating macro environment could additionally increase risk costs and lower loan growth. Due to expected negative net profit growth in 2015[2], what we consider to be too high consensus expectations and too high valuations, we reiterate our Sell on BCV and downgrade SGKB to Sell.

Back to school for five minutes – A recap of how we should think about interest income and balance sheet risks

A typical (Swiss) bank's net interest income is basically driven by the loan/mortgage volume (growth), the interest rate level and the shape of the yield curve, the bank's hedging strategy as well as the interest margin contribution on both sides of the balance sheet (see chart below).

Figure 10: Funds transfer pricing method

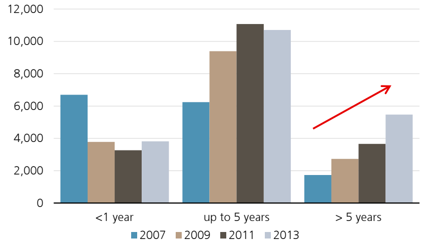


Source: SGKB

The client behaviour plays an important role too in this context too. Given the low interest rate environment over the past few years, clients increasingly asked for long-term (on average around 7 years according to eg, SGKB) fixed-rate mortgages.

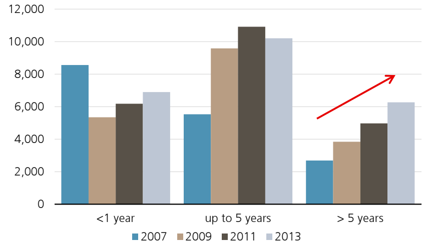
[2] Several non-listed Cantonalbanks (Zuger, Zürcher, Graubündner) also gave a rather cautious outlook for 2015 (incl. in some cases the expectation of falling profits in 2015)

Figure 11: Maturity structure mortgages SGKB



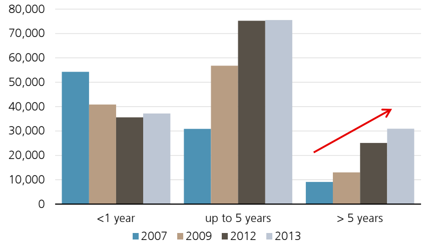
Source: SGKB

Figure 12: Maturity structure mortgages BCV



Source: BCV

Figure 13: Maturity structure mortgages Raiffeisen



Source: Raiffeisen

The term transformation on a typical bank's balance sheet has therefore markedly increased the maturity mismatch on the balance sheet. In other words, the market interest rate risk in the banking book has gone up (a lot) and hence there is increased reliance on derivative markets to hedge all else being equal[3].

The interest income can therefore be broken down into its various components as shown below. SGKB reports the term transformation contribution in the corporate center and, unlike most other banks, does not allocate this back to the divisions (we like this reporting approach as it is very transparent and informative).

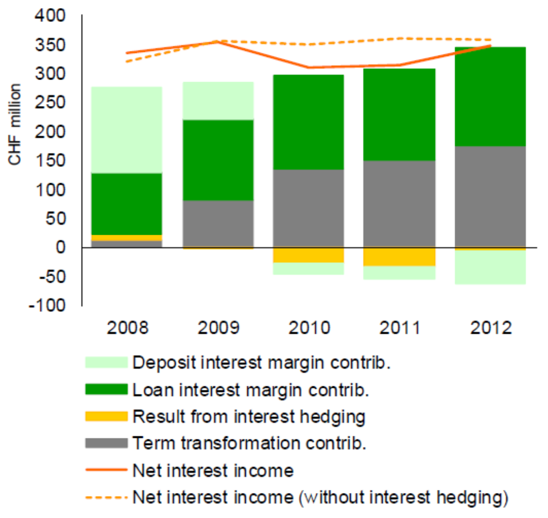
In the case of St. Galler Kantonalbank, net interest income in the Corporate center (which reflects the term transformation contribution) represented a record-high 60% of total net interest income in H1 2012 (it was just below 50% in H1 2014). This income stream is at risk in our view in a flat yield curve and low interest rate environment the longer this situation lasts.

In the case of SGKB and bearing in mind the active management of interest rate risks through swaps, the various net interest income components developed as follows. As can be seen below, in 2012 (no updated chart available), SGKB had a negative deposit spread, a large and increasing term transformation contribution (the treasury result) and an again expanding asset spread (below called 'loan interest margin contribution'). The costs from hedging were significant in both 2010 and 2011 (see below) but decreased in H1 2012, the key reason for the better net interest income result.

SGKB however was also able to re-price mortgage spreads: the average spread on new business was c85bp in H1 2012 which compares to c65bp only 18 months ago. Today, the average spread we think is some 100bp.

[3] On 27 January 2015, Zuger Kantonalbank said "Negative LIBOR-Zinssätze machen Massnahmen zur Absicherung der Zinsänderungsrisiken wirtschaftlich äusserst unattraktiv. Dies kann sich negativ auf das Zinsergebnis 2015 auswirken." (negative LIBOR rates make hedging economically extremely unattractive. This can have a negative impact on net interest income in 2015)

Figure 14: Development of Interest Income (applying the funds transfer pricing method): Interest Margin Contribution and Term Transformation Contribution



Source: SGKB

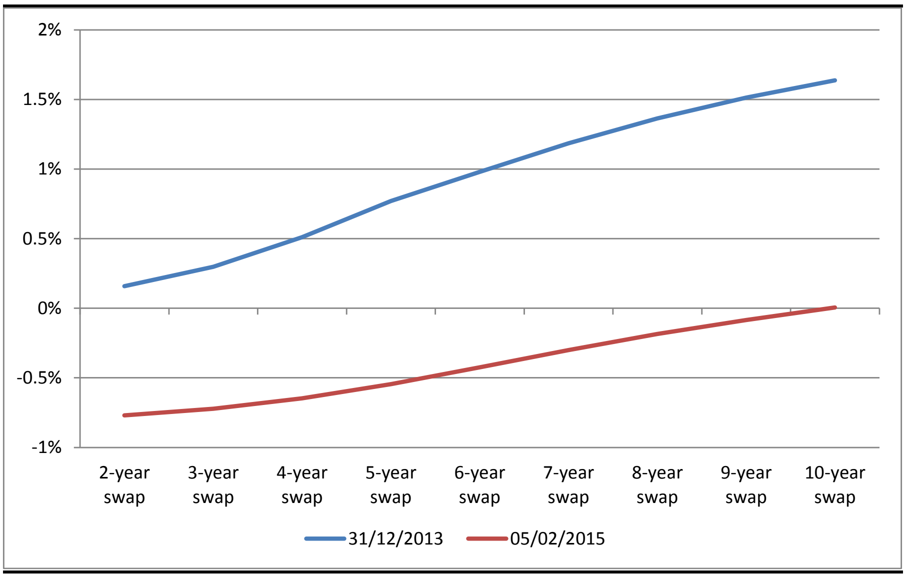
As a result of current interest rate trends and balance sheet dynamics as well as bearing in mind the risk limits imposed by the board, banks could increasingly be 'forced' to use (expensive) interest rate swaps in order to reduce the above mentioned risks.

What happens in a negative interest rate environment?

The Swiss swap curve is in negative territory but not inverted. Banks typically use swap curves to price their products on both the asset and liability side.

Negative interest rates could have material implications on both the banks' asset and liability side in terms of spreads and client behaviour. Additionally, hedging is costly and could further erode margins.

Figure 15: Swap rates Switzerland



Source: Datastream

Breaking down interest income into its subcomponents and bearing in mind the current interest rate environment, we think the impact could be as follows:

Figure 16: Impact of flat yield curve and negative rates on interest income components

Deposit interest margin contribution	negative
Loan interest margin contribution	positive (repricing)
Result from interest hedging	negative
Term transformation contribution	negative

Source: UBS research

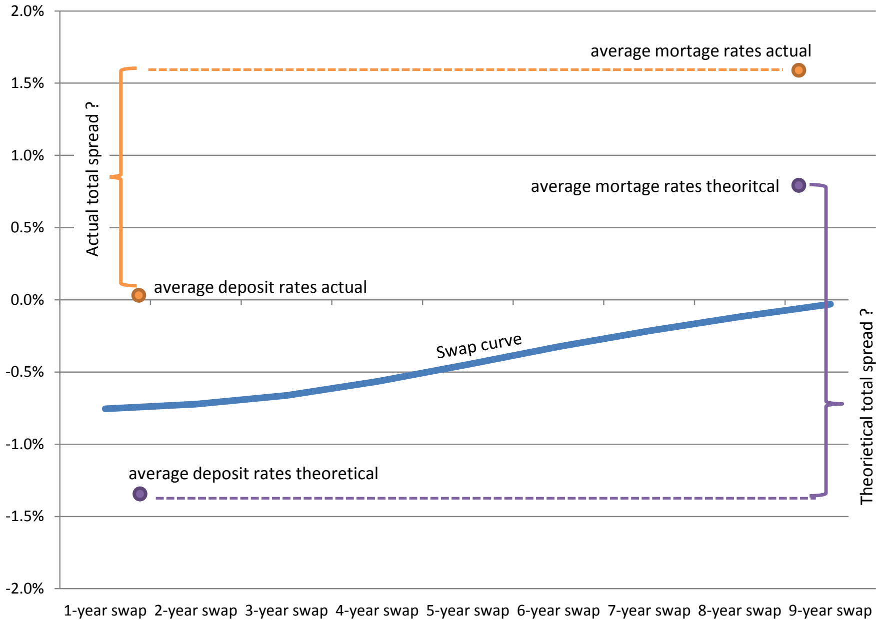
How can banks react?

As reported by several newspaper articles (eg, *SonntagsZeitung*, *Tages-Anzeiger*), several banks increased their mortgage rates particularly on long-dated mortgages. At the same time, deposit rates for private individuals have not been set at negative levels (as one could theoretically expect given negative swap rates). This results in our view in a "cross-subsidisation" of the depositors through the mortgage clients.

An increase in mortgage rates against the backdrop of (more) negative swap rates also suggests to us that banks decided to price mortgages based on non-market based interest curves. We think such an approach is not only intended to protect profitability as deposit rates remain 'stuck' at zero but also to influence client behaviour: a flat and extremely low yield curve could incentivise clients to extend their mortgage maturities (see section "Back to school for five minutes" above).

The crucial question therefore is whether the *actual* total spread (orange in the chart below) is larger or smaller than the *theoretical* total spread (purple in the chart below).

Figure 17: Theoretical and actual spread in a negative swap curve environment (illustrative example)

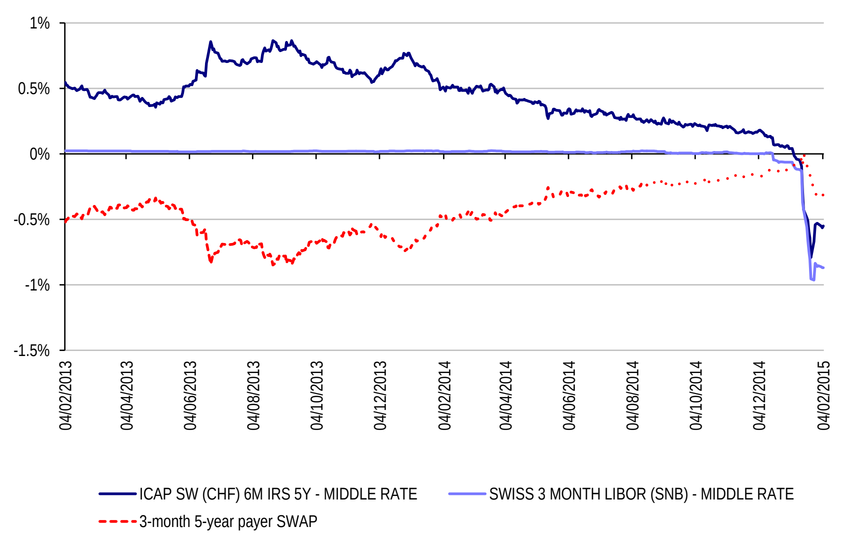


Source: UBS research

Client demand for long dated mortgages could go up and this could therefore increase balance sheet risks and expose banks to future (unexpected) interest rate increases. Hedging such risks on the other hand could materially erode the (current and future) profitability. Also, the existing payer swaps (bank pays fixed rate and receives floating rates) will become even more of a drag as the negative carry increased.

As shown below, the cost of hedging has gone up recently a lot (see red dotted line) – damaging the banks' profitability.

Figure 18: Negative carry for payer swaps turn more negative again



Source: Datastream / UBS research

Also, negative interest rates or a deflationary environment should theoretically incentivise people to hold cash or deposits and to repay a loan. The current 'distorted' environment in Switzerland (ie. increasing mortgage spreads in a falling interest rate environment and zero deposit rates despite negative swap rates) could even further support such behaviour we think.

Our conclusion – it's tough in an unchartered territory

The uncertainty is extremely high in our view. Directionally, we think banks' profitability and net interest income could be hurt materially by 1) low or negative loan growth 2) hedging costs going up 3) negative deposit spreads widening only partially compensated by 4) asset spread repricing. All this could be compounded by increasing risk costs as the macro environment remains challenging.

Also, we think that banks with 1) large long-dated mortgage books, 2) large payer swap books, 3) material client behaviour changes and 4) lending in real estate "hot spots" could be impacted the most.

Company Pages

EFG International
Upgrade to Buy

Equities

Switzerland
Banks, Ex-S&L

12-month rating	**Buy**
	Prior: Neutral
12m price target	**CHF13.00**
	Prior: CHF10.00
Price	**CHF10.20**

RIC: EFGN.S **BBG:** EFGN SW

Trading data and key metrics

52-wk range	CHF13.00-8.92
Market cap.	CHF1.50bn/US$1.62bn
Shares o/s	147m (ORD)
Free float	100%
Avg. daily volume ('000)	103
Avg. daily value (m)	CHF1.1
Common s/h equity (12/14E)	CHF1.12bn
P/BV (12/14E)	1.3x
Tier 1 ratio	15%

EPS (UBS, diluted) (CHF)

	From	To	% ch	Cons.
12/14E	0.82	0.82	0.00	0.73
12/15E	0.62	0.87	39.55	0.85
12/16E	0.87	0.95	9.94	1.06

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Material EPS upgrades for three reasons

We increase 2015E, 2016E and 2017E adj. EPS by 40%, 10% and11% but we remain c20% below our pre-Swiss franc strengthening levels (when the SNB announced the end of the EURCHF1.20 floor). The upgrade (ie, reversal of previous downgrade) is mainly driven by 1) a recently weaker Swiss franc resulting in 12% higher average assets under management 2015E, 2) significantly lower assumed negative side-effects and 3) the potential for EFG announcing mitigating (cost?) measures (not in our numbers yet). We upgrade EFG International to Buy and set a new price target of CHF13 (+30%).

Still double-digit EPS growth beyond 2015...

We see only 6% bottom-line growth 2015E but forecast 18% EPS CAGR 2015-2018E. We like the EFG Int. investment case primarily for three reasons: 1) Various forward looking indicators like (gross) hiring remain strong in our opinion and they should translate into profit growth over the coming three years. 2) We see a rising dividend both in absolute terms and in terms of pay-out ratio. We see the H1 2014 CET 1 ratio of 14% (target is "low teens") increasing to c16% in 2016E even assuming that the dividend increases to CHF0.45 in 2016E (dividend yield c4.5%, up from 3% in 2015E).

...and excess capital (soon) offers strategic flexibility

3) excess capital of some CHF300m at the of end-2016 offers strategic flexibility and the opportunity to further increase the dividend payout ratio or to announce a share buyback programme or to make EPS accretive acquisitions. Consolidation looks set to pick up in Switzerland as discussed in previous research (eg, 5 Sept 2014 Swiss banks report).

Valuation: Based on a one-stage Gordon growth model

PE in 2015E is c11.5x and goes to c10.5x in 2016E. We think a US settlement, visible (additional) cost-cutting benefits and thus decent expected earnings growth beyond 2015 could be positive for the stock price. Also, a further update on cash returns (dividends, share buybacks) could be welcome newsflow. EFG's investment case is also about a potential multiple expansion following a multi-year transition period.

Highlights (CHFm)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenues	763	697	666	699	702	743	817	896
Profit before tax	(289)	120	84	75	148	162	194	234
Net earnings (local GAAP)	(311)	81	64	59	130	142	169	203
Net earnings (UBS)	40	100	68	126	133	145	171	206
Tier 1 ratio %	12.9	17.2	13.8	15.4	15.9	16.3	16.7	17.1
EPS (UBS, diluted) (CHF)	0.28	0.69	0.44	0.82	0.87	0.95	1.12	1.35
Profitability/valuation	**12/11**	**12/12**	**12/13**	**12/14E**	**12/15E**	**12/16E**	**12/17E**	**12/18E**
ROE (UBS) %	6.1	11.0	5.7	11.4	11.4	11.5	12.6	14.0
P/PPOP (diluted)	22.4	7.5	15.1	10.8	10.2	9.4	7.8	6.5
P/BV x	2.8	0.9	1.6	1.3	1.2	1.1	1.1	1.0
P/BV (UBS) x	6.6	1.1	2.2	1.8	1.6	1.4	1.3	1.2
P/E (UBS, diluted)	35.4	11.1	27.4	12.4	11.7	10.7	9.1	7.5
Net dividend yield %	1.0	1.3	1.6	2.5	2.9	4.4	5.9	7.4

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of CHF10.20 on 06 Feb 2015 11:05 GMT

Investment Thesis

EFG International

12-month rating **Buy**

12m price target **CHF13.00**

Investment case

We like the EFG Int. investment case primarily for three reasons: 1) Various forward looking indicators like (gross) hiring remain strong in our opinion and they should translate into profit growth over the coming three years. 2) We see a rising dividend both in absolute terms and in terms of pay-out ratio. We see the H1 2014 CET 1 ratio of 14% (target is "low teens") increasing to c16% in 2016E even assuming that the dividend increases to CHF0.45 in 2016E (dividend yield c4.5%, up from 3% in 2015E). 3) excess capital of some CHF300m at end-2016 offers strategic flexibility and the opportunity to further increase the dividend payout ratio or to announce a share buyback programme or to make EPS accretive acquisitions. Since the announcement of the strategic review in October 2011, EFG has delivered tangible results in terms of business location streamlining, capital structure, EFG FP IPO and general cost cutting.

Upside scenario

A more positive view would be built around higher gross margin levels. We predict a slightly recovering trend until 2018. A 5bp higher gross margin in 2015E (CHF45m more revenues and assuming a 20% marginal CI ratio) would translate into almost 20% higher EPS. We could see the fair value going to cCHF16.

Downside scenario

A more negative view would be built around lower gross margin levels. We predict a slightly recovering trend until 2018. A 5bp lower gross margin in 2015E (CHF45m less revenues and assuming a 20% marginal CI ratio) would translate into almost 20% lower EPS. We could see the fair value going to cCHF9 (assuming a c10% multiple compression too).

Upcoming catalysts

29 July 2015: H1 2015 results

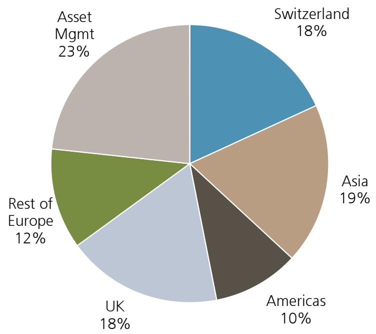
Business description

EFG International is a Swiss-incorporated, global, private bank. It was founded in 1995. EFG's history has been marked by rapid, organic expansion, as well as acquisitions, followed by a consolidation and streamlining phase under a new management team. EFG's private banking businesses operate in 30 locations.

Industry outlook

Headwinds remain manifold: On the cyclical side, we mention low, falling interest rates, low trading volumes and risk aversion. On the structural side, it has mainly been pressure on Swiss banking secrecy that has been weighing on flows, gross margins and pre-tax AuM margins. Additionally, fines and settlements have burdened P&Ls. The cyclical gross margin recovery potential could be 20bp in some cases – about half the decrease many banks have experienced (this is not reflected in our estimates). The European legalisation should be finished by end-2015. The US tax programme should be finalised by 2015 too (with 'digestible' fines for larger banks). Medium term, additional pressure on flows and/or margins could come from automatic exchange of information (AEI) – fiscal compliance is becoming a global phenomenon.

Profits by region 2013 (%)



Source: EFG International

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Upgrade to Buy

We increase 2015E and 2016E adj. EPS by 40% and 10%, respectively, but we remain c20% below our pre-Swiss franc strengthening levels (when the SNB announced the end of the EURCHF1.20 floor). We upgrade EFG International to Buy and set a new price target of CHF13 (+30%).

The uncertainty attached to our estimates remains high but we feel it is not justified anymore to 'stay on the side-lines' with a Neutral rating as we regard the risk/reward as more attractive again.

Our price target and thus our rating is based on a one stage Gordon growth model where we apply a ROTE 2016 of 14.6% (up from 13.9%), a growth rate of 4% (unchanged) and a cost of equity of 9% (unchanged).

Figure 19: Reversing the recent profit downgrades for two main reasons

Underlying net profit (CHF million)	2015E	2016E	2017E	2018E
Pre-SNB decision	154	191	221	259
New estimates as published 20 January 2015	95	132	154	191
New estimates as published 5 February 2015	133	145	171	206
Decrease compared to Pre-SNB decisions	-14%	-24%	-22%	-20%
Increase compared to 20 January 2015 estimates	40%	10%	11%	8%

Source: UBS estimates

The upgrade (ie. reversal of previous downgrade) is mainly driven by:

1) a recently weaker Swiss franc supported by press speculation (*Tages-Anzeiger*) around an unofficial EURCHF target band of 1.05-1.10, resulting in 12% higher average assets under management 2015E (also partially driven by higher net new money estimates);

2) Significantly lower assumed negative side-effects (resulting in higher gross margin and net new money 2015);

3) The potential for EFG announcing mitigating (cost?) measures (not in our numbers yet).

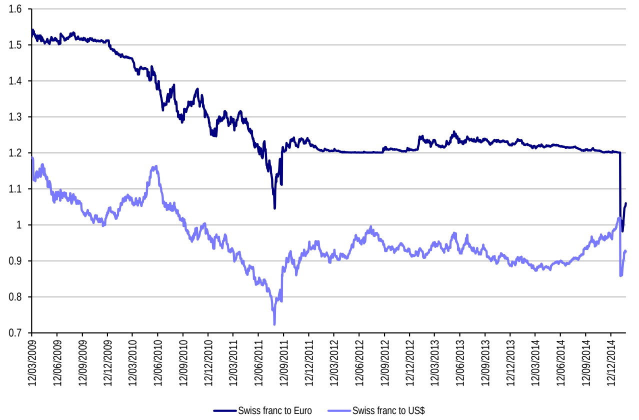
Some relief on the currency side (for now)

We still think that the sudden Swiss franc strengthening is a non-linear, unexpected and material shock for the economy and banks, with potentially profound short-, medium- and long-term impacts.

We recently reduced our earnings forecasts materially for most banks. The reductions came from the negative transaction effect, translation effect and negative ripple effects. The negative transaction and translation effect was discussed and derived in our 15 January 2015 note *FX impact of the SNB scrapping the EURCHF floor*[4]. As shown in this report and assuming a 10% Swiss franc appreciation, the currency mismatch between costs (33% Swiss franc costs) and revenues (c4% Swiss franc revenues) could increase EFG's CI ratio by about 2%.

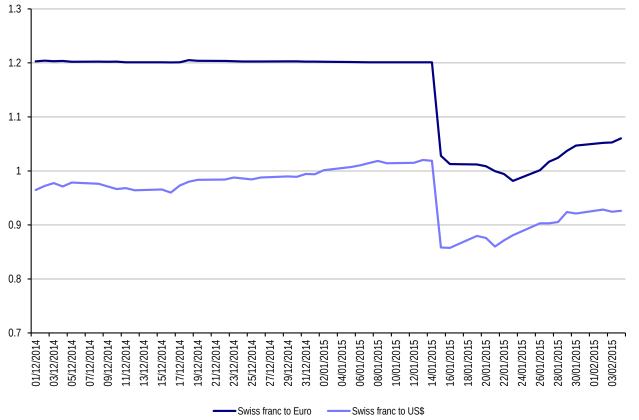
[4] https://neo.ubs.com/r/?id=o22d28a,14afa39,14b1304&ap_oid=21695128

Figure 20: Swiss franc against euro and dollar – long-term



Source: Datastream

Figure 21: Swiss franc against euro and dollar – short-term



Source: Datastream

Our previous estimates regarding the YTD negative impact on assets under management were too conservative and fears that the EURCHF could stay even below parity for longer have so far not materialised. Also recent press articles (eg, *Tages-Anzeiger*) suggest that the SNB could be willing to stabilise the EURCHF exchange rate at around 1.05 to 1.1. As a consequence of this, we increase our average 2015E assets under management by 12% (also partially driven by higher net new money estimates).

Negative side-effects smaller than feared

As mentioned in our 20 January 2015 report, we decided to use cautious forecasts to show that a negative stance on Swiss private banks is not warranted in our view given 2016 PE ratios.

We now believe that our cautious forecasts were overly cautious, and we now only factor in very small negative ripple effects into EFG's revenues for 2015 and beyond.

Also, the Swiss franc strengthening topic seems mainly a Swiss domestic theme and the uncertainty, if any, seems limited to the Swiss domestic client base we think (eg, some negative impact on certain structured products, lower treasury results, some deleveraging). For foreign clients, we no longer think that there will be any meaningful negative revenue impact – on the contrary, some increased forex volatility and renewed demand for certain products (eg, structured products and (discretionary mandates) could even result in some revenue opportunities.

Overall, we now expect the gross margin to go from 87bp in 2014E to 84bp in 2015. This trend assumes a low single digit basis point headwind from lower net interest income and some higher gross margin legalisation outflows, largely being compensated by higher client activity levels (eg, FX) and increasing penetration of higher margin products (eg, discretionary mandates).

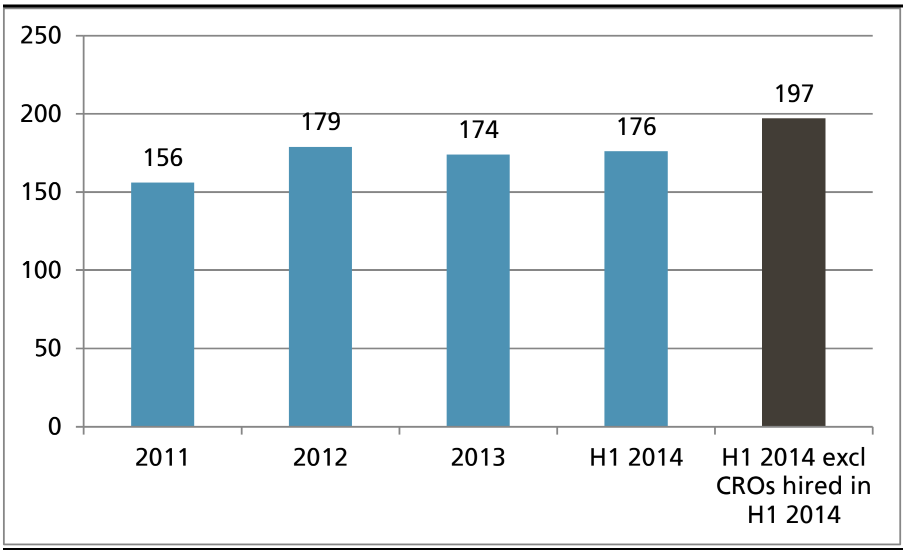
Key drivers for EFG's profits

The three biggest levers to EFG's profits and thus the share price are in our view: 1) increase average assets per CRO; 2) increase in critical mass per location; and 3) penetration of higher margin products. We think trends in all three areas are encouraging:

1) increase average assets per CRO

As shown below, the average assets under management per client advisor have increased 13% since the end of 2011 and are up 26% on an adjusted basis (ie, excluding the client advisors hired in H1 2014). The average AUM per client advisor is c.CHF230 million at Credit Suisse. We think such an additional 10% higher AUM base would come at a very low marginal CI ratio.

Figure 22: AUM per CRO (CHF mio)



Source: Company data, UBS research

2) increase in critical mass per location

Total assets under management started to grow again mid-2013. EFG does not disclose AUM per location but given overall strong hiring trends across the board in basically all locations and decent net new money trends, we expect decent operating leverage in several locations.

3) penetration of higher margin products

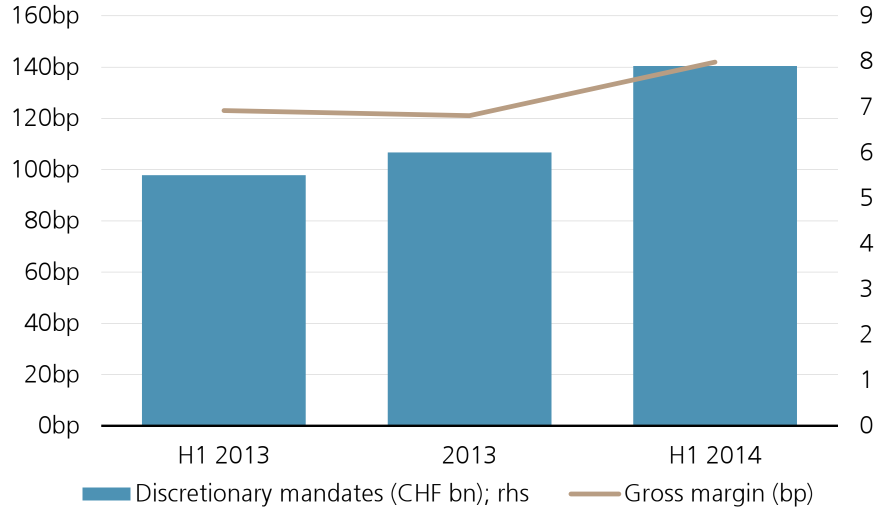
Various regulatory changes ('suitability'-themes, MIFID, FIDLEG etc) fundamentally change the banks' product offerings. A consistent, quality-assuring and structured investment and advisory process will be the core of all banks' services.

Under the umbrella "Investment Solutions", EFG offers "Investment Advisory Solutions", "Discretionary Services" and "New Capital Funds".

Over the past eighteen months, we think the percentage penetration of discretionary products doubled in Switzerland. We think the penetration is now in the high teens (compared to a 10% group average) in Switzerland.

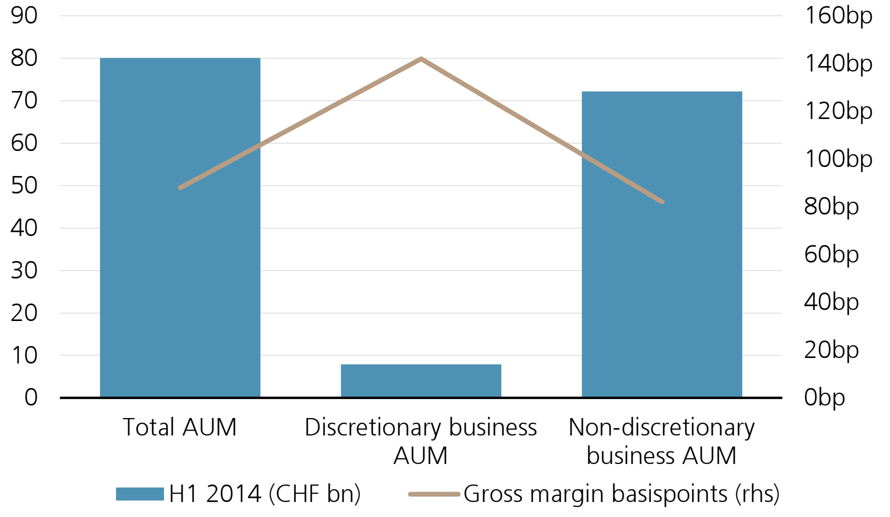
Based on some data published by EFG, we think discretionary AUM increased 44% between H1 2013 and H1 2014 to CHF7.9 billion. The gross margin of these mandates is above 140bp by our estimates.

Figure 23: Discretionary mandates and gross margin levels



Source: Company data, UBS research

Figure 24: Discretionary and non-discretionary mandates and gross margin levels



Source: Company data, UBS research

Underlying results will converge with stated results. H2 2014 preview

We think the 88bp H1 gross margin is a reasonable assumption for H2 too (we then assume a 1-2bp reduction each year going forward). NNM flows could have slowed to c5% (cCHF2bn) in H2 (H1 was 7%) we think and we forecast year-end 2014 assets under management of CHF85bn, up 12% y/y.

EFG International (EFGN.S)

Profit & Loss (CHFm)	**12/11**	**12/12**	**12/13**	**12/14E**	*% ch*	**12/15E**	*% ch*	**12/16E**	**12/17E**	**12/18E**
Net income interest	212	224	213	249	*17.0*	244	*-2.0*	252	264	278
Total non interest income	552	473	453	449	*-0.8*	457	*1.8*	491	552	618
Total income	**763**	**697**	**666**	**699**	*4.9*	**702**	*0.4*	**743**	**817**	**896**
Total cash expenses	(681)	(537)	(532)	(545)	*-2.6*	(540)	*1.0*	(567)	(606)	(646)
Pre-depreciation operating profit	**82**	**161**	**134**	**154**	*14.3*	**162**	*5.5*	**176**	**210**	**250**
Depreciation & amort (excl. goodwill)	(18)	(13)	(11)	(10)	*9.9*	(10)	*0.0*	(10)	(10)	(10)
Operating profit pre provisions	**64**	**148**	**123**	**144**	*16.4*	**152**	*5.9*	**166**	**200**	**240**
Total provisions	(2)	(4)	(35)	(1)	*97.2*	(1)	*0.0*	(1)	(3)	(3)
Operating profit post provisions	**62**	**143**	**88**	**143**	*61.6*	**151**	*5.9*	**165**	**197**	**237**
Income from associates & JVs (pre-tax)	0	0	0	0	-	0	-	0	0	0
Other pre-tax items	0	0	0	0	-	0	-	0	0	0
Profit before tax (UBS)	**62**	**143**	**88**	**143**	*61.6*	**151**	*5.9*	**165**	**197**	**237**
Exceptionals (incl goodwill)	(351)	(23)	(4)	(67)	*NM*	(3)	*94.9*	(3)	(3)	(3)
Profit before tax	**(289)**	**120**	**84**	**75**	*-10.4*	**148**	*95.6*	**162**	**194**	**234**
Tax	(2)	(19)	(8)	(15)	*-82.0*	(18)	*-18.7*	(19)	(25)	(30)
Profit after tax	**(291)**	**102**	**76**	**61**	*-20.3*	**130**	*114.6*	**142**	**169**	**203**
Other post-tax items	0	0	0	0	-	0	-	0	0	0
Preference dividends	(17)	(8)	(1)	0	*77.8*	0	*0.0*	0	0	0
Minorities	(3)	(13)	(11)	(1)	*89.9*	0	-	0	0	0
Net earnings (local GAAP)	**(311)**	**81**	**64**	**59**	*-7.7*	**130**	*118.9*	**142**	**169**	**203**
Net earnings (before pref divs)	**(294)**	**89**	**65**	**59**	*-8.7*	**130**	*118.5*	**142**	**169**	**203**
Net earnings (UBS)	**40**	**100**	**68**	**126**	*85.3*	**133**	*5.6*	**145**	**171**	**206**

Per share (CHF)	**12/11**	**12/12**	**12/13**	**12/14E**	*% ch*	**12/15E**	*% ch*	**12/16E**	**12/17E**	**12/18E**
EPS (local GAAP, basic)	(2.12)	0.55	0.44	0.40	*-7.7*	0.88	*118.9*	0.97	1.15	1.39
EPS (UBS, diluted)	0.28	0.69	0.44	0.82	*85.3*	0.87	*5.6*	0.95	1.12	1.35
PPOP (diluted)	0.44	1.02	0.81	0.94	*16.4*	1.00	*5.9*	1.09	1.31	1.57
Net DPS	0.10	0.10	0.20	0.25	*25.0*	0.30	*20.0*	0.45	0.60	0.75
BVPS	3.54	8.85	7.43	7.64	*2.7*	8.27	*8.3*	8.94	9.64	10.42
BVPS (UBS)	1.49	6.84	5.61	5.82	*3.6*	6.45	*10.9*	7.12	7.82	8.60

Balance sheet (CHFm)	**12/11**	**12/12**	**12/13**	**12/14E**	*% ch*	**12/15E**	*% ch*	**12/16E**	**12/17E**	**12/18E**
Banking assets (year end)	21,041	23,626	21,699	23,868	*10.0*	26,255	*10.0*	28,881	31,769	34,946
Banking assets (average)	20,967	22,333	22,662	22,784	*0.5*	25,062	*10.0*	27,568	30,325	33,357
Total assets (year end)	21,041	23,626	21,699	23,868	*10.0*	26,255	*10.0*	28,881	31,769	34,946
Risk weighted assets (RWA) (year end)	5,614	6,046	5,661	5,800	*2.5*	6,264	*8.0*	6,765	7,306	7,891
Risk weighted assets (RWA) (average)	5,557	5,830	5,854	5,730	*-2.1*	6,032	*5.3*	6,515	7,036	7,599
Customer loans	9,548	10,434	11,562	12,487	*8.0*	13,486	*8.0*	14,565	15,730	16,988
Customer loans (average)	9,253	9,991	10,998	12,024	*9.3*	12,986	*8.0*	14,025	15,147	16,359
Interest earning assets (average)	20,967	22,333	22,662	22,784	*0.5*	25,062	*10.0*	27,568	30,325	33,357
Customer deposits	14,398	16,084	16,444	17,266	*5.0*	18,129	*5.0*	19,036	19,988	20,987
Common s/h equity (year end)	519	1,298	1,090	1,120	*2.7*	1,213	*8.3*	1,311	1,414	1,529
Common s/h equity (average)	659	909	1,194	1,105	*-7.5*	1,167	*5.6*	1,262	1,362	1,471
Total SHF (equity, pref & MI) (year end)	1,036	1,421	1,111	1,155	*4.0*	1,248	*8.1*	1,347	1,449	1,564
Total SHF (equity, pref & MI) (average)	682	973	1,249	1,117	*-10.6*	1,186	*6.1*	1,281	1,362	1,471
Net tangible assets	736	1,126	844	889	*5.2*	982	*10.5*	1,080	1,182	1,297

Balance sheet structure (%)	**12/11**	**12/12**	**12/13**	**12/14E**	*% ch*	**12/15E**	*% ch*	**12/16E**	**12/17E**	**12/18E**
Loans / banking assets (year end)	45.4	44.2	53.3	52.3	*-1.8*	51.4	*-1.8*	50.4	49.5	48.6
Deposits / banking assets (year end)	68.4	68.1	75.8	72.3	*-4.5*	69.1	*-4.5*	65.9	62.9	60.1
Loans / deposits	66.3	64.9	70.3	72.3	*2.9*	74.4	*2.9*	76.5	78.7	80.9
Total SHF / banking assets (year end)	4.9	6.0	5.1	4.8	*-5.5*	4.8	*-1.8*	4.7	4.6	4.5

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

EFG International (EFGN.S)

Capital adequacy (CHFm)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Tier 1 capital	723	1,037	782	891	996	1,106	1,220	1,347
Total capital	719	1,096	1,020	1,129	1,234	1,344	1,459	1,586
Risk weighted assets (RWA) (year end)	5,614	6,046	5,661	5,800	6,264	6,765	7,306	7,891
Core tier 1 ratio %	4.1	16.9	13.5	15.1	15.6	16.1	16.5	16.9
Tier 1 ratio %	12.9	17.2	13.8	15.4	15.9	16.3	16.7	17.1
Total capital ratio %	12.8	18.1	18.0	19.5	19.7	19.9	20.0	20.1
Tangible equity	218	1,004	823	853	946	1,044	1,147	1,262
Equity / assets %	2.5	5.5	5.0	4.7	4.6	4.5	4.4	4.4
Tangible equity to tangible assets %	1.1	4.3	3.8	3.6	3.6	3.6	3.6	3.6

Asset quality (CHFm)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Non performing assets	5	5	6	6	7	7	8	8
Total risk reserves	19	24	59	60	61	62	65	68
NPLs / loans %	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NPL coverage %	406.4	456.2	1018.9	959.4	903.2	850.0	825.2	799.4
Provision charge / average loans %	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0
Net NPAs / shareholders funds %	(1.4)	(1.3)	(4.8)	(4.6)	(4.3)	(4.1)	(3.9)	(3.8)

Profitability (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Net interest margin (avg assets)	1.01	1.00	0.94	1.09	0.98	0.91	0.87	0.83
Provisions / operating profit	3.0	3.0	28.5	0.7	0.7	0.6	1.5	1.2
ROE (UBS earnings)	6.1	11.0	5.7	11.4	11.4	11.5	12.6	14.0
RoAdjE (UBS earnings & equity)	18.4	16.4	7.4	15.0	14.7	14.6	15.7	17.1
RoRWA (UBS)	0.77	1.94	1.34	2.21	2.20	2.23	2.44	2.71
RoA (UBS earnings)	(1.39)	0.46	0.34	0.27	0.52	0.52	0.56	0.61

Productivity (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Cost income ratio	93.5	79.5	82.2	79.9	78.8	78.1	75.9	73.6
Cost / average assets	3.34	2.46	2.39	2.44	2.19	2.09	2.03	1.97
Compensation expense ratio	87.8	73.3	76.3	74.1	72.8	72.0	69.5	66.9

Growth (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenue	-5.0	-8.7	-4.5	4.9	0.4	5.9	9.9	9.7
Operating profit pre provisions	-44.5	131.5	-16.5	16.4	5.9	9.3	20.6	19.9
Net earnings (UBS)	-69.4	149.0	-32.4	85.3	5.6	9.4	18.2	20.2
Net DPS	0.0	0.0	100.0	25.0	20.0	50.0	33.3	25.0
Total assets (year end)	0.7	12.3	-8.2	10.0	10.0	10.0	10.0	10.0
Customer loans	6.6	9.3	10.8	8.0	8.0	8.0	8.0	8.0
Customer deposits	-3.4	11.7	2.2	5.0	5.0	5.0	5.0	5.0

Value (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Market cap/revenues	1.9	1.6	2.7	2.1	2.1	2.0	1.8	1.7
Market cap/deposits	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
P/PPOP (diluted)	22.4	7.5	15.1	10.8	10.2	9.4	7.8	6.5
P/E (local GAAP, basic)	NM	13.9	27.8	25.3	11.5	10.5	8.9	7.4
P/E (UBS, diluted)	35.4	11.1	27.4	12.4	11.7	10.7	9.1	7.5
Net dividend yield %	1.0	1.3	1.6	2.5	2.9	4.4	5.9	7.4
P/BV x	2.8	0.9	1.6	1.3	1.2	1.1	1.1	1.0
P/BV (UBS) x	6.6	1.1	2.2	1.8	1.6	1.4	1.3	1.2

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Julius Baer Group
Upgrade to Buy

Material EPS upgrades for three reasons
We increase 2015E, 2016E and 2017E adj. EPS by 27%, 19% and 11%, respectively, but we remain c18% below our pre-Swiss franc strengthening levels (when SNB announced the end of the EURCHF1.20 floor). The upgrade (ie, reversal of previous downgrade) is mainly driven by 1) a recently weaker Swiss franc resulting in 8% higher average assets under management 2015E, 2) significantly lower assumed negative side-effects and 3) a CHF100m new cost cutting potentially fully compensating the circa four percentage point CI ratio deterioration from the negative currency transaction effect. We therefore upgrade Julius Baer to Buy and set a new price target of CHF46 (+31%).

Still double-digit EPS growth beyond 2015...
We see no bottom-line growth in 2015E but forecast 12% EPS CAGR 2015-2018E. We like the Julius Baer investment case primarily for three reasons: 1) decent 4-6% net new money (we stay at 4%), some positive market performance and at least stable gross margin should translate into mid- to high-single digit top-line growth. Gross margin trends in IWM are promising and bode well for 2015 too. 2) Working down legacy topics: the legalisation of the back-book should largely be accomplished in 2015 and the US tax dispute should be solved too, potentially resulting in a multiple expansion.

...and decent cash returns and strategic flexibility
3) Excess capital of more than CHF600m at the of end-2015 (that's including a US tax dispute charge) offers strategic flexibility and the opportunity to further increase the dividend payout ratio or to announce a share buyback programme or to make EPS accretive acquisitions (similar to eg, Bank Leumi). Consolidation looks set to pick up in Switzerland as discussed in previous research (eg, 5 Sept 2014 Swiss banks report).

Valuation: Based on a one-stage Gordon growth model
PE in 2015E is c16x and goes to c14x in 2016E. We think a US settlement (but not above CHF1bn), visible (additional) cost-cutting benefits and thus decent expected earnings growth beyond 2015 could be positive for the stock price. Also, a further update on cash returns (dividends, share buybacks) could be welcome newsflow.

Equities

Switzerland
Banks, Ex-S&L

12-month rating	**Buy**
	Prior: Neutral
12m price target	**CHF46.00**
	Prior: CHF35.00
Price	**CHF42.12**

RIC: BAER.VX **BBG:** BAER VX

Trading data and key metrics

52-wk range	CHF46.37-34.51
Market cap.	CHF9.55bn/US$10.4bn
Shares o/s	227m (BEAR)
Free float	100%
Avg. daily volume ('000)	876
Avg. daily value (m)	CHF36.0
Common s/h equity (12/15E)	CHF4.92bn
P/BV (12/15E)	1.9x
Tier 1 ratio	17%

EPS (UBS, diluted) (CHF)

	From	To	% ch	Cons.
12/15E	2.03	2.58	27.19	2.84
12/16E	2.42	2.89	19.11	3.19
12/17E	2.97	3.28	10.62	3.18

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Highlights (CHFm)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenues	1,737	2,195	2,547	2,530	2,687	2,895	3,107	3,330
Profit before tax	508	583	707	707	787	895	992	1,092
Net earnings (local GAAP)	422	480	586	578	646	734	813	895
Net earnings (UBS)	422	480	586	578	646	734	813	895
Tier 1 ratio %	25.4	18.0	19.2	16.6	17.5	18.2	19.1	19.9
EPS (UBS, diluted) (CHF)	2.09	2.15	2.62	2.58	2.89	3.28	3.64	4.01
Profitability/valuation	**12/12**	**12/13**	**12/14**	**12/15E**	**12/16E**	**12/17E**	**12/18E**	**12/19E**
ROE (UBS) %	9.5	9.8	11.3	11.3	12.6	13.3	13.7	14.0
P/PPOP (diluted)	13.7	14.1	12.0	12.6	11.5	10.3	9.3	8.5
P/BV x	1.5	1.8	1.7	1.9	1.8	1.6	1.5	1.4
P/BV (UBS) x	2.3	3.1	3.1	3.5	3.0	2.6	2.3	2.1
P/E (UBS, diluted)	16.0	18.4	15.6	16.3	14.6	12.8	11.6	10.5
Net dividend yield %	1.8	1.5	2.4	2.4	2.8	3.6	4.2	4.7

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of CHF42.12 on 06 Feb 2015 11:06 GMT

Investment Thesis

Julius Baer Group

12-month rating **Buy**

12m price target **CHF46.00**

Investment case

We like the Julius Baer investment case for three reasons: 1) decent 4-6% net new money, some positive market performance and at least stable gross margin should translate into mid- to high-single digit top-line growth. Gross margin trends in IWM are promising and bode well for 2015 too. 2) Working down legacy topics: the legalisation of the back-book should largely be accomplished in 2015 and the US tax dispute should be solved too, potentially resulting in a multiple expansion. 3) Excess capital of more than CHF600m at the of end-2015 (that's including a US tax dispute charge) offers strategic flexibility and the opportunity to further increase the dividend payout ratio or to announce a share buyback programme or to make EPS accretive acquisitions (similar to eg, Bank Leumi). Consolidation looks set to pick up in Switzerland as discussed in previous research (eg, 5 Sept 2014 Swiss banks report).

Upside scenario

A more positive view would be built around a more benign outcome in the US tax settlement and higher gross margin levels. We predict a flattish trend throughout 2018. A 5bp higher gross margin in 2015E (CHF150m more revenues and assuming a 20% marginal CI ratio) would translate into at least 10% higher EPS. In a more bullish scenario assuming 10bp higher gross margins, we could see the fair value going to cCHF53.

Downside scenario

A more negative view would be built around a more difficult outcome in the US tax settlement (ie, a settlement above CHF1bn) and lower gross margin levels. We predict a flattish trend throughout 2018. A 5bp lower gross margin in 2015E (CHF150m less revenues and assuming a 20% marginal CI ratio) would translate into at least 10% lower EPS. In a more bullish scenario assuming 10bp lower gross margins, we could see the fair value going to cCHF35.

Upcoming catalysts

15 May 2015: 4-month trading statement
21 July 2015: H1 2015 results

Business description

Julius Baer (JB) is a global private bank headquartered in Zurich, Switzerland. It has more than 5,000 employees. Total assets under management stand at around CHF290bn. About 50% of total assets are from growth markets (emerging markets). JB regards Asia as its second home market.

Industry outlook

Headwinds remain manifold: On the cyclical side, we mention low, falling interest rates, low trading volumes and risk aversion. On the structural side, it has mainly been pressure on Swiss banking secrecy that has been weighing on flows, gross margins and pre-tax AuM margins. Additionally, fines and settlements have burdened P&Ls. The cyclical gross margin recovery potential could be 20bp in some cases – about half the decrease many banks have experienced (this is not reflected in our estimates). The European legalisation should be finished by end-2015. The US tax programme should be finalised by 2015 too (with 'digestible' fines for larger banks). Medium term, additional pressure on flows and/or margins could come from automatic exchange of information (AEI) – fiscal compliance is becoming a global phenomenon.

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Upgrade to Buy

We increase 2015E, 2016E and 2017E adj. EPS by 27%, 19% and 11%, respectively, but we remain c18% below our pre-Swiss franc strengthening levels (when SNB announced the end of the EURCHF1.20 floor). We upgrade Julius Baer to Buy and set a new price target of CHF46 (+31%).

What we liked about the 2014 results and the accompanying newsflow:

(1) Higher than expected CHF1 **dividend** per share and the optionality around additional share buy backs and the excess capital position.

(2) The **new IT system** will be implemented in a CI ratio-neutral way according to management. This is better than what the market expected.

(3) New CHF100 million **cost cutting programme** basically compensates for the estimated up to four percentage point negative impact on the CI ratio coming from the negative currency transaction effect.

(4) Management made reassuring comments about the potential **negative side effects** of the recent Swiss franc strengths. This would appear to confirm our new view that the Swiss franc strength is predominantly a "Swiss domestic problem" and that its impact on the business elsewhere on the world is very limited.

(5) **IWM** (Merrill Lynch acquisition) is showing decent trends, particularly in gross margin terms. This is also encouraging for 2015.

(6) **Net new money** was better than expected in H2 2014 and shows the broad-based client acquisition capability and product offering.

(7) Julius Baer **reiterated all targets** and thinks that they can even be achieved already in 2015.

The uncertainty attached to our estimates remains high but we feel it is not justified anymore to 'stay on the side-lines' with a Neutral rating as we regard the risk/reward as more attractive again.

Our price target and thus our rating is based on a one stage Gordon growth model where we apply a ROTE 2016 of 22.4% (up from 19.3%), a growth rate of 4% (unchanged) and a cost of equity of 9% (unchanged).

Figure 25: Reversing the recent profit downgrades for two main reasons

Underlying net profit (CHF million)	2015E	2016E	2017E	2018E
Pre-SNB decision	702	772	851	937
New estimates as published 20 January 2015	455	542	664	770
New estimates as published 5 February 2015	578	646	734	813
Decrease compared to Pre-SNB decisions	-18%	-16%	-14%	-13%
Increase compared to 20 January 2015 estimates	27%	19%	11%	6%

Source: UBS estimates

The upgrade (ie, reversal of previous downgrade) is mainly driven by:

4) a recently weaker Swiss franc supported by press speculation (*Tages-Anzeiger*) around an unofficial EURCHF target band of 1.05-1.10) resulting in 8% higher average assets under management 2015E (also partially driven by higher net new money estimates);

5) a new CHF100m cost cutting programme (c6% of total cost base) potentially fully compensating for the theoretical four percentage point CI ratio deterioration from the negative currency transaction effect (assuming a 10% Swiss franc strengthening);

6) significantly lower assumed negative side-effects (resulting in higher gross margin and net new money 2015).

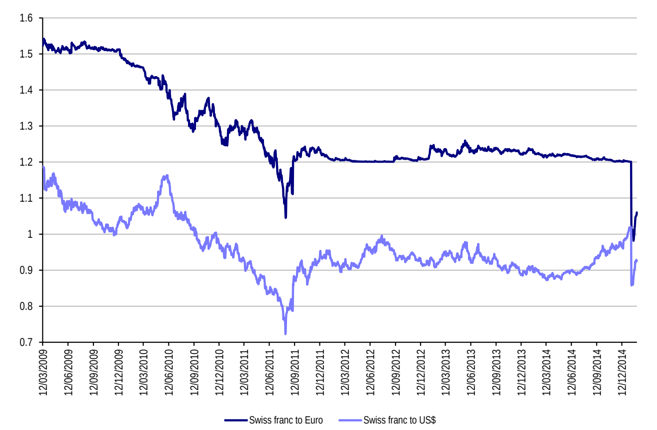
We now briefly discuss all three areas.

Some relief on the currency side (for now)

We still think that the sudden Swiss franc strengthening is a non-linear, unexpected and material shock for the economy and banks with potentially profound short-, medium- and long-term impacts.

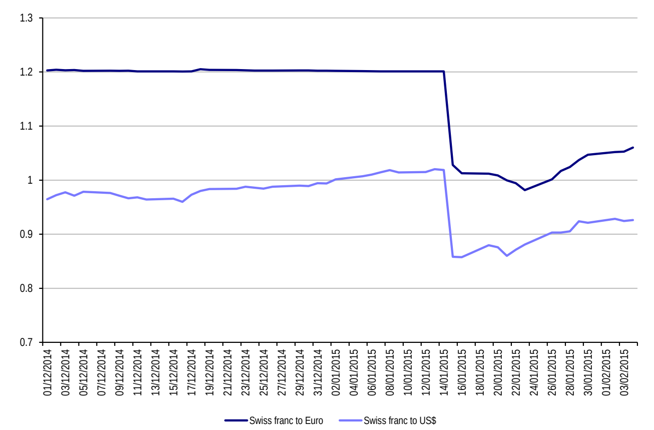
We recently reduced our earnings forecasts materially for most banks. The reductions came from the negative transaction effect, translation effect and negative ripple effects. The negative transaction and translation effect was discussed and derived in our 15 January 2015 note *FX impact of the SNB scrapping the EURCHF floor*[5]. As shown in this report and assuming a 10% Swiss franc appreciation, the currency mismatch between costs (60% Swiss franc costs) and revenues (c13% Swiss franc revenues) could increase Julius Baer's CI ratio by about 4%, which would almost exactly equal the announced new CHF100 million cost cutting programme.

Figure 26: Swiss franc against euro and dollar – long-term



Source: Datastream

Figure 27: Swiss franc against euro and dollar – short-term



Source: Datastream

Our previous estimates regarding the YTD negative impact on assets under management were too conservative and fears that the EURCHF could stay even below parity for longer have so far not materialised. Also recent press articles (eg, *Tages-Anzeiger*) suggest that the SNB could be willing to stabilise the EURCHF

[5] https://neo.ubs.com/r/?id=o22d28a,14afa39,14b1304&ap_oid=21695128

exchange rate at around 1.05 to 1.1. As a consequence of this, we increase our average 2015E assets under management by 8%.

Negative side-effects smaller than feared

As mentioned in our 20 January 2015 report, we decided to use cautious forecasts to show that a negative stance on Swiss private banks is not warranted in our view given 2016 PE ratios.

We now believe that our cautious forecasts were overly cautious and we now only factor in very small negative ripple effects into JB's revenues for 2015 and beyond.

Also, the Swiss franc strengthening topic seems mainly a Swiss domestic theme and the uncertainty, if any, seems limited to the Swiss domestic client base we think (eg, some negative impact on certain structured products, lower treasury results, some deleveraging). For foreign clients, we no longer think that there will be any meaningful negative revenue impact – on the contrary, some increased forex volatility and renewed demand for certain products (eg, structured products and (discretionary mandates) could even result in some revenue opportunities.

Overall, we now expect the gross margin to go from 94bp in 2014 to 92bp in 2015 and beyond. This trend assumes a low single digit basis point headwind from lower net interest income and some higher gross margin legalisation outflows (eg, Italy) largely being compensated by higher client activity levels (eg, FX) and increasing penetration of higher margin products (eg, discretionary mandates).

Excess capital analysis and estimates

Market expectations for the potential level of a fine have increased on the back of the Credit Suisse US tax settlement, we think probably to excessive levels. We use a CHF400-800m (after tax) settlement range in our estimates which, compared to company capital ratio targets, we estimate could potentially eliminate about half the 2014 year-end excess capital. Compared to regulatory and own minimum targets, however, we believe JB would still have some excess capital, thereby offering strategic flexibility. We think a settlement of up to CHF1 billion could be priced in at current levels and would expect a positive market reaction should it be lower. We see an increasing likelihood of a positive 'relief' market reaction once the settlement is out of the way.

Figure 28: Regulatory capital analysis (CHF million). A US settlement could wipe out half the 2014 excess capital

	Basel 3 fully loaded				
	2012	**2013**	**H1 14**	**2014**	**2015E** incl. US fine *
Total capital	3,563	2,462	3,339	3,380	3,060
Tier 1 capital	3,470	2,913	3,267	3,306	3,060
CET 1 capital	2,775	2,462	2,681	2,713	2,467
RWA (BIS)	12,770	16,223	16,462	17,205	18,409
Total capital ratio	27.9%	15.2%	20.3%	19.6%	16.6%
Tier 1 ratio	27.2%	18.0%	19.8%	19.2%	16.6%
CET 1 ratio	21.7%	15.2%	16.3%	15.8%	13.4%
Capital analysis based on company targets	**2012**	**2013**	**H1 14**	**2014**	**2015E**
BIS Total capital ratio company target	>15%	>15%	>15%	>15%	>15%
BIS Tier 1 capital ratio company target	>12%	>12%	>12%	>12%	>12%
BIS CET 1 capital ratio target (UBS assumption)	10%	10%	10%	10%	10%
Minimum Total capital	1,916	2,433	2,469	2,581	2,761
Excess total capital	1,648	29	870	799	299
Minimum Tier 1 capital	1,532	1,947	1,975	2,065	2,209
Excess Tier 1 capital	1,938	966	1,292	1,241	851
Minimum CET 1 capital	1,277	1,622	1,646	1,721	1,841
Excess CET 1 capital	1,498	840	1,035	993	627
Capital analysis based on minimum regulatory requirements	**2012**	**2013**	**H1 14**	**2014**	**2015E**
BIS min. Total capital ratio	>12.0%	>12.0%	>12.0%	>12.0%	>12.0%
BIS min. Tier 1 capital ratio	>9.6%	>9.6%	>9.6%	>9.6%	>9.6%
BIS min. CET 1 capital ratio	>7.8%	>7.8%	>7.8%	>7.8%	>7.8%
Minimum Total capital	1,532	1,947	1,975	2,065	2,209
Excess total capital	2,031	515	1,364	1,315	851
Minimum Tier 1 capital	1,226	1,557	1,580	1,652	1,767
Excess Tier 1 capital	2,244	1,356	1,687	1,654	1,293
Minimum CET 1 capital	996	1,265	1,284	1,342	1,436
Excess CET 1 capital	1,779	1,197	1,397	1,371	1,032

Source: Company data, UBS research estimates * Mid-point of CHF400-800m range

Figure 29: Financials

(CHF m)	2013H1	2013H2	2013	2014H1	2014H2	2014	2015E	2016E	2017E	2018E
Net interest income	275	277	552	347	301	648	603	621	652	698
Underlying net interest income	*242*	*272*	*514*	*284*	*292*	*576*	*603*	*621*	*652*	*698*
Fee income	599	679	1,277	746	772	1,518	1,480	1,598	1,753	1,897
Trading income	185	130	315	115	213	328	394	413	434	456
Underlying trading income	*218*	*135*	*353*	*178*	*222*	*400*	*394*	*413*	*434*	*456*
Total banking operating income	1,058	1,086	2,144	1,208	1,286	2,494	2,476	2,632	2,839	3,050
Non-banking ncome	19	32	51	28	25	53	54	55	56	57
Total income	1,077	1,118	2,195	1,236	1,311	2,547	2,530	2,687	2,895	3,107
Staff costs	-488	-496	-984	-592	-590	-1,182	-1,182	-1,241	-1,316	-1,394
SG&A	-214	-276	-490	-243	-270	-513	-513	-539	-571	-605
Total operating expenses	-702	-772	-1,475	-835	-860	-1,695	-1,695	-1,780	-1,887	-2,000
Depreciation & amortization	-44	-47	-91	-39	-46	-85	-88	-90	-93	-96
Total costs (incl. depreciation)	-746	-819	-1,566	-874	-906	-1,780	-1,783	-1,870	-1,980	-2,096
Gross operating profit	331	298	629	362	405	767	747	817	915	1,012
Value adj., provision and losses	-12	-34	-46	-8	-52	-60	-40	-30	-20	-20
Other items	0	0	0	0	0	0	0	0	0	0
Restructuring charges (net of tax)	0	0	0	0	0	0	0	0	0	0
Pre-tax profit	319	265	583	354	353	707	707	787	895	992
Income tax	-57	-46	-103	-66	-55	-121	-129	-142	-161	-178
Post tax profit	261	219	480	288	298	586	578	646	734	813
Minorities	0	0	0	0	0	0	0	0	0	0
Adjusted cash net Profit	261	219	480	288	298	586	578	646	734	813
Cash net profit	261	219	480	288	298	586	578	646	734	813
IFRS net profit	114	73	188	179	189	367	405	603	692	771
Adj. cash EPS	1.17	0.98	2.15	1.29	1.33	2.62	2.58	2.89	3.28	3.64
Dividend	0.00	0.60	0.60	0.00	1.00	1.00	1.00	1.20	1.50	1.75
Year-End shares in issue (m)	224	224	224	224	224	224	224	224	224	224
Avg shares in issue (m)	224	224	224	224	224	224	224	224	224	224
Cost income ratio (%)	69.3	73.3	71.3	70.7	69.1	69.9	70.5	69.6	68.4	67.4
Tax rate (%)	18.0	17.2	17.7	18.6	15.6	17.1	18.3	18.0	18.0	18.0
Julius Baer Group Assets under management and NNM trends										
(CHF m)	2013H1	2013H2	2013	2014H1	2014H2	2014	2015E	2016E	2017E	2018E
Assets under management (AuM)	217.7	254.4	254.4	274.2	290.6	290.6	283.0	303.5	325.8	349.6
of which net new money	*3.6%*	*3.8%*	*4.0%*	*5.9%*	*3.8%*	*5.0%*	*4.0%*	*3.7%*	*3.9%*	*3.8%*
of which performance	*0.5%*	*1.7%*	*2.5%*	*2.1%*	*4.3%*	*6.8%*	*-7.3%*	*3.5%*	*3.5%*	*3.5%*
Average AuM stated	211.5	247.1	229.0	261.4	283.1	272.2	274.0	293.3	314.7	337.7
Average AuM calculated	203.5	247.1	229.0	264.3	282.4	272.5	274.0	293.3	314.7	337.7
Net inflows (CHFbn)	3.4	4.1	7.5	7.5	5.2	12.7	11.6	10.6	11.7	12.4
Adj. Cash RoE (%)	11.0	9.0	9.8	11.3	11.3	11.3	11.3	12.6	13.3	13.7
Cash RoTE (%)	17.2	14.9	16.0	20.0	20.5	19.9	20.5	22.4	22.1	21.4
Julius Baer Group Detailed Earnings Assumptions										
(CHF m)	2013H1	2013H2	2013	2014H1	2014H2	2014	2015E	2016E	2017E	2018E
AuM margins										
Total Income in bp AuM	101.9bp	90.5bp	95.9bp	94.6bp	92.6bp	93.6bp	92.3bp	91.6bp	92.0bp	92.0bp
Reported gross margin	101.8bp	90.7bp	95.9bp							
Fee income bp AuM	56.6bp	54.9bp	55.8bp	57.1bp	54.5bp	55.8bp	54.0bp	54.5bp	55.7bp	56.2bp
Underlying interest income in bp AuM	22.9bp	22.0bp	22.4bp	21.7bp	20.6bp	21.2bp	22.0bp	21.2bp	20.7bp	20.7bp
Underlying trading income in bp AuM	20.6bp	10.9bp	15.4bp	13.6bp	15.7bp	14.7bp	14.4bp	14.1bp	13.8bp	13.5bp
Costs in bp AuM	70.6bp	66.3bp	68.4bp	66.9bp	64.0bp	65.4bp	65.1bp	63.8bp	62.9bp	62.0bp
Pre tax return in bp AuM	30.1bp	21.4bp	25.5bp	27.1bp	24.9bp	26.0bp	25.8bp	26.8bp	28.5bp	29.4bp
After tax return in bp AuM	24.7bp	17.8bp	21.0bp	22.0bp	21.1bp	21.5bp	21.1bp	22.0bp	23.3bp	24.1bp
Julius Baer Group Balance-Sheet										
(CHF m)	2013H1	2013H2	2013	2014H1	2014H2	2014	2015E	2016E	2017E	2018E
Attributable equity	4,743	5,039	5,039	5,198	5,338	5,338	4,919	5,299	5,722	6,157
Tangible equity	2,979	2,912	2,912	2,853	2,974	2,974	2,672	3,093	3,559	4,036
NAV per share (CHF)	21.2	22.5	22.5	23.2	23.8	23.8	22.0	23.7	25.6	27.5
Tang NAV per share (CHF)	13.3	13.0	13.0	12.7	13.3	13.3	11.9	13.8	15.9	18.0
RWA (CHFm)	15,218	16,223	16,223	16,462	17,205	17,205	18,409	19,698	21,077	22,341
Tier one capital (CHFm); fully applied B3 from 2012	3,263	2,913	2,913	3,267	3,306	3,306	3,060	3,437	3,836	4,257
Tier 1 ratio (%)	21.4	18.0	18.0	19.8	19.2	19.2	16.6	17.5	18.2	19.1
CET 1 capital; fully applied	3,038	2,462	2,462	2,681	2,713	2,713	2,467	2,844	3,243	3,664
CET 1 ratio	20.0	15.2	15.2	16.3	15.8	15.8	13.4	14.4	15.4	16.4
Total capital; fully applied	3,724	3,203	3,196	3,339	3,380	3,380	3,060	3,437	3,836	4,257
Total capital ratio (%)	24.5	19.7	19.7	20.3	19.6	19.6	16.6	17.5	18.2	19.1

Source: UBS estimates

Penetration of higher-margin products – a relevant trend for the industry and for Julius Baer

Various regulatory changes ('suitability'-themes, MIFID, FIDLEG etc) fundamentally change the banks' product offering. We believe a consistent, quality-assuring, and structured investment and advisory process will be the core of all banks' services. The number of self-directed clients will likely decrease further. Clients with access to both investment advisors and client advisors generate an attractive 100bp+ gross margin we estimate, and we see that segment growing further as a percentage of total assets under management.

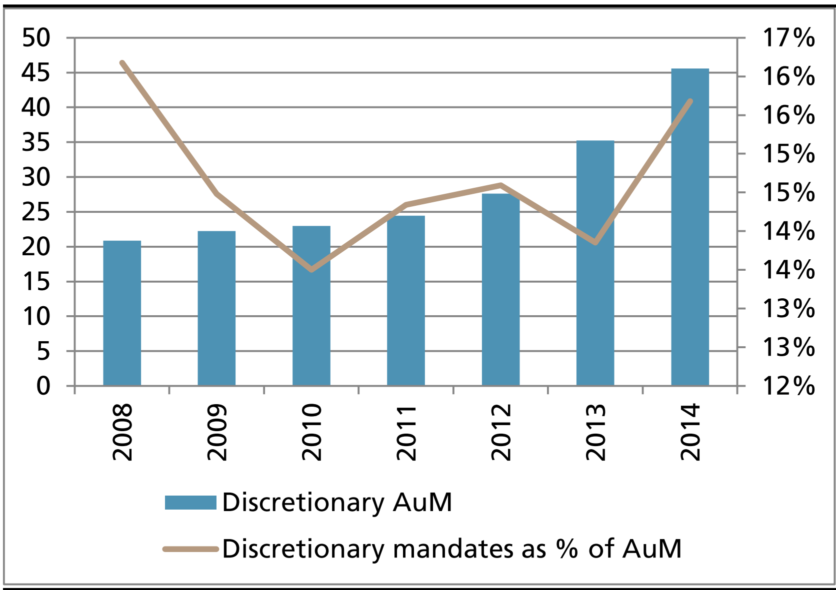
Private banks have to disclose the share of discretionary mandates (typically about 20% of total AuM). Such clients fully delegate the investment decisions to their bank and typically pay an all-in fee, which tends to be attractive for the banks.

The share of discretionary mandates for Julius Baer, for example, has remained fairly stable, in the mid-teens, with a (promising) upwards trend in 2014.

Adding other (advisory) mandates where the final investment decision remains with the client, we think Julius Baer's total mandate share could now be close to 30%. Discretionary and advisory mandates typically include a pre-defined service level (portfolio screening, dynamic planning, investment advice, portfolio health checks, followed by specific recommendations, depending on the particular client profile), for which the banks (hope they can) charge a premium price. Also, revenues from such mandates tend to be less volatile and stickier.

Advisory mandates sit between fully discretionary mandates and pure execution accounts. On the one hand, they satisfy the clients' need for advice in areas such as asset allocation and investment management. On the other hand, clients retain their independence as the final decision remains with them.

Figure 30: Discretionary mandates (CHF billion) at Julius Baer



Source: Julius Baer

We estimate a 10-percentage-point shift from lower-margin traditional assets into discretionary and other advisory mandates could result in a meaningful gross margin uptick of probably close to 10bp – as shown in the illustrative example below.

Figure 31: Gross margin uptick coming from shift to higher-margin products

	Year 1		Year 3	
	AuM	Gross margin	AuM	Gross margin
Traditional assets (equities, bonds, cash)	80	50bp	70	50bp
Discretionary and other advisory mandates	20	130bp	30	130bp
Total gross margin	**100**	**66bp**	**100**	**74bp**

Source: Company data, UBS estimates

Julius Baer Group (BAER.VX)

Profit & Loss (CHFm)	12/12	12/13	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
Net income interest	559	552	648	603	-7.0	621	3.0	652	698	746
Total non interest income	1,179	1,643	1,899	1,927	1.5	2,066	7.2	2,243	2,410	2,584
Total income	**1,737**	**2,195**	**2,547**	**2,530**	-0.7	**2,687**	6.2	**2,895**	**3,107**	**3,330**
Total cash expenses	(1,167)	(1,475)	(1,695)	(1,695)	0.0	(1,780)	-5.0	(1,887)	(2,000)	(2,120)
Pre-depreciation operating profit	**570**	**720**	**852**	**835**	-2.0	**907**	8.7	**1,008**	**1,107**	**1,210**
Depreciation & amort (excl. goodwill)	(79)	(91)	(85)	(88)	-3.0	(90)	-3.0	(93)	(96)	(99)
Operating profit pre provisions	**491**	**629**	**767**	**747**	-2.5	**817**	9.3	**915**	**1,012**	**1,112**
Total provisions	17	(46)	(60)	(40)	33.2	(30)	25.0	(20)	(20)	(20)
Operating profit post provisions	**508**	**583**	**707**	**707**	0.1	**787**	11.3	**895**	**992**	**1,092**
Income from associates & JVs (pre-tax)	0	0	0	0	-	0	-	0	0	0
Other pre-tax items	0	0	0	0	-	0	-	0	0	0
Profit before tax (UBS)	**508**	**583**	**707**	**707**	0.1	**787**	11.3	**895**	**992**	**1,092**
Exceptionals (incl goodwill)	0	0	0	0	-	0	-	0	0	0
Profit before tax	**508**	**583**	**707**	**707**	0.1	**787**	11.3	**895**	**992**	**1,092**
Tax	(86)	(103)	(121)	(129)	-6.7	(142)	-9.8	(161)	(178)	(197)
Profit after tax	**422**	**480**	**586**	**578**	-1.3	**646**	11.6	**734**	**813**	**895**
Other post-tax items	0	0	0	0	-	0	-	0	0	0
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	**422**	**480**	**586**	**578**	-1.3	**646**	11.6	**734**	**813**	**895**
Net earnings (before pref divs)	**422**	**480**	**586**	**578**	-1.3	**646**	11.6	**734**	**813**	**895**
Net earnings (UBS)	**422**	**480**	**586**	**578**	-1.3	**646**	11.6	**734**	**813**	**895**

Per share (CHF)	12/12	12/13	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
EPS (local GAAP, basic)	2.09	2.15	2.62	2.58	-1.3	2.89	11.7	3.28	3.64	4.01
EPS (UBS, diluted)	2.09	2.15	2.62	2.58	-1.3	2.89	11.7	3.28	3.64	4.01
PPOP (diluted)	2.43	2.81	3.43	3.34	-2.5	3.65	9.4	4.10	4.53	4.97
Net DPS	0.60	0.60	1.00	1.00	0.0	1.20	20.0	1.50	1.75	2.00
BVPS	21.79	22.22	23.54	21.98	-6.6	23.67	7.7	25.57	27.51	29.57
BVPS (UBS)	14.24	12.84	13.12	11.94	-9.0	13.82	15.8	15.90	18.03	20.28

Balance sheet (CHFm)	12/12	12/13	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
Banking assets (year end)	54,821	72,522	82,234	87,168	6.0	92,398	6.0	97,942	103,818	110,047
Banking assets (average)	53,862	63,671	77,378	84,701	9.5	89,783	6.0	95,170	100,880	106,933
Total assets (year end)	54,821	72,522	82,234	87,168	6.0	92,398	6.0	97,942	103,818	110,047
Risk weighted assets (RWA) (year end)	12,770	16,223	17,205	18,409	7.0	19,698	7.0	21,077	22,341	23,682
Risk weighted assets (RWA) (average)	12,790	14,497	16,714	17,807	6.5	19,054	7.0	20,387	21,709	23,012
Customer loans	19,783	27,536	33,669	34,679	3.0	37,192	7.2	39,926	42,846	45,868
Customer loans (average)	18,096	23,660	30,603	34,174	11.7	35,935	5.2	38,559	41,386	44,357
Interest earning assets (average)	19,783	27,536	33,669	34,679	3.0	37,192	7.2	39,926	42,846	45,868
Customer deposits	39,104	51,559	61,821	65,530	6.0	69,462	6.0	73,629	78,047	82,730
Common s/h equity (year end)	4,722	5,039	5,338	4,919	-7.8	5,299	7.7	5,722	6,157	6,618
Common s/h equity (average)	4,454	4,880	5,188	5,128	-1.2	5,109	-0.4	5,510	5,939	6,388
Total SHF (equity, pref & MI) (year end)	4,724	5,039	5,347	4,919	-8.0	5,299	7.7	5,722	6,157	6,618
Total SHF (equity, pref & MI) (average)	4,454	4,880	5,188	5,128	-1.2	5,109	-0.4	5,510	5,939	6,388
Net tangible assets	3,089	2,912	2,983	2,672	-10.4	3,093	15.8	3,559	4,036	4,540

Balance sheet structure (%)	12/12	12/13	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
Loans / banking assets (year end)	36.1	38.0	40.9	39.8	-2.8	40.3	1.2	40.8	41.3	41.7
Deposits / banking assets (year end)	71.3	71.1	75.2	75.2	0.0	75.2	0.0	75.2	75.2	75.2
Loans / deposits	50.6	53.4	54.5	52.9	-2.8	53.5	1.2	54.2	54.9	55.4
Total SHF / banking assets (year end)	8.6	6.9	6.5	5.6	-13.2	5.7	1.6	5.8	5.9	6.0

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Julius Baer Group (BAER.VX)

Capital adequacy (CHFm)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Tier 1 capital	3,245	2,913	3,306	3,060	3,437	3,836	4,257	4,705
Total capital	3,563	3,196	3,380	3,060	3,437	3,836	4,257	4,705
Risk weighted assets (RWA) (year end)	12,770	16,223	17,205	18,409	19,698	21,077	22,341	23,682
Core tier 1 ratio %	25.4	18.0	19.2	16.6	17.5	18.2	19.1	19.9
Tier 1 ratio %	25.4	18.0	19.2	16.6	17.5	18.2	19.1	19.9
Total capital ratio %	27.9	19.7	19.6	16.6	17.5	18.2	19.1	19.9
Tangible equity	3,087	2,912	2,974	2,672	3,093	3,559	4,036	4,540
Equity / assets %	8.6	6.9	6.5	5.6	5.7	5.8	5.9	6.0
Tangible equity to tangible assets %	5.8	4.1	3.7	3.1	3.4	3.7	4.0	4.2

Asset quality (CHFm)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Non performing assets	0	0	0	0	0	0	0	0
Total risk reserves	40	40	40	40	40	40	40	40
NPLs / loans %	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NPL coverage %	-	-	-	-	-	-	-	-
Provision charge / average loans %	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net NPAs / shareholders funds %	(0.8)	(0.8)	(0.7)	(0.8)	(0.8)	(0.7)	(0.6)	(0.6)

Profitability (%)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Net interest margin (avg assets)	1.04	0.87	0.84	0.71	0.69	0.69	0.69	0.70
Provisions / operating profit	(3.5)	7.3	7.8	5.4	3.7	2.2	2.0	1.8
ROE (UBS earnings)	9.5	9.8	11.3	11.3	12.6	13.3	13.7	14.0
RoAdjE (UBS earnings & equity)	15.2	16.0	19.9	20.5	22.4	22.1	21.4	20.9
RoRWA (UBS)	3.30	3.31	3.51	3.25	3.39	3.60	3.75	3.89
RoA (UBS earnings)	0.78	0.75	0.76	0.68	0.72	0.77	0.81	0.84

Productivity (%)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Cost income ratio	71.7	71.3	69.9	70.5	69.6	68.4	67.4	66.6
Cost / average assets	2.31	2.46	2.30	2.10	2.08	2.08	2.08	2.07
Compensation expense ratio	62.0	61.0	60.6	61.3	60.3	59.0	58.0	57.1

Growth (%)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenue	-0.9	26.3	16.0	-0.7	6.2	7.7	7.3	7.2
Operating profit pre provisions	-1.4	28.0	21.9	-2.5	9.3	12.0	10.5	9.9
Net earnings (UBS)	5.3	13.8	22.0	-1.3	11.6	13.7	10.7	10.1
Net DPS	-40.0	0.0	66.7	0.0	20.0	25.0	16.7	14.3
Total assets (year end)	3.6	32.3	13.4	6.0	6.0	6.0	6.0	6.0
Customer loans	20.6	39.2	22.3	3.0	7.2	7.4	7.3	7.1
Customer deposits	12.2	31.9	19.9	6.0	6.0	6.0	6.0	6.0

Value (x)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Market cap/revenues	4.0	4.1	3.6	3.8	3.6	3.3	3.1	2.9
Market cap/deposits	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1
P/PPOP (diluted)	13.7	14.1	12.0	12.6	11.5	10.3	9.3	8.5
P/E (local GAAP, basic)	16.0	18.4	15.6	16.3	14.6	12.8	11.6	10.5
P/E (UBS, diluted)	16.0	18.4	15.6	16.3	14.6	12.8	11.6	10.5
Net dividend yield %	1.8	1.5	2.4	2.4	2.8	3.6	4.2	4.7
P/BV x	1.5	1.8	1.7	1.9	1.8	1.6	1.5	1.4
P/BV (UBS) x	2.3	3.1	3.1	3.5	3.0	2.6	2.3	2.1

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Partners Group Holding AG
Upgrade to Buy

Equities

Switzerland
Banks, Ex-S&L

12-month rating	**Buy**
	Prior: Neutral
12m price target	**CHF300.00**
	Prior: CHF220.00
Price	**CHF261.50**

RIC: PGHN.S **BBG:** PGHN SE

Trading data and key metrics

52-wk range	CHF295.00-215.40
Market cap.	CHF6.66bn/US$7.22bn
Shares o/s	25.5m (ORD)
Free float	53%
Avg. daily volume ('000)	61
Avg. daily value (m)	CHF15.8
Common s/h equity (12/14E)	CHF1.04bn
P/BV (12/14E)	6.5x
Net debt / EBITDA (12/14E)	NM

EPS (UBS, diluted) (CHF)

	From	To	% ch	Cons.
12/14E	13.3	13.3	0.00	13.1
12/15E	12.4	13.6	9.64	13.0
12/16E	15.0	16.2	7.90	15.3

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Double-digit growth and visibility have a high value – upgrade PGHN to Buy

PGHN offers visible, annuity-type revenues that are growing double-digit due to structural drivers. PGHN should offer mid-teens profit growth for several years thanks to double digit inflow levels. PGHN could further benefit from asset allocation shifts to private markets given the low (or even negative) yield. The firm has established by now a strong track record not only in private equity, but also private real estate and private infrastructure.

Supportive environment for private markets despite high valuations

A large-scale quantitative easing programme and the resulting conditions could be favorable for private equity and private market solution providers in general. Lower yield in public markets would further amplify the chase for yields and asset allocations could be shifted towards private markets. Furthermore, cheap funding and hence higher leverage could support valuations and ease exit conditions.

Higher EPS due to higher performance fees

We increase our 2015, 2016 and 2017 EPS by10%, 8% and 9%, respectively, as we are now ready to factor in higher performance fees. Client demand guidance for 2015: gross client demand of EUR5-7 billion and taildowns, redemptions and other negative effects of EUR-2-3 billion. On the back of expected client demand we factor in EUR5.2 billion, at the upper end of the target range. Finding the right balance between margins/price discipline and strong volumes could be key for PGHN's success and financials over the coming two to three years.

Valuation: Target valuation approach

PE 2015E stands at c20x. We do not expect a PE multiple expansion over the coming 12 months. Given expected mid- to high-teen profit growth beyond 2015 (yes, 2015 is hampered by negative currency effect), we expect PGHN to trade on a c19x forward PE ratio in early 2016 too. In other words, PGHN's share price during 2015 could increase almost by the expected 2016 profit growth.

Highlights (CHFm)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenues	343	449	488	577	589	701	824	918
EBIT (UBS)	193	256	278	334	345	421	514	577
Net earnings (UBS)	212	265	292	341	348	417	502	560
EPS (UBS, diluted) (CHF)	8.4	10.5	11.5	13.3	13.6	16.2	19.5	21.7
DPS (CHF)	5.5	6.3	7.3	8.0	9.0	10.0	11.5	12.5
Net (debt) / cash	79	235	58	216	222	305	433	519

Profitability/valuation	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
EBIT margin %	56.3	57.1	56.9	57.9	58.6	60.1	62.4	62.9
ROIC (EBIT) %	53.0	63.7	48.2	39.9	36.1	42.5	51.8	56.2
EV/EBITDA (core) x	19.0	16.4	20.1	19.2	19.2	15.8	12.8	10.2
P/E (UBS, diluted) x	19.1	17.0	20.1	19.7	19.3	16.2	13.4	12.0
Equity FCF (UBS) yield %	5.3	6.1	5.6	6.3	5.4	6.4	7.7	8.6
Net dividend yield %	3.4	3.5	3.1	3.1	3.4	3.8	4.4	4.8

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of CHF261.50 on 06 Feb 2015 11:06 GMT

Investment Thesis

Partners Group Holding AG

12-month rating **Buy**

12m price target **CHF300.00**

Investment case

Partners Group is trading at a significant premium to its Swiss asset manager/wealth manager peers. We think this is justified, given the significantly higher net new money growth compared with peers, fewer structural headwinds as well as the relatively high predictability of earnings. Partners Group is expanding 'new' areas, such as private infrastructure and private real estate. Partners Group has built up a strong private equity track record – whether or not it will be similarly successful in these new fields remains to be seen.

Upside scenario

A 15bps higher gross margin in 2016 (all else equal) and a RoE of 37%, assuming a 25% marginal cost/income ratio would mean 12% higher pre-tax profit and a fair value of CHF337 per share.

Downside scenario

A 15bps lower gross margin in 2016 (all else equal) and a RoE of 30%, assuming a 25% marginal cost/income ratio would mean 12% lower pre-tax profit and a fair value of CHF266 per share.

Upcoming catalysts

Full-year 2014 results: 24 March 2015
16 July 2015 Pre-close announcement AuM as of 30 June 2015
08 September 2015 Interim results & interim report as of 30 June 2015

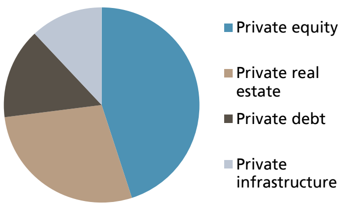
Business description

Founded in 1996, Partners Group is a leading private markets asset management firm. Initially focused on private equity, the company has diversified its activities into private debt, private real estate, private infrastructure, absolute return strategies and listed alternatives. Partners Group manages various funds, structured products and customised portfolios for an international clientele of institutional investors, private banks and other financial institutions. The company is headquartered in Zug, Switzerland, and listed on the Swiss Exchange.

Industry outlook

Rising pension fund asset allocations to alternative and private market investments support strong inflows to sector and consequently recurring fees. At the same time, higher valuations, falling fees and increased competition put pressure on margins.

Assets raised by asset class



Source: PGHN

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Partners Group to benefit from structural shifts across all horizons

Long-term: PGHN among the first movers to target defined contribution pension schemes

According to press reports (eg, WSJ), Partners Group is in the process of launching private market fund solutions for defined contribution pension schemes in the United States (401k market) and is already offering solutions in the United Kingdom. We see tapping these very large markets as a very significant mid and long-term opportunity for Partners Group.

Mid-term: Global asset allocation shifting towards private market investments – supports management fees

In a low interest rate environment globally, asset allocations are shifting towards private market investments as pension and mutual funds struggle to deliver on expected returns simply by investing into traditional "safe" assets. The appeal of higher yields and certain private market investors' track record will likely attract very substantial demand from these institutional investors. We see Partners Group as one of the natural beneficiaries of this trend. Higher net inflows over time result in, ideally, higher AuM, which in turn lifts up management fees (calculated based on committed funds). Partners Group's capacity to take in money hinges on its ability to deploy those funds (ie, investment opportunities are the bottleneck). With consistent and clear net hiring policy across all locations and market segments, Partners Group aims to actively tackle the challenge investment capacity challenge.

Short/mid-term: QE supports exit conditions for 2006-09 vintages – positive for performance fees

In our view, the ECB's recently launched quantitative easing program, as envisioned by central bankers, will lead to further intensifying of the hunt for yield and thus will contribute to further asset price inflation in private markets as well. This creates improving exit conditions (ie, higher valuations and demand, as well as liquidity in some cases). This benefits investment programs maturing in the next 2-3 years.

At the same time, investments with sufficient yields could also prove challenging. However, we are less concerned about these prospects at the moment for two reasons: 1) performance fees from these investments will crystalize only a long time from now (ie, beyond reasonable visibility) and 2) Partners Group's investment platform typically excels in scanning investments opportunities and executes transactions only with reasonable valuation levels or with those with prospects for vast operational improvement.

Performance fees could quadruple in the next 3 years

As the holding period for 2006 and 2007 vintages became longer over the financial crises, the exits were pushed back by a year or two, thus these programmes will most probably pay performance fees together with the 2008 and 2009 vintages. If we factor in a favourable exit environment and thus higher money multiples, this could in fact result in tripling or quadrupling performance fees in 2016 and 2017. Based on the aforementioned conditions and developments, we raise our performance fee estimates for the next 4 years by more than 60% on average. We think consensus does not have this in the numbers yet.

Valuation

We recently changed our valuation model to a target multiples approach (using 19x (up from 18x due to higher structural growth) for management fees and 11x for performance fees) pointing to a new fair value of CHF300.

Partners Group Holding AG (PGHN.S)

Income statement (CHFm)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Revenues	**343**	**449**	**488**	**577**	18.3	**589**	2.1	**701**	**824**	**918**
Gross profit	343	449	488	577	18.3	589	2.1	701	824	918
EBITDA (UBS)	**209**	**276**	**297**	**356**	20.1	**356**	0.0	**433**	**525**	**588**
Depreciation & amortisation	(16)	(20)	(19)	(22)	15.5	(11)	-48.6	(11)	(11)	(11)
EBIT (UBS)	**193**	**256**	**278**	**334**	20.4	**345**	3.2	**421**	**514**	**577**
Associates & investment income	3	6	4	5	21.0	5	2.2	6	6	7
Other non-operating income	34	26	40	38	-5.5	33	-13.3	34	35	35
Net interest	0	0	0	0	-	0	-	0	0	0
Exceptionals (incl goodwill)	(1)	0	34	50	49.3	0	-	0	0	0
Profit before tax	**230**	**289**	**355**	**427**	20.2	**383**	-10.4	**461**	**555**	**619**
Tax	(19)	(23)	(29)	(36)	-22.6	(34)	3.6	(44)	(53)	(59)
Profit after tax	**211**	**266**	**326**	**391**	20.0	**348**	-11.0	**417**	**502**	**560**
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	0	0	0	0	-	0	-	0	0	0
Extraordinary items	(9)	(9)	(9)	(7)	25.0	0	-	0	0	0
Net earnings (local GAAP)	**202**	**257**	**317**	**385**	21.3	**348**	-9.4	**417**	**502**	**560**
Net earnings (UBS)	**212**	**265**	**292**	**341**	16.7	**348**	2.1	**417**	**502**	**560**
Tax rate (%)	8.1	8.1	8.2	8.4	2.0	9.0	7.5	9.5	9.5	9.5

Per share (CHF)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
EPS (UBS, diluted)	8.4	10.5	11.5	13.3	15.2	13.6	2.1	16.2	19.5	21.7
EPS (local GAAP, diluted)	8.0	10.1	12.5	15.0	19.7	13.6	-9.4	16.2	19.5	21.7
EPS (UBS, basic)	8.4	10.5	11.5	13.3	15.2	13.6	2.1	16.2	19.5	21.7
Net DPS (CHF)	5.5	6.3	7.3	8.0	10.3	9.0	12.5	10.0	11.5	12.5
Cash EPS (UBS, diluted)[1]	9.0	11.3	12.3	14.1	15.1	14.0	-1.0	16.6	19.9	22.2
Book value per share	22.5	27.4	33.6	40.2	19.6	44.7	11.2	50.9	58.9	68.1
Average shares (diluted)	25.3	25.3	25.3	25.7	1.3	25.7	0.0	25.8	25.8	25.8

Balance sheet (CHFm)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Tangible fixed assets	17	19	21	8	-61.2	9	5.0	9	9	9
Intangible fixed assets	50	38	53	58	10.1	60	3.4	60	60	60
Investments	239	231	254	313	23.3	364	16.2	437	514	599
Other assets	339	342	679	858	26.4	920	7.1	924	924	992
Total fixed assets	**645**	**631**	**1,007**	**1,238**	22.9	**1,353**	9.2	**1,429**	**1,507**	**1,659**
Net working capital	**0**	**0**	**0**	**0**	-	**0**	-	**0**	**0**	**0**
Cash	79	235	58	216	269.9	222	2.8	305	433	519
Short term debt	0	0	0	0	-	0	-	0	0	0
Long term debt	0	0	0	0	-	0	-	0	0	0
Preferred shares	0	0	0	0	-	0	-	0	0	0
Net (debt) / cash	**79**	**235**	**58**	**216**	269.9	**222**	2.8	**305**	**433**	**519**
Other debt-deemed liabilities	(154)	(168)	(209)	(418)	-100.2	(422)	-1.0	(422)	(422)	(422)
Provisions & non-debt deemed liabs	0	0	0	0	-	0	-	0	0	0
Total equity	**571**	**698**	**857**	**1,036**	20.9	**1,152**	11.2	**1,311**	**1,517**	**1,755**
Minority interests	1	1	0	1	-	1	10.0	1	1	1
Common s/h equity	**572**	**699**	**857**	**1,036**	21.0	**1,153**	11.2	**1,312**	**1,518**	**1,756**
Operating invested capital	**406**	**400**	**753**	**925**	22.8	**988**	6.9	**992**	**992**	**1,060**
Total capital employed	**645**	**631**	**1,007**	**1,238**	22.9	**1,353**	9.2	**1,429**	**1,507**	**1,659**

Cash flow (CHFm)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
EBIT (UBS)	193	256	278	334	20.4	345	3.2	421	514	577
Depreciation & amortisation	16	20	19	22	15.5	11	-48.6	11	11	11
Net change in working capital	0	0	0	0	-	0	-	0	0	0
Net interest	0	0	0	0	-	0	-	0	0	0
Tax paid	(19)	(23)	(29)	(36)	-22.6	(34)	3.6	(44)	(53)	(59)
Other operating	28	24	69	86	25.3	38	-56.3	40	44	45
Operating cash flow	**218**	**277**	**336**	**406**	20.1	**359**	0.0	**428**	**516**	**574**
Tangible capital expenditure	(10)	(2)	(2)	13	-	0	-	0	0	0
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Equity free cash flow	**208**	**274**	**334**	**419**	25.5	**359**	-14.4	**428**	**516**	**574**
Net (acquisitions) & disposals	0	0	0	0	-	0	-	0	0	0
Equity dividends paid	(5)	(6)	(7)	(8)	-10.3	(9)	-12.5	(10)	(11)	(12)
Share issues / (buybacks)	0	0	0	0	-	0	-	0	0	0
Net other cash flows	3	6	4	5	21.0	5	2.2	6	9	10
Cash flow (inc)/dec in net debt	**206**	**274**	**331**	**416**	25.8	**355**	-14.7	**424**	**514**	**572**
FX / non cash items	(353)	(119)	(507)	(258)	49.0	(349)	-35.0	(342)	(386)	(486)
Balance sheet (inc)/dec in net debt	**(146)**	**155**	**(176)**	**158**	-	**6**	-96.2	**82**	**128**	**86**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.[1]Cash EPS (UBS, diluted) is calculated using UBS net income adding back depreciation and amortization.

Partners Group Holding AG (PGHN.S)

Valuation (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
P/E (local GAAP, diluted)	20.0	17.6	18.6	17.5	19.3	16.2	13.4	12.0
P/E (UBS, diluted)	19.1	17.0	20.1	19.7	19.3	16.2	13.4	12.0
P/CEPS	17.8	15.8	18.9	18.5	18.7	15.7	13.1	11.8
Equity FCF (UBS) yield %	5.3	6.1	5.6	6.3	5.4	6.4	7.7	8.6
Net dividend yield (%)	3.4	3.5	3.1	3.1	3.4	3.8	4.4	4.8
P/BV x	7.1	6.5	6.9	6.5	5.8	5.1	4.4	3.8
EV/revenues (core)	NM	NM	NM	NM	NM	9.7	8.1	6.5
EV/EBITDA (core)	19.0	16.4	20.1	19.2	19.2	15.8	12.8	10.2
EV/EBIT (core)	20.6	17.6	21.5	20.4	19.9	16.2	13.0	10.4
EV/OpFCF (core)	19.0	16.4	20.1	19.2	19.2	15.8	12.8	10.2
EV/op. invested capital	NM	NM	NM	8.1	7.2	6.9	6.8	5.9

Enterprise value (CHFm)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Market cap.	3,966	4,522	5,921	6,663	6,663	6,663	6,663	6,663
Net debt (cash)	(153)	(157)	(147)	(137)	(219)	(263)	(369)	(476)
Buy out of minorities	1	1	0	0	1	1	1	1
Pension provisions/other	160	161	188	314	420	422	422	422
Total enterprise value	**3,974**	**4,527**	**5,964**	**6,840**	**6,865**	**6,823**	**6,718**	**6,611**
Non core assets	(4)	(6)	(4)	(10)	(11)	(11)	(11)	(599)
Core enterprise value	**3,970**	**4,521**	**5,959**	**6,831**	**6,855**	**6,813**	**6,707**	**6,012**

Growth (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenue	-7.9	30.9	8.7	18.3	2.1	19.0	17.5	11.4
EBITDA (UBS)	-15.0	32.1	7.4	20.1	0.0	21.4	21.4	12.0
EBIT (UBS)	-19.1	32.8	8.3	20.4	3.2	22.1	22.0	12.3
EPS (UBS, diluted)	-29.7	24.8	10.1	15.2	2.1	19.3	20.4	11.6
Net DPS	10.0	13.6	16.0	10.3	12.5	11.1	15.0	8.7

Margins & Profitability (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Gross profit margin	NM	NM	NM	NM	NM	NM	NM	NM
EBITDA margin	60.9	61.5	60.8	61.7	60.5	61.7	63.7	64.1
EBIT margin	56.3	57.1	56.9	57.9	58.6	60.1	62.4	62.9
Net earnings (UBS) margin	61.9	59.1	59.9	59.1	59.1	59.5	60.9	61.0
ROIC (EBIT)	53.0	63.7	48.2	39.9	36.1	42.5	51.8	56.2
ROIC post tax	48.6	58.4	43.8	36.0	32.8	38.4	46.8	50.8
ROE (UBS)	37.1	41.8	37.6	36.0	31.8	33.8	35.5	34.2

Capital structure & Coverage (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Net debt / EBITDA	(0.4)	(0.8)	(0.2)	(0.6)	(0.6)	(0.7)	(0.8)	(0.9)
Net debt / total equity %	(13.9)	(33.6)	(6.8)	(20.9)	(19.3)	(23.2)	(28.5)	(29.6)
Net debt / (net debt + total equity) %	(16.2)	(50.7)	(7.3)	(26.4)	(23.9)	(30.2)	(39.9)	(42.0)
Net debt/EV	(2.0)	(5.2)	(1.0)	(3.2)	(3.2)	(4.5)	(6.4)	(8.6)
Capex / depreciation %	61.6	12.3	10.0	(59.8)	3.7	0.0	0.0	0.0
Capex / revenue %	2.9	0.5	0.4	NM	0.1	0.0	0.0	0.0
EBIT / net interest	-	-	-	-	-	-	-	-
Dividend cover (UBS)	1.5	1.7	1.6	1.7	1.5	1.6	1.7	1.7
Div. payout ratio (UBS) %	65.5	59.7	62.8	60.2	66.4	61.8	59.0	57.5

Revenues by division (CHFm)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Others	343	449	488	577	589	701	824	918
Total	**343**	**449**	**488**	**577**	**589**	**701**	**824**	**918**

EBIT (UBS) by division (CHFm)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Others	193	256	278	334	345	421	514	577
Total	**193**	**256**	**278**	**334**	**345**	**421**	**514**	**577**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

St Galler Kantonalbank
Downgrade to Sell

Equities

Switzerland
Banks, Ex-S&L

12-month rating	**Sell**
	Prior: Neutral
12m price target	**CHF300.00**
	Prior: CHF360.00
Price	**CHF357.75**
RIC: SGKN.S **BBG:** SGKN SW	

Trading data and key metrics

52-wk range	CHF378.00-333.75
Market cap.	CHF1.99bn/US$2.16bn
Shares o/s	5.57m (REG)
Free float	100%
Avg. daily volume ('000)	2
Avg. daily value (m)	CHF0.7
Common s/h equity (12/14E)	CHF2.03bn
P/BV (12/14E)	1.0x
Tier 1 ratio	13%

EPS (UBS, diluted) (CHF)

	From	To	% ch	Cons.
12/14E	27.51	27.51	0.00	27.40
12/15E	26.31	24.39	-7.29	28.83
12/16E	27.16	23.74	-12.56	28.77

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A well-run company but not immune to adverse sector headwinds

SGKB is, in our view, a well-run company when it comes to its core businesses, retail and corporate banking. The risk policy is conservative and the asset quality is well managed. Nevertheless, SGKB is not immune to various adverse sector headwinds, such as in private banking or those driven by low interest rates.

Negative interest rates could have material negative impact on SGKB's profits

The Swiss swap curve is in negative territory. Over the coming years, we think this could have material implications for SGKB's asset and liability side in terms of spreads and client behaviour. Additionally, hedging is costly and could further erode margins. A deteriorating macro environment could additionally increase risk costs and lower loan growth. Due to negative net profit growth in 2015, what we consider to be too high consensus expectations and too high valuation, we downgrade SGKB to Sell.

EPS cuts and lower price target

The uncertainty attached to our estimates is high. We cut our 2015, 2016 and 2017 EPS by 7%, 13% and 12%, respectively, and lower our price target to CHF300 (-17%). We now expect negative loan and net interest income growth in 2015E. St. Galler is due to publish its 2014 results on 11 February 2015 7am CET. We forecast a H2 2014 net profit of CHF79m bringing the 2014 full-year net profit close to the 2013 level, in line with the company guidance. The discussion on the results day will however likely focus on the recent Swiss franc move and the extreme interest rate environment. Any new targets and a specific outlook could have a meaningful impact on the share price and consensus estimates.

Valuation: Based on a one-stage Gordon growth model

A PE 2015E of c.15x and a P/NAV of c1x for a ROE of 6.6% in 2015 looks too stretched to us. Our negative view is also supported by a challenging macro outlook, too high consensus estimates and negative profit growth in 2015E we think.

Highlights (CHFm)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenues	478	502	489	449	431	433	447	464
Profit before tax	176	197	115	184	165	161	175	186
Net earnings (local GAAP)	136	151	109	153	135	132	143	152
Net earnings (UBS)	153	170	158	153	135	132	143	152
Tier 1 ratio %	12.3	12.6	12.7	12.7	13.3	14.0	14.3	14.7
EPS (UBS, diluted) (CHF)	27.50	30.63	28.52	27.51	24.39	23.74	25.84	27.45
Profitability/valuation	**12/11**	**12/12**	**12/13**	**12/14E**	**12/15E**	**12/16E**	**12/17E**	**12/18E**
ROE (UBS) %	8.3	9.0	8.1	7.6	6.6	6.2	6.6	6.8
P/PPOP (diluted)	13.7	9.5	9.9	10.5	11.1	11.1	10.7	10.1
P/BV x	1.3	1.0	1.1	1.0	1.0	0.9	0.9	0.9
P/BV (UBS) x	1.3	1.1	1.1	1.0	1.0	0.9	0.9	0.9
P/E (UBS, diluted)	15.8	11.7	13.1	13.0	14.7	15.1	13.8	13.0
Net dividend yield %	3.5	4.2	4.0	4.2	3.9	3.9	4.2	4.5

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of CHF357.75 on 06 Feb 2015 11:05 GMT

Investment Thesis

St Galler Kantonalbank

12-month rating **Sell**

12m price target **CHF300.00**

Investment case

SGKB is, in our view, a well-run company when it comes to its core businesses, retail and corporate banking. The risk policy is conservative and the asset quality is well managed. Nevertheless, SGKB is not immune to various adverse sector headwinds, such as in private banking or those driven by low interest rates.

Upside scenario

A more bullish scenario would be built around a more positive view on net interest income and lower risk costs. Some 5% higher net interest income and c60% lower risk costs could translate into at least 15% higher earnings potentially justifying a fair value per share of cCHF350.

Downside scenario

A more bearish scenario would be built around a more positive view on net interest income and lower risk costs. Some 5% lower net interest income and c60% higher risk costs could translate into c15% lower earnings potentially justifying a fair value per share of cCHF250.

Upcoming catalysts

Full-year 2014 results: 11 February 2015
H1 2015 results: 11 August 2015

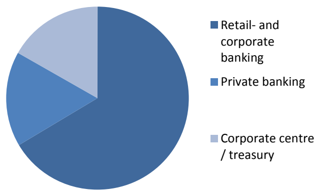
Business description

St. Galler Kantonalbank (SGKB) is the leading retail bank in the eastern canton of St. Gall, and one of the largest Swiss cantonal banks. SGKB, which has a balance sheet of some CHF28 billion and assets under management of around CHF35 billion, has diversified its business mix towards private banking over the past few years, but has recently decided to focus on Switzerland and Germany as its core private banking markets.

Industry outlook

The Swiss swap curve is in negative territory. Over the coming years, we think this could have material implications for banks' asset and liability side in terms of spreads and client behaviour. Additionally, hedging is costly and could further erode margins. A deteriorating macro environment could additionally increase risk costs and lower loan growth.

Profit by division 2014E



Source: UBS estimates

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Valuation

We value St. Galler Kantonalbank using a Gordon growth model. Cost of equity is 8% (unchanged), growth 1% (down from 3% given the even lower yield environment and expected growth rates) and the sustainable ROTE is 6.6% (2016E).

St Galler Kantonalbank (SGKN.S)

Profit & Loss (CHFm)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Net income interest	289	313	306	296	-3.3	281	-5.0	275	281	289
Total non interest income	189	188	183	153	-16.3	150	-2.0	158	166	175
Total income	**478**	**502**	**489**	**449**	-8.2	**431**	-4.0	**433**	**447**	**464**
Total cash expenses	(288)	(280)	(268)	(246)	8.2	(239)	2.8	(242)	(249)	(257)
Pre-depreciation operating profit	**190**	**222**	**221**	**203**	-8.2	**192**	-5.4	**191**	**198**	**208**
Depreciation & amort (excl. goodwill)	(13)	(12)	(13)	(13)	0.0	(13)	0.0	(13)	(13)	(11)
Operating profit pre provisions	**177**	**210**	**208**	**190**	-8.7	**179**	-5.7	**178**	**185**	**196**
Total provisions	(5)	(10)	(17)	(6)	63.7	(14)	-133.2	(18)	(10)	(10)
Operating profit post provisions	**172**	**200**	**191**	**184**	-3.9	**165**	-10.3	**161**	**175**	**186**
Income from associates & JVs (pre-tax)	0	0	0	0	-	0	-	0	0	0
Other pre-tax items	11	8	(13)	0	-	0	-	0	0	0
Profit before tax (UBS)	**182**	**208**	**178**	**184**	3.3	**165**	-10.3	**161**	**175**	**186**
Exceptionals (incl goodwill)	(6)	(11)	(63)	0	-	0	-	0	0	0
Profit before tax	**176**	**197**	**115**	**184**	59.7	**165**	-10.3	**161**	**175**	**186**
Tax	(30)	(38)	(20)	(31)	-57.9	(30)	5.0	(29)	(31)	(33)
Profit after tax	**146**	**159**	**95**	**153**	60.1	**135**	-11.3	**132**	**143**	**152**
Other post-tax items	(11)	(8)	13	0	-	0	-	0	0	0
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	**136**	**151**	**109**	**153**	40.5	**135**	-11.3	**132**	**143**	**152**
Net earnings (before pref divs)	**136**	**151**	**109**	**153**	40.5	**135**	-11.3	**132**	**143**	**152**
Net earnings (UBS)	**153**	**170**	**158**	**153**	-3.6	**135**	-11.3	**132**	**143**	**152**

Per share (CHF)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
EPS (local GAAP, basic)	24.46	27.28	19.58	27.51	40.5	24.39	-11.3	23.74	25.84	27.45
EPS (UBS, diluted)	27.50	30.63	28.52	27.51	-3.6	24.39	-11.3	23.74	25.84	27.45
PPOP (diluted)	31.80	37.76	37.47	34.22	-8.7	32.26	-5.7	32.12	33.31	35.35
Net DPS	15.00	15.00	15.00	15.00	0.0	14.00	-6.7	14.00	15.00	16.00
BVPS	334.50	347.23	352.31	366.08	3.9	375.47	2.6	385.22	397.06	409.51
BVPS (UBS)	323.87	339.95	352.13	365.91	3.9	375.30	2.6	385.22	397.06	409.51

Balance sheet (CHFm)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Banking assets (year end)	26,074	27,638	27,852	28,966	4.0	28,386	-2.0	27,819	28,931	30,089
Banking assets (average)	25,228	26,856	27,745	28,409	2.4	28,676	0.9	28,102	28,375	29,510
Total assets (year end)	26,074	27,638	27,852	28,966	4.0	28,386	-2.0	27,819	28,931	30,089
Risk weighted assets (RWA) (year end)	13,888	14,316	14,426	15,004	4.0	14,703	-2.0	14,409	14,486	14,486
Risk weighted assets (RWA) (average)	13,357	14,102	14,371	14,715	2.4	14,854	0.9	14,556	14,448	14,486
Customer loans	21,271	22,360	23,042	23,964	4.0	23,245	-3.0	22,780	23,691	24,639
Customer loans (average)	20,575	21,816	22,701	23,503	3.5	23,604	0.4	23,013	23,236	24,165
Interest earning assets (average)	25,228	26,856	27,745	28,409	2.4	28,676	0.9	28,102	28,375	29,510
Customer deposits	18,922	19,902	18,962	19,720	4.0	20,509	4.0	21,329	22,182	23,070
Common s/h equity (year end)	1,863	1,934	1,962	2,032	3.5	2,084	2.6	2,138	2,204	2,273
Common s/h equity (average)	1,847	1,899	1,948	1,997	2.5	2,058	3.0	2,111	2,171	2,238
Total SHF (equity, pref & MI) (year end)	1,863	1,934	1,962	2,032	3.5	2,084	2.6	2,138	2,204	2,273
Total SHF (equity, pref & MI) (average)	1,863	1,934	1,962	2,032	3.5	2,084	2.6	2,138	2,204	2,273
Net tangible assets	1,804	1,894	1,961	2,031	3.5	2,083	2.6	2,138	2,204	2,273

Balance sheet structure (%)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Loans / banking assets (year end)	81.6	80.9	82.7	82.7	0.0	81.9	-1.0	81.9	81.9	81.9
Deposits / banking assets (year end)	72.6	72.0	68.1	68.1	0.0	72.2	6.1	76.7	76.7	76.7
Loans / deposits	112.4	112.4	121.5	121.5	0.0	113.3	-6.7	106.8	106.8	106.8
Total SHF / banking assets (year end)	7.1	7.0	7.0	7.0	-0.4	7.3	4.7	7.7	7.6	7.6

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

St Galler Kantonalbank (SGKN.S)

Capital adequacy (CHFm)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Tier 1 capital	1,708	1,804	1,829	1,899	1,956	2,010	2,071	2,134
Total capital	1,708	1,804	1,829	1,899	1,956	2,010	2,071	2,134
Risk weighted assets (RWA) (year end)	13,888	14,316	14,426	15,004	14,703	14,409	14,486	14,486
Core tier 1 ratio %	12.3	12.6	12.7	12.7	13.3	14.0	14.3	14.7
Tier 1 ratio %	12.3	12.6	12.7	12.7	13.3	14.0	14.3	14.7
Total capital ratio %	12.3	12.6	12.7	12.7	13.3	14.0	14.3	14.7
Tangible equity	1,804	1,894	1,961	2,031	2,083	2,138	2,204	2,273
Equity / assets %	7.1	7.0	7.0	7.0	7.3	7.7	7.6	7.6
Tangible equity to tangible assets %	6.9	6.9	7.0	7.0	7.3	7.7	7.6	7.6

Asset quality (CHFm)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Non performing assets	48	56	70	70	70	70	70	70
Total risk reserves	159	160	196	202	216	233	243	254
NPLs / loans %	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
NPL coverage %	331.9	285.5	279.5	288.1	308.1	333.2	347.4	362.2
Provision charge / average loans %	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net NPAs / shareholders funds %	(6.0)	(5.4)	(6.4)	(6.5)	(7.0)	(7.6)	(7.9)	(8.1)

Profitability (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Net interest margin (avg assets)	1.15	1.17	1.10	1.04	0.98	0.98	0.99	0.98
Provisions / operating profit	2.6	4.6	8.0	3.2	7.8	9.9	5.4	5.3
ROE (UBS earnings)	8.3	9.0	8.1	7.6	6.6	6.2	6.6	6.8
RoAdjE (UBS earnings & equity)	8.6	9.2	8.2	7.6	6.6	6.2	6.6	6.8
RoRWA (UBS)	1.14	1.21	1.10	1.04	0.91	0.91	0.99	1.05
RoA (UBS earnings)	0.58	0.59	0.34	0.54	0.47	0.47	0.51	0.52

Productivity (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Cost income ratio	66.6	61.9	61.3	57.7	58.5	58.8	58.6	57.8
Cost / average assets	1.19	1.09	1.01	0.91	0.88	0.91	0.92	0.91
Compensation expense ratio	50.1	45.3	45.2	43.6	43.9	44.0	43.8	43.1

Growth (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenue	-2.4	4.9	-2.6	-8.2	-4.0	0.5	3.2	3.9
Operating profit pre provisions	-10.5	18.7	-0.8	-8.7	-5.7	-0.4	3.7	6.1
Net earnings (UBS)	-7.8	11.4	-6.9	-3.6	-11.3	-2.6	8.8	6.2
Net DPS	-16.7	0.0	0.0	0.0	-6.7	0.0	7.1	6.7
Total assets (year end)	6.9	6.0	0.8	4.0	-2.0	-2.0	4.0	4.0
Customer loans	7.0	5.1	3.0	4.0	-3.0	-2.0	4.0	4.0
Customer deposits	7.8	5.2	-4.7	4.0	4.0	4.0	4.0	4.0

Value (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Market cap/revenues	5.1	4.0	4.2	4.4	4.6	4.6	4.5	4.3
Market cap/deposits	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
P/PPOP (diluted)	13.7	9.5	9.9	10.5	11.1	11.1	10.7	10.1
P/E (local GAAP, basic)	17.8	13.2	19.0	13.0	14.7	15.1	13.8	13.0
P/E (UBS, diluted)	15.8	11.7	13.1	13.0	14.7	15.1	13.8	13.0
Net dividend yield %	3.5	4.2	4.0	4.2	3.9	3.9	4.2	4.5
P/BV x	1.3	1.0	1.1	1.0	1.0	0.9	0.9	0.9
P/BV (UBS) x	1.3	1.1	1.1	1.0	1.0	0.9	0.9	0.9

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

VZ Holding
Upgrade to Buy

Equities

Switzerland
Diversified Financial

12-month rating	**Buy**
	Prior: Neutral
12m price target	**CHF222.00**
	Prior: CHF153.00
Price	**CHF167.40**

RIC: VZN.S **BBG:** VZN SW

Trading data and key metrics

52-wk range	CHF179.90-143.00
Market cap.	CHF1.34bn/US$1.45bn
Shares o/s	8.00m (ORD)
Free float	39%
Avg. daily volume ('000)	3
Avg. daily value (m)	CHF0.6
Common s/h equity (12/14E)	CHF0.32bn
P/BV (12/14E)	4.2x
Tier 1 ratio	-

EPS (UBS, diluted) (CHF)

	From	To	% ch	Cons.
12/14E	8.72	8.72	0.00	8.74
12/15E	10.02	10.37	3.46	9.79
12/16E	11.54	11.92	3.31	11.17

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Genuine growth and visibility have a high value – upgrade VZ to Buy

VZ offers visible, annuity-type revenues that are growing double-digit due to structural drivers. VZ should offer mid-teens profit growth for several years thanks to double digit inflow levels. VZ will continue to benefit from an ageing population seeking high-quality advice in many areas (old age saving, independent portfolio management, housing etcetera). The impact from the recent currency moves as well as negative interest rates should have a very small impact on VZ's financials and growth trajectory. Also, unlike many other Swiss financials, VZ doesn't face any material regulatory headwinds or private banking secrecy related uncertainties.

VZ trades on a 2015E PE of c16x and this could even increase

We expect some PE multiple expansion for VZ over the coming 12 months on the back of a re-acceleration of profit growth. Given expected mid- to high-teen profit growth, we expect VZ to trade on at least a c16x forward PE ratio in early 2016. In other words, VZ's share price during 2015 should increase by at least the expected 2015 profit growth (and this growth level could stay in sharp contrast to Swiss private banks that face currency headwinds in 2015).

VZ's business model is today built on more pillars

Over the years, VZ's business model has broadened successfully into adjacent areas, such as banking products and online services. The typical VZ client has CHF0.5-1 million of investable assets – an attractive client segment also from a gross margin point of view. Given a certain mix shift towards lower-margin products (passive products, all-in fee products and mortgages), we would expect modest gross margin pressure but this would be compensated by strong volume growth (NNM in the mid-teens). The roll-out of more front-end capacities and other initiatives should ensure the long-term growth profile.

Valuation: Based on a one-stage Gordon growth model

We increase our EPS by c3% throughout our forecast period. PE 2015E is 16x and goes to 14x in 2016E. At our price target, PE 2016E would stand at c18x – we think justified given the high-growth, high-quality and visible earnings trends. We see NAV per share growth at a very attractive 16% CAGR until 2017E (ROE in the mid-twenties and c45% dividend payout ratio).

Highlights (CHFm)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenues	143	153	171	195	226	257	293	334
Profit before tax	63	67	73	83	100	115	132	152
Net earnings (local GAAP)	51	54	60	69	82	94	108	125
Net earnings (UBS)	51	54	60	69	82	94	108	125
Tier 1 ratio %	-	-	-	-	-	-	-	-
EPS (UBS, diluted) (CHF)	6.48	6.92	7.61	8.72	10.37	11.92	13.73	15.80
Profitability/valuation	**12/11**	**12/12**	**12/13**	**12/14E**	**12/15E**	**12/16E**	**12/17E**	**12/18E**
ROE (UBS) %	27.7	24.9	23.4	22.9	23.4	23.1	23.1	23.2
P/PPOP (diluted)	14.2	11.7	15.2	15.9	13.2	11.5	10.0	8.7
P/BV x	4.5	3.4	4.0	4.2	3.6	3.1	2.7	2.3
P/BV (UBS) x	4.5	3.4	4.0	4.2	3.6	3.1	2.7	2.3
P/E (UBS, diluted)	17.5	14.3	18.4	19.2	16.1	14.0	12.2	10.6
Net dividend yield %	2.1	2.7	2.1	2.1	2.5	3.3	3.9	4.5

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of CHF167.40 on 06 Feb 2015 11:06 GMT

Investment Thesis

VZ Holding

12-month rating **Buy**

12m price target **CHF222.00**

Investment case

VZ's investment case offers a well-functioning, transparent, high-quality and fast-growing business model. After 'only' 10.6% year-on-year earnings growth in 2014E, we see a return to solid double-digit profit growth rates for several years to come. Net new money in the mid-teens is four times the Swiss private banks peer group average. Over the years, VZ's business model has broadened successfully into adjacent areas, such as banking products and online services. The typical VZ client has CHF0.5-1 million of investable assets – an attractive client segment also from a gross margin point of view. Given a certain mix shift towards lower-margin products (passive products, all-in fee products and mortgages), we would expect modest gross margin pressure but this would be compensated by strong volume growth (NNM in the mid-teens). The roll-out of more front-end capacities and other initiatives should ensure the long-term growth profile.

Upside scenario

A more positive view would be built around higher gross margin levels. We predict a slightly downward trend throughout 2018. A 5bp higher gross margin in 2015E could translate into 7% higher EPS. In a more bullish scenario assuming 10bp higher gross margins, we could see the fair value going to cCHF241.

Downside scenario

A more negative view would be built around lower gross margin levels. We predict a slightly downward trend throughout 2018. A 5bp lower gross margin in 2015E could translate into 7% lower EPS. In a more bearish scenario assuming 10bp lower gross margins, we could see the fair value going to cCHF200.

Upcoming catalysts

2014 full-year results: 2 March 2015
H1 2015 results: 17 August 2015

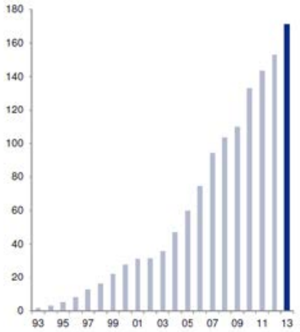
Business description

VZ Holding is an independent niche player in the Swiss financial services market. Its main business (c90% of revenues) is consulting services, in particular retirement planning, and integrated wealth management services for private clients aged above 55. The company also provides insurance and pension fund management for corporate clients. Since March 2007, VZ has been listed on the SIX Swiss Exchange.

Industry outlook

Headwinds remain manifold: On the cyclical side, we mention low, falling interest rates, low trading volumes and risk aversion. The cyclical gross margin recovery potential could be material. VZ and its peers will continue to benefit from an ageing population seeking high-quality advice in many areas (old age saving, independent portfolio management, housing etc.)

Revenues over time (CHF million)



Source: VZ Holding

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Valuation

We value VZ using a Gordon growth model. Cost of equity is 8% (down from 9% and in-line with other Swiss banks), growth 4% (up from 3%) and the sustainable ROTE is 23.1% (2016E).

VZ Holding (VZN.S)

Profit & Loss (CHFm)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Net income interest	21	21	22	22	-0.7	22	2.3	23	26	29
Total non interest income	123	132	149	173	15.8	204	17.9	235	267	305
Total income	**143**	**153**	**171**	**195**	13.7	**226**	16.2	**257**	**293**	**334**
Total cash expenses	(77)	(83)	(94)	(107)	-13.4	(122)	-14.0	(138)	(157)	(178)
Pre-depreciation operating profit	**66**	**70**	**77**	**88**	14.1	**104**	18.9	**119**	**136**	**156**
Depreciation & amort (excl. goodwill)	(3)	(3)	(4)	(4)	-10.9	(4)	0.0	(4)	(4)	(4)
Operating profit pre provisions	**63**	**66**	**73**	**83**	14.3	**100**	19.9	**115**	**132**	**152**
Total provisions	0	0	0	0	-	0	-	0	0	0
Operating profit post provisions	**63**	**66**	**73**	**83**	14.3	**100**	19.9	**115**	**132**	**152**
Income from associates & JVs (pre-tax)	0	0	0	0	-	0	-	0	0	0
Other pre-tax items	0	0	0	0	-	0	-	0	0	0
Profit before tax (UBS)	**63**	**67**	**73**	**83**	14.1	**100**	19.9	**115**	**132**	**152**
Exceptionals (incl goodwill)	0	0	0	0	-	0	-	0	0	0
Profit before tax	**63**	**67**	**73**	**83**	14.1	**100**	19.9	**115**	**132**	**152**
Tax	(12)	(13)	(13)	(14)	-11.9	(18)	-24.8	(21)	(24)	(27)
Profit after tax	**51**	**54**	**60**	**69**	14.5	**82**	18.9	**94**	**108**	**125**
Other post-tax items	0	0	0	0	-	0	-	0	0	0
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	**51**	**54**	**60**	**69**	14.5	**82**	18.9	**94**	**108**	**125**
Net earnings (before pref divs)	**51**	**54**	**60**	**69**	14.5	**82**	18.9	**94**	**108**	**125**
Net earnings (UBS)	**51**	**54**	**60**	**69**	14.5	**82**	18.9	**94**	**108**	**125**

Per share (CHF)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
EPS (local GAAP, basic)	6.48	6.92	7.61	8.72	14.5	10.37	18.9	11.92	13.73	15.80
EPS (UBS, diluted)	6.48	6.92	7.61	8.72	14.5	10.37	18.9	11.92	13.73	15.80
PPOP (diluted)	8.02	8.47	9.22	10.54	14.3	12.64	19.9	14.54	16.74	19.27
Net DPS	2.40	2.65	3.00	3.50	16.7	4.20	20.0	5.50	6.50	7.50
BVPS	25.09	29.36	34.72	40.24	15.9	46.95	16.7	54.50	62.52	71.58
BVPS (UBS)	25.09	29.36	34.72	40.24	15.9	46.95	16.7	54.50	62.52	71.58

Balance sheet (CHFm)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Banking assets (year end)	1,059	1,038	1,461	1,607	10.0	1,768	10.0	1,944	1,944	1,944
Banking assets (average)	949	1,048	1,250	1,534	22.8	1,687	10.0	1,856	1,944	1,944
Total assets (year end)	1,059	1,038	1,461	1,607	10.0	1,768	10.0	1,944	1,944	1,944
Risk weighted assets (RWA) (year end)	0	0	0	0	-	0	-	0	0	0
Risk weighted assets (RWA) (average)	0	0	0	0	-	0	-	0	0	0
Customer loans	0	0	0	0	-	0	-	0	0	0
Customer loans (average)	0	0	0	0	-	0	-	0	0	0
Interest earning assets (average)	917	1,014	1,210	1,488	23.0	1,637	10.0	1,801	1,886	1,886
Customer deposits	834	753	1,080	1,156	7.0	1,237	7.0	1,324	1,324	1,324
Common s/h equity (year end)	201	235	278	322	15.9	376	16.7	436	500	573
Common s/h equity (average)	184	218	256	300	17.0	349	16.3	406	468	536
Total SHF (equity, pref & MI) (year end)	201	235	278	322	15.9	376	16.7	436	500	573
Total SHF (equity, pref & MI) (average)	184	218	256	300	17.0	349	16.3	406	468	536
Net tangible assets	201	235	278	322	15.9	376	16.7	436	500	573

Balance sheet structure (%)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Loans / banking assets (year end)	0.0	0.0	0.0	0.0	-	0.0	-	0.0	0.0	0.0
Deposits / banking assets (year end)	78.8	72.5	74.0	71.9	-2.7	70.0	-2.7	68.1	68.1	68.1
Loans / deposits	0.0	0.0	0.0	0.0	-	0.0	-	0.0	0.0	0.0
Total SHF / banking assets (year end)	19.0	22.6	19.0	20.0	5.4	21.2	6.1	22.4	25.7	29.5

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

VZ Holding (VZN.S)

Capital adequacy (CHFm)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Tier 1 capital	0	0	0	0	0	0	0	0
Total capital	-	-	-	-	-	-	-	-
Risk weighted assets (RWA) (year end)	0	0	0	0	0	0	0	0
Core tier 1 ratio %	-	-	-	-	-	-	-	-
Tier 1 ratio %	-	-	-	-	-	-	-	-
Total capital ratio %	-	-	-	-	-	-	-	-
Tangible equity	201	235	278	322	376	436	500	573
Equity / assets %	19.0	22.6	19.0	20.0	21.2	22.4	25.7	29.5
Tangible equity to tangible assets %	19.0	22.6	19.0	20.0	21.2	22.4	25.7	29.5
Asset quality (CHFm)	**12/11**	**12/12**	**12/13**	**12/14E**	**12/15E**	**12/16E**	**12/17E**	**12/18E**
Non performing assets	0	0	0	0	0	0	0	0
Total risk reserves	0	0	0	0	0	0	0	0
NPLs / loans %	-	-	-	-	-	-	-	-
NPL coverage %	-	-	-	-	-	-	-	-
Provision charge / average loans %	-	-	-	-	-	-	-	-
Net NPAs / shareholders funds %	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Profitability (%)	**12/11**	**12/12**	**12/13**	**12/14E**	**12/15E**	**12/16E**	**12/17E**	**12/18E**
Net interest margin (avg assets)	2.21	2.05	1.73	1.40	1.30	1.21	1.32	1.50
Provisions / operating profit	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ROE (UBS earnings)	27.7	24.9	23.4	22.9	23.4	23.1	23.1	23.2
RoAdjE (UBS earnings & equity)	27.7	24.9	23.4	22.9	23.4	23.1	23.1	23.2
RoRWA (UBS)	-	-	-	-	-	-	-	-
RoA (UBS earnings)	5.37	5.18	4.80	4.48	4.84	5.06	5.56	6.40
Productivity (%)	**12/11**	**12/12**	**12/13**	**12/14E**	**12/15E**	**12/16E**	**12/17E**	**12/18E**
Cost income ratio	56.0	56.6	57.5	57.3	55.9	55.4	55.0	54.6
Cost / average assets	8.47	8.27	7.88	7.27	7.50	7.68	8.29	9.38
Compensation expense ratio	47.9	48.3	48.9	48.7	47.5	47.2	46.9	46.7
Growth (%)	**12/11**	**12/12**	**12/13**	**12/14E**	**12/15E**	**12/16E**	**12/17E**	**12/18E**
Revenue	8.0	6.8	11.7	13.7	16.2	13.7	14.0	14.0
Operating profit pre provisions	2.8	5.4	9.4	14.3	19.9	15.0	15.2	15.1
Net earnings (UBS)	3.4	6.4	10.6	14.5	18.9	15.0	15.2	15.1
Net DPS	4.3	10.4	13.2	16.7	20.0	31.0	18.2	15.4
Total assets (year end)	26.0	-1.9	40.7	10.0	10.0	10.0	0.0	0.0
Customer loans	-	-	-	-	-	-	-	-
Customer deposits	27.5	-9.8	43.6	7.0	7.0	7.0	0.0	0.0
Value (x)	**12/11**	**12/12**	**12/13**	**12/14E**	**12/15E**	**12/16E**	**12/17E**	**12/18E**
Market cap/revenues	6.3	5.2	6.6	6.9	5.9	5.2	4.6	4.0
Market cap/deposits	1.1	1.1	1.0	1.2	1.1	1.0	1.0	1.0
P/PPOP (diluted)	14.2	11.7	15.2	15.9	13.2	11.5	10.0	8.7
P/E (local GAAP, basic)	17.5	14.3	18.4	19.2	16.1	14.0	12.2	10.6
P/E (UBS, diluted)	17.5	14.3	18.4	19.2	16.1	14.0	12.2	10.6
Net dividend yield %	2.1	2.7	2.1	2.1	2.5	3.3	3.9	4.5
P/BV x	4.5	3.4	4.0	4.2	3.6	3.1	2.7	2.3
P/BV (UBS) x	4.5	3.4	4.0	4.2	3.6	3.1	2.7	2.3

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

EFG International Investment case

We like the EFG Int. investment case primarily for three reasons: 1) Various forward looking indicators like (gross) hiring remain strong in our opinion and they should translate into profit growth over the coming three years. 2) We see a rising dividend both in absolute terms and in terms of pay-out ratio. We see the H1 2014 CET 1 ratio of 14% (target is "low teens") increasing to c16% in 2016E even assuming that the dividend increases to CHF0.45 in 2016E (dividend yield c4.5%, up from 3% in 2015E). 3) excess capital of some CHF300m at end-2016 offers strategic flexibility and the opportunity to further increase the dividend payout ratio or to announce a share buyback programme or to make EPS accretive acquisitions. Since the announcement of the strategic review in October 2011, EFG has delivered tangible results in terms of business location streamlining, capital structure, EFG FP IPO and general cost cutting.

Julius Baer Group Investment case

We like the Julius Baer investment case for three reasons: 1) decent 4-6% net new money, some positive market performance and at least stable gross margin should translate into mid- to high-single digit top-line growth. Gross margin trends in IWM are promising and bode well for 2015 too. 2) Working down legacy topics: the legalisation of the back-book should largely be accomplished in 2015 and the US tax dispute should be solved too, potentially resulting in a multiple expansion. 3) Excess capital of more than CHF600m at the of end-2015 (that's including a US tax dispute charge) offers strategic flexibility and the opportunity to further increase the dividend payout ratio or to announce a share buyback programme or to make EPS accretive acquisitions (similar to eg, Bank Leumi). Consolidation looks set to pick up in Switzerland as discussed in previous research (eg, 5 Sept 2014 Swiss banks report).

St Galler Kantonalbank Investment case

SGKB is, in our view, a well-run company when it comes to its core businesses, retail and corporate banking. The risk policy is conservative and the asset quality is well managed. Nevertheless, SGKB is not immune to various adverse sector headwinds, such as in private banking or those driven by low interest rates.

VZ Holding Investment case

VZ's investment case offers a well-functioning, transparent, high-quality and fast-growing business model. After 'only' 10.6% year-on-year earnings growth in 2014E, we see a return to solid double-digit profit growth rates for several years to come. Net new money in the mid-teens is four times the Swiss private banks peer group average. Over the years, VZ's business model has broadened successfully into adjacent areas, such as banking products and online services. The typical VZ client has CHF0.5-1 million of investable assets – an attractive client segment also from a gross margin point of view. Given a certain mix shift towards lower-margin products (passive products, all-in fee products and mortgages), we would expect modest gross margin pressure but this would be compensated by strong volume growth (NNM in the mid-teens). The roll-out of more front-end capacities and other initiatives should ensure the long-term growth profile.

Partners Group Holding AG Investment case

Partners Group is trading at a significant premium to its Swiss asset manager/wealth manager peers. We think this is justified, given the significantly higher net new money growth compared with peers, fewer structural headwinds as well as the relatively high predictability of earnings. Partners Group is expanding 'new' areas, such as private infrastructure and private real estate. Partners Group has built up a strong private equity track record – whether or not it will be similarly successful in these new fields remains to be seen.

Statement of Risk

All the companies in this report are exposed to a number of risks, including market risks, such as exchange rate and interest rate fluctuations, the conditions and the activity level of the capital markets, regulatory and taxation changes, pressure on Swiss banking secrecy, pressure on private banking offshore centres from various bodies, reputational risks, tax amnesties, and macroeconomic conditions, especially in Switzerland, Germany and Austria. In addition, the banks' earnings situation is subject to secular trends in the wealth management industry, such as growth and concentration of the managed assets.

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12-Month Rating	**Definition**	**Coverage**[1]	**IB Services**[2]
Buy	FSR is > 6% above the MRA.	47%	37%
Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	11%	21%
Short-Term Rating	**Definition**	**Coverage**[3]	**IB Services**[4]
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 31 December 2014.
1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Banque Cantonale Vaudoise[5]	BCVN.S	Sell	N/A	CHF558.00	05 Feb 2015
Cembra Money Bank AG[5, 59]	CMBN.S	Buy	N/A	CHF56.75	05 Feb 2015
Credit Suisse Group[5, 16]	CSGN.VX	Neutral	N/A	CHF20.20	05 Feb 2015
EFG International[2, 4, 5]	EFGN.S	Neutral	N/A	CHF10.30	05 Feb 2015
GAM Holding Ltd[4, 5, 18]	GAMH.S	Buy	N/A	CHF16.70	05 Feb 2015
Julius Baer Group[2, 4, 5]	BAER.VX	Neutral	N/A	CHF41.88	05 Feb 2015
Leonteq AG[5]	LEON.S	Neutral	N/A	CHF218.20	05 Feb 2015
Partners Group Holding AG[4, 5]	PGHN.S	Neutral	N/A	CHF262.25	05 Feb 2015
St Galler Kantonalbank[5]	SGKN.S	Neutral	N/A	CHF357.50	05 Feb 2015
Vontobel[5]	VONN.S	Neutral	N/A	CHF32.65	05 Feb 2015
VZ Holding[5, 59]	VZN.S	Neutral	N/A	CHF167.20	05 Feb 2015

Source: UBS. All prices as of local market close.
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