December 2023

UBS Group

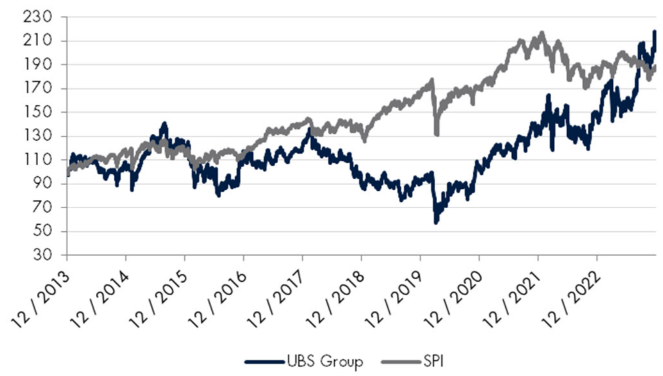
Market profile

Country	Switzerland
Sector	Financial
Market cap (CHF bn)	84.4
52-week high / low (CHF)	25.4 / 14.2

Key metrics (CHF)

	2022	2023e	2024e
EPS (CHF)	1.96	0.99	1.44
PE	8.8x	24.6x	16.9x
Dividend Yield	2.7%	2.3%	2.6%

Evolution of stock price with respect to benchmark (rebased)



Executive summary

Even before its acquisition of Credit Suisse, UBS was already the biggest domestic bank in Switzerland, as well as a leading wealth manager worldwide. UBS is active in wealth and asset management services, along with personal, corporate, and investment banking.

The Group has a presence in almost 50 countries and employs over 120'000 people (including Credit Suisse pro-forma at the time of the acquisition) representing 150 nationalities.

UBS's businesses are organized globally into four business divisions: Global Wealth Management (55% of revenues), Personal & Corporate Banking (12%), Asset Management (9%) and the Investment Bank (25%).

The largest proportion of revenues (40%) stems from the Americas region, which is mostly the USA. For this reason UBS reports its figures in USD.

Switzerland represents 22% of revenues and UBS is the clear market leader, serving over 2.6 mn clients through 194 branches (UBS stand-alone before the Credit Suisse acquisition)

While revenues are somewhat cyclical, UBS is positioned in attractive and growing segments (wealth and asset management) in lucrative geographies (USA & Asia).

The bank has shown steady progress on its profitability measures over the last 4 years. This will be momentarily halted due to the integration of Credit Suisse, but longer term, profitability should reach even higher levels which warrants a higher share price.

UBS Group

Daniel Pfund, Senior Financial Analyst **December 2023**

Company description

Even before its acquisition of Credit Suisse, UBS was already the biggest domestic bank in Switzerland, as well as a leading wealth manager worldwide. UBS is active in wealth and asset management services, along with personal, corporate, and investment banking.

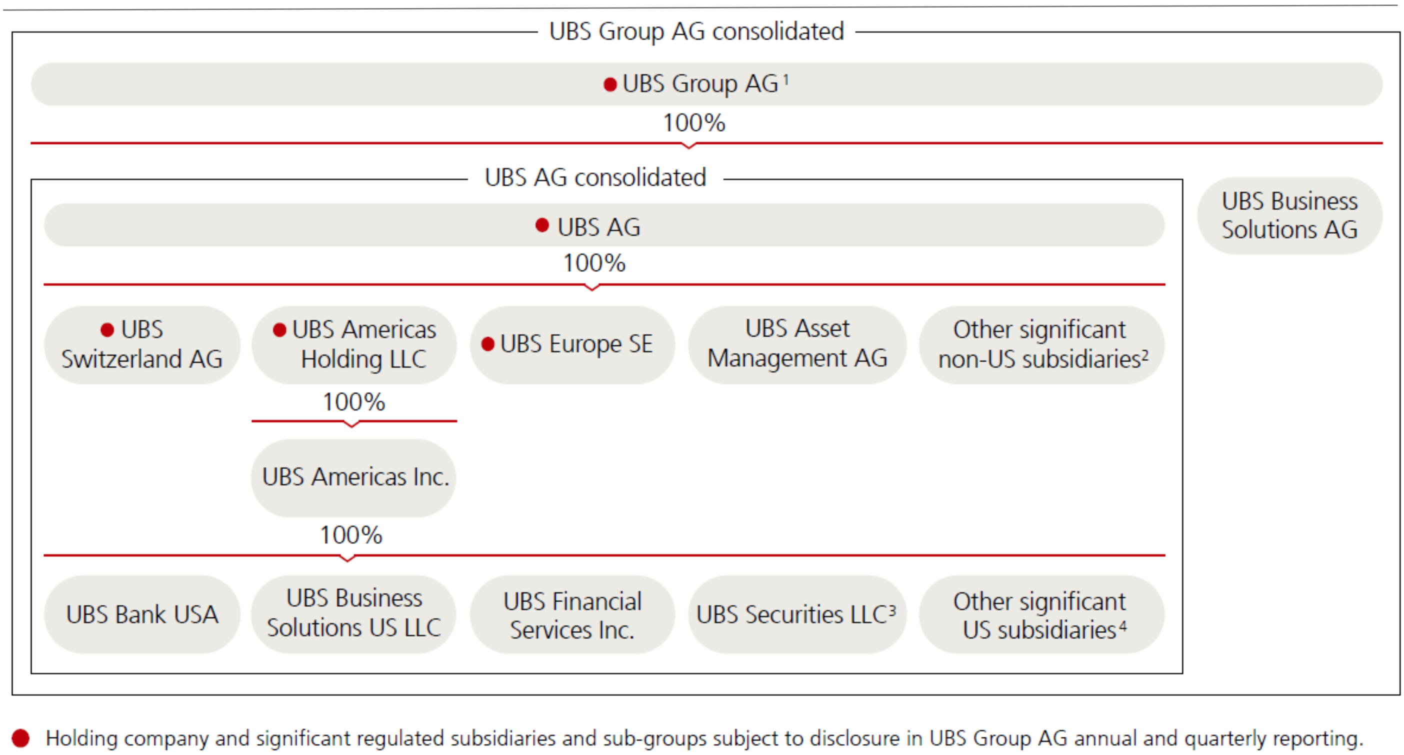
The Group has a presence in almost 50 countries and employs over 120'000 people (including Credit Suisse pro-forma at the time of the acquisition) representing 150 nationalities. UBS is dedicated to being a world-class employer for talented individuals and seeks to strengthen their unique culture to provide a framework for employee growth and well-being. Worldwide, at the end of 2022 the group had about USD 4 trillion in invested assets (before the Credit Suisse acquisition), making it one of the biggest wealth and asset managers in the world.

The financial group is dedicated to ESG principles and actively promotes the participation of women (41% of the workforce) and targets 30% global female representation at Director level and above by 2025 (the percentage was 28% at the end of 2022).

About 28% of the employees are in Switzerland, 30% in the Americas, 22% in Asia Pacific, and 20% in the EMEA region (Europe, ex-Switzerland, Middle-East and Africa). The average years of service of employees is 8 years.

UBS' self-stated purpose is "reimagining the power of investing. Connecting people for a better world.".

Fig.1: UBS's legal structure
Source: Company data, IAM research



Albeit a Swiss company, UBS reports its figures in US dollars. As we will see, the Americas region makes up the lion share of its revenues, so it makes sense to report in USD. All figures in this report are in USD unless otherwise stated (notable exceptions are per share figures in CHF).

UBS's businesses are organized globally into four business divisions: Global Wealth Management, Personal & Corporate Banking, Asset Management and the Investment Bank. All four business divisions are supported by Group Functions and qualify as reportable segments for the purpose of segment reporting. Together with Group Functions, the four business divisions reflect the management structure of the Group.

– **Global Wealth Management** (55% of revenues in 2022) provides financial services, advice and solutions to private wealth clients. Its offering ranges from investment management to estate planning and corporate finance advice, in addition to specific wealth management and banking products and services.

– **Personal & Corporate Banking** (12%) serves its private, corporate, and institutional clients' needs, from banking to retirement, financing, investments and strategic transactions, in Switzerland, through its branch network and digital channels.

– **Asset Management** (9%) is a global, large-scale and diversified asset manager. It offers investment capabilities and styles across all major traditional and alternative asset classes, as well as advisory support to institutions, wholesale intermediaries and wealth management clients.

– The **Investment Bank** (25%) provides a range of services to institutional, corporate and wealth management clients globally, to help them raise capital, grow their businesses, invest and manage risks. Its offering includes research, advisory services, facilitating clients raising debt and equity from the public and private markets and capital markets, cash and derivatives trading across equities and fixed income, and financing.

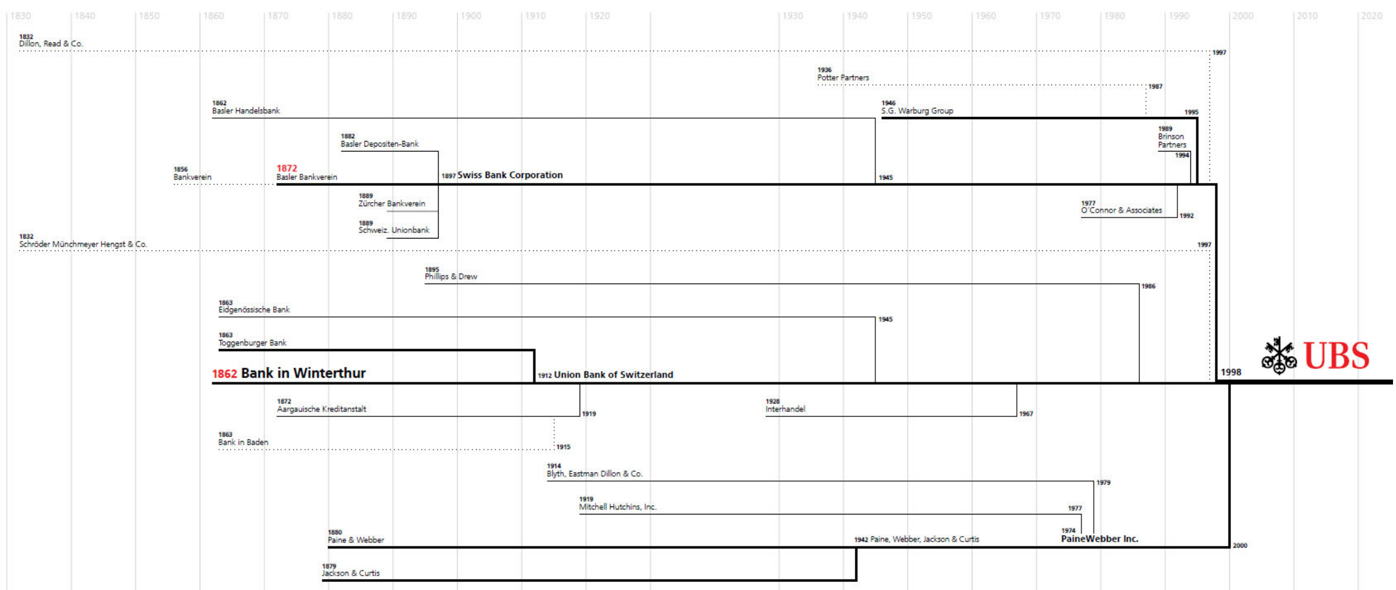
– **Group Functions** (cost center: –1% of revenues) is made up of the following major areas: Group Services (which consists of Chief Digital and Information Office, Communications & Branding, Compliance, Finance, Group Sustainability and Impact, Human Resources, Group Legal, Regulatory & Governance, and Risk Control), Group Treasury and Non-core and Legacy Portfolio.

History of the company

The origins of UBS trace back directly to Bank in Winterthur, which was founded in 1862. Since then, many financial institutions have become part of the history of the

Fig.2: UBS (stand-alone) history

Source: Company data, IAM research



current UBS Group and helped shape its development. 1998 was a major turning point: two of the three largest Swiss banks, Union Bank of Switzerland and Swiss Bank Corporation (SBC), merged to form UBS. Both banks were well established and successful. Union Bank of Switzerland had grown organically to become the largest Swiss bank. In contrast, SBC had grown mainly through strategic partnerships and acquisitions, including S.G. Warburg in 1995.

In 2000, UBS acquired PaineWebber, a US brokerage and asset management firm with roots going back to 1879, establishing the Swiss bank as a significant player in the US. For nearly 60 years, UBS has also been building a strong presence in the Asia Pacific region, where they are by far the largest wealth manager, with asset management and investment banking capabilities.

After incurring significant losses in the 2008 financial crisis, the group sought to return to its roots, emphasizing a client-centric model that requires less risk-taking and capital. In 2011, UBS started a strategic transformation of their business model to focus on their traditional businesses: wealth management globally, and personal and corporate banking in Switzerland.

On Sunday, the 19th of March 2023, UBS acquired Credit Suisse, its cross-town archrival in a deal termed as an "emergency rescue". While the sheer size of the deal would have made such an acquisition impossible, it was the free fall of Credit Suisse and its imminent demise that called for such a mega-merger. With the blessing of the Swiss government, FINMA, SNB, and the ComCo, UBS snatched Credit Suisse for a meagre CHF 3 billion, in an all-share deal (1 new UBS share per 22.48 Credit Suisse shares).

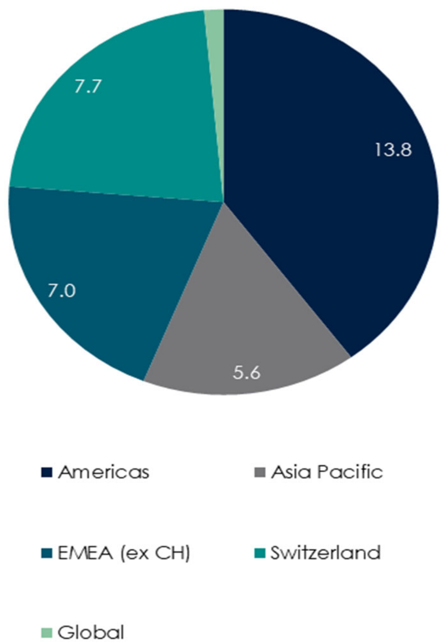
Today, UBS is a leading and truly global wealth manager, a leading Swiss personal and corporate bank, a global, largescale, and diversified asset manager, and a focused investment bank.

Geographic exposure

The revenue breakdown by region is shown in Figure 3. The Americas region makes up 40% of revenues, almost the double of Switzerland (22%). For UBS, the Americas regions is essentially the United States of America.

Fig.3: Revenues by region (USD bn, 2022)

Source: Company data, IAM research



Industry Overview & Competitive positioning

UBS has a global and diversified business model.

Regionally, more than half of the group's wealth management clients' invested assets are in the US, which is the largest wealth pool globally. In this region, UBS is focused on improving scale and profitability by deepening their relationships with core clients and by building out Global Wealth Management's digital-led capabilities and banking platform.

In Asia Pacific, which is the fastest-growing wealth market, UBS is by far the largest wealth manager and is capitalizing on that scale to drive growth. They are also further developing their onshore business in China and working to offer their capabilities in a more cohesive way to all their clients in Southeast Asia.

In EMEA, UBS is focused on improving profitability and driving growth, by streamlining their domestic footprint and providing holistic coverage for entrepreneurs.

Finally, in Switzerland, UBS has a highly integrated business and aims to expand their lead as the #1 universal bank. UBS is driving the digital transformation, improving the client experience, and focusing on capturing selected growth opportunities.

Investing in technology is a key cornerstone of success in the rapidly evolving world of financial services. UBS has a vast array of different technology components that they inherited through their various acquisitions. A major task of UBS's information technology team is to simplify these systems. To give an idea of the huge work involved, UBS removed approximately 39'000 legacy components in 2022 alone, and decommissioned more than 600 applications, as a step to modernize their technology estate and enhance their cybersecurity position. We can attest that UBS is extremely security conscious to the point of having one of the most stringent security checked app on the Google Play store and Apple app store.

In the Global Wealth Management division, UBS is investing heavily to strengthen their capabilities in serving their clients with the most sophisticated needs through their Global Family & Institutional Wealth (GFIW) offering. The GFIW offering addresses the execution, investment, risk managing, financing and banking needs of family offices and their corporate entities, as well as entrepreneurs. Competitors in this division fall into two categories: competitors with a strong position in the Americas, but more limited global footprints, such as Morgan Stanley and JPMorgan Chase; and competitors with similar international footprints but with a smaller presence than UBS in the US, such as Julius Baer.

The Personal & Corporate Banking division operates primarily in the Swiss market. In this division, UBS is organized into 10 regions, covering distinct Swiss economic areas. As in other divisions, UBS operates a multichannel approach and is constantly developing their digital and remote channels in order to gain market share. Their main competitors in Personal Banking are Raiffeisen banks, the cantonal banks, PostFinance, and other regional and local Swiss banks. With the integration of Credit Suisse, UBS will be a local behemoth, and might lose quite a few clients that were diversifying between the two big banks (especially corporates). Areas of competition are basic banking services, mortgages, and foreign exchange, as well as investment mandates and funds. In this division, UBS also faces competition from international neobanks and other national digital market participants. UBS is proud to have been named "Best Bank in Switzerland", serving over 30% of the Swiss population (over 2.6 million clients) through their 194 branches all over the country. These figures are all on a stand-alone basis (before the Credit Suisse acquisition).

In Corporate & Institutional Clients, the cantonal banks, and globally active foreign banks are the main competitors. UBS has competition in basic banking services, cash management, trade and export finance, asset servicing, investment advice for institutional clients, corporate finance and lending, and cash and securities transactions for banks. UBS has a strong position in Switzerland, serving over 100'000 corporate and institutional clients (representing over 90% of large Swiss corporations).

Asset Management is a global, large-scale and diversified asset manager with USD 1.1 trn in invested assets. It is UBS' most profitable division because it also serves

Fig.4: UBS' revenues over time (mn CHF)

Source: Company data, IAM research

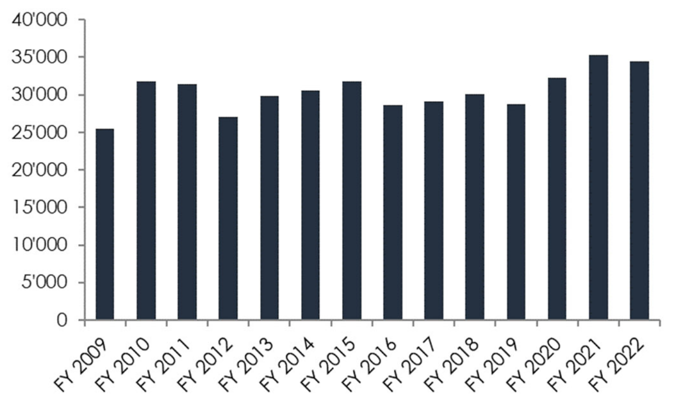
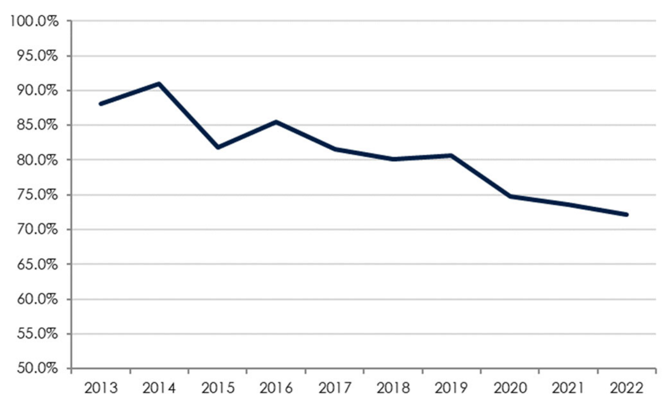


Fig.5: UBS' costs to income ratio over time

Source: Company data, IAM research



UBS' Wealth Management. Asset management is a scale business, as almost all the costs are fixed, and any net new revenue falls immediately to the bottom line. Investment funds compete on costs measured in basis points (0.01%) and clients can easily and rapidly transfer their funds from one asset manager to another.

UBS' investment bank is major player worldwide with analysts based in 22 countries with coverage of more than 3000 stocks in 49 different countries. The bank's main competitors are major global investment banks such as Morgan Stanley and Goldman Sachs, as well as corporate investment banks (Bank of America, Barclays, Citigroup, BNP Paribas, Deutsche Bank and JPMorgan Chase).

Financial analysis

Growth

The chart in Figure 4 shows UBS' revenues since 2009. Over the 13 years period, the compound annual growth rate was 2.3%. Over the shorter period of the last 5 years, the compound annual growth rate was slightly higher at 3.4%. Overall, this is quite disappointing for such a bank behemoth as UBS. Even if the banking industry is mature, UBS should be gaining market share and grow faster. Management's target is for growth of more than 5% over the economic cycle.

With the integration of Credit Suisse, UBS will have even higher market shares, which should allow the company to reach its 5% growth target.

Margins

Financial companies don't publish operating margins like all other companies. They compare their costs to their income and publish a cost/income ratio. Probably because their costs are mostly fixed, and revenues are more cyclical. This could imply that costs are higher than revenues, and publishing a negative operating margin would make no sense.

Figure 5 shows UBS' cost/income ratio over time. This is the inverse of an operating margin, so the lower the better. We can see that in the last decade, UBS has been making steady progress in reigning in costs (as well as being helped by revenue growth).

With the integration of Credit Suisse, costs will likely jump in the short term. But after a couple of years, we would expect the group to be able to show once again a lower cost/income ratio. Management targets a ratio (pre-acquisition) of 70-73%.

Dividends

UBS' dividend over time is shown in Figure 6 with the corresponding dividend yield. We can see that dividends are somewhat erratic, but the company aims to maintain one (it was cut during the Great Financial Crisis of 2008/2009). It seems like the company tries to target the dividend to be around 3% of the share price.

We would like to remind investors that dividends are not a tax efficient way to return capital. Indeed, the dividend comes from money the company already paid taxes on, as it cannot deduct it as an expense. Afterwards, the investor is also taxed on this same amount (35% at source), so there is a double taxation of the distributed dividend. In contrast, share buybacks are a more efficient way to

Fig.6: Dividend per share in CHF and dividend yield (rhs)

Source: Company data, IAM research

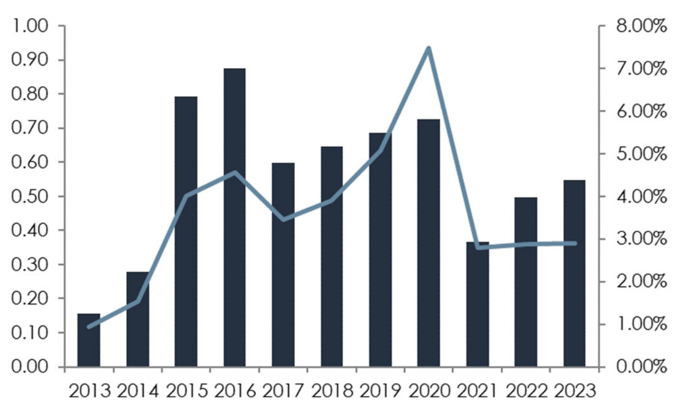
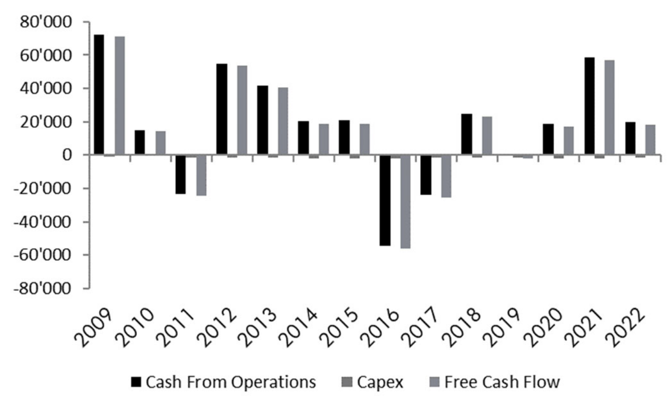


Fig.7: UBS' cash flow over time

Source: IAM research



return capital back to shareholders, as they are only taxed at the company level.

Fortunately, UBS is also buying back their own shares regularly (although not every year). But unfortunately, it's not always evident that this money goes towards improving the earnings per share. In fact, UBS distributes shares to its employees as variable bonuses (quite common in the financial industry), which of course increases the number of shares outstanding over time. Buybacks try to counter mostly this dilution, as the number of shares outstanding has been steady around 3.7 bn.

Free Cash Flow

Free cash flow (FCF) is an essential component of any company and can be considered its life blood. Free cash flow refers to the cash a business generates after is has accounted for the outflow of money towards operations and maintaining capital assets. It is from FCF that the company can decide to either reimburse debt (capital allocation), make acquisitions (mergers & acquisitions), or distribute cash to shareholders (dividends and share buybacks).

As we can see in Figure 7, UBS' free cash flow is almost identical to its operating cash flow. That's because banking is an intangible business and capital expenditures are minor expenses (a so called "asset light" business model). Most of UBS' costs are employee costs. Most capex costs are IT related, and UBS needs to invest massively in this sector in order to remain first in class. Historically, the company spends about 5% of sales on capital expenditures.

Fig.8: UBS' Return On Equity (ROE)

Source: Company data, IAM research

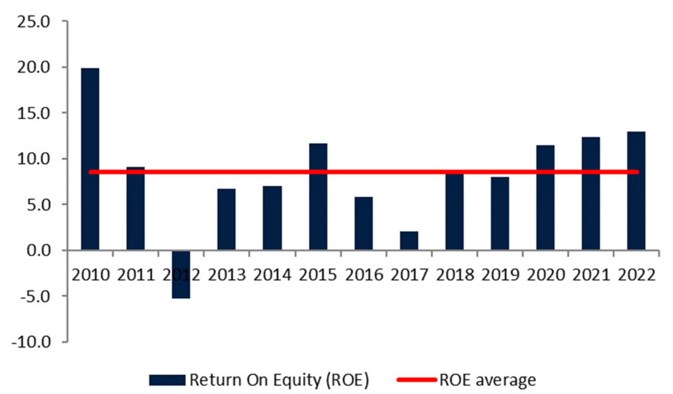
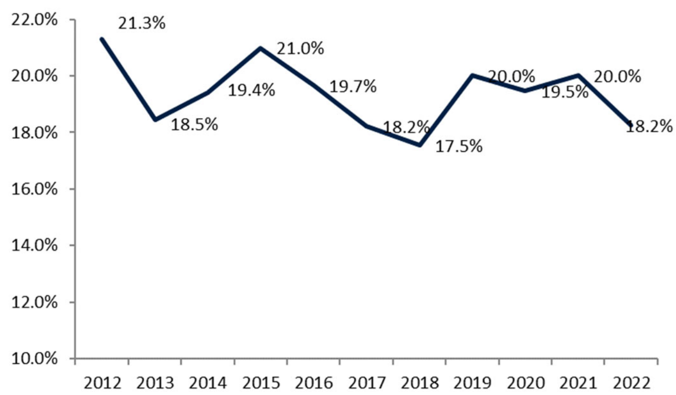


Fig.9: Tier1 Capital / Risk Weighted Assets

Source: Company data, IAM research



The figure also shows how cyclical this business remains. Although UBS tries to focus on less cyclical businesses such as wealth management, only a minor proportion of revenues come from fixed fees. The rest comes from market dependent outcomes (trading fees, and investment banking).

Return on Equity

Figure 8 shows UBS' return on equity (ROE) over the last 12 years. The average is 8.5%. ROE was negative from 2007 to 2009.

For a company to add economic value, its ROE should be above its cost of equity. The cost of equity can be calculated with the risk free rate, the market return and the beta. Which beta to use can be subjective, so this is not a science. We take the current risk free rate from the Swiss National Bank's deposit rate of 1.75%. Using an adjusted beta of 1.3 and historic market return of 8%, we find a cost of equity of 9.9%. This means that UBS is not adding economic value with its average ROE of 8.5%. Nevertheless, the ROE trending path is higher and in 2022, UBS reached 13% ROE. This is one metric that will need to be followed closely for shareholders to be remunerated correctly.

Balance Sheet

The balance sheet of a bank is a crucial component of the trust clients have with their financial institution. This was what precipitated the demise of Credit Suisse. Trust and reputation take a lifetime to acquire, but can vanish extremely quickly. For these reasons, banks are highly

Fig.10: 12M forward P/E over last decade

Source: IAM research

regulated (by the FINMA in Switzerland, and equivalent authorities in each country).

UBS had deep financial distress during the Great Financial Crisis of 2008/2009 to the point where the Swiss government had to intervene to save the bank. As a consequence, the government enacted laws to avoid such distress again in the future (although we can debate if they functioned correctly in Credit Suisse's case). These laws required banks to increase their capital reserves as a proportion of the risks they took. One measure of capital reserves is comparing the core equity tier1 (shareholder money) to the risk weighted assets the bank has invested in.

The chart in Figure 9 shows UBS' core equity tier1 capital compared to its risk weighted assets. We can see that UBS is adequately capitalized, and the ratio remains in a fairly tight range of 17.5—21.3%.

Investment case

UBS is a shareholder friendly company. They have set targets for management that are inline with shareholder value creation. Financial targets include 15-18% Return on CET1 Capital, 70-73% Cost/Income ratio, and 10-15% Global Wealth Management profit before tax growth. The company also targets Capital ratios that go above the minimum requirements set by the FINMA: 13% CET1 capital ratio, >3.7% CET1 leverage ratio, and >5bn USD share repurchases (this target is likely postponed now with the Credit Suisse acquisition). Commercial growth targets include reaching over 6 trillion USD in invested assets across global wealth management, asset management, and personal & corporate banking; and finally the group targets >5% net new fee-generation assets growth over the cycle.

We acknowledge that reaching some of these targets will be more difficult and take more time now with the acquisition of Credit Suisse. We will probably have to wait a couple of years for the integration to be complete, as UBS is entering now the difficult phase of implementation. The low-hanging fruits of cost-cutting and trimming unprofitable business is almost over. After this crucial phase, we believe the CEO will retire and leave the job to a younger person, probably from the internal ranks, as Mr. Ermotti stated several times that he would prefer someone with knowledge of the UBS culture.

Valuation

The chart in Figure 10 depicts UBS' price to earnings (P/E) multiple over the past decade and its average (11.6x). As we can see, the P/E multiple is at the top of its historic range. The main culprit is that earnings are depressed due to the integration costs of Credit Suisse. As a long-term investor, we can look further than the current depressed situation, and use another valuation metric that is relevant to banks: the price to book ratio.

The chart in Figure 11 depicts UBS's price to book (P/B) ratio over the last decade and its average (1.15x). There is a strong correlation between banks' P/B ratios and their profitability (ROE). If UBS can reach their 15% return on CET1 capital target, we believe the shares should reprice higher accordingly (closer to 1.5x P/B).

Fig.11: P/B over last decade

Source: IAM research