AFS – UBS Dividend Report

Dividend Policy

From the 2017 annual report:

"Our aim is to further increase returns to shareholders while building on our strong capital position. Going forward, our priority is to pay an ordinary dividend, growing at mid-to-high single-digit percentage per annum, while considering supplementary returns, most likely in the form of share buybacks."

UBS' dividend has been exempt of withholding taxes as it has been paid out of capital contribution reserves the past years.

Financial Calendar

15 March 2019	Publication annual report
25 April 2019	Q1 2019 results
2 May 2019	Annual General Meeting
6 May 2019	Ex-dividend date
23 July 2019	Q2 2019 results
22 October 2019	Q3 2019 results

https://www.ubs.com/global/en/about_ubs/investor_relations/ubs_events.html

French Tax Evasion Case

French prosecutors imposed a EUR 3.7 billion fine and EUR 800 million in civil damages on UBS for helping its clients evade taxes. The bank already tried to settle the matter with the authorities in 2014 and 2016, to no avail. UBS said that it will appeal against the fine and argues that the French court doesn't have "any concrete evidence" to support its case. It also claimed that the calculation of the fine is contradictory as the EUR 620 million in foregone taxes is only a fraction of the imposed fine. UBS' complete rebuttal can be found here.

UBS has set aside USD 640 million in legal provisions for its Wealth Management business, meaning that it would need to reserve approximately USD 4.5 billion to cover the total charges. This is just below last year's net profit of USD 4.9 billion. As a result, there have been some concerns about the impact of the fine on UBS' dividend.

CEO Sergio Ermotti said last month that the bank will provide more details on the implications of the fine when the annual report is published, thus next week. General Counsel Markus Diethelm confirmed at the same time that as long as the process is unsolved, thus under appeal, the bank won't take any additional charges for the matter. The bank indicated that the appeal could take up to two years. If the appeal is rejected, UBS could start another appellate process that could last an additional two years.

Capital Position

UBS' CET1 ratio stood at 13.1% at the end of 2018 and it aims to keep the balance around 13% until the end of 2021. Furthermore, the current leverage ratio of 3.8% is in line with the bank's 3.7% mid-term target. The Swiss National Bank has imposed a minimum CET1 ratio of 10% and a leverage ratio of at least 3.5% by the start of 2020. If UBS is ordered to pay the French tax fine, its CET1 ratio would decrease by approximately 170 bps to 11.4%. The leverage ratio would drop to 3.3%, thus below the minimum requirement set by the Swiss regulators.

UBS expects its return on CET1 capital to be around 15% this year, equivalent to approximately USD 5.2 billion in net profit. A 5 cent increase of the 2019 dividend to CHF 0.75 per share, in line with last year's dividend hike, is equal to a distribution of USD 2.9 billion. The USD 2.3 billion in generated capital will be sufficient to cover the USD 1.6 billion needed to recover the leverage ratio to 3.5% by the end of the year, in case a fine has to be paid this year.

UBS is expected to accrue approximately 85 bps of capital after dividends in 2019 based on the aforementioned estimates. This means that the CET1 ratio can recover to 13% in two years, providing it stops repurchasing shares.

Share Repurchases

As stated in the dividend policy, UBS considers repurchasing shares when the capital position allows it, basically if the CET1 ratio is above 13%. The bank repurchased CHF 750 million worth of shares last year and plans to repurchase USD 1 billion of shares in 2019. However, UBS will be forced to stop repurchasing shares if the appeal against the fine is rejected as the fully-loaded CET1 ratio will decrease well below 13% as a result. On the other hand, UBS will have sufficient room to keep repurchasing at least USD 1 billion worth of shares a year and keep the fully-loaded CET1 ratio above 13% if the fine is scrapped or significantly lowered.

Dividend Withholding Taxes

UBS has paid out its dividend from the capital contribution reserves the past years, thus free of the 35% Swiss withholding tax. There will be CHF 27.5 billion of the balance left after the dividend over 2018 is paid out in May. However, only CHF 15.3 billion of the reserve is available to distribute free of withholding taxes. As a result, UBS will be able to pay out a tax-free dividend for another four to five years. The dividend over 2022, payable in 2023, thus likely is the last completely tax-free distribution.

AFS Dividend Comment

CEO Sergio Ermotti said last month that the 2018 dividend of CHF 0.70 per share will be paid out no matter what. Yet he didn't commit to a dividend payment over 2019. This could open up the possibility of a dividend cut. However, I don't expect the 2019 dividend to be cut in wake of the fine.

Firstly, UBS will appeal against the charges, a process that takes up to two years. If the appeal is rejected, the bank has the option for a further retrial of the fine, buying itself even more time. Furthermore, UBS rakes in enough capital to fully pay the potential fine and restore its CET1 ratio within two years just by halting its share buyback program. In case the fine is reduced to the EUR 620 million in foregone taxes, it might even proceed with repurchasing shares at the current pace.

As a result, I expect UBS to raise its dividend over 2019 in line with the dividend policy to CHF 0.75 per share. As mentioned above, I expect this dividend to be stay free of withholding taxes. The 2020 dividend future last traded at CHF 0.655 on 22 February, down from CHF 0.68 before the French fine was announced.

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