Wells Fargo & Co (NYSE: WFC)

Sector: Financial Services

Target Price	Current Price	52 Week High	52 Week Low	P/E	Market Cap.	Dividend Yield	Beta
$54.09	$45.75	$56.34	$44.50	11.24	$230.8B	3.32%	0.86

Business Description

Wells Fargo & Co is a diversified, community-based financial services company with $1.9 trillion in assets. WFC operates in three main business segments: Community Banking, Wholesale Banking, and Wealth and Investment Management. Community Banking, responsible for half of the company's revenue, offers retail and small business banking services as well as consumer lending. Wholesale Banking provides financial solutions to businesses across the United States. The majority of revenue in this business segment comes from commercial banking services. Wealth and Investment Management offers financial advisory, wealth management, brokerage, retirement, trust, and reinsurance services.

Industry Trends

The banking industry has been underperforming in 2016 due a low interest rate environment. U.S. regional banks have fallen 6% in 2016 versus a 7% gain for the S&P 500. Banks in the United States are positioned for increased profits when the Federal Reserve raises interest rates as this will result in an increase in interest rate margins. Regional bank revenues have stayed consistent over the past five years. The industry has seen slower growth in recent years due to increased regulation and capital reserve requirements since 2010.

Investment Thesis

Wells Fargo & Co provides a strong buy opportunity, especially after the recent drop in share price, because 1) they are best positioned to capitalize on more normal interest rates among banks, 2) their risk management prowess has led to industry leading financial strength, and 3) they have begun to focus on areas of their business in which their market share is lower. WFC's sharp focus on retail banking has seen the bank's customer base grow to 1 of every 3 households in the US, creating significant cost advantages from a cheap funding source that is essential in a regulatory environment where expenses are mounting. Gains from higher interest rates could reach 5%. From a financial health standpoint, WFC maintains very healthy capital levels, with a ROE of 12.2% that easily outpaces a comparable average of 8.73%, and an impressive 3.30% dividend yield, greater than the comparable average of 2.54%. Finally, the growth of WFC's treasury management, cards, and investment banking divisions has outpaced peers. These business lines, within Wholesale Banking largely, offer protection from a decline in retail customers, provide profitable opportunities for cross-selling and relationship building, and can easily leverage existing technological and infrastructural advantages.

Valuation Assumptions

WACC: 4.07%
Terminal FCF Growth Rate: 2.0%
Provision for Loan Loss Rate: 16.5%
Estimated EPS: 4.48; Avg P/E: 12.42x
Estimated BVPS: 37.89; Avg P/B: 1.04x

Key Financials

ROA: 1.2%
ROE: 12.2%
Profit Margin: 25.5%
Total Loans to Deposit: 76.5%
Efficiency Ratio: 57.3%

Corporate Social Responsibility

ESG Disclosure Score: 51.32 (Industry average: 29.40)
Sustainalytics ESG Score: 60.18 (Industry average: 56.96)
Percent Women on Board: 37.50% (Industry average: 21.81%)
Percent Women Employees: 56% (Industry average: 52.97%)
Average Comp Awarded Per Executive: $11.12M (Industry average: $8.81M)

5-Year Stock Performance

Competitive Analysis

Wells Fargo's competes with many different financial services firms across their different business lines, but their main competitors based on size, geography, and similarity of offerings are: US Bancorp, JP Morgan Chase and Co, Bank of America Corp, Citigroup Inc, and PNC Financial Services. Other major competitors include: Goldman Sachs Group, Morgan Stanley, Bank of New York Mellon, BB&T Corp, KeyCorp, SunTrust Banks, Regions Financial Corp, and M&T Bank Corp.

Competitive Advantages

Wells Fargo & Co has either the number one or two market share in the following areas: commercial & industrial lending, commercial real estate mortgages, home-equity loans, and residential mortgage originations. Wells Fargo has more retail deposits than any other bank in the country, and US commercial banks historically have had very predictable deposit growth with deposits across the industry growing for 66 consecutive years at a rate nearly double the GDP growth rate. As a result of their immense and low-cost deposit base, WFC has created a dominant market share in one of the simpler, profitable, and stable business strategies – taking in deposits and lending them out – with high customer switching costs. Furthermore, WFC's low efficiency ratio and conservative underwriting standards also contribute to their trustworthy brand name and low-cost production.

Risks

The recent investigation into unauthorized account creations between 2011 and 2015 has led to the firing of over 5,300 employees and a fine of $185M. This may result in excessive public scrutiny and new lawsuits, which could cause the company to spend additional capital on litigation. Revenues may face some slowdown in growth from potential impacts on cross-selling in retail brokerage. Additionally, WFC may suffer a negative impact to its pristine reputation. We believe these risks can be resolved by aggressive changes in company sales practices and hiring, including replacement of executives. If there is an economic downturn and interest rates remain lower for longer, WFC will continue to face tighter interest spreads and may need to increase capital available for loan provisions. WFC is positioned to mitigate economic risks from low rates because of their recent actions to increase portfolio duration and interest rate hedges.

Report Prepared By:
Taishi Kato and Sean Phelan on 09/23/2016

Sources: Bloomberg, Yahoo! Finance