Wells Fargo & Co

Ticker: WFC
Sector: Diversified financial
Industry: Financial

Intrinsic Value: $54.84
Current Price: $42.61
Stop Loss: $32.27
Upside Review: $70.00

TTM P/E: 11.03
Forward P/E: 11.05
FV Imp. P/E: 14.17
Beta: 1.16

Market Cap: $225.03B
Dividend Yield: 2.51%
52 Wk Range: $31.2-$44.79

Industry Trends:

As US economic has become a little brighter, we see commercial customers making new investments, new individuals signing mortgage, credit cards being actively used for consumer products. In addition, the industry-wide, nonperforming loans (NPL) continue to decline. The improving housing market is a strong contribution to new mortgages. Market interest rates have increased since May 2013, when Fed sent out signal that it would pull back the bonds purchasing program, although Fed decided to maintain QE. In our investment horizon, this is an upward interest trend.

Business Summary:

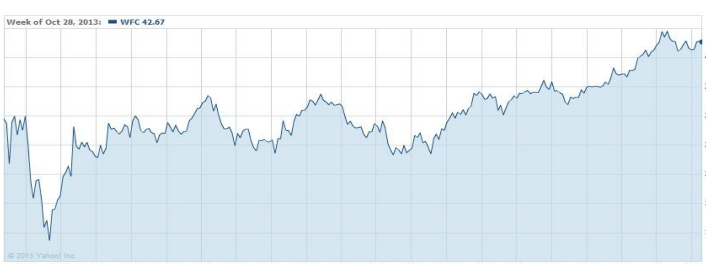
WFC is a diversified financial services company providing banking, insurance, investment, mortgage, leading, credit cards, and consumer finance. Its products and services can be classified as Community banking, Wholesale banking, and Wealth, Brokerage and Retirement, accounted for 59.57%, 26.87%, and 13.56% respectively. The company doubled in sized in 2008 with its purchase of Wachovia and become one of the four largest banks in the U.S. The company's key advantage is the low-cost deposit base, which is growing 5% CAGR since 2008. Of $1 trillion in deposit, $288 billion is demand deposit which bear no interest cost.

In addition, WFC's operating margin and net margin have been obviously improving. For Q3 2013, operating margin was 40.54% while net margin was 27.24%, both constantly increased.

Investment Thesis:

WFC is now the largest deposit service provider in major metropolitan markets. Moreover, WFC is focusing on cross-selling also strengthen the customer relationships, increasing switching costs and adding to the bank's pricing power. As mentioned above, WFC has over $1 trillion in low-interest bearing cost funding. Its funding advantage allows the bank to achieve an outstanding level of profitability. Loans make up to 56% of the assets, while the company expose to trading assets less than 5% of the assets. This simple business model reduces WFC's vulnerability to

WFC 5 year stock performance:



	WFC	BOA	JPM	C	HSBC	Industry Avg
Market Cap (billion)	225.03	149.54	197.40	147.83	205.21	185.00
Rev TTM (billion)	89.53	99.61	106.94	94.04	77.85	93.59
Operating Margin	33.1%	12.2%	33.2%	11.3%	14.5%	20.8%
Net Margin	22.0%	5.0%	21.9%	8.3%	20.2%	15.5%
EPS TTM	3.85	0.67	4.45	3.98	0.85	2.76
P/E (TTM)	11.03	9.82	8.12	9.82	12.62	10.28
Div Yld	2.5%	0.3%	2.6%	0.1%	4.3%	2.0%
ROE	13.2%	1.3%	10.7%	4.1%	8.2%	7.5%
ROA	1.4%	0.2%	0.9%	0.4%	0.5%	0.7%
NIM	3.6%	2.5%	2.3%	2.8%	1.8%	2.6%
Credit Rating	A+	A-	A	A-	A+	N/a

Sources:
Bloomberg, Value Line Investment Survey, S&P Net Advantage, Yahoo! Finance, sec.gov

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Competitive Analysis:

WFC has a strong business model that drives the company's margin to outperform its peers. Its net margin is the highest, while operating margin is just 0.1% behind the leader – JPM. Dividend yield, ROE and ROA are obviously outperform its peers while its risk is considerably low with credit rating A+ from S&P and a beta of 1.16.

Pros:

- WFC's earnings have a high upside potential as credit quality improves and interest rise
- Unique business model that is difficult to duplicate
- The bank has potential to gain more revenue from Wachovia customers by expanding its products and services to them
- Management plans to eventually retain only 35%-50% of earnings, and we think even a 40% payout ratio could result in a 50% increase in dividends per share over the next five years
- Initiative to expand its business domestically and internationally. In Q3 2013, WFC acquired the U.K. arm of Hypothekenbank Frankfurt from Germany-based Commerzbank AG. Also, management made an effort to expand into new market, such as New York

Risk Factors:

- The costs associated with past mortgage missteps will continue to rise as homeowners and regulators target the bank, making the final extent of Wells Fargo's liability difficult to predict
- According to the completion, Wells Fargo may be forced into riskier lines of business as it attempts to provide variety of services to its customers.
- An extended period of deleveraging combined with low interest rates could dramatically reduce profitability

Total Return Estimates:	
3 Yr FV Reversion*:	11.23%
5 Yr FV Reversion*:	7.66%
(* - From limit order price of $42.67)	
Key Valuation Assumptions:	
Long term ROE	13%
Cost of equity	9.49%
Terminal Growth Rate	4.8%
10 yr. Risk Free Rate	2.65%
Equity Risk Premium	6.84%
Key Financial Data:	
Est. 2013 EPS	$3.92
Est. 2014 EPS	$4.57
3-5 Yr. Est. EPS Growth	10%
ROE	13.2%
ROA	1.4%
Price /Book	1.48
Price/Cash Flow	5.03
Debt/Equity market value	0.94
Tier 1 Capital Ratio	12.15
CSR Scores	
Human Rights	1/1
Business Ethics Policy	1/1
ESG Disclosure Score	30.26/46.05
Equal Opportunity Score	1/1
Emission Reduction	1/1
Environmental Disclosure Score	13.39/43/27