Price	31.29
Target Price	37.51
Total Projected Return	19.9%
Exchange	NYSE
52-Week High	34.19
52-Week Low	22.58
Market Cap	164.61 B
Dividend Yield	1.5%
Annual Dividend	0.48
Trailing P/E Ratio	11.09
Forward P/E Ratio	8.6
Diluted Shares O/S	5.36B
ROE	11.86%
Institutional Ownership	77.1%
1-Month Return	3.58%
3-Month Return	21.31%
12-Month Return	-1.24%

Summary

Wells Fargo is a diversified financial services company that provides banking, insurance, investment, mortgage and consumer finance. It is headquartered in San Francisco and nearly all business occurs in the U.S. In December 2008, Wells Fargo acquired Wachovia, nearly doubling Wells' national footprint in terms of retail banking outlets.

Investment Thesis

Similar to virtually all major banks, Wells Fargo has been negatively impacted by the credit crunch and subsequent recession, with revenue and profit declines. However, these declines should be taken in context because they are not extraordinarily large compared to other banks. Wells Fargo has not been forced to write down large losses on its assets compared to the other four large banks.

The company faces the same risks as most other financial institutions, such as negative consumer sentiment, slow growth in lending, national and international regulation in the forms of Dodd-Frank and Basel III, as well as general market uncertainty. Over the five years to 2017, Wells Fargo is the best-positioned bank to pick up market share while growing revenue and net income due to its limited exposure to risky investments and the financial strength of its parent company, Berkshire Hathaway.

Company Overview

Business Segments[1]

Wells Fargo & Company is a $1.3 trillion diversified financial services company providing banking, insurance, investments, mortgage banking, investment banking, retail banking, brokerage, and consumer finance through banking stores, the internet, and other distribution channels to consumers, businesses, and institutions in all 50 states and in other countries. The company was formed as a result of the 1998 merger of Norwest Corporation and the former Wells Fargo & Company. On December 31, 2008, Wells Fargo acquired Wachovia Corporation in a transaction valued at $12.5 billion to Wachovia shareholders. Wachovia was one of the nation's largest diversified financial services companies providing retail banking and brokerage, asset and wealth management, and corporate and investment banking. The acquisition makes Wells Fargo a premier nationwide commercial bank with a presence from coast-to-coast and the best nationwide distribution system in the industry.

For purposes of management reporting, Wells Fargo reports in three different lines of business: Community Banking, Wholesale Banking, and Wealth, Brokerage, and Retirement.

Community Banking: The Community Banking group offers a complete line of diversified financial products and services to consumers and small businesses with annual sales generally up to $20 million in which the owner generally is the financial decision maker. The Community Banking Group also offers investment management and other services to retail customers and high net worth individuals, securities brokerage through affiliates, and venture capital financing. This business segment includes the *Wells Fargo Advantage Funds*, a family of mutual funds, as well as personal trust and agency assets. Loan products in this business segment include lines of credit, equity lines and loans, equipment and transportation loans, education loans, origination and purchase of residential mortgage loans, and servicing of mortgage loans and credit cards. Several other products are available to small business owners including receivables and inventory financing. Consumer and business deposit products within Community Banking include checking accounts, savings accounts, time deposits, debit cards, and IRAs. Community Banking serves its target customers through a wide range of channels which represents the best

[1] Listing of business segments sourced primarily from Wells Fargo Annual Report(s)

nationwide distribution network in the industry. Customers are served through traditional banking stores, in-store banking centers, business centers, and ATMs. Wells also offers 24-hour telephone banking. Online banking services include sign-on online banking, bill pay and brokerage, and online banking for small businesses. Online banking is important to WFC as it is a market share leader and online customers tend to be more profitable than traditional clients are.

Wholesale Banking: The Wholesale Banking Group serves businesses across the US with annual sales generally in excess of $10 million. Wholesale Banking provides a complete line of commercial, corporate and real estate banking products and services. These products include traditional commercial loans and lines of credit, asset-based lending, equipment leasing, mezzanine financing, treasury and investment management, insurance, and investment banking, among others. Wholesale banking also manages and administers institutional investments, employee benefit trusts, and mutual funds. Wholesale Banking also supports the commercial real estate market with products and services such as construction loans (commercial and residential), land acquisition and development loans, affordable housing loans and letters of credit, commercial real estate loan servicing and real estate and mortgage brokering services, among others.

Wealth, Brokerage and Retirement: WB&R provides a full range of financial advisory services to clients using a planning approach to meet each client's needs. Wealth Management provides affluent and high net worth clients with a complete range of wealth management solutions, including financial planning, private banking, credit, investment management and trust. Family Wealth meets the unique needs of ultra-high net worth customers. Brokerage serves customers' advisory, brokerage and financial needs as part of one of the largest full-service brokerage firms in the United States. Retirement is a national leader in providing institutional retirement and trust services (including 401(k) and pension plan record keeping for businesses, retail retirement solutions for individuals, and reinsurance services for the life insurance industry.

Dodd-Frank Legislation and the Volcker Rule

The Dodd-Frank Wall Street Reform and Consumer Protection Act introduces a broad reform of the financial services sector that has not been seen since regulations passed after the Great Depression. The controversial law has been praised in some respects and criticized in others. While out of the scope of this analysis to detail the Dodd-Frank legislation, the summary view is that several new costs will be incurred by financial firms. These include, but are not limited to debit card fees, transparent investments in hedge funds, bringing derivatives onto monitored exchanges, funding for new regulatory bodies, position limits are trading of commodities, large margin requirements for swap trading, and proprietary trading regulation – also known as the Volcker Rule[2]. Many of these costs have not been realized, as many individual rules are still being written. However, two years after introduction of Dodd-Frank, banks are now realizing some outlays. Huntington Bank, a large regional bank, realized nearly $12 million dollars is Dodd-Frank related costs in the Q4 2011 alone.[3] Nearly all debit card rewards programs have been terminated due to rate limit rules, and the Volcker Rule has stirred fervent debate as of late.

When asked if the Volcker Rule affects Wells in a meaningful way, Chairman and CEO John Stumpf replied, "I have a view that it should not hurt customers. I can't imagine that's the intention of Volcker or the congress, but the way the rules are coming down, they're very broad in their prohibitions and very narrow in their permissions. Let me give you one example that would be impacted – when we make somebody a mortgage, we give them a rate lock… for 60 or 90 days. If rates go up even by a quarter point, that's thousands of dollars over the life of a loan. If this is implemented the wrong way, we might not be able to do that. Because we won't be able to buy swaps and hedge, we have to have a gigantic group of consultants and accountants and attorneys making sure that that doesn't fit."[4]

A large concern for many banks is in regards to proprietary trading under the Volcker rule. In large parts, prop trading is eliminated in these diversified banks. In the current language, there

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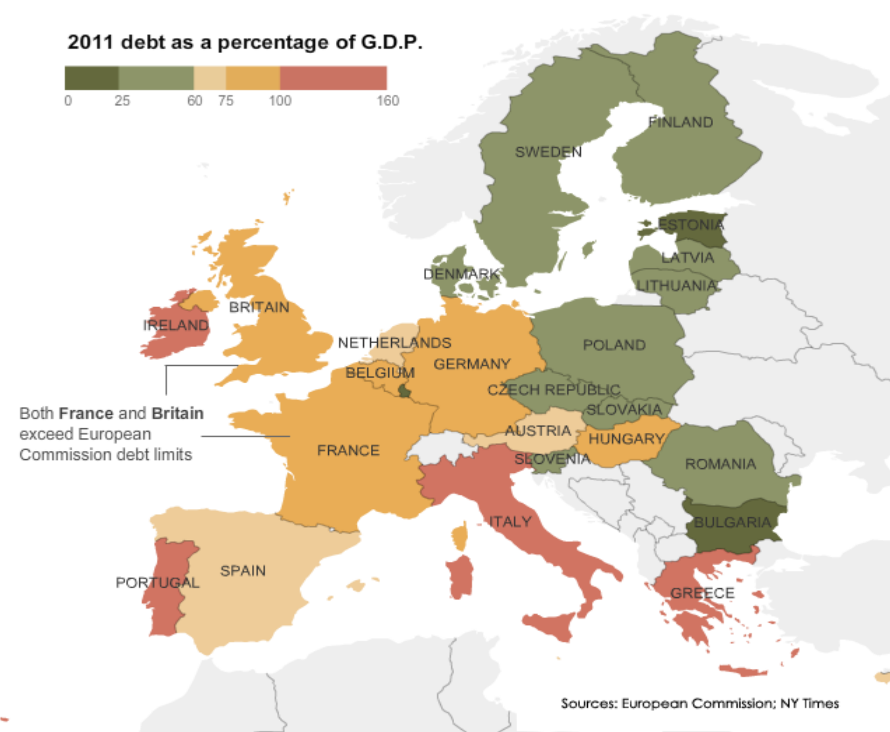
[2] Brief Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act – Congressional archives
[3] Jeff Blendick – Regional Credit Officer, Huntington National Bank
[4] "Wells Fargo's Stumpf on the Volcker Rule" – John Stumpf, CNBC Interview

are loopholes to this rule – such as simply moving the prop trading to the repo desk[5] – but fortunately for Wells Fargo, they have little to no exposure to this line of business.

European Sovereign Debt Crisis

The past 4 years have been turbulent, to say the least, for financial stocks. After recovering from one of the largest financial emergencies in this nation's history, entire European countries seem to be at risk of default. While 3Q 2011 aggregate net exposure for the six largest U.S. banks totaled nearly $50 billion dollars, this number represents 0.5% of total assets and less than 9% of Tier 1 common capital.[6] These numbers, seen as manageable, could quickly change if other Euro zone countries begin to weaken. Of the six largest U.S. banks, Wells Fargo is the only bank to have negligible exposure to any of this debt, positioning it as the least likely to be effected by any negative events in Europe. The following map outlines current debt to GDP ratios for European Union countries.



[5] "Occupy the SEC Comment Letter on the Volcker Rule" – www.occupythesec.org
[6] "U.S. Banks Face Rising Risk of Contagion from Euro Crisis" – SeekingAlpha

Basel III Capital Requirements

Basel III is a new global regulator standard on bank capital and liquidity requirements agreed upon by members of the committee of banking authorities established by major central banks. It was developed in a response to the deficiencies in financial regulation revealed by the global financial crisis. By now accounting for systemic market risk, Basel III strengthens bank capital requirements and introduces new requirements on bank liquidity and leverage. The OECD estimates that the implementation of Basel III will decrease annual GDP growth 0.05 to 0.15 percentage points as it continues to be implemented over 2011 and 2012. As a result, banks will have to reassess their risk management strategies and implement more effective safeguards against issuing risky loans.[7]

Wells Fargo is among the best of the large banks in terms of Tier 1 capital and common equity ratios under Basel III (in its current form). As not all banks offer current Tier 1 common equity numbers under proposed Basel III restrictions, the best estimate of bank rankings can only come from current common equity ratios under Basel II regulation. Per Table 1 below, JP Morgan and Wells Fargo already surpass the 2013 minimum (7%), while Citi is estimating that it will and Bank of America is estimating that it will *just meet* the minimum requirements. This puts Wells Fargo in an advantageous position of not having to deal with regulatory red tape and investor scrutiny.

Company	Tier 1 Common Equity Ratio[8][9]
JP Morgan	7.60%
Wells Fargo	7.50%
Citi**	8%**
Bank of America**	6.75% – 7%**

Table 1: Note that ** denotes company projected ratios at 1/1/13. Both Wells Fargo and JP Morgan expect to have Tier 1 ratios of 9% or more by the same time.

[7] "Investment Banking & Securities Dealing in the US" – IbisWorld
[8] Ratios gathered from company annual or quarterly reports, as well as official company presentation material
[9] "Big Four Strain Towards Basel III" – American Banker

Federal Reserve Funds Policy

In late 2011, the Board of Governors of the Federal Reserve issued a press release[10] stating that the federal funds rate would stay within a target range of 0 to ¼ percent through mid-2013. This policy places stresses on the income for financial institutions. The prime rate refers to the interest rate banks charge to their most creditworthy and largest corporate customers. Industry revenue comes from the spread between the federal funds rate and the prime rate along with interest rates banks charge to the rest of its customers via various loans and consumer mortgages. A minimal prime rate normally boosts loan demand under non-recessionary conditions. In order for banks to realize higher net interest income, a higher rate needs to be in place. While the Fed does not set the prices for mortgage rates, its fed funds rate has a large impact on this number.[11] As the largest home lender in the U.S., the fed funds rate directly affects Wells Fargo more than any other financial institution. The company has taken proactive steps to increase market share, so when rates do begin to rise, Wells Fargo should be in prime position to take advantage of increased interest revenues.

Litigation

Current litigation is a forefront concern with investors and banks. The financial collapse of 2008 prompted the ensuing scandals of predatory loan policies and "robo signing," or the fraudulent endorsement of court documents. In late February 2012, Bank of America, Wells Fargo, and three other large banks agreed on a $25 billion dollar settlement with 49 state attorneys general. This landmark deal has come out largely in favor of the banking industry. Wells Fargo will pay approximately $4.3 billion dollars, second only to Bank of America's $8.6 billion liability. Mark Vitner, a senior economist at Wells Fargo Securities, said the settlement might help the housing market in the end because it lets banks proceed with millions of foreclosures that have been stalled. "We've got a lot of issues to work our way through in the housing market," Vitner said. "What this settlement does is allow that process to get started."[12]

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[10] "FRB: Press Release – FOMC Statement" – Board of Governors of the Federal Reserve System
[11] "Commercial Banking in the US Industry Report" – IbisWorld
[12] "$25B settlement reached over foreclosures" – WSJ

Wells Fargo, in its most recent 10-K, established further liabilities for contingent litigation losses. The high end of the range of potential litigation losses in excess of the Company's best estimates within the range of potential losses used in establishing the total litigation liability was $1.2 billion as of December 31, 2011. As these final write-downs come to fruition, the banking industry as a whole, and in particular Wells Fargo, can finally lay to rest some of the effects of the housing bubble burst.

Investment Thesis

Recent Company Events and Upcoming Catalysts

Through superior risk management practices and mitigation of the negative effects of the financial crisis, Wells Fargo has positioned itself as a leading performer in the banking industry. With its strong capital position, I expect the company to diversify and expand its business globally through mergers and acquisitions.

The company has made several acquisitions over the trailing twelve months. I detail some of the most recent activities below.[13]

February 21, 2012 – "Wells Fargo Acquires the U.S. Based Energy Lending Business of BNP Paribas"

Wells Fargo announced that it entered into a definitive agreement to acquire the North American reserve-based and related diversified energy lending business of BNP Paribas.

This particular acquisition consists of BNP's approximately 175 customer relationships, nearly $9.5 billion of loan commitments, and approximately $3.9 billion in loans outstanding. Around 90% of the portfolio is U.S.-based, with the remainder primarily located in Canada, a market of growing importance for the Wells Fargo Energy group.

December 1, 2011 – "Wells Fargo completes final transition of Wachovia banking locations"

A date of structural importance, December 1, 2011 marked the end of major transitions for Wachovia banking locations. For investors, this means significant noninterest expense savings

[13] All events and dates are from official Wells Fargo Press releases on their listed dates

on general and administrative expense as well as capital expenditures for renovating the locations. Since the Dec. 31, 2008 merger, Wells Fargo has:

- Converted more than 38 million accounts from Wachovia, including mortgage, deposit, brokerage and credit card, among others.
- Doubled its YoY revenue from 2008 – 2009 reflecting the merger client base.
- Ranked as America's No. 1 small business lender for nine consecutive years, in large part due to:
    - Providing $15 billion in new loans to small businesses during 2010
    - Increasing new loan commitments to U.S. small businesses by eight percent in 2011
    - Being the first bank ever to lend $1 billion in SBA 7(a) loans to small businesses in one year

Nov 2, 2011 – "Wells Fargo Under Contract to Purchase $3.3 Billion IBRC Commercial Real Estate Loan Portfolio"

In line with company management, Wells Fargo announced the purchase of real estate loans from a foreign entity – the Irish Bank Resolution Corporation (formerly Anglo Irish Bank). The face value of this transaction totals $3.3 billion in customer balances for Wells Fargo.

Going forward, I expect a growing number of organizations to be absorbed into the Wells Fargo portfolio. The company has been speculated to be in talks with Ally Financial, formerly of General Motors and currently owned by the United States government.[14] This vehicle loan portfolio could add significant interest revenues to Wells Fargo's bottom line, although it must be noted that other institutions such as Citibank are said to be interested as well.

What comes as a surprise to many investors for a company so large is that 98% of Wells Fargo's business is based domestically; only 2% of the bank's 260,000 employees are based outside the United States. As a company ranked number one in market capitalization among U.S. banks and fourth by assets, this presents an enticing opportunity to expand the business internationally. On March 4, 2012, Wells Fargo CEO John Stumpf reiterated previous statements by CFO Tim Sloan

[14] "You've Got to Respect Wells Fargo" - SeekingAlpha

regarding international expansion. Stumpf told the Financial Times that Wells Fargo plans to increase the scope of its wealth management and insurance divisions through acquiring companies at fire sale prices – such as shrinking European banks. They are currently in early talks looking at Deutsche Bank's asset management group.[15] While all of this talk may be premature, the fact that the bank plans to open operations in 20 countries including Germany, China, Australia, and Britain points to more growth opportunity than any of the other large financial institutions.[16]

Financial Analysis

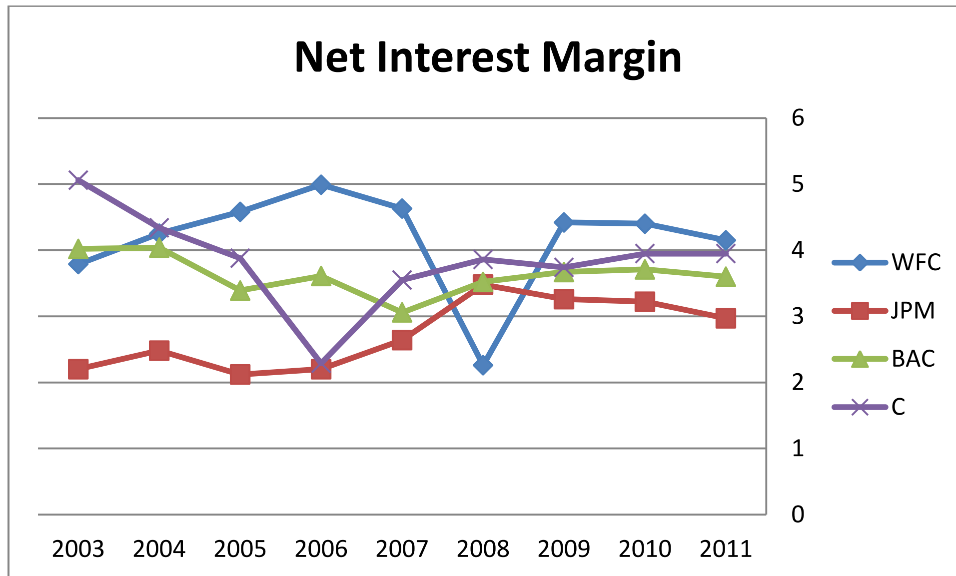
From a fundamental company growth point of view, I have outlined the prospects for the company to grow internationally – but where does the company stand today? Specifically, is Wells Fargo a more attractive investment than peers in its industry are? To this end, one needs to look at some fundamental ratios that are integral for valuing banking institutions. Banks are notoriously difficult institutions to value, due to off balance sheet operations, complex business structures, volume and value of transactions, and overall uniqueness of the business. The following statistics provide an overall picture of banks, with a discounted cash flow analysis and historic price multiples to solidify the metrics. No single metric alone should be used to make a decision. Everything together helps to give a complete picture of the investment. The decisions one needs to make based on this information needs to come with financial discipline and emotional intelligence, without which would make the following techniques useless.

Net Interest Margin (NIM)

Net interest margin (NIM) is one of the most basic factors that are both unique to financial institutions as well as integral into adequately comparing the company to its peers. Net interest margin conveys how profitability Wells Fargo deploys capital through loans than competitors, measured as the ratio of net interest income to average earning assets. Net interest margin is an important measure of a bank's profitability, and Wells' 5-year average of 4.6% and FY11 average of over 4.15% dominate industry peers, as Bank of America, JP Morgan, and Citi are at

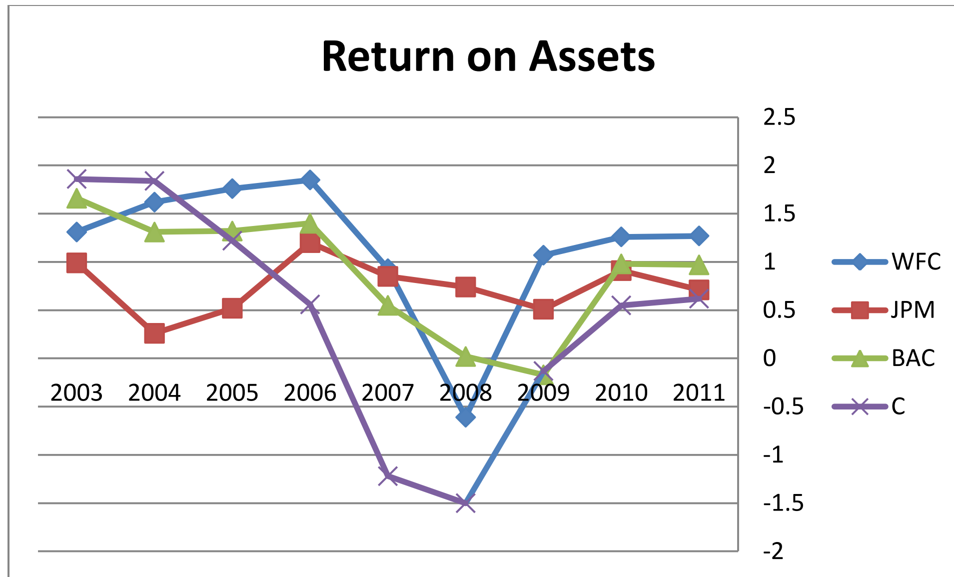
[15] "Wells Fargo Set for Further Expansion" – Financial Times
[16] "Wells Fargo to Increase International Operations" - Reuters

3.6%, 2.97%, and 3.95% respectively. Wells Fargo is significantly more profitable than competitors in terms of net interest margin are.



Return on Assets (ROA)

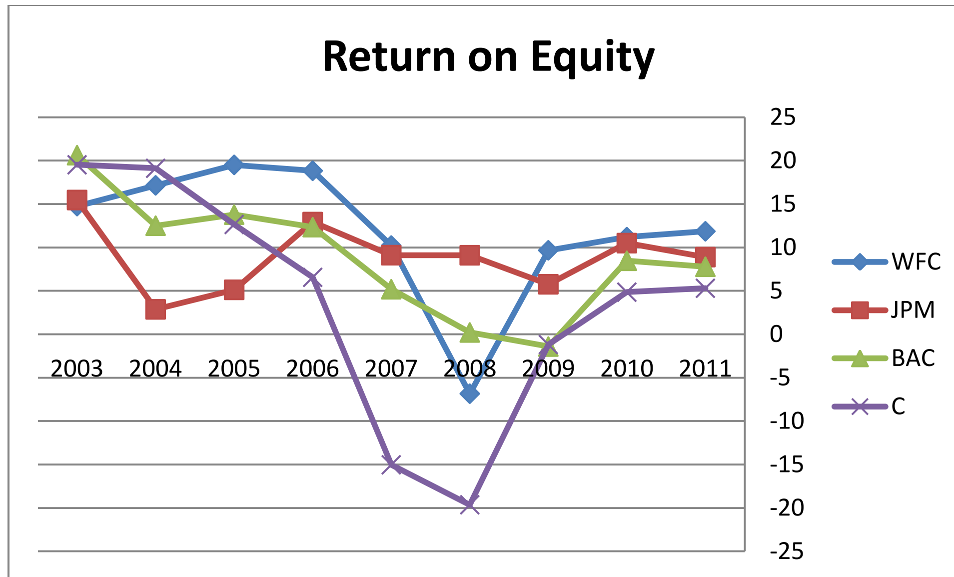
Return on assets is also quite important for banking institutions. Rising ROA normally indicates improving margins, and lower loan loss rates. Financial institutions normally have quite low ROA numbers, due to the outsized amount of assets carried by the firms (in the trillions). Usual industry return on assets in normal economic conditions generally ranges between 0.8% and 1.5%. Once again, Wells Fargo significantly trumps industry peers in this vital statistic. For fiscal 2011, Wells had a ROA of 1.27, while Citigroup's ROA landed the lowest at .62, JPMorgan next at .71, and Bank of America second at .97. Not only did Wells beat out the competition in 2011, but in every year (save 2008) *since 2005*. It is hard to argue against a company who employs its assets so efficiently.



Return on Equity (ROE)

ROE is a key performance indicator. It assesses how efficiently company management utilizes the company's existing capital base in order to produce more money. During the 1990's and early 2000's, a leading ROE would normalize around 17% to 20%. However, those years are also associated with loose capital restrictions and lack of regulatory oversight. Since the 2008 financial crisis, exceptional return on equity numbers has been in the 10% to 15% range.[17] New international capital standards, primarily the Basel Capital Accord standards, are much to do with this decrease. The *only* large financial institution to fall in this range is Wells Fargo and Company. Not only is the company in the range, it has stayed in this range (or higher) for more than a decade – again except for the outlier 2008 year. This consistency is very important and once again, Wells beats out the other large competitors. Please refer to Table 3 for ROE comparison.

[17] http://www.nytimes.com/2010/01/05/business/05views.html



Dividends

	Q1	Q2	Q3	Q4
2008	0.31	0.31	0.34	0.34
2009	0.34	0.05	0.05	0.05
2010	0.05	0.05	0.05	0.05
2011	0.12	0.12	0.12	0.12

Table 2 Wells Fargo quarterly dividend payments (per share basis)

As one can infer from Table 2 above, Wells Fargo is significantly off its highs in terms of dividend yield. This is, of course, due to the financial crisis and is a trend one sees among all large dividend paying financial institutions for the same period. Dividend yield in and of itself, however, is unreliable – especially in the current economic climate. Stocks that have seen their share price depressed to unreasonable levels based off fear and overselling will have unreasonably high dividend yields.

The dividend payout ratio is a much more accurate and reliable measure of a banking institution's health since it measures on a per share basis. A ratio of 30-50% is not uncommon – in times of financial stability. Bank payout ratios have sunk to historic lows over the past three years, yet once again, Wells Fargo is at the top of the financial behemoths in terms of payout. JPMorgan and Wells are near 17% while Citi sits near zero since 2009 and Bank of America is an outlier due to EPS of only .01 during 2011 with DPS of .04, paying out 400%.

While Wells Fargo did decrease dividends during the financial crisis, the company had the financial wherewithal to at least continue paying at a reasonable payout ratio. It is not unreasonable to believe that this payout ratio will increase significantly in the coming two years. Based on future earnings growth and financial stability of the firm post-Wachovia merger, I see the dividend payout ratio for Wells to increase to 30% by year-end and marginally higher in 2013. Refer to Table 3 for a company comparison of dividend payout ratio for fiscal 2011.

Stock Price & Price/Earnings

In order to effectively price Wells Fargo with perspective to historic multiples, I determined one year target multiples and target per share values. Current multiples generally trade at a discount to the 10-year median and even more so to the 10 year highs. Financial history tells us that firm ratios will drive toward an average value. Because Wells Fargo was not systemically impacted by the financial crisis – albeit acquiring a large competitor in Wachovia – I believe that Wells Fargo is trading at a true discount to historic norms. Not only this, but the entire financial sector, including Wells Fargo, is trading at a discount to the S&P 500. Based on the below comparative analysis, and giving equal weightings to all indicators, Wells Fargo combined price per share target is $36.60, a premium to today's closing price and in line with my discounted cash flow analysis (see next section). As I believe there is merit to valuing a company based on historic norms, I will use 50% of this target price to determine my final Wells Fargo share price listed in the "Conclusion" section.

Wells Fargo and Company	High	Low	Median	Current	1-Year Target Multiple	Target E,S,B, /share	1 Year Target Price
P/Forward E	13	7	10	8.6	11.2	3.5	39.20
P/S	2.1	1.8	1.95	1.86	2	15	30.00
P/B	1.4	1.1	1.25	1.16	1.3	30	39.00
P/EBITDA	4.1	3.9	4	4.05	4.2	8.5	35.70
P/CF	9.6	8.6	9.1	8.4	9.4	4	37.60
			Average Price per Share (multiples)				36.30

Complete Ratio Comparison

	WFC	JPM	BAC	C
NIM	***4.15***	2.97	3.6	3.95
ROA	***1.27***	0.71	0.97	0.62
ROE	***11.86***	8.89	7.78	8.89
Dividend Payout	***0.17***	***0.17***	N/A	0.01
P/Forward E	8.6	7.51	7.31	***7.17***
P/S	3.31	1.5	***0.8***	0.962
P/B	1.16	0.8	***0.3***	0.554
P/EBITDA	4.05	4.3	3.47	***2.79***
P/CF	8.4	6.6	***4.7***	7.48

Table 3 Ratio comparison of largest U.S. banking institutions [18]

Income Statement and Discounted Cash Flow Analysis

In creation of my income statement projections (see figure below) and my discounted cash flow analysis (DCF) of Wells Fargo and Company, I made several assumptions for the company going forward. The DCF referenced can be found in Appendix A at the end of this paper.

- Based on available quarterly reports and company statements, I expect overall market similar growth (~4%) for 2011 vs. 2010. This is due in large part to final restructuring and transition related to the Wachovia merger, as well as overall market weakness.
- Based on my previous discussion on company acquisitions and international expansion, I believe revenue, particularly noninterest income from wealth management services, etc. will grow aggressively over the next 5 – 10 years. For this reason, I assume a 4% terminal growth rate with strong mid-decade growth for Wells Fargo.
- Bank stocks historically have traded at a discount to the market, and I have made the same assumption with Wells Fargo. Financials are also highly cyclical, making me lean to a high discount rate. Continued uncertainty surrounding banking regulations, nervous investors concerning financial sector companies, and macroeconomic weakness indicate a proper discount rate to be 13% for Wells Fargo.
- Provisions for credit losses have had a significant impact on financials since 2007 (see Figure 1). The settlement of mortgage related lawsuits over the next 2-5 years will have

[18] Company ratios obtained from http://bankregdata.com

a positive impact on company earnings. I have accounted for this very conservatively going forward as this is one of the most uncertain aspects of Wells Fargo's income statement.

❖ Wells Fargo has legacy Wachovia related preferred stock. I have included paying dividends as a negative effect to free cash flow as the stock in question is perpetual stock. Unless this stock is bought back by the company, Wells will have this continual dividend liability to pay out.

Wells Fargo Corporation (Millions)	FY 2013E	FY 2012E	FY 2011E	FY 2010	FY 2009	FY 2008	FY 2007
Net interest income	53,017	49,595	46,468	44,757	46,324	25,143	20,974
Noninterest income	49,938	46,342	42,928	40,453	42,362	16,734	18,546
Total Revenue	**102,954**	**95,938**	**89,396**	**85,210**	**88,686**	**41,877**	**39,520**
Noninterest Expenses							
Salaries				13,869	13,757	8,260	7,762
Commission and incentive compensation				8,692	8,021	2,676	3,284
Employee Benefits				4,651	4,689	2,004	2,322
Equipment				2,636	2,506	1,357	1,294
Net occupancy				3,030	3,127	1,619	1,545
Core deposit and other intangibles				2,199	2,577	186	158
Provision for credit losses				15,753	21,668	15,979	4,939
FDIC and other deoposit assessments				1,197	1,849	120	34
Other Expense				14,182	12,494	6,376	6,347
Total	-	-	-	66,209	70,688	38,577	27,685
Operating Income	28,420	26,667	25,516	19,001	17,998	3,300	11,835
Inc before inc taxes & minority interest	28,420	26,667	25,516	19,001	17,998	3,300	11,835
Provision for Income taxes	8,526	8,000	7,655	6,338	5,331	602	3,570
Minority interest	250	250	250	301	392	43	208
Wells Fargo Net Income	19,644	18,417	17,611	12,362	12,275	2,655	8,057
Less: Preferred stock dividends and accretion and other	(800)	(800)	(800)	(730)	(4,285)	(286)	-
WFC Net Income applicable to common stock	**18,844**	**17,617**	**16,811**	**11,632**	**7,990**	**2,369**	**8,057**
Wtd avg common shs-Basic	5,514.1	5,406.0	5,300.0	5,227.0	4,545.0	3,378.0	3,349.0
EPS-Basic (pre acct chnge)	3.42	3.26	3.17	2.23	1.76	0.70	2.41
Net Income	3.42	3.26	3.17	2.23	1.76	0.70	2.41
Wtd avg common shs-diluted	5,566.1	5,457.0	5,350.0	5,263.0	4,563.0	3,391.0	3,383.0
EPS-diluted	3.39	3.23	3.14	2.21	1.75	0.70	2.38
Net Income	3.39	3.23	3.14	2.21	1.75	0.70	2.38
Consensus	*3.50*	*3.25*	*2.85*				
Guidance			*3.00*				

Figure 1 Wells Fargo and Company Income Statement Projections

Conclusion

Risks and Concerns

The government spent hundreds of billions of dollars to prop up the Commercial Banking industry and the economy during the recession. From late 2009 to early 2011, those efforts seemed to pay off, but the industry is not in the clear yet. The consumer credit market is thawing slower than anticipated. The Federal Reserve is no longer able to simulate the economy, having kept interest rates at an all-time low between 0.0% and 0.25%. In normal environments these rates would be advantageous to borrowers and banks, but the credit markets have taken a turn for the worse as a result of continued economic uncertainty due to the European sovereign debt crisis and the Standard & Poor's' downgrade of US Treasuries in August 2011. Volatile capital markets coupled with sluggish job growth have increased US consumers' uncertainty.

Because of this negative market outlook, more consumers are putting money into banks versus utilizing excessive credit amounts. According to the FDIC, industry deposits grew at an average annual rate of 4.7% over the past five years to $8.9 trillion.[19] While bank deposits are increasing, fund outflow in the form of loans has experienced a large decrease. Revenue growth over the five-year period came largely from increased interest income from government stimulus, not organic growth from issuing new loans.

These concerns, along with continual legislation – specifically Dodd-Frank – present the largest concerns for Wells Fargo going forward.

Final Recommendation and Price Target

My final recommendation regarding Wells Fargo is to **BUY.** I have a price target of **$37.51** on the stock, representing a **20% upside** to the current price of $31.29. The target is an aggregate of 50% weighted DCF target and 50% weighted price multiple target.

While other financial institutions (particularly Bank of America) represent higher return opportunities, the *smart* investor will want to put his or her money in *sound, structured* companies with proven management. Having weathered the financial crisis well, coupled with

[19] Commercial Banking in the US Industry Report - Ibisworld

fundamental company profitability indicators that beat all other peers, Wells Fargo presents an opportune risk/reward strategy. The ideal investor would be purchasing stock knowing that the company that has significant future growth prospects, is expanding and acquiring other businesses (versus selling off billions in assets like some other firms are currently doing), and has the management to guide the company to success over the next five to ten years. I reiterate my “Buy” rating as well as a “long term” holding period.

APPENDIX A – DISCOUNTED CASH FLOW ANALYSIS

Wells Fargo (WFC)

Terminal Discount Rate = 13.0%
Terminal FCF Growth = 4.0%

Year	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E
Net interest income	46,468	49,595	53,017	56,463	60,133	63,741	67,565	71,619	75,200	78,960	82,118
% Growth		6.7%	6.9%	6.5%	6.5%	6.0%	6.0%	6.0%	5.0%	5.0%	4.0%
Noninterest income	42,928	46,342	49,938	53,933	58,247	62,324	66,064	70,028	73,529	77,206	80,294
% Growth		8.0%	7.8%	8.0%	8.0%	7.0%	6.0%	6.0%	5.0%	5.0%	4.0%
Revenue	89,396	95,938	102,954	110,395	118,380	126,065	133,629	141,647	148,729	156,166	162,412
% Growth		7.3%	7.3%	7.2%	7.2%	6.5%	6.0%	6.0%	5.0%	5.0%	4.0%
Income (loss) before taxes	**25,516**	**26,667**	**28,420**	**27,599**	**29,595**	**31,516**	**33,407**	**35,412**	**37,182**	**39,041**	**40,603**
EBIT margin	28.5%	27.8%	27.6%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
Income tax expense (benefit)	7,655	8,000	8,526	8,280	8,878	9,455	10,022	10,624	11,155	11,712	12,181
Tax Rate	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%
Net Income	**16,811**	**17,617**	**18,844**	**19,319**	**20,716**	**22,061**	**23,385**	**24,788**	**26,028**	**27,329**	**28,422**
% Growth		4.8%	7.0%	2.5%	7.2%	6.5%	6.0%	6.0%	5.0%	5.0%	4.0%
Preferred Stock dividends	800	800	800	800	800	800	800	800	800	800	800
Free Cash Flow	**16,011**	**16,817**	**18,044**	**18,519**	**19,916**	**21,261**	**22,585**	**23,988**	**25,228**	**26,529**	**27,622**
% Growth		5.0%	7.3%	2.6%	7.5%	6.8%	6.2%	6.2%	5.2%	5.2%	4.1%

NPV of Cash Flows	**113,105**	55%	
NPV of terminal value	**94,029**	45%	
Projected Equity Value	**207,135**	100%	
Free Cash Flow Yield	**9.56%**		
Current P/E	**10.0**	**9.5**	**8.9**
Projected P/E	*12.3*	*11.8*	*11.0*
Current EV/EBITDA	**14.3**	**13.6**	**12.8**
Projected EV/EBITDA	*15.8*	*15.1*	*14.2*
Shares Outstanding	5,350		
Current Price	$ 31.29		
Implied equity value/share	$ 38.72		
Upside/(Downside) to DCF	23.7%		

Terminal Value	**319,189**
Free Cash Yield	**8.65%**
Terminal P/E	**11.2**
Terminal EV/EBITDA	**12.7**

APPENDIX B – SENSITIVITY ANALYSIS

	Terminal FCF Growth Rate										
Terminal Discount Rate	**0.00%**	**0.50%**	**1.00%**	**1.50%**	**2.00%**	**2.50%**	**3.00%**	**3.50%**	**4.00%**	**4.50%**	**5.00%**
10.00%	41.05	42.20	43.48	44.91	46.52	48.35	50.43	52.84	55.64	58.96	62.94
10.50%	39.26	40.26	41.37	42.59	43.97	45.51	47.27	49.27	51.58	54.27	57.46
11.00%	37.67	38.55	39.51	40.57	41.75	43.07	44.55	46.23	48.16	50.37	52.96
11.50%	36.26	37.02	37.86	38.79	39.81	40.94	42.21	43.63	45.25	47.09	49.22
12.00%	34.99	35.67	36.40	37.21	38.10	39.08	40.17	41.38	42.75	44.30	46.08
12.50%	33.86	34.46	35.10	35.81	36.59	37.44	38.38	39.43	40.59	41.91	43.40
13.00%	32.84	33.37	33.94	34.57	35.24	35.99	36.81	37.71	38.72	39.84	41.10
13.50%	31.92	32.39	32.90	33.45	34.05	34.70	35.42	36.20	37.07	38.04	39.12
14.00%	31.09	31.51	31.96	32.45	32.98	33.55	34.18	34.87	35.63	36.46	37.39
14.50%	30.33	30.71	31.11	31.55	32.02	32.53	33.08	33.68	34.34	35.07	35.87
15.00%	29.65	29.99	30.35	30.74	31.15	31.61	32.10	32.63	33.21	33.84	34.54