Wells Fargo & Company (WFC)

$52.66 (As of 01/07/20)

Price Target (6-12 Months): **$55.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 11/12/19) Prior Recommendation: Underperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5) Zacks Style Scores: Value: B | Growth: F | Momentum: A	**3-Hold** VGM:C

Summary

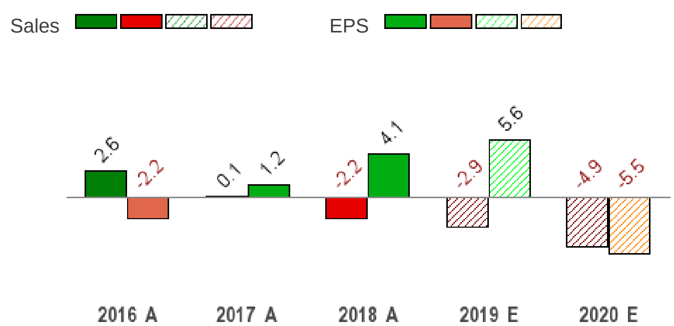
Shares of Wells Fargo have underperformed the industry in the past six months. Earnings estimates have been revised upward ahead of the company's fourth quarter results. Also, the company's earnings surprise history remains impressive, having surpassed the Zacks Consensus Estimate in three of the trailing four quarters. Strartegic acquisitions along with rising loans and deposit balances are impressive. Also, recent Fed's move on interest rate is likely to aid NIM. Though the company's investment in the businesses to enhance compliance and risk-management capability seems impressive, Wells Fargo has been slapped with several sanctions, which continues on the CFPB's dissatisfaction with the bank's progress on fixing risk-management issues. Also, rising costs curb bottom-line expansion. Moreover, lower NII remain a concerrn.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$54.75 - $43.34**
20 Day Average Volume (sh)	**16,101,445**
Market Cap	**$222.7 B**
YTD Price Change	**-2.1%**
Beta	**1.11**
Dividend / Div Yld	**$2.04 / 3.9%**
Industry	**Banks - Major Regional**
Zacks Industry Rank	**Top 12% (30 out of 254)**
Last EPS Surprise	**-20.0%**
Last Sales Surprise	**4.2%**
EPS F1 Est- 4 week change	**0.1%**
Expected Report Date	**01/14/2020**
Earnings ESP	**-0.0%**
P/E TTM	**11.4**
P/E F1	**12.3**
PEG F1	**1.1**
P/S TTM	**2.1**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2020	19,466 E	19,673 E	19,887 E	19,983 E	79,740 E
2019	21,609 A	21,584 A	22,010 A	19,877 E	83,881 E
2018	21,934 A	21,553 A	21,941 A	20,980 A	86,408 A

EPS Estimates

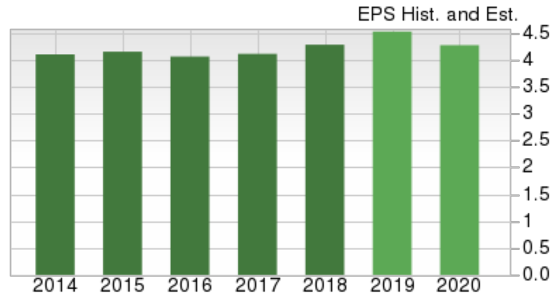
	Q1	Q2	Q3	Q4	Annual*
2020	$0.97 E	$1.04 E	$1.12 E	$1.12 E	$4.27 E
2019	$1.20 A	$1.30 A	$0.92 A	$1.11 E	$4.52 E
2018	$1.12 A	$1.08 A	$1.13 A	$1.21 A	$4.28 A

*Quarterly figures may not add up to annual.

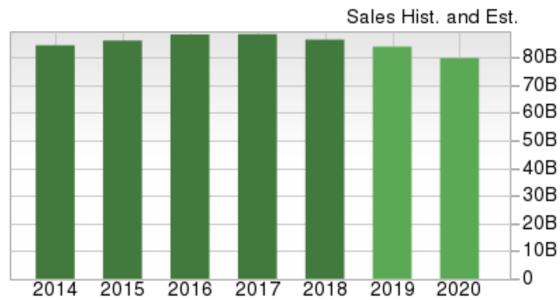
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/07/2020. The reports text is as of 01/08/2020.

Overview

San Francisco-based – Wells Fargo & Company is one of the largest financial services company in the U.S. with $1.9 trillion in assets and over $1.3 trillion in deposits. The company provides banking, insurance, trust and investments, mortgage banking, investment banking, retail banking, brokerage services and consumer and commercial finance through over 7,800 stores, 13,000 ATMs, the internet and other distribution channels across North America and globally. Moreover, the acquisition of the Wachovia Bank in December 2008, transformed it into a premier coast-to-coast financial services franchise.



The company provides its services through three broad segments:



Community Banking offers a complete line of diversified financial products and services to consumers and small businesses, including checking and savings accounts, credit and debit cards, and auto, student, and small business lending.

Wholesale Banking provides financial solutions to businesses across the United States and globally with annual sales generally in excess of $5 million.

Wealth and Investment Management provides a full range of personalized wealth management, investment and retirement products and services to clients across U.S. based businesses.

In July 2019, Wells Fargo divested its Institutional Retirement & Trust business to Principal Financial Group for $1.2 billion. In February 2018, it completed the sale of its Shareowner Services business to U.K.-based Equiniti Group plc, for $227 million. In 2017, Wells Fargo completed the divestiture of Wells Fargo Insurance Services USA, Inc (WFIS) to USI Insurance Services. The company offloaded the commercial insurance business, though retained personal insurance business under the consumer lending segment.

In 2016, Wells Fargo sold its fund administration business, Wells Fargo Global Fund Services. Further, the company acquired GE Capital's Commercial Distribution Finance (CDF) businesses in the Europe, Middle East and Africa (EMEA), Australia & New Zealand and Asia. Along with these, the bank acquired GE Capital's commercial lending and leasing businesses in North America and GE Railcar Services.

Reasons To Buy:

> Wells Fargo continues to benefit from loan and deposit growth, strong capital position and improving credit quality. Also, its acquisition moves are likely to support the company's growth strategy.

- With the gradual change in the rate environment, margin pressure for Wells Fargo eased. In 2017 and 2018, the company reported a rise in net interest margin (NIM) after witnessing a declining trend for years, as higher earning assets and loan yields were partially offset by high deposit costs. Amid the Fed's accommodative monetary-policy stance, the first three quarters of 2019 witnessed slight contraction of margin on account of lower rates. Nevertheless, improvement in economy and decent loan growth might continue to support margin expansion.

- Wells Fargo's expansion plans have historically included a large number of acquisitions including the Wachovia merger in 2008. Moreover, since 2011, the company has completed a number of opportunistic transactions. Further, the expansion moves has been supported by the purchase of a number of businesses from GE Capital. The company plans to expand its operations in international markets and augment its asset management business. It has demonstrated its ability to assimilate local franchises, offering a wider range of products than the acquired company could have, thus increasing the number of options for customers. This has been the driving force behind its growth in the recent years.

- At the Barclays 2018 Global Financial Services Conference in September 2018, the company's chief financial officer, John Shrewsberry anticipates return on equity to be 12-15% over the next two years. In the previous years, management expected to operate in a lower target range due to persistently low interest rates and stricter regulations. However, improving economic conditions has enabled the bank to target higher ranges. Notably, Wells Fargo's return on assets was 0.95% and average return on equity was 9% as of Sep 30, 2019. We believe its solid fundamentals will help achieve the targets over time.

- Wells Fargo experienced strong growth in loans over the past few years, despite the planned run-off from non-strategic/liquidating portfolios. The company's total loans recorded five-year CAGR (2014-2018) of 2.5%, with some annual volatility. Furthermore, deposits recorded five-year CAGR (2014-2018) of 2.4%. Both loans and deposits increased in the first nine months of 2019. Therefore, both loan and deposit balances are poised to grow amid improving economy.

- Despite the macro pressure, Wells Fargo's credit quality continues to normalize. This trend is expected to continue, thereby providing room to drive future earnings. Notably, net charge-offs remained near a low level of 27 basis points (bps) as a percentage of average loans (annualized) as of Sep 30, 2019, exhibiting the benefit of a diversified loan portfolio.

- Shares of Wells Fargo have underperformed the industry in the past six months. Despite this unfavorable trend, the company's earnings estimates for 2019 have been revised slightly upward over the past 30 days. Also, the stock seems undervalued when compared with the broader industry as its current price-to-book value and price-to-earnings(FI) ratios are lower than the respective industry averages. Also, the stock has a Value Score of B. Therefore, given the strong fundamentals and postive estimate revisions, the stock has upside potential.

Reasons To Sell:

> Wells Fargo's involvement in a horde of legal issues is a concern. Also, escalating expenses and lower NII remain headwinds. Furthermore, declining mortgage income remains a major drag.

- Revenue growth has become challenging at Wells Fargo. Though revenues witnessed a CAGR of nearly 1%, over the last five years (2014-2018), the same declined in the first nine months of 2019 due to lower net interest income. Moreover, according to management, net interest income, which makes up more than 55% of revenues, is expected to be down 6% in 2019 influenced by a number of factors, including loan growth, pricing spreads, the level of rates and the slope of the yield curve.

- Mortgage banking income recorded a negative three-year (2016-2018) CAGR of 29.6%, impacting overall top-line growth. The declining trend continued in the first nine months of 2019 as well. Wells Fargo, which was the largest mortgage originator in the United States as of 2017, has been experiencing lower mortgage servicing income.

- Wells Fargo is facing challenges to control costs for the past few years. Though non-interest expenses declined slightly in the first nine months of 2019, it recorded a five-year (2014-2018) CAGR of 3.4% due to hike in personnel and other expenses. The company remains focused on expense management with projection of 2019 expenses to be around $53 billion, which is at the top end of $52 to $53 billion target range. Nevertheless, we believe legal expenses related to pending litigation issues will keep hurting its bottom line in the upcoming period.

- Troubles mounted at Wells Fargo, in September 2016, following the revelation of opening of millions of unauthorized accounts. Since then, the bank has settled numerous litigations and penalties. Further, the bank has been slapped with new sanctions, including a cap on the assets position by the Federal Reserve. Disclosure of issues in its auto-insurance business, online bill pay services, and in the Wealth and Investment Management segments are also on the downside. Recently, in a major setback, U.S. CFPB director expressed her dissatisfaction with Wells Fargo's progress fixing its risk management issues. With the ongoing review process of business practices, more wrongdoings may be revealed, increasing negative impact on the company's top line and reputational headwinds for the bank.

- Wells Fargo received approval for its 2019 capital plan from the Fed. Per the plan, the company raised third-quarter 2019 common stock dividend to 51 cents per share, up 13.3%. The approved plan also includes share buyback program of up to $23.1 billion for the four-quarter period beginning Jul 1, 2019. Previously, on Investor Day in May 2018, the bank raised the higher end of its payout ratio target to 55-80% from 55-75%. Though the company boasts an impressive capital deployment plan with a decent dividend payout ratio, its debt/equity ratio is unfavorable compared with the broader industry. Further, the company's performance in the past few quarters was volatile. Hence, its capital deployment activities might not be sustainable.

Last Earnings Report

Wells Fargo's Q3 Earnings Disappoint, NII Down

Quarter Ending	09/2019
Report Date	Oct 15, 2019
Sales Surprise	4.19%
EPS Surprise	-20.00%
Quarterly EPS	0.92
Annual EPS (TTM)	4.63

Wells Fargo's third-quarter 2019 earnings of 92 cents per share lagged the Zacks Consensus Estimate of $1.15 on lower net interest income. The figure also comes in lower than the prior-year quarter earnings of $1.13 per share.

Results include discrete litigation accrual (not tax-deductible) worth 35 cents per share, and gain from the sale of Institutional Retirement and Trust (IRT) business worth 20 cents. Also, the partial redemption of Series K Preferred Stock decreased earnings by 5 cents.

Higher fee income driven by improved trading activities, partly offset by lower mortgage banking revenues, aided the company's performance. Further, escalation in loans and deposits acted as tailwinds. However, reduced net interest income and rise in expenses were undermining factors. Moreover, provisions soared.

Net income came in at $4.6 billion compared with the $6 billion recorded in the prior-year quarter.

The quarter's total revenues came in at $22 billion, outpacing the Zacks Consensus Estimate of $21.1 billion. The reported figure also comes in higher than the prior-year quarter's tally of $21.9 billion.

Furthermore, on a year-over-year basis, quarterly revenue generation at the business segments was mixed. The Community Banking segment's total quarterly revenues slipped 5.1% and Wholesale Banking revenues were down around 5.5%. Yet, revenues in the Wealth and Investment Management unit were up 21.4%.

Net Interest Income Falls, Costs Up, Fee Income Improves

Wells Fargo's net interest income in the quarter came in at $11.6 billion, down 8% year over year. Higher interest expense and lower interest income from loans held for sale, equity securities and loans led to this downside, partly offset by increased interest income from debt securities, mortgage loans held for sale along with higher other interest income. Furthermore, net interest margin shrunk 28 basis points (bps) year over year to 2.66%.

Non-interest income at Wells Fargo came in at around $10.4 billion, up 11% year over year, primarily owing to rise in service charges on deposit accounts, card fees, net gains from trading activities and equity securities along with elevated other income. These increases were mainly muted by lower mortgage banking revenues and reduced net gains on debt securities.

As of Sep 30, 2019, total loans were $954.9 billion, slightly up sequentially. Higher consumer as well as commercial loan portfolio was recorded. Total deposits came in at $1.31 trillion, up 2% from the prior quarter.

Non-interest expense at Wells Fargo was around $15.2 billion, up 10% from the year-earlier quarter. This rise in expenses primarily resulted from elevated salaries and commission and incentive compensation, equipment costs and other expenses. These were partly offset by lower employee benefits, core deposit and other intangibles, along with FDIC and other deposit assessments.

The company's efficiency ratio of 69.1% came in above the 62% recorded in the year-ago quarter. A rise in efficiency ratio indicates a fall in profitability.

Credit Quality: A Mixed Bag

Wells Fargo's credit quality metrics was a mixed bag in the September-end quarter. Allowance for credit losses, including the allowance for unfunded commitments, totaled $10.6 billion as of Sep 30, 2019, down 3.6% year over year.

Net charge-offs were $645 million or 0.27% of average loans in the reported quarter, down 5.1% from the year-ago quarter's net charge-offs of $680 million (0.29%). Non-performing assets slipped 16.7% to $6 billion, in the third quarter, from $7.2 billion reported in the prior-year quarter. Notably, provision for credit losses was $695 million, 20% higher.

Strong Capital Position

Wells Fargo has maintained a sturdy capital position. During the July-September quarter, the company returned $9 billion to shareholders through common stock dividends and net share repurchases.

Wells Fargo's Tier 1 common equity under Basel III (fully phased-in) decreased to $144.7 billion from $148.9 billion recorded in the prior-year quarter. The Tier 1 common equity to total risk-weighted assets ratio was estimated at 11.6% under Basel III (fully phased-in) as of Sep 30, 2019, down from 11.9% in the year-earlier quarter.

Book value per share advanced to $40.48 from $37.55 recorded in the comparable period last year.

Return on assets was 0.95%, down from 1.27% in the prior-year quarter. Return on equity was 9%, down from 12.04% in the comparable prior-year quarter.

Outlook

Wells Fargo partially redeemed Series K Preferred Stock, which reduced earnings by 5 cents per share due to the elimination of purchase-accounting discount recorded on these shares during the Wachovia acquisition. This partial redemption will reduce the amount of the company's quarterly preferred stock dividends by about $23 million, starting in the fourth quarter.

Fourth-Quarter 2019

Management currently expects MBS premium amortization to continue to increase in the fourth quarter but at a slower pace.

Mortgage originations for the quarter are expected to remain at a level similar to third quarter. Notably, originations increased sequentially due to higher refinance volumes from lower interest rates with refinancing increasing to 40% of originations in the third quarter.

The company expects effective income tax rate to be about 17.5%, excluding the impact of any unanticipated discrete items.

Full-Year 2019

Management expects NII to be down 6% compared with 2018 influenced by a number of factors including loan growth, pricing spreads, the level of rates and the slope of the yield curve.

The company expects 2019 expenses to be around $53 billion, which is at the top end of $52 to $53 billion target range. This excludes annual operating losses in excess of $600 million and also excludes deferred compensation expense. For 2020, expenses are expected in $50-$51 billion range.

Near Term

Per management, the bank's strategic and financial targets beyond 2019 will be established once a permanent CEO comes in place. Therefore, currently, the bank focuses on cost-saving initiatives.

Moreover, ROE is anticipated to be 12-15% over the next two years (ended 2020), while ROTCE is expected to be 14-17%.

Recent News

Wells Fargo & City of Philadelphia Resolve Discrimination Suit - Dec 16, 2019

Relating to a discrimination lawsuit filed against Wells Fargo by the City of Philadelphia in May 2017, the two have agreed for a settlement, per which the bank will contribute $10 million for sustainable housing-related programs for low-and moderate-income residents.

Accusations

In May 2017, a federal lawsuit was filed against Wells Fargo by the City of Philadelphia, accusing the former of engaging in discriminatory lending practices.

The city argued that the bank had purposely provided minorities with riskier loans, carrying high interest rates, even though they were eligible for cheaper loans. In an analysis conducted on the bank, it was revealed that about 23% of loans given to the African-American and Latino borrowers were risky and costly, while for the whites it represented only 7.6%.The complaint also noted that bank officials were aware of such practices.

It was noted that the U.S. Department of Justice and some of the other cities such as Los Angeles, Oakland, Miami, Baltimore, Memphis and Miami Gardens filed similar lawsuits against Wells Fargo. While some of these have already been resolved, others are continuing.

Nevertheless, the bank has declined the charges, claiming those to be “unsubstantiated accusations.” It promises to have fairly conducted business in Philadelphia for the last 140 years. Additionally, Wells Fargo had requested to rescind the suit in July 2017, as the city failed to prove the allegations, but was denied by U.S. District Judge Anita Brody in January 2018.

Last June, Wells Fargo again filed a motion, claiming the city has failed to identify the loans alleged as discriminatory. Furthermore, the number of loans claimed was later reduced to 506 by the city from the previously-claimed 1,067. Nonetheless, the city claimed the bank’s request to be “lacking merit" and believed it should be denied.

In addition to the above, a motion was filed by the city in August 2018, requesting Brody to demand audits and audit-related documents associated with Wells Fargo’s FHA compliance relating to underwriting, buying, or selling loans to minority residents of Philadelphia.

The federal judge ordered the city to produce “enough information to identify each specific loan that the city alleged to be discriminatory in its complaint.” The deadline provided for the same was till Oct 5.

Further, the city’s motion received rejection, under which it had demanded from the court to induce Wells Fargo for providing documents and data of correspondent loans where the latter had purchased debt, although it did not play any role in the credit decision. Moreover, the city’s claims included allegations on Wells Fargo for setting the terms and/or pricing under the Fair Housing Act on these loans as per the bank’s needs though originated by third-party correspondent lenders.

As part of the recent settlement, Wells Fargo refrained from admitting the liability and “vigorously denied” the allegations.

Settlement

Specifically, the settlement includes grants worth $8.5 million for down payment and closing-cost assistance to low- and moderate-income persons and households who would purchase houses within the limit of the city. Notably, the grants will be aided through the Philadelphia Housing Development Corporation’s (PHDC) current program infrastructure.

Further, $1 million will be distributed among up to three non-profit organizations, which have implemented the city’s Residential Mortgage Foreclosure Prevention Program. Lastly, grants worth $0.5 million will be provided to the city’s land-care program.

Notably, homeowners and the referenced not-for-profit organizations will fully benefit from this agreement. Moreover, the funds provided by Wells Fargo will not be used for any other purpose.

Additionally, the City of Philadelphia and Wells Fargo will jointly conduct a program entitled "Understanding Philadelphia". The program initiated for staffs working at Wells Fargo Home Mortgage in the Philadelphia community and officials of the city and PHDC, along with some external subject matter experts.

The program motive is the securitization of the history of the housing market in the city, its varied neighborhoods and residents’ existing housing needs.

"We’re pleased that we’ve been able to resolve this matter in a way that will provide real, tangible sustainable homeownership opportunities for many low- and moderate-income residents of Philadelphia," said Joe Kirk, Wells Fargo region bank president, Greater Philadelphia. "The efforts funded by these grants are consistent with Wells Fargo’s broader philanthropic strategy, which includes a $1 billion commitment over the next six years to address the U.S. housing affordability crisis," Kirk further noted.

Wells Fargo Decreases Its Prime Lending Rate by 25 Bps - Oct 30, 2019

Pursuant to the U.S. Federal Reserve interest rate cut by 25 bps, Wells Fargo reduced its prime lending rate from 5.00% to 4.75%, effective Oct 31. Prior to this, the company reduced the rate from 5.25% to 5.00%, in September 2019.

Wells Fargo Divests Majority Interest in Eastdil – Oct 1, 2019

Wells Fargo closes the sale of its commercial real estate brokerage business, Eastdil Secured (Eastdil) on Oct 1, 2019, and recorded a pre-tax gain of about $360 million, which will be reflected in fourth-quarter 2019 net income.

The plan was annouced in June 2019 to divest the private real estate investment banking division, Eastdil.

Eastdil's management reclaimed ownership in the firm, in partnership with Guggenheim Investments clients and Singaporean sovereign wealth fund Temasek Holdings.

Post-sale, Wells Fargo retained the public market real estate investment bankers of Eastdil, which will form the Real Estate, Gaming, Lodoging, and Leisure ("REGAL") industry coverage group within Corporate & Investment Banking.

Through REGAL, Wells Fargo will provide a full range of investment banking and capital markets services, including advisory solutions on mergers and acquisition, debt and equity origination and structuring. Also, Wells Fargo disclosed that REGAL will continue its long-standing partnership with Wells Fargo's Commercial Real Estate group.

"This newly dedicated Real Estate, Gaming, Lodging, and Leisure investment banking coverage group will leverage partnerships across the bank, with a deep pool of talent and expertise, to serve clients in these key industries and their complex financial needs," said Rob Engel, co-head of Wells Fargo Corporate & Investment Banking.

Wells Fargo Hands Over Turnaround Task to BNY Mellon's CEO - Sep 27, 2019

Wells Fargo announced the appointment of Charles W. Scharf, chairman and CEO of Bank of New York Mellon, as its second CEO post public and political outrage concerning the sales scam in September 2016.

Scharf is said to have experience in retail banking zone, having served roles in JPMorgan and Bank One previously. In July 2017, he became CEO of BNY Mellon, prior to which served as leader in Visa for nearly four years.

"Charlie is a proven leader and an experienced CEO who has excelled at strategic leadership and execution and is well positioned to lead Wells Fargo's continued transformation," said Chairwoman Betsy Duke.

On Oct 21, Scharf will replace interim CEO C. Allen Parker, who will continue to serve as the company's General Counsel.

Wells Fargo kept its promise to appoint someone from outside to complete its transformation. The tough task took six long months as the candidate had to satisfy The Office of the Comptroller of the Currency as well.

The prior CEO and president, Timothy J. Sloan, had made a hasty exit from his position in March 2019 calling his presence a "distraction" that kept the bank from moving past previous wrongdoings.

The new CEO will be required to work toward turning around the company's fortune and name, which nosedived following the sales and subsequent auto lending scandals. Further, the Federal Reserve has placed a cap on its asset size until regulators are satisfied with its progress on corporate governance issues.

Scharf had received $9 million as total pay package at BNY Mellon in 2018. At Wells Fargo, his base salary will match Sloan's $2.5 million. Also, per a sec filing, he will be entitled to a cash bonus of between $5 million and $7.5 million in 2019.

Further, he will receive $26 million as Wells Fargo share rights over five years to make up for the income that was deferred at BNY Mellon. Moreover, board has agreed to award $15.5 million in performance shares for February 2020, subject to certain conditions.

Wells Fargo Unveils DLT-Based Cross-Border Transfer Program - Sep 17, 2019

Wells Fargo is launching pilot digital cash transfer program that will use its distributed ledger technology (DLT) platform to settle cross-border money transfers internally across its global network using digitized cash.

The pilot program is expected to be available in 2020. It will help complete dollar transfers initially and later expand to multicurrency transfers and gradually cover its entire global branch network.

Wells Fargo has no plans to connect its DLT network with any other digital cash solutions in the financial services markets. The company is said to have successfully tested the concept of money transfers between the United States and Canada.

Wells Fargo is introducing the service after acknowledging the importance of digitization of banking services in recent times. Also, it claims that DLT network will be a reusable enterprise utility through which it can build and deploy multiple DLT-based applications.

Lisa Frazier, head of the Innovation Group at Wells Fargo said, "We believe DLT holds promise for a variety of use cases, and we're energized to take this significant step in applying the technology to banking in a material and scalable way. Wells Fargo Digital Cash has the potential to enable Wells Fargo to remove barriers to real-time financial interactions across multiple accounts in multiple marketplaces around the world."

Wells Fargo Ratings Affirmed by Moody's, Outlook Raised - Aug 14, 2019

Moody's Investors Service recently affirmed all the ratings of Wells Fargo and its subsidiaries. Notably, the outlook has been raised from negative to stable.

The Wall Street biggie's senior debt rating has been affirmed at A2, senior debt rating at Aa2 and subordinated debt rating at Aa3. The bank's deposit rating is Aa1/Prime-1 and standalone baseline credit assessment (BCA) stands at a2. The bank's subsidiary has an Aa2 senior debt rating and an Aa3 subordinated debt rating, and its counterparty risk assessments are Aa1(cr)/Prime-1(cr).

Reasons Behind Affirmation

Wells Fargo's strong balance sheet backed by capital strength, liquidity and credit quality supported Moody's decision to affirm ratings. Also, several investments toward corporate risk management and compliance functions to remove the loopholes that have dragged attention from regulators.

Per Moody's, progress in Wells Fargo's balance sheet post fake accounts scandal in September 2016 is commendable. Also, consumer banking financial metrics have been stable, liquidity seems robust and it passed the Fed's annual bank stress test successfully, which indicates its stability.

The ratings agency expects appointment of the new CEO to not affect its risk profile. Also, Wells Fargo's ability to serve core retail and commercial clients without exceeding the asset cap imposed by the Fed in February 2018 impressed Moody's.

However, Moody's remains apprehensive of Wells Fargo's exposure to litigations on account of prior sales practices and risk and compliance shortcomings, which can cause reputational damage. Also, it is of the opinion that the bank will be hit with a multi-billion-dollar cost to settle all outstanding governmental investigations.

Further, if Wells Fargo is unable to satisfy the Fed's requirements for lifting the asset cap in the next year or two, Moody's believes that it could result in deeper risk management and governance deficiencies and will push ratings agency to review the firm's ratings and outlook.

What Can Trigger Change in Ratings?

Upward rating pressure can be created from significantly stronger profitability metrics, a healthy balance sheet and the successful resolution of all legacy issues.

However, management's inability to correct the firm's governance and risk management deficiencies could result in downward ratings movement. Also, any noticeable franchise erosion, such as a loss of deposits, or an outsized spike in nonperforming assets would also affect the ratings.

Wells Fargo to Overhaul Commercial Banking Business – Jun 6, 2019

Wells Fargo has announced plans to restructure its Commercial Banking unit by combining Business Banking, Government & Institutional Banking and Middle Market Banking businesses. It expects to further improve customer experience through this move.

The new structure will be headed by Kyle Hranicky, who has been serving Wells Fargo for the past 25 years. It will have more than 6,000 team members across 24 divisions and 80 markets nationwide, and cater all the financial needs of customers.

Commercial banking division will remain part of its wholesale banking line of business. The wholesale banking division will now be divided into commercial banking, corporate and investment banking, commercial real estate and commercial capital.

The unit will provide credit and treasury solutions to customers with annual sales ranging between $5 million and $2 billion. Further, the bank provides expertise across industries, like Food, Beverage & Agribusiness, Investor Real Estate, Government and Technology throughout its regional presence, with its newly formed national Specialized Industries group.

Also, Wells Fargo reduced the layers of management involved so as to simplify the leadership structure. The commercial business will operate in three regions across the United States i.e., East, Central, and West — each region having a dedicated leader.

"With our new integrated business model and regional structure, we're strengthening our core capabilities - providing local service and industry expertise. Our market leadership affirms that we have the best team in the industry, and we're excited to continue to help our commercial customers grow and be successful." said Hranicky.

CFPB Dissatisfied With Wells Fargo's Progress on Risk Management – Apr 10, 2019

In a letter to Democratic Senators Elizabeth Warren and Sherrod Brown, U.S. Consumer Financial Protection Bureau (CFPB) Director Kathy Kraninger expressed her dissatisfaction with Wells Fargo's progress fixing its risk management issues.

"I am not satisfied with the bank's progress to date and have instructed staff to take all appropriate actions to ensure the bank complies with the consent order and Federal consumer financial law," she wrote in the letter dated April 5. "Broadly speaking, I consider all options on the table for enforcing Bureau consent orders," Kraninger added.

Previously, in Dec 2018, the central bank has rejected Wells Fargo's scandal prevention plans and demanded a stricter check over management. The bank had put forth the plan in April 2018, following which, CEO Tim Sloan and other executives had been in discussions with Fed officials over the ideal measures.

Wells Fargo was supposed to have the plan "approved, implemented and an independent third-party review completed" by the end of September 2018. However, the bank has clearly missed the target date, which could have led to more penalties, but the regulator has instead decided to allot Wells Fargo more time to satisfy the settlement terms.

Delay in plan approval is likely to keep Wells Fargo's asset growth restricted for a longer period. In order to get the cap lifted earlier, the bank will have to bolster its governance and controls.

Background

In February 2018, Federal Reserve chairperson — Janet Yellen — punished the lender with new sanctions for the malpractices and fake accounts scandal which came into the limelight in September 2016.

The Federal Reserve has ordered the bank to replace four board directors and also not increase its assets position beyond $1.95 trillion (as of Dec 31, 2017). Notably, Wells Fargo has been instructed to substitute three directors by April, and the fourth by the end of 2018.

Therefore, the Fed’s action demonstrates poor governance, compliance and risk management of Wells Fargo associated with the sales practices scandal, as well as mishandling of auto-insurance and mortgage fees. Notably, it is restricted from growth until governance and risk management improve; however, the bank is allowed to continue with current banking activities.

Dividend Update

On Oct 22, Wells Fargo announced quarterly common stock dividend of 51 cents per share. The dividend was paid on Dec 1 to its shareholders of record as on Nov 8, 2019.

Valuation

Wells Fargo's shares are up 10.2% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are up 27.3% and 15.2% over the past year, respectively.

The S&P 500 index is up 24.7% in the past year.

The stock is currently trading at 12.31X forward 12 months earnings, which compares to 11.86X for the Zacks sub-industry, 14.68X for the Zacks sector and 18.74X for the S&P 500 index.

Over the past five years, the stock has traded as high as 15.61X and as low as 8.51X, with a 5-year median of 11.83X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $55 price target reflects 12.85X forward earnings.

The table below shows summary valuation data for WFC

Valuation Multiples - WFC					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	12.31	11.86	14.68	18.74
	5-Year High	15.61	13.85	16.21	19.34
	5-Year Low	8.51	9.04	12.01	15.17
	5-Year Median	11.83	11.43	13.98	17.44
P/TB TTM	Current	1.73	2.35	3.26	12.38
	5-Year High	2.36	2.68	3.98	12.45
	5-Year Low	1.42	1.44	2.44	6.03
	5-Year Median	1.95	2.1	3.46	9.07
P/S F12M	Current	2.79	4.07	6.53	3.47
	5-Year High	3.61	4.59	6.61	3.47
	5-Year Low	2.33	2.61	5.2	2.54
	5-Year Median	2.94	3.59	6.04	3

As of 01/07/2020

Industry Analysis **Zacks Industry Rank:** Top 12% (30 out of 254)

Top Peers

Bank of America Corporation **(BAC)**	Neutral
Citigroup Inc. **(C)**	Neutral
Fifth Third Bancorp **(FITB)**	Neutral
JPMorgan Chase & Co. **(JPM)**	Neutral
KeyCorp **(KEY)**	Neutral
M&T Bank Corporation **(MTB)**	Neutral
The PNC Financial Services Group, Inc **(PNC)**	Neutral
U.S. Bancorp **(USB)**	Neutral

Industry Comparison Industry: Banks - Major Regional

Industry Peers

	WFC Neutral	X Industry	S&P 500	BAC Neutral	C Neutral	JPM Neutral
VGM Score	C	-	-	D	D	D
Market Cap	222.72 B	42.71 B	23.72 B	311.41 B	171.95 B	426.19 B
# of Analysts	7	7	13	6	7	5
Dividend Yield	3.87%	2.66%	1.79%	2.08%	2.59%	2.65%
Value Score	B	-	-	C	B	C
Cash/Price	1.46	0.67	0.04	2.23	4.53	2.33
EV/EBITDA	3.34	5.26	13.90	-2.28	-8.48	-3.98
PEG Ratio	1.11	1.45	2.00	1.27	0.80	1.85
Price/Book (P/B)	1.29	1.37	3.34	1.27	0.97	1.81
Price/Cash Flow (P/CF)	8.71	10.68	13.67	10.61	9.13	11.22
P/E (F1)	12.33	12.35	18.72	11.42	9.33	12.97
Price/Sales (P/S)	2.12	2.61	2.66	2.71	1.68	3.01
Earnings Yield	8.11%	8.10%	5.31%	8.75%	10.72%	7.71%
Debt/Equity	1.33	0.95	0.72	0.99	1.36	1.26
Cash Flow ($/share)	6.05	6.05	6.94	3.26	8.63	12.11
Growth Score	F	-	-	F	F	F
Hist. EPS Growth (3-5 yrs)	2.76%	13.07%	10.56%	30.95%	13.07%	15.31%
Proj. EPS Growth (F1/F0)	-5.74%	4.40%	7.42%	12.83%	9.06%	0.59%
Curr. Cash Flow Growth	3.01%	17.06%	14.83%	25.85%	19.03%	23.43%
Hist. Cash Flow Growth (3-5 yrs)	2.49%	7.49%	9.00%	14.04%	5.10%	7.08%
Current Ratio	0.86	0.88	1.23	0.92	1.00	0.93
Debt/Capital	54.26%	45.81%	42.92%	47.56%	55.14%	54.37%
Net Margin	21.67%	23.17%	11.08%	NA	NA	NA
Return on Equity	13.01%	12.25%	17.16%	12.05%	10.16%	14.63%
Sales/Assets	0.05	0.05	0.55	0.05	0.05	0.05
Proj. Sales Growth (F1/F0)	-5.11%	0.49%	4.15%	NA	NA	NA
Momentum Score	A	-	-	A	F	A
Daily Price Chg	-0.83%	-0.60%	0.10%	-0.66%	-0.87%	-1.70%
1 Week Price Chg	-0.93%	-0.81%	-0.30%	-1.27%	0.04%	-0.57%
4 Week Price Chg	-1.92%	1.61%	2.33%	3.25%	3.93%	1.03%
12 Week Price Chg	5.09%	11.86%	7.02%	16.45%	10.59%	13.27%
52 Week Price Chg	10.77%	23.82%	24.61%	35.71%	42.01%	35.11%
20 Day Average Volume	16,101,445	3,702,650	1,589,897	0	0	0
(F1) EPS Est 1 week change	0.26%	0.32%	0.00%	0.71%	-0.34%	0.28%
(F1) EPS Est 4 week change	0.12%	0.24%	0.00%	0.82%	-1.18%	0.58%
(F1) EPS Est 12 week change	-3.72%	-0.38%	-0.56%	1.08%	-1.49%	1.02%
(Q1) EPS Est Mthly Chg	1.43%	0.50%	0.00%	2.11%	0.00%	1.73%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	F
Momentum Score	A
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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