HollAnd Advisors

Holland Views – Wells Fargo – Price: €50: MCap: $223bn

A time to be Greedy – First stop $70

Like Mr Market we are delighted by the appointment of Charles Scharf to be CEO of Well Fargo. We think he is an excellent choice but almost as important his appointment provides a reason for Wells' Regulators and customers to now look forward, rather than back. This is world class bank that has sat in the sin bin for far too long now. Coming from a position of envied strength however the company has suffered losing revenue growth opportunities while its cost base has remained the same over the last few years. It did however do one thing very right during this period, it focused on rebuilding customer trust in the business any way it could, even if that meant uncovering other areas of poor practice and hurting profits/ the share price. These are the right actions that a franchise type business should take during a threat to its credibility and reputation. The result now we believe is be bank that has(and is seen to have) paid the price for its past misdemeanours and can now regrow/realign itself once gain offering personal and corporate customers cost effective financial solutions. Importantly, its main competitive advantage (a very low-cost deposit base) remains sticky and fully intact.

Our focus on Wells during the last 12-24 month has been almost totally fixated on its elevated cost base. Today's share price multiple seemingly discounts this remaining high and thus implicitly assuming Wells has lost the advantages it once held over many of its peers. **We think the complete opposite**. Attached you will find our modelling for the companies cost base and how we think its future reduction(or faster loan growth) will see the company quickly recover the Return on Tangible Equity gap with its peers. Please do take a look at this spreadsheet - Below we extract the commentary from it:

In short however we would ask investors to reflect on the fact that:

- In the financial year to December 2018 Wells had a Return on Tangle Equity(ROTE) of 13.6% and a Cost Income Ratio(CIR) of a whopping 65%
- Bank America, a company Wells towered over for decades, reported a ROTE of 16% from a cost income ratio of 57%
- **Were Wells Fargo's Cost ratio to be 59% a year or two out, its likely ROTE would be c.16.5%. On a PE of 12x this would produce a share price of $71**
- We think this is not only provides great upside to the shares(40% in 2-3 years) it is also a very beatable target all achievable due to self-help, not due to a favourable economic backdrop. More likely **we think a ROTE of 18% one day is restored at Wells (required Cost ratio for this is 56%) On a PE of 13x this would give a share price of c.$85!!**

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