U.S. Bancorp USB (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
45.22 USD	52.00 USD	36.40 USD	70.20 USD	Medium	Wide	Stable	Exemplary	Banks

Strong Loan and Fee Revenue Growth Highlight U.S. Bancorp's 2Q

See Page 2 for the full Analyst Note from 15 Jul 2015

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The primary analyst covering this company does not own its stock.

Research as of 15 Jul 2015
Estimates as of 10 Jul 2015
Pricing data through 04 Aug 2015
Rating updated as of 04 Aug 2015

Currency amounts expressed with “$” are in U.S. dollars (USD) unless otherwise denoted.

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Investment Thesis 26 May 2015

There are few domestic banks that can match the operating performance of U.S. Bancorp since the financial turmoil of 2008-09. U.S. Bancorp's longstanding ability to post excess returns on capital is rooted in its superior credit underwriting, fee generation, strategically beneficial acquisitions, and sound management. As with any high-quality bank, strong loan underwriting is fundamental. At the height of the financial crisis, U.S. Bancorp never incurred a loss from severe credit charge-offs as seen at other institutions. With its well-diversified mix of loans and sound underwriting practices, net charge-offs peaked at just over 2% of loans during the crisis.

U.S. Bancorp has built an imposing slate of fee-based businesses from credit cards, wealth management, and payments processing, which account for approximately half of total revenue. U.S. Bancorp's payments processing business, which generally carries the payments between consumers and merchants, remains very lucrative, with a large number of merchants under contract. The payments processing business also remains highly scalable, and we expect it to continue its consistent contribution to the bottom line. As a result, the bank's efficiency ratio is exceptionally low--typically in the low 50% range. The low interest-rate environment has caused this to increase into the mid-50% range in recent years, but we expect the efficiency ratio to decline as rates rise into a normalized macroeconomic environment.

Even with its favorable mix of businesses and excess returns on capital, dividends have been limited in recent years by regulators to about 30%-35% of net income. We expect that the regulators will continue to allow large U.S. banks to limit dividend payouts from net income following annual reviews. We expect dividends to increase as U.S. Bancorp demonstrates its ability to generate excess capital. Ideally, the company aims to return 60%-80% of net income back to shareholders in the form of dividends or share repurchases. This would be the icing on the cake for USB, one of the best-run banks we cover.

Vital Statistics

Market Cap (USD Mil)	80,177
52-Week High (USD)	46.26
52-Week Low (USD)	38.10
52-Week Total Return %	11.0
YTD Total Return %	1.7
Last Fiscal Year End	31 Dec 2014
5-Yr Forward Revenue CAGR %	7.5
5-Yr Forward EPS CAGR %	8.1
Price/Fair Value	0.87

Valuation Summary and Forecasts

Fiscal Year:	2013	2014	*2015(E)*	*2016(E)*
Price/Earnings	13.3	14.5	*13.9*	*13.0*
Price/Book	2.3	2.1	*2.4*	*2.3*
Price/Tangible Book	3.5	3.1	*2.8*	*2.7*
Dividend Yield %	2.2	2.2	*2.2*	—

Financial Summary and Forecasts (USD Mil)

Fiscal Year:	2013	2014	*2015(E)*	*2016(E)*
Net Revenue	19,369	19,936	*21,432*	*22,964*
Net Revenue YoY %	-3.5	2.9	*7.5*	*7.2*
Net Interest Income	10,604	10,775	*11,659*	*12,580*
Net Interest Margin %	3.1	3.0	*3.0*	*3.1*
Pre-Tax Pre-Provision Earnings	9,104	9,224	*10,380*	*11,269*
Pre-Tax Pre-Provision Earnings YoY %	-5.3	1.3	*12.5*	*8.6*
Net Income	5,552	5,608	*5,804*	*6,241*
Net Income YoY %	2.0	1.0	*3.5*	*7.5*
Diluted EPS	3.03	3.09	*3.25*	*3.49*
Diluted EPS YoY %	5.6	2.1	*5.1*	*7.5*

Source for forecasts in the data tables above: Morningstar Estimates

Profile

As a diversified financial services provider, U.S. Bancorp is the nation's fifth largest bank with branches in 25 states in the western and northern United States. It is primarily funded by low-cost core deposits from the communities it serves. The company operates four profitable segments: wholesale and commercial real estate banking; consumer and small-business banking; wealth management and securities services; and payment services.

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Morningstar Analysis

Strong Loan and Fee Revenue Growth Highlight U.S. Bancorp's 2Q 15 Jul 2015

While U.S. Bancorp had strong balance sheet growth, net interest income growth struggled to increase significantly even though the bank had solid commercial loan growth. Nevertheless, fee revenue, primarily from its payment division as a result of seasonally higher credit and debit card revenue and merchant processing fees, increased along with higher trust and investment management fees. On the other hand, the net interest margin remains under pressure due to higher cash balances at the Federal Reserve funded by strong deposit growth and lower investment portfolio reinvestment rates. In terms of credit costs, asset quality improved with lower non-performing loans and continued low net charge-offs. As a result, we will maintain our wide moat rating and fair value estimate.

U.S. Bancorp reported net income attributable to common shareholders of $1.5 billion, or $0.80 per diluted share, for the second quarter of 2015 compared with $1.5 billion or $0.78 per diluted share a year ago. Net interest income for second-quarter 2015 increased slightly compared with the prior quarter due to lower funding costs coupled with higher nominal levels of investment securities. Loan growth, primarily in commercial and commercial real estate, drove up earning assets. However, yields on loans continued to experience downward pressure resulting in further net interest margin declines. The net interest margin equaled 3.03% for the second quarter compared with 3.08% last quarter. As we move further into the second half of 2015, we expect some stabilization of the net interest margin as yield pressure is expected to ease.

Credit quality remained strong as nonperforming loans continued to decrease and net charge-offs remained at very low levels. Nonperforming loans declined to $1.2 billion for second-quarter 2015 compared with $1.3 billion last quarter. Net charge-off levels remain below longer-term averages at 0.48% for the bank. The strong credit quality has allowed the bank to continue its modest release of loan loss reserves as loan loss provisions equaled $281 million for the quarter compared with $296 million of net charge-offs. We still expect loan loss reserve releases to end during 2015 as loan growth is expected to continue and provisions will be needed to reserve against that growth.

Overall, USB continues to perform well, posting a 53.2% efficiency ratio and a 14.3% return on equity. The bank repurchased 14 million common shares during the quarter, returning 76% of first-quarter 2015 earnings back to shareholders. Capital levels remain solid as USB's fully loaded Basel III common equity to risk-weighted asset ratio remained stable at 9.2%. This solid performance solidifies our stance that U.S. Bancorp as one of our Best Ideas among financial services stocks.

Valuation, Growth and Profitability 26 May 2015

We are raising our fair value estimate to $52 per share from $50 as account for time value of money since our last update along with increasing U.S. Bancorp's moat rating to wide. Our fair value estimate is 15.0 times estimated 2016 earnings and 3.3 times tangible book value. We project long-term net interest margin to increase from 3.0% to 3.3% by 2018.

In addition, we anticipate that total net charge-offs will average approximately 0.7% for most of the projected 2015-19 period, which is slightly above the 2013 level of 0.67% and low 2014 level of 0.57%. We are projecting that the equity/assets ratio will decline slightly from 10.75% for 2015 to 9.5% for 2019. We are projecting the efficiency ratio to range between 47% and 50%, which is consistent with a normalized interest rate environment. All together, we expect return on equity to increase to 17.6% by 2019, which is similar to its returns just before the financial crisis.

Scenario Analysis

We see U.S. Bancorp's net interest margin and net charge-off levels for two major loan categories (commercial

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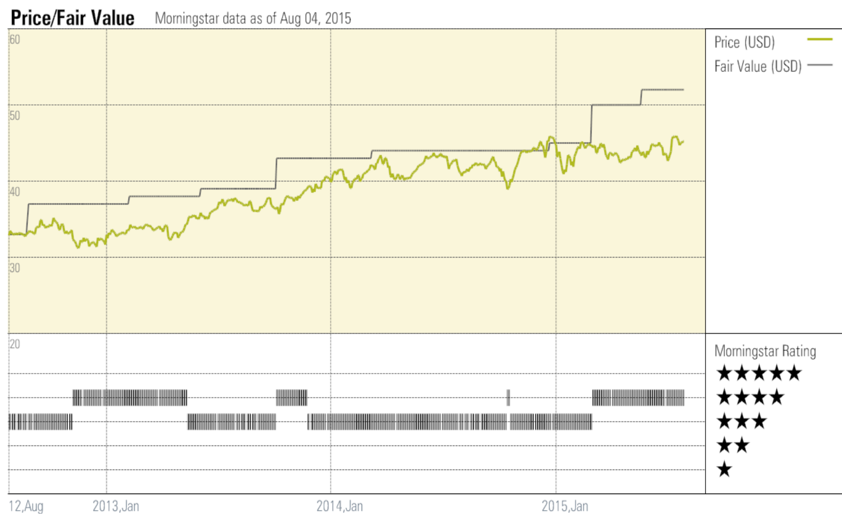
Morningstar Analysis



and credit cards) along with capital levels as the primary drivers of future valuation. In our upside scenario, we assume that net interest margin will equal 3.55% throughout the 2015-19 projected period. In addition, we assumed that overall net charge-offs will decline to an average of 0.46% of loans during the 2015-19 projected period compared with our 0.7% base level. Furthermore, we assume that the bank will operate with an equity/assets ratio of 8%. In this upside scenario, our fair value estimate would be $63 per share, or 18.2 times 2016 earnings per share and 4.0 times 2016 projected tangible book value.

In our downside scenario, we assume that net interest margin will struggle to recover from its current levels. Thus, we assume that net interest margin would fall to 2.75% and stay at that level throughout the five-year projected period. Also in this scenario, we assume that net charge-offs will remain elevated for an extended period averaging 1.22% over the projected period. In addition, we assume that equity/assets ratios would be maintained at a high level of 11.5%. As a result, we estimate the fair value estimate to be $32, or 9.3 times 2016 earnings per share and 2.0 times 2016 projected tangible book value.

Economic Moat

We think U.S. Bancorp has a wide moat as it possesses cost advantages along with switching costs for its customers that are consistent with our bank moat framework. In its retail and commercial banking segment, we think U.S. Bancorp has cost advantages through its superior credit, funding, and operating costs.

Over the past 10 years, overall net charge-offs have never exceeded 2.4%, even during the financial crisis. Many other U.S. banks experienced net charge-offs nearly double that amount during the crisis. Through an economic cycle, we think U.S. Bancorp and its strong credit culture will remain intact, contributing to low credit costs.

Next, we think bank moats are largely derived from a low-cost deposit base, allowing the bank to effectively compete for quality loans away from competitors to grow interest income. We believe U.S. Bancorp enjoys a competitive advantage with its funding costs, as it is smaller than that of aggregate banks insured by the FDIC.

These cost advantages are reinforced by implicit switching cost, which we see as high relative to the benefits of switching. While switching is nominally free, the benefits are often unclear with similar bank products across firms, nominally free checking accounts. Moreover, switching is viewed by customers as troublesome, especially for customers that use multiple products from their bank. As a result, retail banking customers tend to move banks only once a decade.

From a systemic standpoint, we believe the U.S. offers a fair banking environment. Though the quality of regulatory monitoring has become considerably stronger in the past several years, the country still utilizes a complex and somewhat archaic system of regulation. Furthermore, the

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Morningstar Analysis

Nature of Liabilities

	2012	2013	2014	2015(E)	2016(E)
Loan/Deposit Ratio %	83.31	84.89	84.37	84.74	85.09
Short Term Debt (% of Liabilities)	8.39	8.57	8.34	7.94	7.90
Liquid Assets (% of Assets)	13.68	13.57	16.58	16.39	16.33

Leverage

	2012	2013	2014	2015(E)	2016(E)
Assets/Equity	9.07	8.85	9.26	9.30	9.52
Tangible Common Equity/Tangible Assets %	6.54	6.72	6.71	6.86	6.82
Tier I Ratio %	10.50	10.80	9.00	—	—

Source: Morningstar Estimates

company's banking market is quite fragmented—U.S. Bancorp competes with a variety of regional and community banks as well as large money center institutions. Over the past 50 years, the banking system has achieved returns roughly in line with its cost of capital, which supports our view of the environment as intensely competitive. Our outlook is more positive from a macroeconomic and political standpoint. The U.S. is still the world's leading democracy, and maintains the world's reserve currency, all of which contribute to banking stability.

Moat Trend

We see U.S. Bancorp's moat trend as stable. Over our forecast period of 2015-19, we project an efficiency ratio averaging 49.0%, which is less than the last five years' average of 51.2% for U.S. Bancorp. These efficiency ratios are much less than most U.S. banks largely due to the fee revenue businesses of U.S. Bancorp such as payments and wealth management. At this point, we see little change in U.S. Bancorp's cost position in the medium term. In addition, net interest margin over the past five years has averaged 3.26%, which exceeds our net interest margin projection of 3.18% for 2015-19.

With respect to the payments business, we also see the moat trend as stable. While there are several merchant acquirers, the business is dominated by the large U.S. banks, which includes U.S. Bancorp. This is clearly a scalable business whereby little capital investment is required to service additional merchants. Barring significant consolidation with this business or consolidation among the larger processors, we do not see the moat component for this business changing significantly.

Risk

We have few concerns about the credit quality in U.S. Bancorp's loan portfolio. Even with competition for high-quality borrowers intensifying, nonperforming loan levels at U.S. Bancorp continue to decline. Net charge-off levels are under 1% of loans, which is low given the size of its credit card portfolio. Capital levels, which cushion the bank for loan losses, also remain strong and continue to improve as the bank is restricted from paying higher dividends. Furthermore, the allowance for loan losses represents more than 275% of nonperforming loans. We think U.S. Bancorp's balance sheet and loan portfolio poses little risk for significant future loan losses or to its continued strong operating performance.

Financial Health

We think U.S. Bancorp is in good financial health, as demonstrated by its low level of nonperforming loans and sufficient loss reserves to cover them. Capital remains decent, with the common equity Tier 1 ratio at 9.2% as of March, 2015. Dividends are still restrained by regulators, who have been cautious about allowing larger U.S. banks to pay higher dividends. Even with the severity of the financial crisis on banks, U.S. Bancorp never incurred a net loss during this period. In fact, it is achieving returns well in excess its cost of capital.

U.S. Bancorp's funding is also strong. Deposits comprise 78% of total liabilities and carry an average cost of approximately 17 basis points. The remainder of liabilities

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(19% of total assets) is primarily composed of long-term and short-term borrowings. Overall liability funding costs are about 43 basis points, which we think is low for a bank of this size.

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Bulls Say/Bears Say

Bulls Say

- Strong fee revenue continues to help insulate U.S. Bancorp from a flatter yield curve environment.
- Commercial loan growth will continue to strengthen as U.S. Bancorp increases lending and the U.S. economy strengthens. These higher-yielding assets will add to bottom-line performance.
- U.S. Bancorp is a top-five deposit gatherer in 15 of the 25 states in which it operates.

Bears Say

- Net interest margin expansion will be hindered by persistently low interest rates.
- Regulators continue to limit the bank's ability to pay dividends greater than 30% of net income.
- Additional regulation costs will mute net income improvements.

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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	InsiderActivity
MR. RICHARD K. DAVIS	CEO/President/Director/Chairman of the Board,Director	515,864	19 Feb 2015	—
ANDREW CECERE	COO/Vice Chairman	360,418	19 Feb 2015	—
DAVID B. O'MALEY	Director	306,331	18 Jul 2014	—
MS. PAMELA A. JOSEPH	CEO, Subsidiary/Chairman of the Board, Subsidiary	218,999	11 May 2015	134,160
P. W. PARKER	Chief Risk Officer/Vice Chairman	172,715	19 Feb 2015	—
JOHN R. ELMORE	Vice Chairman, Divisional	115,776	19 Feb 2015	—
JOSEPH C. HOESLEY	Vice Chairman, Divisional	107,523	19 Feb 2015	—
JEFFRY H. VON GILLERN	Vice Chairman, Divisional	67,695	23 Apr 2015	—

*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

Fund Ownership

Top Owners	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
Vanguard Total Stock Mkt Idx	1.71	0.33	-1,294	30 Jun 2015
Fidelity® Contrafund® Fund	1.37	0.94	255	30 Jun 2015
Vanguard Five Hundred Index Fund	1.15	0.42	81	30 Jun 2015
Vanguard Institutional Index Fund	1.07	0.42	86	30 Jun 2015
SPDR® S&P 500 ETF	0.95	0.43	21	03 Aug 2015
Concentrated Holders				
iShares US Regional Banks	0.11	18.56	12	03 Aug 2015
PowerShares KBW Bank Portfolio	0.05	8.09	18	03 Aug 2015
BMO Equal Weight US Banks ETF	0.03	7.23	28	30 Jun 2015
Fidelity® Select Banking Portfolio	0.06	6.87	126	30 Jun 2015
ProFunds VP Banks	—	6.48	-3	31 Mar 2015

Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/ Sold (k)	Portfolio Date
State Street Global Advisors (Aus) Ltd	0.94	0.42	16,446	31 Jul 2015
Berkshire Hathaway Inc	4.71	3.41	3,679	31 Mar 2015
New Jersey Division of Pensions and Benefits	0.18	0.12	3,397	30 Jun 2010
Vanguard Group, Inc.	5.34	0.28	2,771	31 Mar 2015
Wells Fargo Advisors, LLC	0.26	0.18	2,259	31 Mar 2015
Top 5 Sellers				
State Street Corp	4.21	0.34	-5,025	31 Mar 2015
1832 Asset Management L.P	0.01	0.02	-2,985	31 Mar 2015
Northern Trust Investments, N.A.	1.39	0.32	-1,728	31 Mar 2015
Marketfield Asset Management LLC	0.07	1.53	-1,543	31 Mar 2015
AllianceBernstein LP	0.79	0.50	-1,430	31 Mar 2015

Management 26 May 2015

We consider the stewardship of U.S. Bancorp's capital to be exemplary. Richard K. Davis has served as CEO of U.S. Bancorp since 2006 after previously serving as chief operating officer. He is clearly the dominant influence throughout the company, and we have been pleased with the performance of the bank under his leadership.

During Davis' tenure as CEO, U.S. Bancorp grew to become the fifth-largest bank in the country, up from the seventh-largest in 2006. It is now located in nearly half the U.S., has gained market share in many of its markets, and came through the worst financial crisis of our generation without realizing a loss in any year. He has helped nurture the company as a community bank operating in many markets while also being a low cost provider of numerous services and products.

More recently, Andrew Cecere became chief operating officer in early 2015 after serving as chief financial officer since 2007. In his place, Kathy Ashcraft Rogers, a 28-year veteran of the bank, was promoted to chief financial officer. We think these moves help to strengthen the overall skills of the senior management team.

As U.S. Bancorp looks to extend its advantages in its businesses, we think it will continue to realize strong returns on equity over the long term. Overall, we believe shareholders will be rewarded for Davis' leadership.

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Analyst Notes

Recent Housing Data Supports Our Case for an Accelerated, Above-Consensus Recovery 23 Jun 2015
The U.S. Census released May new home sales data that caps a string of solid housing data points in recent weeks. It has become abundantly clear that 2015 will be the year that housing regains its footing following a marked growth deceleration from mid-2013 through 2014. The recent data squares well with our longer term forecasts for an above-consensus housing starts and sales trajectory. We slightly increase our 2015 and 2016 multi-family-inclusive new home sales projections to reflect 22% and 24% growth to 565,000 and 700,000, respectively. We leave our housing-leveraged fair value estimates and economic moats unchanged, and reiterate NVR and Weyerhaeuser as our top U.S. housing picks.

The most bullish data of late has been new home sales. May single-family new home sales reached 546,000 on a seasonally adjusted basis, the best sales month since February 2008. On an unadjusted basis, new home sales increased 22% in May and are up 23% year-to-date versus the comparable period a year ago. We believe sales growth is improving due to a confluence of factors, including tighter labor markets, looser mortgage eligibility standards, and increased supply from builders, in an environment with highly favorable demographics, tremendous pent-up demand, and still-favorable affordability.

Other housing data indicate less pronounced trends. Calculated on a three-month moving average, housing starts (which satisfy the for-sale and for-rent market) reached 1.05 million in May, still 30% below our 1.5 million midcycle view. Starts have consistently grown in the mid-single digit range this year. Housing permits, which lead starts by one to two months, have accelerated its growth rate in recent months. Calculated on a three-month moving average, housing permit growth accelerated to 13% in May from 8% in April, indicative of stronger starts growth ahead. We reiterate our housing starts forecast of 1.10 million in 2015, 1.30 million in 2016, and 1.90 million cycle peak in 2019.

For our deep-dive U.S. residential construction outlook, please see our Construction Observer "Fading Financial Constraints Will Unleash Demographic Potential." For our homebuilding industry outlook and Best Idea NVR pitch, please see "NVR is the Builder Best Equipped for Housing's Propulsion."

A Major Refinement to Our Bank Moat Methodology Leads to 8 New Wide Economic Moats 26 May 2015
Following a major refinement to our bank economic moat methodology, we've upgraded eight banks to a wide economic moat: Wells Fargo, U.S. Bancorp, Svenska Handelsbanken, Toronto-Dominion Bank, Bank of Nova Scotia, Royal Bank of Canada, Banco Santander Chile, and Banco De Chile. The changes have resulted in higher fair value estimates across the group, as we assume excess returns persist over a longer time frame than before. Several of our new wide-moat banks are now undervalued, such as U.S. Bancorp, Banco Santander Chile, and Bank of Nova Scotia.

Our new methodology includes analysis of regulatory, competitive, political, and economic elements in all 22 countries we cover. These elements support the sustainability of banks' economic returns over time. Our updated analysis for rating financial systems explains why bank moats differ across our global banking coverage despite similar business models or similar profitability. Accordingly, we note that our wide-moat banks are generally contained within high-quality systems such as Australia, Canada, Sweden, and Chile, which score well across the banking system criteria we've developed. However, some U.S. banks, such as Wells Fargo and U.S. Bancorp, also earn wide moats despite operating in a weaker system. These banks score well on other factors, including evaluations of a bank's culture, balance sheet, its

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U.S. Bancorp USB (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
45.22 USD	52.00 USD	36.40 USD	70.20 USD	Medium	Wide	Stable	Exemplary	Banks

Analyst Notes

ability to fend off disruption, and its ability to generate excess returns.

As in the past, we see low funding costs as a key advantage for retail and commercial banks. However, we believe that switching costs play a key role in a bank's ability to maintain low-cost funding (its cost-advantage-based moat source) and are consequently adding switching costs as a moat source. In addition, we're delving deeper into moat sources for non-interest-earning banking businesses, which can contribute half or more of earnings at complex banks.

Investors see banking crises as the result of extraordinary circumstances, chiefly, unforeseeable economic shocks. They are therefore categorized as freak events. We strongly disagree as we believe that that banking crises are recurring and heavily influenced by nonmacro factors. We've observed over 150 banking crises since 1800 across our coverage of 22 countries.

As a result, we've made a major refinement in our bank moat methodology. We've introduced a deep analysis of the banking systems for all 22 countries we cover, as we believe that the more stable a given system is, the more confidence we can have in banks' excess returns over time. Our research shows that a thorough understanding of a bank's banking system, which includes regulatory, competitive, political and economic elements, informs how sustainable a bank's economic returns are over time.

We believe there are several key benefits for our research. First, we can highlight the strengths and weaknesses of each system, and the system's direct impact on the moatiness of banks. Second, we can explain why bank moats differ across our global banking coverage despite banks' operating similar business models. Third, we can discuss the differences between the moaty qualities of an individual bank and the strength of a banking system. Accordingly, we note that our wide-moat banks are generally contained within high-quality systems such as Australia, Canada, Sweden, and Chile, which score well across the banking system criteria we've developed. For our U.S. banks, we've awarded wide economic moats to several banks despite our fair assessment of the system. We see the U.S. banking system as strong from economic and political perspectives, but weaker from competitive and regulatory fronts. In our opinion, a highly competitive environment with over 6,000 banks operating in the market and the complex regulatory structure allow for lax regulatory monitoring and regulatory arbitrage.

Other changes focus on better describing how competitive advantages are created and sustained at interest-earning and fee-based financial businesses. As in the past, we see low funding costs as a key advantage for retail and commercial banks. While spread-based businesses are the heart of most banks' business models, investment banking, asset and wealth management, custody banking, and insurance can also play material or even dominate an individual firm's business model. Each one of these segments offers a recurring fee revenue stream. We highlight extreme cases in which a bank generating low net interest margins, high operating costs, and high credit costs looks like more like an asset or a wealth manager at the pretax profit level. As a result, the moat sources of banks that operate in multiple businesses can include cost and switching costs, but also intangibles in some cases due to the unusual scale and scope of a bank's expertise within a given niche that enables it to earn premium pricing. We believe firm-level economic moats are best assessed in this context and view a bank's moat rating as a composite of its exposure to--and competitive advantages in--various markets and lines of business.

The Outlook for U.S. Residential Construction Is Bright

05 May 2015

The outlook for housing is strong. We expect a combination

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of favorable demographics and fading financial constraints to push housing starts to 1.9 million by 2019, up from 2014's 1.0 million. We forecast an average 1.6 million starts annually through 2024, which would be the second-strongest decade for new residential construction in the post-war period, bested only by a 1.75 million annual pace in the 1970s. That might sound aggressive given the disappointing recovery of the past several years, yet the outlook is so promising precisely because the recovery has been so bad.

Demographic conditions are better than they appear. Although adult population growth is slowing, the age structure of the adult population is changing in ways that favor housing. The millennials, the largest generation in U. S. history, are entering their 30s, where increases in household formation and homeownership rates are greatest. Meanwhile, the baby boomers are far more likely to age in place than their predecessors. Because homeownership rates don't fall until past age 75, the boomers won't meaningfully subtract from housing demand until the 2030s.

Pent-up housing demand is significant. We estimate up to 6 million households weren't formed from 2005 to 2014 that otherwise might have been. We expect tighter labor markets and looser mortgage eligibility standards to unleash much of this pent-up demand. The job market has reached a tipping point as employers are finding fewer qualified applicants for open positions. A shrinking workforce will soon amplify this problem. We expect a material increase in mortgage availability as regulatory standards are finalized, litigation is settled, and banks, GSEs, and regulators focus on expanding mortgage credit. Meanwhile, over the next five years, the bulk of the foreclosures that occurred between 2009 and 2011 will roll off consumers' credit reports. This alone could account for up to 5 million homeowners returning to the market.

Our forthcoming report, "U.S. Residential Construction Outlook: Fading Financial Constraints Will Unleash Demographic Potential," details our expectations for housing, including household formation, homeownership, housing starts, new home sales, and home improvement spending. We identify companies most leveraged to the bullish narrative across the basic materials, consumer, financials, and industrials sectors.

Lower Asset Yields Continue to Pressure Net Interest Income for U.S. Bancorp 15 Apr 2015

Despite strong balance sheet growth still being achieved through solid commercial loan growth funded with core deposits, U.S. Bancorp struggled to raise net interest income growth in the first quarter, as the net interest margin remained under pressure due to lower asset yields. Nevertheless, excellent credit quality and low net charge-offs allowed U.S. Bancorp to keep its credit costs low, resulting in higher net income compared with a year ago. As a result, we will maintain our moat rating and fair value estimate.

The bank reported net income to common shareholders of $1.4 billion, or $0.76 per diluted share, for first-quarter 2015 compared with $1.3 billion or $0.73 per diluted share a year ago. Net interest income for first-quarter 2015 decreased compared with the prior quarter due to higher levels of cash equivalents and modest quarterly loan increases (excluding the reclassification of certain municipal loans to securities) as the bank positions itself to meet liquidity coverage ratio standards as well as loan demand. Loan growth drove up earning assets. However, yields on loans and securities continued to fall while funding costs remained stable, resulting in NIM declining. The NIM equaled 3.08% for the first quarter, compared with 3.14% last quarter. Going forward, we expect a further compression of 3-5 basis points per quarter as yield pressures continue.

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Credit quality remained strong and continues to improve as net charge-offs decreased to 0.45% of loans compared with 0.58% a year ago. These charge-off levels remain below longer-term averages for US Bancorp. The strong credit quality has allowed the bank to continue its modest release of loan loss reserves as loan loss provisions equaled $264 million for the quarter, compared with $278 million of net charge-offs. Regarding any future reserve releases, we still expect those to end in 2015 as loan growth is expected to continue and provisions will be needed to reserve against that growth.

Overall, US Bancorp continues to perform well, posting a 54.3% efficiency ratio and a 14.1% return on equity. The bank repurchased 12 million common shares during the quarter, returning 70% of first-quarter 2015 earnings back to shareholders. Capital levels remain solid as US Bancorp's fully loaded Basel III common equity to risk-weighted asset ratio equaled 9.2%. Given US Bancorp's consistent strong performance and solid Dodd-Frank Stress test results disclosed in March, we think the bank will continue to meet all regulatory capital requirements.

Citigroup Emerges From CCAR as Winner; Bank of America and Foreign Banks Disappoint 11 Mar 2015

The Federal Reserve announced late on March 11 that it has approved the capital plans of 28 banks (out of 31) participating in the Comprehensive Capital Analysis and Review while objecting to two banks' capital plans. For Bank of America, the Federal Reserve did not object to the capital plan but indicated that there were deficiencies in the capital planning process, which warranted near-term attention. The two objections (Deutsche Bank Trust Corporation and Santander Holdings USA) were over qualitative concerns because of widespread deficiencies across their capital planning processes. We do not anticipate changing our fair value estimates or moat ratings for any of the banks, but we think there are several key takeaways from the CCAR results.

U.S. money center banks continued to play a game of musical chairs with respect to their CCAR positioning, reinforcing our thesis that Bank of America, Citigroup, and JPMorgan are converging on a qualitative basis. The factors that once set JPMorgan apart from its more troubled peers are slowly disappearing--in part because Bank of America and Citigroup were forced to aggressively reduce risk. Among these three banks, Citigroup is the big winner in 2015, boosting its dividend and embarking on a large buyback program.

Last year, Bank of America was forced to adjust its capital plan, while this year JPMorgan was the firm that required a mulligan as the firm seemingly presented an overly aggressive request. JPMorgan's 2015 adjusted capital plan raised its minimum Tier 1 leverage ratio in a severely adverse scenario from 3.8% to 4.1%--just over the 4% limit. We estimate this change reduced planned distributions by roughly $8 billion, though the company will still boost its dividend by 10% and authorize $6.4 billion in buybacks--2.9% of its market capitalization. Bank of America, on the other hand, received no objection on a quantitative basis, but will need to correct deficiencies in its capital planning process, particularly its loss and revenue modeling, as well as improve certain internal control practices by September. In 2013, JPMorgan received a similar reprimand, but was still able to increase its dividend and repurchase shares as planned after complying with the Fed's demands. We therefore are not overly concerned by Bank of America's position. More discouraging, though, is the relatively small size of Bank of America's planned actions. The company plans only $4 billion in repurchases--just 2.4% of the company's market value--and no increases in dividends. We assume the company's inability to consistently demonstrate recurring earnings played a role.

Citigroup, on the other hand, appears to have passed with

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flying colors this year after posting the worst failure in 2014, based on qualitative factors. Citigroup will raise its dividend to $0.05 per quarter and repurchase up to $7.8 billion in shares beginning in the second quarter--a healthy 5% of its current market capitalization. Wells Fargo also received no objections, as we expected, and bumped its quarterly dividend to $0.375 from $0.35.

Not surprisingly, the credit card companies' excess capital and superb profitability also paid off. American Express is raising its dividend by 12% and buying back $6.6 billion in shares--8% of its market cap, while Discover will boost its quarterly dividend from $0.24 to $0.28 and repurchase $2.2 billion, or 8.5%, of its stock.

The large U.S. subsidiaries of foreign banks continued to have a difficult time with this process. Deutsche Bank Trust Corporation and Santander Holding USA both passed the stress tests on a quantitative basis, with Tier 1 ratios of 34.7% and 9.4%, respectively, in the severely adverse scenarios. But, their capital plans were rejected on a qualitative basis. For both banks, specific deficiencies were identified in a number of key areas including governance, internal controls, risk identification and risk management, management information systems, and assumptions and analysis that support the capital planning processes. For Deutsche Bank, the result was completely expected. Deutsche was entering the Comprehensive Capital Assessment and Review process for the first time in 2015, and foreign banks entering the process typically fail on their first attempt. For example, HSBC North America Holdings and RBS Citizens failed last year, which was their first time, but received Fed approval the second time around. Overall, the results for Deutsche are much less important than they are for U.S. banks--foreign banks that receive objections may not be allowed to distribute dividends from the U.S. subsidiary to the parent company, but cannot be prevented from paying dividends to shareholders at a parent level.

The Federal Reserve also issued a qualitative objection to the capital plans of Santander Holdings USA, a division of Spain's Banco Santander. This is the second year in a row that Santander Holdings USA received a qualitative objection from the Federal Reserve, and the reasoning behind the objection is exactly the same as the prior year. As such, it appears that Santander Holdings did little to improve the internal controls and risk management deficiencies highlighted by the Fed since last year. This sort of indifference certainly creates a negative perception of the bank, but actually has little impact on the bank's ability to pay dividends to its shareholders as a foreign bank. Like Deutsche Bank, the objection prevents Santander Holdings USA from distributing dividends to the parent company, but the parent company's dividend to shareholders is not dependent on this transfer of capital, as it can draw upon funds flowing to the parent from its several geographic subsidiaries to fund the dividend. Further, the Spanish parent may not be interested in extracting a dividend from its U.S. operations because the U.S. market represents one of the global bank's best organic growth opportunities. In our view, we think this result is suggestive that Banco Santander is more focused on meeting European capital regulations and guidelines and that the U.S. arm’s risk controls and capital planning will improve in conjunction with the broader bank’s progression.

Last, it is also noteworthy that along with JPMorgan Chase, both Goldman Sachs Group and Morgan Stanley received nonobjections to their resubmitted capital action plans since last week's stress test results were released. Under the adjusted plans, Goldman Sachs' minimum Tier 1 capital ratio will be 6.4% instead of 5.9%, and its total risk-based capital ratio will be 8.1% instead of 7.6%. For Morgan Stanley, its minimum Tier 1 capital ratio will be 6.2% instead of 6.0%, and its total risk-based capital ratio will be 8.2% instead of 7.4%. Overall, we remain satisfied with both companies'

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Analyst Notes

capital ratios under the Federal Reserve's severely adverse scenario.

Banks Breeze Through Federal Reserve's Annual Quantitative Stress Tests 05 Mar 2015

Late on March 5, the Fed released the results from the supervisory stress tests conducted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act. This year, the stress test differed from prior years in that the Federal Reserve used two scenarios, "adverse" and the newly added "severely adverse" scenarios, with the latter characterized by a substantial global weakening in economic activity, including a severe U.S. recession, large reductions in asset prices, significant widening of corporate bond spreads, and a sharp increase in equity market volatility. All 31 of the banks subject to the stress test passed as the minimum of their Tier 1 common ratio stayed above 5% under both the severely adverse and adverse stress-case scenarios. The results are no surprise to us as they are generally in line with Morningstar's own Stress Test analyses.

The Fed noted in its press release that for all 31 banks as group, that the cumulative loss rate for all accrual loan portfolios is 6.1% over a nine-quarter period, lower than the loss rate from the 2014 DFAST, or Dodd-Frank Act Stress Test. As stated in the Federal Reserve's press release, this reflects a "continuing a trend of declining loan loss rates under the severely adverse scenario over time, as borrower and loan characteristics have continued to improve." We also are interested to see that estimated losses relating to trading activities and large counterparty failures were manageable across the universe of large banks (public information on individual counterparty exposures is scarce) equaled $55 billion this year under the adverse scenario--nearly equaling the $57 billion in estimated losses last year. Under the severely adverse scenario, estimated losses totaled $103 billion.

Next on the calendar for the Fed is the March 11 release of the results from the Comprehensive Capital Analysis and Review. The CCAR takes into account each company's capital plans, such as dividend payments, stock repurchases, or planned acquisitions, along with a qualitative assessment of the bank's capital planning process. The Fed basically evaluates whether each bank would still pass the stress test even after planned capital releases. We think the capital return plans of the U.S. banks we cover will be accepted by the Fed, given these banks' experience with the process. We're more concerned, however, about Deutsche Bank, which is entering the process for the first time in 2015. In 2014, non-U.S. banks in their first go-around with the tests fared poorly--Banco Santander, HSBC, and Royal Bank of Scotland's capital return plans were rejected by the Fed on qualitative grounds.

In fact, we would not be surprised to see certain companies approved for significant dividend increases at that time. Given that all companies would maintain adequate capital buffers under a severely adverse scenario, we think firms with exceptionally low payout ratios like Bank of America and Citigroup could easily boost payout assuming their qualitative processes have improved. We also think the exceptionally high capital levels of American Express and Discover would allow these firms to boost buybacks or dividends.

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Morningstar Analyst Forecasts

Financial Summary and Forecasts

Growth (% YoY)	3-Year Hist. CAGR	Dec 2012	Dec 2013	Dec 2014	*Forecast* Dec 2015	*Forecast* Dec 2016	*5-Year Proj. CAGR*
Net Interest Income	*2.1*	6.1	-1.3	1.6	*8.2*	*7.9*	*7.5*
Pre-Tax, Pre-Provision Earnings	*0.9*	7.1	-5.3	1.3	*12.5*	*8.6*	*9.0*
Net Income	*5.7*	14.5	2.0	1.0	*3.5*	*7.5*	*8.1*
Diluted EPS	*7.8*	16.1	5.6	2.1	*5.1*	*7.5*	*8.1*

Profitability	3-Year Hist. Avg	Dec 2012	Dec 2013	Dec 2014	*Dec 2015*	*Dec 2016*	*5-Year Proj. Avg*
Net Interest Margin %	*3.1*	3.3	3.1	3.0	*3.0*	*3.1*	*3.2*
Non-Interest Income (% of Revenue)	*45.9*	46.5	45.3	46.0	*45.6*	*45.2*	*44.6*
Efficiency Ratio %	*51.8*	50.7	51.9	52.8	*50.6*	*50.1*	*49.0*
Return on Average Assets %	*1.6*	1.6	1.6	1.5	*1.5*	*1.6*	*1.7*
Return on Average Equity %	*14.6*	15.5	14.6	13.8	*14.0*	*14.6*	*15.8*
Return on Tangible Equity %	*20.1*	21.1	20.4	18.8	*18.4*	*19.1*	*20.5*

Leverage	3-Year Hist. Avg	Dec 2012	Dec 2013	Dec 2014	*Dec 2015*	*Dec 2016*	*5-Year Proj. Avg*
Assets/Equity	*9.06*	9.07	8.85	9.26	*9.30*	*9.52*	*9.68*
Tangible Common Equity/Tangible Assets %	*6.66*	6.54	6.72	6.71	*6.86*	*6.82*	*6.87*
Tier I Ratio %	*10.10*	10.50	10.80	9.00	—	—	—

Valuation Summary and Forecasts

	2013	2014	*2015(E)*	*2016(E)*
Price/Fair Value	0.94	1.00	—	—
Price/Earnings	13.3	14.5	*13.9*	*13.0*
Price/Book	2.3	2.1	*2.4*	*2.3*
Price/Tangible Book	3.5	3.1	*2.8*	*2.7*
Dividend Yield %	2.2	2.2	*2.2*	—

Key Valuation Drivers

Cost of Equity %	9.0
Long-Run Tax Rate %	26.8
Stage II Net Income Growth Rate %	3.5
Stage II Return on New Invested Capital %	14.0
Perpetuity Year	20.0

Additional estimates and scenarios available for download at http://select.morningstar.com.

Discounted Cash Flow Valuation

	USD Mil	Firm Value (%)	Per Share Value
Present Value Stage I	23,308	25.2	12.86
Present Value Stage II	39,162	42.4	21.60
Present Value of the Perpetuity	29,977	32.4	16.53
Total Common Equity Value before Adjustment	**92,447**	**100.0**	**50.99**
Other Adjustments	—	—	—
Equity Value	**92,447**	—	**50.99**
Projected Diluted Shares	1,813		
Fair Value per Share (USD)	—		

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Morningstar Analyst Forecasts

Income Statement (USD Mil)

				Forecast	
	Dec 2012	Dec 2013	Dec 2014	*Dec 2015*	*Dec 2016*
Net Interest Income	**10,745**	**10,604**	**10,775**	**11,659**	**12,580**
Provision for Losses on Loans	1,882	1,340	1,229	*1,780*	*2,071*
Net Interest Income after Provision	**8,863**	**9,264**	**9,546**	**9,879**	**10,509**
Non-Interest Income	9,334	8,765	9,161	*9,773*	*10,384*
Net Revenue	**20,079**	**19,369**	**19,936**	**21,432**	**22,964**
Net Revenue After Provision (excluding Gains on Sale)	18,197	18,029	18,707	*19,652*	*20,893*
Gains on Sale	-15	9	3	—	—
Net Revenue After Provision (including Gains on Sale)	**18,182**	**18,038**	**18,710**	**19,652**	**20,893**
Non-Interest Expense	10,456	10,274	10,715	*11,053*	*11,695*
Operating Income (excluding Gains on Sale)	**7,741**	**7,755**	**7,992**	**8,599**	**9,198**
Taxes	2,236	2,032	2,087	*2,300*	*2,460*
Minority Interest, net of income taxes	-157	-104	57	*114*	*116*
Income after Taxes	**5,647**	**5,836**	**5,851**	**6,185**	**6,621**
Cumulative Effect of Accounting Change	—	—	—	—	—
After-tax Non-recurring Items	—	—	—	—	—
Discounted Operations	—	—	—	—	—
Preferred Dividends	**204**	**284**	**243**	**380**	**380**
Net Income attributable to common shareholders, Excluding All After-tax items	**5,443**	**5,552**	**5,608**	**5,804**	**6,241**
Net Income attributable to common shareholders, including all after-tax items	**5,443**	**5,552**	**5,608**	**5,804**	**6,241**
Average Diluted Shares Outstanding	1,896	1,832	1,813	*1,813*	*1,813*
Diluted EPS Excluding Charges	**2.87**	**3.03**	**3.09**	**3.25**	**3.49**
Diluted EPS Including Charges	**2.87**	**3.03**	**3.09**	**3.25**	**3.49**

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U.S. Bancorp USB (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
45.22 USD	52.00 USD	36.40 USD	70.20 USD	Medium	Wide	Stable	Exemplary	Banks

Morningstar Analyst Forecasts

Balance Sheet (USD Mil)

			Forecast	
Earning Assets	Dec 2013	Dec 2014	*Dec 2015*	*Dec 2016*
Cash and Due from Banks	8,477	10,654	*10,143*	*10,650*
Interest Bearing Deposits at Banks	—	—	—	—
Federal Funds Sold and Securities Borrowed or Purchased Under Agreement to Resell	—	—	—	—
Brokerage Receivables	—	—	—	—
Other Receivables (excluding interest receivables)	—	—	—	—
Trading Assets	—	—	—	—
Investment Securities Held to Maturity	38,920	44,974	*46,323*	*47,713*
Investment Securities Available-for-Sale	40,935	56,069	*58,312*	*60,644*
Financial Instruments Owned, at Fair Value (trading securities)	—	—	—	—
Other Earning Assets	34,558	32,340	*32,392*	*33,146*
Loans Held for Sale	3,268	4,792	*3,835*	*4,043*
Loans and Leases	226,773	242,570	*255,670*	*269,563*
Unearned Discount	—	—	—	—
Allowance for Loan Losses	-4,250	-4,039	*-4,091*	*-4,313*
Net Loans and Leases	**222,523**	**238,531**	**251,579**	**265,250**
Non-Earning Assets				
Premises & Equipment, Net	2,606	2,618	*2,832*	*3,062*
Premises & Equipment, Gross	2,606	2,618	*2,832*	*3,062*
(Accumulated Depreciation)	—	—	—	—
Interest Receivables	—	—	—	—
Goodwill	9,205	9,389	*9,389*	*9,389*
Identifiable Intangibles	3,529	3,162	*2,962*	*2,762*
Deferred Tax Assets	—	—	—	—
Other Non-Earning Assets (Other Real Estate Owned etc.)	—	—	—	—
Total Assets	**364,021**	**402,529**	**417,768**	**436,660**

			Forecast	
Liabilities	Dec 2013	Dec 2014	*Dec 2015*	*Dec 2016*
Total Deposits	262,123	282,733	*296,870*	*311,713*
Customer Deposits	262,123	282,733	*296,870*	*311,713*
Federal Funds Purchased and Securities Loaned or Sold under Agreements to Repurchase	—	—	—	—
Brokerage Payables	—	—	—	—
Trading Liabilities	—	—	—	—
Financial Instruments Sold, but not yet purchased at Fair Value	—	—	—	—
Other Payables	—	—	—	—
Short-Term Debt	27,608	29,893	*29,541*	*30,836*
Long-Term Debt	20,049	32,260	*31,880*	*33,278*
Additional Debt	—	—	—	—
Total Short-Term, Long-Term and Other Debt	**47,657**	**62,153**	**61,421**	**64,114**
Deferred Tax Liabilities	—	—	—	—
Other Liabilities (bank acceptance outstanding, accrued expenses, etc.)	12,434	13,475	*13,879*	*14,296*
Total Liabilities	**322,214**	**358,361**	**372,170**	**390,123**
Equity				
Common Stock	21	21	*21*	*21*
Paid-in Capital	8,216	8,313	*8,313*	*8,313*
Retained Earnings	38,667	42,530	*43,965*	*44,904*
Preferred Equity	4,756	4,756	*4,756*	*4,756*
Treasury Stock	-9,476	-11,245	*-11,245*	*-11,245*
Accumulated Other Comprehensive Income	-1,071	-896	*-900*	*-900*
Other Equity	—	—	—	—
Shareholders?Equity	41,113	43,479	*44,910*	*45,849*
Total Liabilities & Shareholders?Equity (including Minority Interest)	**364,021**	**402,529**	**417,768**	**436,660**

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U.S. Bancorp USB (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
45.22 USD	52.00 USD	36.40 USD	70.20 USD	Medium	Wide	Stable	Exemplary	Banks

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Valuation Analysis

		Price/Earnings				Price/Book				Price/Tangible Book			
Company/Ticker	Price/Fair Value	2013	2014	*2015(E)*	*2016(E)*	2013	2014	*2015(E)*	*2016(E)*	2013	2014	*2015(E)*	*2016(E)*
Wells Fargo & Co WFC USA	0.9	11.7	13.4	*14.0*	*14.0*	1.9	2.0	*2.1*	*2.0*	2.6	2.8	*2.4*	*2.3*
Bank of America Corporation BAC USA	1.0	17.7	49.7	*12.4*	*12.0*	0.9	0.8	*0.8*	*0.8*	1.5	1.3	*1.0*	*1.0*
Fifth Third Bancorp FITB USA	0.8	10.5	12.1	*13.0*	*11.6*	1.3	1.2	*1.4*	*1.4*	1.8	1.6	*1.6*	*1.6*
Average		13.3	25.1	*13.1*	*12.5*	1.4	1.3	*1.4*	*1.4*	2.0	1.9	*1.7*	*1.6*
U.S. Bancorp USB US	**0.9**	**13.3**	**14.5**	***13.9***	***13.0***	**2.3**	**2.1**	***2.4***	***2.3***	**3.5**	**3.1**	***2.8***	***2.7***

Returns Analysis

		Return on Average Equity %				Return on Average Assets %				Return on Tangible Equity %			
Company/Ticker	Last Historical Year Total Assets (Mil)	2013	2014	*2015(E)*	*2016(E)*	2013	2014	*2015(E)*	*2016(E)*	2013	2014	*2015(E)*	*2016(E)*
Wells Fargo & Co WFC USA	1,527,015 USD	13.4	13.6	*13.2*	*12.9*	1.5	1.5	*1.5*	*1.4*	17.5	18.2	*17.4*	*16.6*
Bank of America Corporation BAC USA	2,104,534 USD	4.9	2.0	*7.0*	*7.1*	0.5	0.2	*0.8*	*0.9*	7.3	2.8	*9.4*	*9.4*
Fifth Third Bancorp FITB USA	138,706 USD	13.0	9.8	*9.0*	*9.9*	1.5	1.1	*1.0*	*1.1*	16.1	11.5	*11.0*	*11.9*
Average		10.4	8.5	*9.7*	*10.0*	1.2	0.9	*1.1*	*1.1*	13.6	10.8	*12.6*	*12.6*
U.S. Bancorp USB US	**402,529** USD	**14.6**	**13.8**	***14.0***	***14.6***	**1.6**	**1.5**	***1.5***	***1.6***	**20.4**	**18.8**	***18.4***	***19.1***

Growth Analysis

		Net Revenue Growth %				Pre-Tax, Pre-Provision Earnings Growth %				EPS Growth %			
Company/Ticker	Last Historical Year Revenue (Mil)	2013	2014	*2015(E)*	*2016(E)*	2013	2014	*2015(E)*	*2016(E)*	2013	2014	*2015(E)*	*2016(E)*
Wells Fargo & Co WFC USA	84,347 USD	-2.7	0.7	*1.5*	*5.9*	-2.1	1.1	*1.2*	*11.2*	15.6	5.4	*0.5*	*0.0*
Bank of America Corporation BAC USA	82,893 USD	7.3	-5.5	*3.8*	*2.2*	75.5	-53.7	*220.0*	*7.5*	244.6	-59.2	*302.6*	*2.9*
Fifth Third Bancorp FITB USA	6,031 USD	5.2	-10.7	*3.4*	*6.8*	12.5	-17.1	*6.1*	*12.9*	23.4	-16.6	*-2.9*	*12.3*
Average		3.3	-5.2	*2.9*	*5.0*	28.6	-23.2	*75.8*	*10.5*	94.5	-23.5	*100.1*	*5.1*
U.S. Bancorp USB US	**19,936** USD	**-3.5**	**2.9**	***7.5***	***7.2***	**-5.3**	**1.3**	***12.5***	***8.6***	**5.6**	**2.1**	***5.1***	***7.5***

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Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Profitability Analysis

Company/Ticker	Last Historical Year Revenue (Mil)	Net Interest Margin % 2013	2014	2015(E)	2016(E)	Efficiency Ratio % 2013	2014	2015(E)	2016(E)	Non Interest Income % of Revenue 2013	2014	2015(E)	2016(E)
Wells Fargo & Co WFC USA	84,347 USD	3.2	3.2	*3.2*	*3.2*	56.5	56.5	*56.5*	*54.7*	48.9	48.4	*48.2*	*48.8*
Bank of America Corporation BAC USA	82,893 USD	2.4	2.3	*2.3*	*2.4*	77.7	89.5	*65.1*	*63.5*	51.8	51.8	*52.8*	*52.2*
Fifth Third Bancorp FITB USA	6,031 USD	3.2	3.0	*3.0*	*3.1*	58.7	61.5	*60.1*	*57.9*	47.3	40.7	*41.4*	*40.6*
Average		2.9	2.8	*2.8*	*2.9*	64.3	69.2	*60.6*	*58.7*	49.3	47.0	*47.5*	*47.2*
U.S. Bancorp USB US	**19,936** USD	**3.1**	**3.0**	***3.0***	***3.1***	**51.9**	**52.8**	***50.6***	***50.1***	**45.3**	**46.0**	***45.6***	***45.2***

Leverage Analysis

Company/Ticker	Last Historical Year Total Debt (Mil)	Assets/Equity 2013	2014	2015(E)	2016(E)	Tangible Common Equity/ Tangible Assets % 2013	2014	2015(E)	2016(E)	Tier I Ratio % 2013	2014	2015(E)	2016(E)
Wells Fargo & Co WFC USA	206,881 USD	9.0	9.0	*9.1*	*9.1*	7.5	7.5	*7.6*	*7.7*	—	—	—	—
Bank of America Corporation BAC USA	274,311 USD	9.0	8.6	*8.3*	*8.3*	6.9	7.4	*8.1*	*8.2*	12.9	12.4	—	—
Fifth Third Bancorp FITB USA	16,523 USD	8.9	8.9	*9.1*	*9.1*	8.0	8.1	*7.9*	*8.0*	10.4	10.4	*10.8*	—
Average		9.0	8.8	*8.8*	*8.8*	7.5	7.7	*7.9*	*8.0*	11.7	11.4	*10.8*	—
U.S. Bancorp USB US	**62,153** USD	**8.9**	**9.3**	***9.3***	***9.5***	**6.7**	**6.7**	***6.9***	***6.8***	**10.8**	**9.0**	**—**	**—**

Liquidity Analysis

Company/Ticker	Last Historical Year Market Cap (Mil)	Loans/Deposits % 2013	2014	2015(E)	2016(E)	Short-Term Debt % of Liabilities 2013	2014	2015(E)	2016(E)	Liquid Assets (% of Total Assets) 2013	2014	2015(E)	2016(E)
Wells Fargo & Co WFC USA	297,727 USD	75.2	75.2	*74.3*	*72.3*	4.0	4.0	*3.8*	*3.2*	35.9	35.9	*35.9*	*36.2*
Bank of America Corporation BAC USA	186,340 USD	81.4	77.5	*75.0*	*73.0*	2.5	1.7	*1.4*	*1.2*	38.2	40.4	*40.4*	*40.6*
Fifth Third Bancorp FITB USA	17,138 USD	87.7	87.3	*86.0*	*85.7*	1.2	1.3	*1.2*	*1.2*	17.0	18.6	*18.9*	*19.0*
Average		81.4	80.0	*78.4*	*77.0*	2.6	2.3	*2.1*	*1.9*	30.4	31.6	*31.7*	*31.9*
U.S. Bancorp USB US	**80,177** USD	**84.9**	**84.4**	***84.7***	***85.1***	**8.6**	**8.3**	***7.9***	***7.9***	**13.6**	**16.6**	***16.4***	***16.3***

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Research Methodology for Valuing Companies

Components of Our Methodology

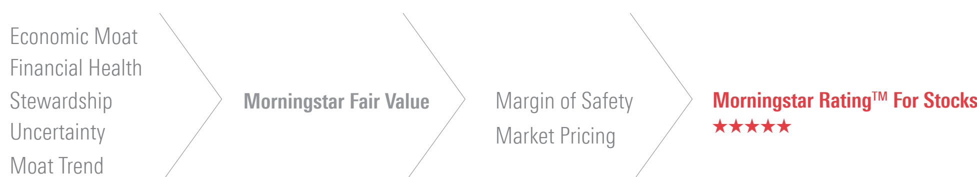
- Economic Moat™ Rating
- Moat Trend™ Rating
- Moat Valuation
- Three-Stage Discounted Cash Flow
- Weighted Average Cost of Capital
- Fair Value Estimate
- Scenario Analysis
- Uncertainty Ratings
- Margin of Safety
- Consider Buying/Selling
- Stewardship Rating

We believe that a company's intrinsic worth results from the future cash flows it can generate.
The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk-adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth. Four key components drive the Morningstar rating: our assessment of the firm's economic moat, our estimate of the stock's fair value, our uncertainty around that fair value estimate and the current market price. This process ultimately culminates in our single-point star rating. Underlying this rating is a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's equity analysts.

The concept of the Morningstar Economic Moat™ Rating plays a vital role not only in our qualitative assessment of a firm's investment potential, but also in our actual calculation of our fair value estimates. We assign three moat ratings—none, narrow, or wide—as well as the Morningstar Moat Trend™ Rating—positive, stable, or negative—to each company we cover. Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns on invested capital over at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. The assumptions that we make about a firm's economic moat play a vital role in determining the length of "economic outperformance" that we assume in the terminal sections of our valuation model. To assess the sustainability of excess profits, analysts perform ongoing assessments of what we call the moat trend. A firm's moat trend is positive in cases where we think its sources of competitive advantage are growing stronger; stable where we don't anticipate changes to competitive advantages over the next several years; or negative when we see signs of deterioration.

At the heart of our valuation system is a detailed projection of a company's future cash flows. The first stage of our three-stage discounted cash flow model can last from 5 to 10 years and contains numerous detailed assumptions about various financial and operating items. The second stage of our model—where a firm's return on new invested capital (RONIC) and earnings growth rate implicitly fade until the perpetuity year—can last anywhere from one year (for companies with no economic moat) to 10-15 years (for wide-moat companies). In our third stage, we assume the firm's RONIC equals its weighted average cost of capital, and we calculate a continuing value using a standard perpetuity formula. In deciding on the rate at which to discount future cash flows, we use a building block approach,

Morningstar Research Methodology for Valuing Companies



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Detailed Methodology Documents and Materials*

- Comprehensive Equity Research Methodology
- Uncertainty Methodology
- Cost of Equity Methodology
- Morningstar DCF Valuation Model
- Stewardship Rating Methodology

*Please contact a sales representative for more information.

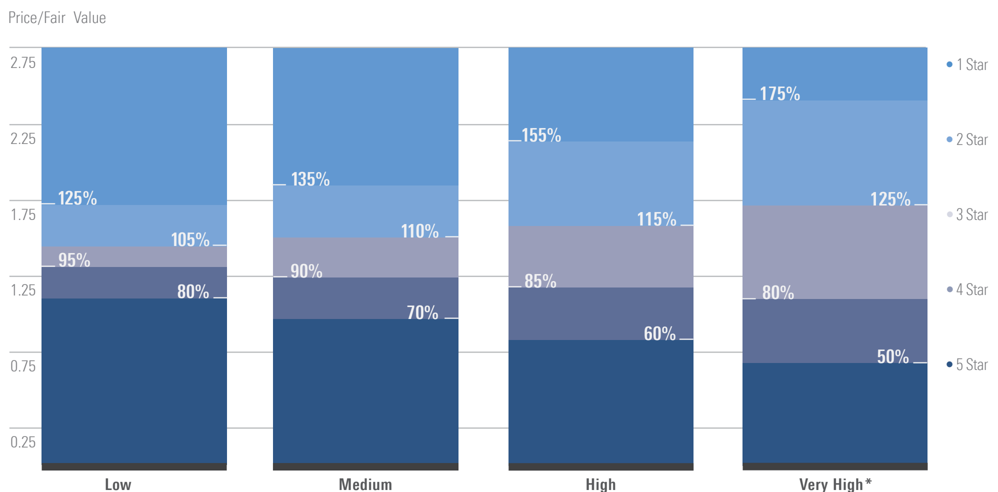
which takes into account expectations for market real return, inflation, country risk premia, corporate credit spread, and any additional systematic risk.

We also employ a number of other tools to augment our valuation process, including scenario analysis, where we assess the likelihood and performance of a business under different economic and firm-specific conditions. Our analysts model three scenarios for each company we cover, stress-testing the model and examining the distribution of resulting fair values.

The Morningstar Uncertainty Rating captures the range of likely potential fair values and uses it to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating represents the analysts' ability to bound the estimated value of the shares in a company around the Fair Value Estimate, based on the characteristics of the business underlying the stock, including operating and financial leverage, sales sensitivity to the overall economy, product concentration, pricing power, and other company-specific factors.

Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

Morningstar Margin of Safety and Star Rating Bands



* Occasionally a stock's uncertainty will be too high for us to estimate, in which case we label it Extreme.

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Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
45.22 USD	52.00 USD	36.40 USD	70.20 USD	Medium	Wide	Stable	Exemplary	Banks

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