

State Street Corp. (STT)

\$81.69 (As of 01/10/20)

Price Target (6-12 Months): **\$95.00**

Long Term: 6-12 Months

Zacks Recommendation:

Outperform

(Since: 12/10/19)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

1-Strong Buy

Zacks Style Scores:

VGM:C

Value: C

Growth: D

Momentum: A

Summary

Shares of State Street have underperformed the industry over the past year. Yet, it has an impressive earnings surprise history. The company has surpassed the Zacks Consensus Estimate in each of the trailing four quarters. New business wins, strategic opportunistic acquisitions over the past several years and strong balance sheet position are likely to continue supporting the company's profitability. Also, the company's efficient capital deployment activities reflect strong liquidity position and are expected to enhance shareholder value. Though the Federal Reserve's accommodative monetary policy stance, mounting operating expenses and overall tough operating environment will likely hurt financials in the quarters ahead, the company's efforts to technologically upgrade business will go a long way in supporting profitability.

Price, Consensus & Surprise



Data Overview

52 Week High-Low **\$82.94 - \$48.62**

20 Day Average Volume (sh) **2,062,694**

Market Cap **\$29.7 B**

YTD Price Change **3.3%**

Beta **1.58**

Dividend / Div Yld **\$2.08 / 2.5%**

Industry **[Banks - Major Regional](#)**

Zacks Industry Rank **Top 21% (53 out of 254)**

Last EPS Surprise **8.6%**

Last Sales Surprise **1.4%**

EPS F1 Est- 4 week change **4.2%**

Expected Report Date **01/17/2020**

Earnings ESP **0.3%**

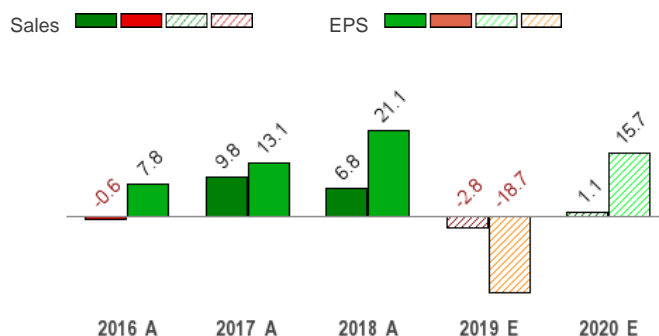
P/E TTM **13.9**

P/E F1 **12.0**

PEG F1 **1.1**

P/S TTM **2.3**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	2,899 E	2,913 E	2,934 E	3,005 E	11,763 E
2019	2,932 A	2,873 A	2,903 A	2,924 E	11,638 E
2018	3,021 A	3,026 A	2,951 A	2,986 A	11,976 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.37 E	\$1.76 E	\$1.81 E	\$1.99 E	\$6.79 E
2019	\$1.24 A	\$1.45 A	\$1.51 A	\$1.70 E	\$5.87 E
2018	\$1.62 A	\$2.05 A	\$1.87 A	\$1.68 A	\$7.22 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 01/10/2020. The reports text is as of 01/13/2020.

Overview

Incorporated in 1832 and headquartered in Boston, MA, State Street Corporation is a financial holding company. It provides a range of products and services for institutional investors worldwide through its subsidiaries.

The company primarily performs its business through its principal banking subsidiary, State Street Bank. Its customers include providers of mutual funds, managers of collective investment funds and other investment pools, providers of corporate and public retirement plans, insurance companies, foundations, endowments and investment managers.

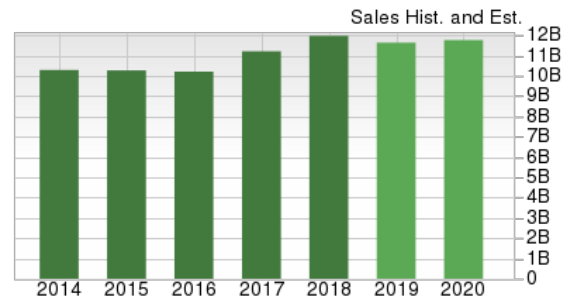
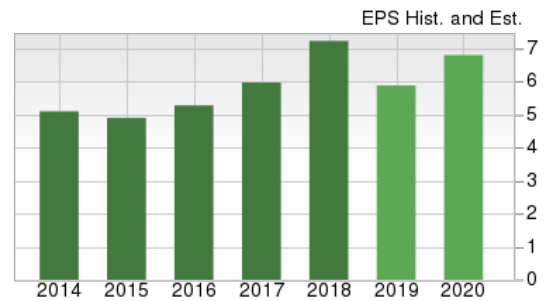
State Street operates through the following two divisions:

The *Investment Servicing* division (constituting 84% of total revenues in 2018) offers a range of services, including custody, product-and participant-level accounting, daily pricing and administration; master trust and master custody; recordkeeping; shareholder accounting; foreign exchange, brokerage and other trading; securities finance; deposit and short-term investment facilities; loans and lease financing; outsourcing of investment manager and hedge fund manager operations, as well as performance, risk and compliance analytics.

The *Investment Management* division (16%) provides a range of services for managing financial assets such as investment research services and investment management, including both passive and active U.S. and non-U.S. equity as well as fixed-income strategies, in addition to other related services such as securities finance.

In 2016, State Street acquired GE Asset Management. In 2018, the company acquired Charles River Development (CRD).

As of Sep 30, 2019, State Street had assets under custody and administration of \$32.9 trillion, and AUM of \$3 trillion.



Reasons To Buy:

- ▲ State Street has been witnessing consistent improvement in revenues, largely driven by an increase in management fees and securities finance income. Over the last five years (2014-2018), total revenues recorded a CAGR of 3.9%. While revenues declined during the first nine months of 2019, continuous investment in new products, new business wins and inorganic growth strategy is expected to support top-line growth. The company remains well positioned with respect to its fundamental business activities, given its significant global exposure and a broad array of innovative products and services.
- ▲ We remain encouraged by State Street's capital deployment activities. The company's 2019 capital plan (approved by the Federal Reserve) included a 10.6% dividend hike and \$2 billion share repurchase authorization. As of Sep 30, 2019, nearly \$1.5 billion worth of shares were left to be repurchased. Given its solid liquidity position, earnings strength and lower debt-to-equity ratio compared with the industry, the company will likely be able to sustain improved capital deployments and continue to enhance shareholder value.
- ▲ Shares of State Street have underperformed the industry over the past year. However, the company's current-year earnings estimates have been revised 5.8% upward over the past 30 days. Therefore, given the strength in fundamentals and positive estimate revisions, the price performance is expected to improve in the future.

State Street is well poised for growth based on strong capital position and new business wins. Synergies from strategic acquisitions and global footprints are also expected to support profitability.

Risks

- Elevated operating expenses are a major concern for State Street. Operating expenses witnessed a five-year (2014-2018) CAGR of 3.5%, with the uptrend continuing in the first nine months of 2019. Higher compensation and employee benefit costs, as well as acquisition and restructuring costs, are primary reasons for the rise. While the company successfully achieved the expense savings target through State Street Beacon in 2018, the initiative did not significantly support financials. Also, the company's new expense-saving program is expected to result in \$400 million in cost savings in 2019 through workforce reduction, though the overall expenses are likely to remain elevated in the quarters ahead.
 - Moreover, State Street's trailing 12-month return on equity (ROE) undercuts its growth potential. The company's ROE of 11.34% compares unfavorably with 17.16% for the S&P 500, highlighting that it is less efficient in using shareholder funds.
 - Further, State Street seems overvalued compared with the broader industry. Its current price-to-book and price-to-earnings (F1) ratios are above the respective industry averages.
-

Last Earnings Report

State Street Q3 Earnings Beat Estimates, Revenues Decline Y/Y

State Street's third-quarter 2019 adjusted earnings of \$1.51 per share beat the Zacks Consensus Estimate of \$1.40. However, the figure was 19.3% below the prior-year quarter level.

Results reflect new investment servicing wins of \$1 trillion, rise in AUM balance and successful implementation of the company's expense saving initiatives. However, lower revenues, rise in operating expenses, and decline in assets under custody and administration were on the downside.

After considering several non-recurring items, net income available to common shareholders was \$528 million, down 25.4% from the year-ago quarter.

Revenues Down, Expenses Rise

Total revenues were \$2.90 billion, decreasing 2.9% year over year. However, the top line beat the Zacks Consensus Estimate of \$2.86 billion.

Net interest revenues declined 4.2% from the year-ago quarter to \$644 million. The fall was due to lower non-interest-bearing deposit balances and accelerated MBS premium amortization from declining long rates. Also, net interest margin decreased 6 basis points year over year to 1.42%.

Fee revenues declined 2.5% to \$2.26 billion. This fall was mainly due to decline in servicing and management revenues.

Non-interest expenses were \$2.18 billion, up 4.3%. Rise in information systems and communications costs, and amortization of other intangible assets were partially offset by lower compensation and employee benefits costs. Excluding notable items, adjusted expenses increased 2.1% to \$2.14 billion.

As of Sep 30, 2019, total assets under custody and administration were \$32.9 trillion, down 3.2% year over year. However, AUM was \$3 trillion, up 5.1%.

Strong Capital and Profitability Ratios

Under Basel III (Standardized approach), estimated Tier 1 common ratio was 11.3% as of Sep 30, 2019, compared with 13% as of Sep 30, 2018. Return on common equity came in at 9.7% compared with 14.0% in the year-ago quarter.

Share Repurchase Update

During the reported quarter, State Street repurchased \$500 million worth of shares. This was part of its 2019 capital plan.

Outlook

Fourth Quarter

Management expects net interest income to be down 3-5% sequentially. Fee revenues are expected to increase 1-2% from the prior quarter, driven by seasonality related to the CRD buyout. Specifically, servicing fee is expected to be stable sequentially, while management fee is projected to be up 1-2%.

On cost front, operating expenses (non-GAAP basis) are expected to be flat sequentially.

2019

The company expects to reduce underlying expenses (non-GAAP basis) by 1.5% (up from 1% targeted earlier) through 4.5% productivity savings.

State Street remains on track to generate roughly \$400 million in cost savings. The company had earlier targeted savings of \$350 million. It has already achieved \$275 million in savings during the nine months-ended Sep 30, 2019. Also, during the same time frame, the company recorded high cost location headcount reductions of more than 2,700, which exceeded the initial target of 1,500.

Effective tax rate is expected to be in the low end of the 17-19% range.

Medium-term Targets

Including the impact of the Charles River Development buyout, the company expects revenues to increase 4-5%. Pre-tax margin is expected to improve 2%. Management expects earnings per share growth of 10-15% and ROE of 12-15%. Total payout ratio is expected to be greater than or equal to 80%.

Quarter Ending **09/2019**

Report Date	Oct 18, 2019
Sales Surprise	1.42%
EPS Surprise	8.63%
Quarterly EPS	1.51
Annual EPS (TTM)	5.88

Recent News

Dividend Update

On Dec 19, 2019, State Street declared a cash dividend of 52 cents per share. The dividend will be paid on Jan 16, 2020 to shareholders of record as of Jan 2.

Valuation

State Street's shares are up 19.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are up 25.4% and 14.4%, respectively over the past year.

The S&P 500 index is up 25.6% in the past year.

The stock is currently trading at 12.00X forward 12 months earnings, which compares to 11.85X for the Zacks sub-industry, 14.88X for the Zacks sector and 18.88X for the S&P 500 index.

Over the past five years, the stock has traded as high as 16.12X and as low as 7.86X, with a 5-year median of 12.69X. Our Outperform recommendation indicates that the stock will perform better than the market. Our \$95 price target reflects 13.95X forward earnings.

The table below shows summary valuation data for STT

Valuation Multiples - STT					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	12	11.85	14.88	18.88
	5-Year High	16.12	13.85	16.21	19.34
	5-Year Low	7.86	9.04	12.01	15.17
	5-Year Median	12.69	11.43	13.98	17.44
P/TB TTM	Current	2.54	2.35	3.28	12.5
	5-Year High	3.68	2.68	3.98	12.53
	5-Year Low	1.53	1.44	2.44	6.03
	5-Year Median	2.66	2.11	3.46	9.07
P/S F12M	Current	2.52	4.07	6.53	3.5
	5-Year High	3.41	4.59	6.61	3.5
	5-Year Low	1.57	2.61	5.2	2.54
	5-Year Median	2.54	3.59	6.04	3

As of 01/10/2020

Industry Analysis Zacks Industry Rank: Top 21% (53 out of 254)



Top Peers

The Bank of New York Mellon Corporation (BK)	Neutral
Citigroup Inc. (C)	Neutral
First Republic Bank (FRC)	Neutral
HSBC Holdings plc (HSBC)	Neutral
JPMorgan Chase & Co. (JPM)	Neutral
Northern Trust Corporation (NTRS)	Neutral
UBS Group AG (UBS)	Neutral
U.S. Bancorp (USB)	Neutral

Industry Comparison Industry: Banks - Major Regional				Industry Peers		
	STT Outperform	X Industry	S&P 500	BK Neutral	JPM Neutral	NTRS Neutral
VGM Score	C	-	-	B	D	D
Market Cap	29.70 B	42.88 B	24.03 B	46.61 B	426.78 B	22.67 B
# of Analysts	6	7	13	7	6	5
Dividend Yield	2.55%	2.65%	1.78%	2.45%	2.65%	2.62%
Value Score	C	-	-	B	C	D
Cash/Price	2.41	0.67	0.04	3.23	2.33	1.43
EV/EBITDA	-5.17	5.18	14.04	-8.38	-3.98	-1.57
PEG Ratio	1.13	1.43	2.02	1.43	1.85	1.57
Price/Book (P/B)	1.38	1.37	3.32	1.23	1.81	2.28
Price/Cash Flow (P/CF)	7.54	10.64	13.52	8.92	11.24	11.10
P/E (F1)	12.03	12.03	18.82	11.82	12.95	14.76
Price/Sales (P/S)	2.27	2.56	2.63	2.32	3.01	3.27
Earnings Yield	8.31%	8.31%	5.31%	8.47%	7.72%	6.78%
Debt/Equity	0.53	0.95	0.72	0.76	1.26	0.41
Cash Flow (\$/share)	10.83	6.05	6.94	5.67	12.11	9.64
Growth Score	D	-	-	D	F	D
Hist. EPS Growth (3-5 yrs)	8.30%	13.07%	10.56%	12.42%	15.31%	16.57%
Proj. EPS Growth (F1/F0)	15.61%	4.47%	7.49%	7.31%	1.51%	8.79%
Curr. Cash Flow Growth	16.39%	17.06%	14.83%	3.03%	23.43%	25.17%
Hist. Cash Flow Growth (3-5 yrs)	8.18%	7.49%	9.00%	6.49%	7.08%	14.23%
Current Ratio	0.48	0.88	1.23	0.70	0.93	0.61
Debt/Capital	31.24%	45.81%	42.99%	41.10%	54.37%	27.18%
Net Margin	16.18%	23.17%	11.08%	19.31%	24.70%	22.10%
Return on Equity	11.34%	12.25%	17.16%	10.57%	14.63%	15.66%
Sales/Assets	0.05	0.05	0.55	0.05	0.05	0.05
Proj. Sales Growth (F1/F0)	1.07%	0.57%	4.20%	-1.72%	0.02%	3.55%
Momentum Score	A	-	-	A	A	A
Daily Price Chg	-1.48%	-1.05%	-0.33%	-1.83%	-1.00%	-1.05%
1 Week Price Chg	-0.69%	-0.81%	-0.30%	-0.10%	-0.57%	-1.51%
4 Week Price Chg	1.58%	-2.63%	1.71%	-1.33%	-1.41%	-2.63%
12 Week Price Chg	36.83%	11.08%	6.05%	13.88%	13.06%	14.10%
52 Week Price Chg	22.82%	22.02%	22.39%	6.47%	35.54%	26.03%
20 Day Average Volume	2,062,694	3,870,692	1,580,816	2,995,824	9,316,014	909,983
(F1) EPS Est 1 week change	2.77%	0.18%	0.00%	1.56%	0.18%	2.42%
(F1) EPS Est 4 week change	4.21%	0.58%	0.00%	1.23%	0.58%	1.74%
(F1) EPS Est 12 week change	10.61%	0.40%	-0.50%	3.48%	1.02%	5.27%
(Q1) EPS Est Mthly Chg	6.20%	0.38%	0.00%	-0.33%	1.73%	3.25%

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	C
Growth Score	D
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.

Disclosures

This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock. The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment. This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. ZIR is not a broker-dealer. ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients. Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.

No part of this report can be reprinted, republished or transmitted electronically without the prior written authorization of ZIR.