State Street Corp. (STT)

$58.86 (As of 03/13/20)

Price Target (6-12 Months): **$63.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 03/08/20) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:D
	Value: C | Growth: D | Momentum: C	

Summary

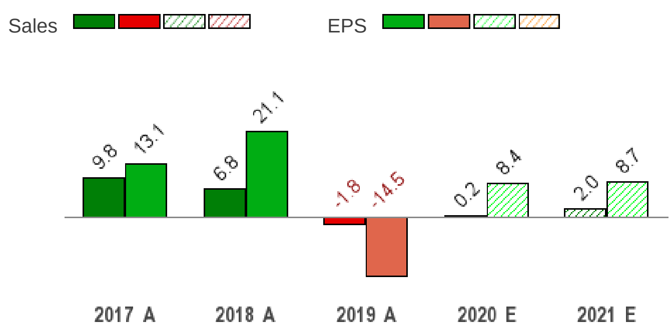
State Street's shares have outperformed the industry over the past year. The company has an impressive earnings surprise history, having surpassed the Zacks Consensus Estimate in each of the trailing four quarters. The company's new business servicing wins, opportunistic acquisitions, global reach and strong balance sheet position are likely to continue supporting growth. Further, its efficient capital deployment activities reflect a strong liquidity position and are expected to enhance shareholder value. The company's efforts to technologically upgrade business will go a long way in supporting profits. However, the Federal Reserve's accommodative monetary policy stance will likely hurt margins. Also, mounting operating expenses amid an overall tough operating environment makes us apprehensive and might hurt the bottom line.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	$85.89 - $47.48
20 Day Average Volume (sh)	3,910,495
Market Cap	$20.9 B
YTD Price Change	-25.6%
Beta	1.54
Dividend / Div Yld	$2.08 / 3.5%
Industry	[Banks - Major Regional]
Zacks Industry Rank	Bottom 24% (193 out of 253)
Last EPS Surprise	16.5%
Last Sales Surprise	4.3%
EPS F1 Est- 4 week change	-3.0%
Expected Report Date	04/28/2020
Earnings ESP	-2.1%
P/E TTM	9.5
P/E F1	8.8
PEG F1	0.8
P/S TTM	1.6

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	2,992 E	3,022 E	3,018 E	3,090 E	12,022 E
2020	2,932 E	2,940 E	2,934 E	2,995 E	11,785 E
2019	2,932 A	2,873 A	2,903 A	3,048 A	11,756 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	$1.51 E	$1.91 E	$1.93 E	$2.05 E	$7.27 E
2020	$1.37 E	$1.66 E	$1.72 E	$1.93 E	$6.69 E
2019	$1.24 A	$1.45 A	$1.51 A	$1.98 A	$6.17 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 03/13/2020. The reports text is as of 03/16/2020.

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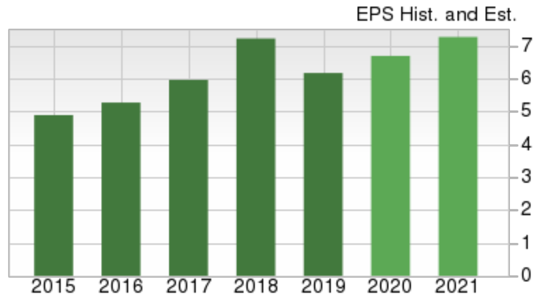
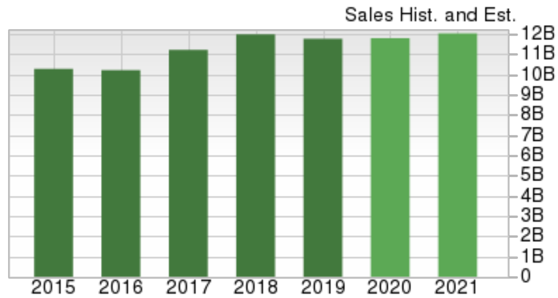
Overview

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 83.8% of total revenues in 2019) 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 (17.2%) 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 Dec 31, 2019, State Street had assets under custody and administration of $34.4 trillion, and AUM of $3.1 trillion.

Reasons To Buy:

State Street is well poised for growth backed by new business wins and a strong balance sheet position. Synergies from strategic buyouts and global footprint are also expected to support profitability.

- Organic growth remains a key positive for State Street. Though the company's total fee revenues declined in 2019 owing to challenging industry conditions and FX volatility, the same witnessed a four-year CAGR of 3.7% (2016-2019). Continuous investment in new products, new servicing business wins and inorganic growth strategy are expected to support fee income. 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 Dec 31, 2019, nearly $1 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.

- Further, State Street seems undervalued compared with the broader industry. Its current PEG and price-to-cash flow ratios are below the respective industry averages.

Reasons To Sell:

Persistently increasing expenses along with decline in margins due to lower rates will likely hurt State Street's profitability. Further, a tough operating backdrop makes us apprehensive.

- Elevated operating expenses are a major concern for State Street. Operating expenses witnessed a five-year (2014-2018) CAGR of 2.5%. Higher Information systems and communications expenses, as well as acquisition and restructuring costs are the primary reasons for the rise. While the company has been successful in achieving expense savings targets in 2019 and 2018 through high cost location workforce reduction and restructuring initiatives, overall costs are likely to remain elevated in the quarters aheah.

- Relatively lower interest rates amid the Fed's accommodative monetary policy are expected to hurt State Street's net interest income (NII) and net interest margin (NIM). Further, both have been witnessing a declining trend over the past several quarters, the third quarter of 2019 being the exception. Notably, the company anticipates NII to decline in 2020.

- Moreover, State Street's trailing 12-month return on equity (ROE) undercuts its growth potential. The company's ROE of 11.81% compares unfavorably with 16.74% for the S&P 500, highlighting that it is less efficient in using shareholder funds.

- Shares of State Street have outperformed the industry over the past year. However, the company's 2020 earnings estimates have been revised marginally lower over the past 60 days. Therefore, given the concerns and negative estimate revisions, the price performance is not expected to continue in the near term.

Last Earnings Report

State Street Q4 Earnings Top Estimates on Cost Savings

Quarter Ending	12/2019
Report Date	Jan 17, 2020
Sales Surprise	4.25%
EPS Surprise	16.47%
Quarterly EPS	1.98
Annual EPS (TTM)	6.18

State Street's fourth-quarter 2019 adjusted earnings of $1.98 per share outpaced the Zacks Consensus Estimate of $1.70. Also, the figure was 18.6% above the prior-year quarter level.

Results reflect new investment servicing wins of $294 billion, rise in assets balance, modest improvement in fee income and successful implementation of the company's expense saving initiatives. However, lower net interest income mainly due to lower rates was a headwind.

After considering several non-recurring items, net income available to common shareholders was $632 million, surging 59.6% from the year-ago quarter.

For 2019, adjusted earnings of $6.17 per share was down 14.2% but beat the consensus estimate of $5.88. After considering several non-recurring items, net income available to common shareholders was $2.15 billion, down 10.6%.

Revenues Up, Expenses Down

Total revenues for the quarter were $3.05 billion, increasing 5% year over year. Also, the top line beat the Zacks Consensus Estimate of $2.92 billion.

For 2019, total revenues fell 3% to $11.76 billion. However, the figure beat the Zacks Consensus Estimate of $11.64 billion.

Net interest revenues declined 1.2% from the year-ago quarter to $636 million. The fall was due to the absence of episodic market-related benefits and lower market rates.

Also, net interest margin decreased 19 basis points year over year to 1.36%.

Fee revenues grew 1.8% to $2.37 billion. This rise was mainly driven by higher servicing and management revenues.

Non-interest expenses were $2.27 billion, down 8.8%. Decline was attributable to the impact of lower repositioning charges and the company's cost savings efforts. Excluding notable items, adjusted expenses decreased 2.1% to $2.13 billion.

As of Dec 31, 2019, total assets under custody and administration were $34.4 trillion, up 8.7% year over year. Also, assets under management was $3.1 trillion, up 24.1%.

Strong Capital and Profitability Ratios

Under Basel III (Standardized approach), estimated Tier 1 common ratio was 11.9% as of Dec 31, 2019, compared with 11.7% as of Dec 31, 2018.

Return on common equity came in at 11.6% compared with 7.2% 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

First-Quarter 2020

Management expects fee revenues to be down 2-3% sequentially, given headwinds such as the expected asset mix shift by a single client in asset management and seasonally lower CRD revenues.

NII is anticipated to be down almost 5% from the prior quarter, given the full quarter impact of the October's Fed rate cut, lower day count and the fourth-quarter long-term debt issuance.

Expenses are likely to be down nearly 1% year over year and will include seasonal expenses usually occurring in the first quarter.

Effective tax rates are expected to be at high end of the 17-19% range.

2020

The company has based its outlook on certain assumptions that include slow global growth, modest support from equity markets and continued low market volatility.

Management expects NII to be down 5-7% year over year, driven by the carryover impact of lower market rates and continued rotation in the deposit book. Also, NII is likely to largely stabilize in the second half of 2020, if there is no significant change in the interest rate environment.

Fee revenues are expected to increase 1-3%. This includes expectation of servicing fees growing at the low to middle end of this range, and management fees growing at the high end of the band. Further, CRD revenues are projected to grow at low double-digits.

Management targets to achieve roughly 4-5% in cost savings, driven by continued focus on resource discipline and process engineering as well as technology optimization plan. This will include a reduction in headcount of an additional 750 roles in high-cost locations and IT expenditure to be flat to down 2%.

These expense savings will be partly offset by nearly 3-4% increase in expenses related to the ongoing business building investment scenarios like CRD, tech infrastructure, and the variable cost of new business growth. Thus, operating expenses (non-GAAP basis) are expected to be down roughly 1%.

Effective tax rate is expected to be in 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%.

Recent News

Dividend Update

On Feb 20, State Street declared a cash dividend of 52 cents per share. The dividend will be paid out on Apr 15 to shareholders of record as of Apr 1.

Valuation

State Street's shares are down 16.8% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 21.5% and 17.8% over the past year, respectively.

The S&P 500 index is down 5.2% in the past year.

The stock is currently trading at 8.61X forward 12 months earnings, which compares to 8.20X for the Zacks sub-industry, 11.62X for the Zacks sector and 15.74X for the S&P 500 index.

Over the past five years, the stock has traded as high as 16.12X and as low as 7.05X, with a 5-year median of 12.52X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our $63 price target reflects 9.21X 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	8.61	8.2	11.62	15.74
	5-Year High	16.12	13.85	16.21	19.34
	5-Year Low	7.05	8.2	11.62	15.18
	5-Year Median	12.52	11.31	13.97	17.42
P/TB TTM	Current	1.81	1.6	2.62	10.29
	5-Year High	3.68	2.68	3.98	12.86
	5-Year Low	1.48	1.37	2.39	6.02
	5-Year Median	2.57	2.12	3.46	9.14
P/S F12M	Current	1.77	2.71	5.99	2.9
	5-Year High	3.41	4.59	6.64	3.44
	5-Year Low	1.45	2.61	5.39	2.54
	5-Year Median	2.51	3.59	6.04	3

As of 03/13/2020

Industry Analysis **Zacks Industry Rank:** Bottom 24% (193 out of 253)

Top Peers

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

Industry Comparison Industry: Banks - Major Regional

Industry Peers

	STT Neutral	X Industry	S&P 500	BK Neutral	JPM Neutral	NTRS Underperform
VGM Score	D	-	-	F	D	D
Market Cap	20.86 B	25.92 B	19.05 B	30.21 B	319.42 B	15.91 B
# of Analysts	7	8	13	7	9	6
Dividend Yield	3.53%	4.00%	2.31%	3.63%	3.46%	3.68%
Value Score	C	-	-	D	C	D
Cash/Price	3.50	0.94	0.05	4.70	2.78	2.70
EV/EBITDA	-8.05	3.65	11.57	-9.99	-4.04	-8.12
PEG Ratio	0.82	0.96	1.68	1.15	1.97	1.04
Price/Book (P/B)	1.00	0.83	2.56	0.83	1.39	1.64
Price/Cash Flow (P/CF)	5.52	6.19	10.18	5.95	7.40	7.99
P/E (F1)	8.80	8.26	14.94	8.44	9.83	11.33
Price/Sales (P/S)	1.59	1.65	2.02	1.45	2.23	2.31
Earnings Yield	11.37%	12.11%	6.67%	11.84%	10.17%	8.82%
Debt/Equity	0.58	0.86	0.70	0.74	1.24	0.41
Cash Flow ($/share)	10.66	6.63	7.01	5.74	14.04	9.51
Growth Score	D	-	-	F	C	D
Hist. EPS Growth (3-5 yrs)	7.88%	13.58%	10.85%	11.50%	16.24%	16.37%
Proj. EPS Growth (F1/F0)	8.43%	1.54%	5.99%	0.60%	-1.42%	1.26%
Curr. Cash Flow Growth	-5.72%	2.66%	6.15%	-5.62%	9.35%	-5.52%
Hist. Cash Flow Growth (3-5 yrs)	5.53%	9.49%	8.52%	5.07%	10.67%	10.90%
Current Ratio	0.50	0.90	1.24	0.70	0.92	0.65
Debt/Capital	33.86%	43.35%	42.57%	40.45%	54.21%	26.50%
Net Margin	18.14%	22.06%	11.64%	21.39%	25.49%	21.64%
Return on Equity	11.81%	11.95%	16.74%	10.49%	15.19%	15.15%
Sales/Assets	0.05	0.05	0.54	0.06	0.05	0.05
Proj. Sales Growth (F1/F0)	0.25%	-0.07%	3.54%	-4.07%	1.61%	3.35%
Momentum Score	C	-	-	F	F	D
Daily Price Chg	22.32%	15.62%	8.21%	15.62%	18.01%	20.64%
1 Week Price Chg	-11.72%	-9.20%	-0.67%	-4.59%	-6.92%	-11.53%
4 Week Price Chg	-25.35%	-32.77%	-22.67%	-25.85%	-24.64%	-24.86%
12 Week Price Chg	-26.09%	-33.05%	-20.46%	-32.88%	-24.35%	-29.04%
52 Week Price Chg	-16.26%	-28.25%	-10.79%	-35.31%	-1.36%	-19.52%
20 Day Average Volume	3,910,495	7,859,821	3,061,271	7,768,407	23,815,252	2,052,474
(F1) EPS Est 1 week change	-0.45%	-1.35%	0.00%	-0.39%	-0.78%	-1.68%
(F1) EPS Est 4 week change	-3.03%	-2.12%	-0.32%	-2.37%	-1.36%	-5.73%
(F1) EPS Est 12 week change	4.14%	-1.97%	-0.65%	-4.28%	1.47%	-5.90%
(Q1) EPS Est Mthly Chg	-0.97%	-1.27%	-0.62%	-0.83%	2.36%	-1.79%

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	C
VGM Score	D

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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