

State Street Corp. (STT)

\$58.46 (As of 05/18/20)

Price Target (6-12 Months): **\$62.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 03/08/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: B

Growth: C

Momentum: B

Summary

State Street's shares have outperformed the industry over the past year. Its earnings outpaced the Zacks Consensus Estimate in each of the trailing four quarters. First-quarter 2020 results reflect an increase in fee income. The company's new business servicing wins, opportunistic buyouts, 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, elevated operating expenses amid an overall tough operating environment make us apprehensive and might hurt the bottom line.

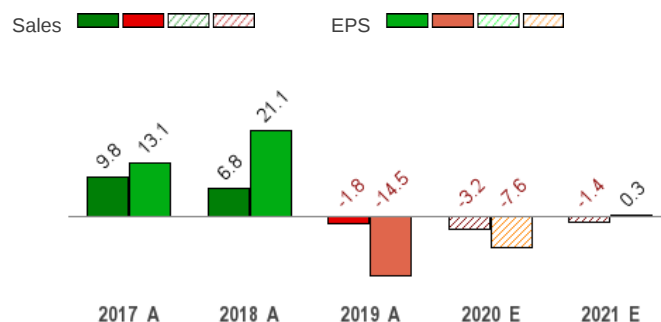
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$85.89 - \$42.10
20 Day Average Volume (sh)	2,265,396
Market Cap	\$20.6 B
YTD Price Change	-26.1%
Beta	1.55
Dividend / Div Yld	\$2.08 / 3.6%
Industry	Banks - Major Regional
Zacks Industry Rank	Bottom 4% (244 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	23.7%
Last Sales Surprise	5.5%
EPS F1 Est- 4 week change	7.5%
Expected Report Date	07/17/2020
Earnings ESP	3.3%
P/E TTM	8.8
P/E F1	10.3
PEG F1	1.0
P/S TTM	1.6

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	2,825 E	2,870 E	2,875 E	2,957 E	11,219 E
2020	3,065 A	2,806 E	2,728 E	2,762 E	11,384 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	\$1.22 E	\$1.55 E	\$1.53 E	\$1.67 E	\$5.72 E
2020	\$1.67 A	\$1.41 E	\$1.34 E	\$1.48 E	\$5.70 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 05/18/2020. The reports text is as of 05/19/2020.

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.

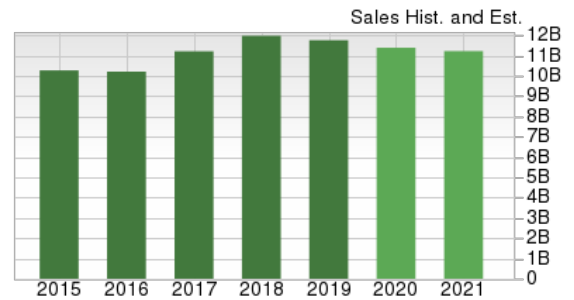
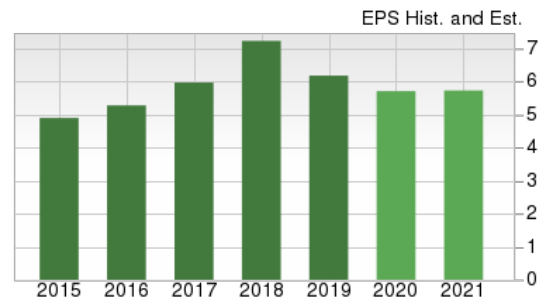
State Street operates through the following two divisions:

The *Investment Servicing* division (constituting 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 Mar 31, 2020, State Street had assets under custody and administration of \$31.9 trillion, and AUM of \$2.7 trillion.



Reasons To Buy:

- ▲ 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). The uptrend continued in the first quarter 2020, mainly driven by a rise in client activity, higher average equity market levels and significant market volatility. The company remains well positioned with respect to fundamental business activities, given significant global exposure and a broad array of innovative products and services. Continuous investment in new products, new servicing business wins and inorganic growth strategy are expected to keep supporting fee income going forward.
- ▲ As of Mar 31, 2020, State Street had total debt of \$51.4 billion, up substantially on a sequential basis mainly due to rise in short-term borrowings. The company's total debt-total capital ratio of 39.44 is lower than the industry average of 49.85. Its time-interest-earned ratio of 5.3 at the end of first-quarter 2020 has improved over the last few quarters. Further, given the record of consistent earnings growth, State Street has lower credit risk and lesser likelihood of default of interest and debt repayments if the economic situation worsens.
- ▲ State Street's capital deployment activities are solid. The company's 2019 capital plan (approved by the Federal Reserve) included a 10.6% dividend hike and \$2-billion share repurchase authorization. In mid-March, the company suspended buybacks owing to coronavirus concerns. Given its solid liquidity position, earnings strength and lower debt-to-equity ratio than the industry, the company will likely be able to sustain improved capital deployments and continue enhancing shareholder value.
- ▲ Shares of State Street have outperformed the industry so far this year. Also, the company's earnings estimates for 2020 have been revised 6.1% upward over the past 30 days. The stock seems undervalued than the broader industry. Its current PEG and price-to-earnings (F1) ratios are below the respective industry averages. It has a Value Score of B. Therefore, given the strong fundamentals and positive estimate revisions, the stock has upside potential.

State Street is well poised for growth on the back of new business wins and a strong balance sheet position. Synergies from strategic buyouts and its global footprint are expected to aid profitability.

Reasons To Sell:

- ▼ Street's net interest income and net interest margin. Both the metrics have been witnessing a declining trend over the last several quarters (on a year-over-year basis), with third-quarter 2019 being an exception.
- ▼ Elevated operating expenses are a major concern for State Street. Operating expenses witnessed a five-year (2015-2019) CAGR of 2.9%. 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 ahead.
- ▼ State Street's trailing 12-month return on equity (ROE) undercuts its growth potential. The company's ROE of 12.36% compares unfavorably with 16.29% for the S&P 500, highlighting that it is less efficient in using shareholder funds.

Persistently increasing expenses and a decline in margins due to lower rates will likely hurt State Street's profitability. Additionally, a tough operating backdrop is a major near-term concern.

Last Earnings Report

State Street's Q1 Earnings Beat on Higher Fee Income

State Street's first-quarter 2020 adjusted earnings of \$1.67 per share comfortably outpaced the Zacks Consensus Estimate of \$1.35. Also, the figure was 34.7% higher than the prior-year level.

The results reflect new investment servicing wins of \$171 billion, improvement in fee income and successful implementation of its cost-saving initiatives. However, lower net interest income mainly due to lower rates and rise in provisions were headwinds.

After considering several non-recurring items, net income available to common shareholders was \$580 million, up 28.3% from the year-ago quarter.

Revenues Up, Expenses Down

Total revenues were \$3.07 billion, increasing 4.5% year over year. Also, the top line beat the Zacks Consensus Estimate of \$2.91 billion.

Net interest revenues declined 1.3% from the year-ago quarter to \$664 million. The fall was mainly due to lower market rates, partially offset by solid deposit balance and episodic market-related benefits.

Net interest margin decreased 24 basis points year over year to 1.30%.

Total fee revenues grew 6.2% from the prior-year quarter to \$2.40 billion. This rise was mainly driven by higher foreign exchange trading services, which surged 63.9% from the year-ago quarter.

Non-interest expenses were \$2.26 billion, down 1.7% from a year ago. The decline was attributed to the company's cost-savings efforts. Excluding notable items, adjusted expenses decreased 1.1% from the prior-year period to \$2.24 billion.

Provision for credit losses jumped 49.4% from the year-ago period to \$124 million.

As of Mar 31, 2020, total assets under custody and administration were \$31.9 trillion, down 2.4% year over year. Also, assets under management were \$2.7 trillion, up 4.1% from the prior-year figure.

Strong Capital and Profitability Ratios

Under Basel III (Standardized approach), estimated Tier 1 common ratio was 10.7% as of Mar 31, 2020 compared with 11.5% in the corresponding period of 2019.

Return on common equity came in at 10.9% compared with 8.7% 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. In mid-March, the company suspended the share buyback plan amid coronavirus pandemic.

Second-Quarter 2020 Outlook

Management expects fee revenues to be down 5-9% sequentially, owing to lower equity market levels. Servicing fees are anticipated to be down 5%, management fees 9% and some reversion is expected in trading revenues.

NII is anticipated to be down almost 11% from the prior quarter, given the full quarter impact of the Fed rate cuts.

Effective tax rates are expected to be in the 13-15% range.

2020 Outlook

The company based its outlook on certain assumptions that include low interest rate environment across the globe and average equity market levels for 2020 lower as compared to 2019.

Management still expects NII to be down 10% year over year, driven by the impact of lower rates and the relatively solid performance in the first quarter.

Fee revenues are expected to decrease 1-2%, given the significant changes in the economic outlook. Specifically, servicing fees are likely to be down 1-3%, mainly owing to lower-than-expected market averages. Further, management fees are expected to be down 3-5%, depending on equity market performance. Management expects that spike in FX trading revenues will gradually subside with market volumes and volatility, while securities finance will continue to be adversely impacted by lower levels of leverage.

Additionally, within software and processing fees, the company remains confident in the CRD deal synergies. Nonetheless, uncertainty and operational pressures due to the coronavirus pandemic on the front office clients is expected to "create go-live delays and slow down professional services projects of several current CRD clients." Hence, CRD revenue are expected to growth at about 5-6%.

Management expects software and processing fees ex-CRD to be between \$60 million and \$70 million per quarter for the rest of the year, absent any further significant market-related adjustments.

Quarter Ending 03/2020

Report Date	Apr 17, 2020
Sales Surprise	5.45%
EPS Surprise	23.70%
Quarterly EPS	1.67
Annual EPS (TTM)	6.61

Notably, the company remains on track to achieve on track revenue and expense synergies from CRD deal in 2021.

Management projects money market fund fee waivers to be approximately \$10-\$40 millions, largely in the second half of the year.

The company continues to execute investments and optimization savings initiatives efforts as detailed earlier in the year. It remain on track in lowering compensation and benefits costs, occupancy costs and other costs and IT costs. Further, now the company projects expenses to decline 1-2%, a change from prior guidance of down roughly 1%.

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 was paid out on Apr 15 to shareholders of record as of Apr 1.

Valuation

State Street's shares are down 2.4% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 26.8% and 19% over the past year, respectively.

The S&P 500 index is up 3.8% in the past year.

The stock is currently trading at 10.24X forward 12 months earnings, which compares to 12.11X for the Zacks sub-industry, 14.66X for the Zacks sector and 20.83X for the S&P 500 index.

Over the past five years, the stock has traded as high as 16.12X and as low as 6.47X, with a 5-year median of 12.35X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$62 price target reflects 10.82X 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	10.24	12.11	14.66	20.83
	5-Year High	16.12	14.2	16.18	20.87
	5-Year Low	6.47	8.01	11.58	15.23
	5-Year Median	12.35	11.31	13.94	17.49
P/TB TTM	Current	1.76	1.32	3.3	11.3
	5-Year High	3.68	2.68	4	12.77
	5-Year Low	1.33	1.21	2	5.97
	5-Year Median	2.49	2.12	3.49	9.21
P/S F12M	Current	1.82	2.39	5.81	3.24
	5-Year High	3.41	4.59	6.7	3.44
	5-Year Low	1.3	2.34	4.99	2.53
	5-Year Median	2.48	3.59	6.05	3.01

As of 05/18/2020

Industry Analysis Zacks Industry Rank: Bottom 4% (244 out of 254)



Top Peers

Company (Ticker)	Rec	Rank
The Bank of New York Mellon Corporation (BK)	Neutral	3
Citigroup Inc. (C)	Neutral	4
First Republic Bank (FRC)	Neutral	3
HSBC Holdings plc (HSBC)	Neutral	4
JPMorgan ChaseCo. (JPM)	Neutral	3
UBS Group AG (UBS)	Neutral	2
Northern Trust Corporation (NTRS)	Underperform	3
U.S. Bancorp (USB)	Underperform	5

Industry Comparison Industry: Banks - Major Regional				Industry Peers		
	STT	X Industry	S&P 500	BK	JPM	NTRS
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Underperform
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	B	-	-	F	F	F
Market Cap	20.58 B	29.87 B	20.09 B	29.87 B	275.60 B	15.80 B
# of Analysts	7	8	14	7	9	5
Dividend Yield	3.56%	4.56%	2.1%	3.68%	3.98%	3.69%
Value Score	B	-	-	D	F	F
Cash/Price	8.07	1.20	0.07	7.56	4.45	3.84
EV/EBITDA	-24.36	2.74	12.13	-15.74	-7.91	-12.86
PEG Ratio	0.95	2.22	2.72	1.22	3.52	1.31
Price/Book (P/B)	0.96	0.79	2.75	0.79	1.19	1.58
Price/Cash Flow (P/CF)	5.48	5.71	10.86	5.88	6.44	7.98
P/E (F1)	10.15	14.98	20.10	9.76	17.62	14.22
Price/Sales (P/S)	1.57	1.57	2.05	1.44	1.98	2.30
Earnings Yield	9.75%	6.68%	4.77%	10.26%	5.67%	7.03%
Debt/Equity	0.73	1.06	0.76	0.77	1.29	0.41
Cash Flow (\$/share)	10.66	6.63	7.01	5.74	14.04	9.51
Growth Score	C	-	-	F	F	F
Hist. EPS Growth (3-5 yrs)	7.98%	12.51%	10.87%	10.63%	15.63%	16.16%
Proj. EPS Growth (F1/F0)	-7.59%	-49.46%	-10.31%	-14.00%	-52.10%	-19.43%
Curr. Cash Flow Growth	-5.72%	2.66%	5.51%	-5.62%	9.35%	-5.52%
Hist. Cash Flow Growth (3-5 yrs)	5.53%	9.49%	8.55%	5.07%	10.67%	10.90%
Current Ratio	0.59	0.90	1.28	0.72	0.89	0.68
Debt/Capital	39.44%	49.85%	44.46%	41.44%	54.97%	27.57%
Net Margin	19.13%	21.37%	10.59%	21.60%	21.61%	21.88%
Return on Equity	12.36%	10.59%	16.29%	10.59%	12.52%	15.18%
Sales/Assets	0.05	0.05	0.55	0.05	0.05	0.05
Proj. Sales Growth (F1/F0)	-3.17%	-3.92%	-2.49%	-5.10%	-4.67%	-2.16%
Momentum Score	B	-	-	C	B	A
Daily Price Chg	7.44%	8.34%	5.21%	5.21%	5.30%	6.76%
1 Week Price Chg	-9.65%	-9.65%	-4.56%	-9.28%	-7.34%	-6.40%
4 Week Price Chg	0.48%	-1.37%	4.12%	-7.36%	-1.37%	-4.27%
12 Week Price Chg	-21.01%	-36.88%	-16.39%	-21.80%	-31.56%	-21.33%
52 Week Price Chg	-2.32%	-29.70%	-5.84%	-26.63%	-18.77%	-18.78%
20 Day Average Volume	2,265,396	6,442,063	2,651,378	5,231,351	22,628,972	1,165,769
(F1) EPS Est 1 week change	-0.32%	0.00%	0.00%	-6.13%	0.00%	1.40%
(F1) EPS Est 4 week change	7.46%	-5.65%	-4.48%	-5.65%	0.28%	3.76%
(F1) EPS Est 12 week change	-17.68%	-51.63%	-16.39%	-16.85%	-52.08%	-24.99%
(Q1) EPS Est Mthly Chg	15.85%	0.45%	-9.90%	0.56%	0.45%	0.88%

Zacks Stock Rating System

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

Zacks Recommendation

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

Zacks Rank

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

Zacks Style Scores

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

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

Value Score	B
Growth Score	C
Momentum Score	B
VGM Score	B

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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