

State Street Corp. (STT)

\$69.07 (As of 08/25/20)

Price Target (6-12 Months): **\$73.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 08/25/20)

Prior Recommendation: Outperform

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 so far this year. Its earnings have surpassed the Zacks Consensus Estimate in each of the trailing four quarters. State Street's new business servicing wins, opportunistic buyouts, global reach and strong balance sheet position are expected to continue supporting growth. Moreover, its dividend payment plan reflects a strong liquidity position, through which it is expected to continue enhancing shareholder value. Further, the company's efforts to technologically upgrade operations will likely go a long way in supporting financials. However, pressure on margins due to near-zero interest rates remains a major concern. Moreover, elevated operating expenses owing to the company's constant restructuring efforts are expected to hurt bottom-line growth to some extent in the near term.

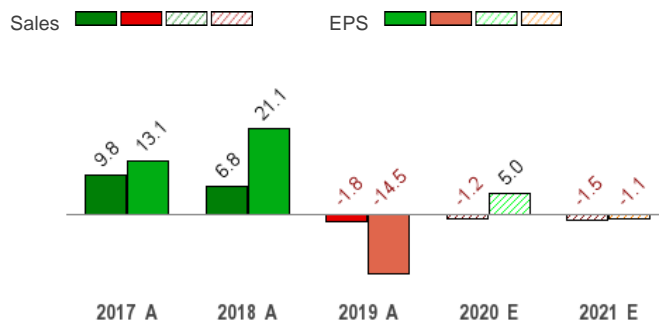
Price, Consensus & Surprise



Data Overview

| | |
|----------------------------|--|
| 52 Week High-Low | \$85.89 - \$42.10 |
| 20 Day Average Volume (sh) | 1,823,064 |
| Market Cap | \$24.3 B |
| YTD Price Change | -12.7% |
| Beta | 1.50 |
| Dividend / Div Yld | \$2.08 / 3.0% |
| Industry | Banks - Major Regional |
| Zacks Industry Rank | Bottom 15% (215 out of 252) |

Sales and EPS Growth Rates (Y/Y %)



| | |
|---------------------------|------------|
| Last EPS Surprise | 15.3% |
| Last Sales Surprise | 2.3% |
| EPS F1 Est- 4 week change | 0.5% |
| Expected Report Date | 10/16/2020 |
| Earnings ESP | 0.3% |
| P/E TTM | 9.8 |
| P/E F1 | 10.7 |
| PEG F1 | 1.0 |
| P/S TTM | 1.9 |

Sales Estimates (millions of \$)

| | Q1 | Q2 | Q3 | Q4 | Annual* |
|------|---------|---------|---------|---------|----------|
| 2021 | 2,804 E | 2,864 E | 2,870 E | 2,946 E | 11,450 E |
| 2020 | 3,065 A | 2,937 A | 2,774 E | 2,825 E | 11,619 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 | \$1.26 E | \$1.70 E | \$1.70 E | \$1.87 E | \$6.41 E |
| 2020 | \$1.67 A | \$1.88 A | \$1.42 E | \$1.56 E | \$6.48 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 08/25/2020. The reports text is as of 08/26/2020.

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.

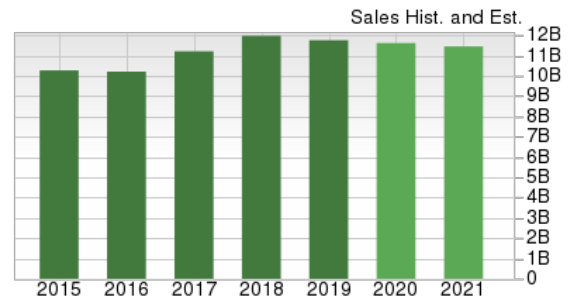
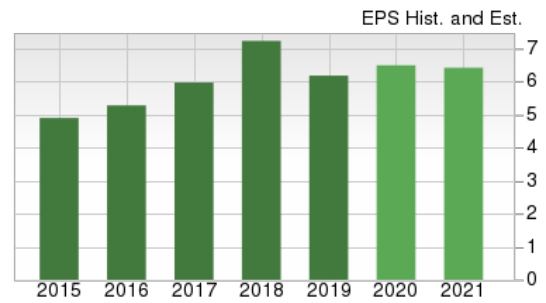
State Street operates through the following two divisions:

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 Jun 30, 2020, State Street had assets under custody and administration of \$33.5 trillion, and AUM of \$3.1 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 half of 2020, mainly driven by a rise in client activity and significant market volatility. The company remains well positioned with respect to fundamental business activities, given its global exposure and a broad array of innovative products and services. Continuous investments in new products, new business servicing wins and inorganic growth strategy are expected to keep supporting revenues, going forward.
- ▲ As of Jun 30, 2020, State Street had total debt of \$31.3 billion, significantly higher than the cash and cash equivalents balance of \$3.7 billion. However, during the second quarter, the company paid off most of its short-term borrowings and hence, total debt recorded a decline of 39.2% on a sequential basis. Also, its second-quarter 2020 times-interest-earned ratio of 5.5 improved on a sequential basis. The company's total debt to total capital of 38.5% declined sequentially in the second quarter. Thus, despite being highly leveraged, the company is expected to be able to continue to meet debt obligations in the near term even if economic situation worsens, given its record of consistent earnings growth.
- ▲ State Street cleared the 2020 stress test. The company will be paying dividend at the current level of 52 cents per share and has suspended share repurchases for the third quarter 2020. Nevertheless, given its solid capital position, earnings strength and lower debt-to-equity ratio than the industry, the company will likely be able to sustain dividend payments 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 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. 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:

- ▼ Near-zero interest rates and the Fed's accommodative monetary policy stance are expected to continue to hurt State Street's net interest income (NII) and net interest margin (NIM). Both the metrics have been witnessing a declining trend over the last several quarters (on a year-over-year basis), with the trend continuing in the first half of 2020.
- ▼ Elevated operating expenses are expected to continue to hurt State Street's bottom line to some extent in the quarters ahead. While expenses declined in the first six months of 2020 on a year-over-year basis, the same witnessed a five-year (2015-2019) CAGR of 2.9%. Higher Information systems and communications expenses, as well as acquisition and restructuring costs were 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 12.74% compares unfavorably with 14.66% 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 Q2 Earnings Beat on Fee Income Growth

State Street's second-quarter 2020 adjusted earnings of \$1.88 per share comfortably outpaced the Zacks Consensus Estimate of \$1.63. Also, the figure was 29.7% higher than the prior-year level.

The results reflected new investment servicing wins of \$162 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 \$662 million, up 23.3% from the year-ago quarter.

Revenues Up, Expenses Down

Total revenues were \$2.93 billion, increasing 2.2% year over year. Also, the top line beat the Zacks Consensus Estimate of \$2.87 billion.

Net interest revenues declined 8.8% from the year-ago quarter to \$559 million. The fall was mainly due to lower market rates, partially offset by a solid deposit balance and participation in the Money Market Mutual Fund Liquidity Facility program.

Net interest margin decreased 54 basis points year over year to 0.93%.

Total fee revenues grew 5.2% from the prior-year quarter to \$2.38 billion. This rise was mainly driven by higher foreign exchange trading services (up 26%), and software and processing fees (up 45.8%).

Non-interest expenses were \$2.08 billion, down 3.3% from a year ago. The decline was attributed to the company's cost-savings efforts. Excluding notable items, adjusted expenses decreased 3.4% from the prior-year period to \$2.07 billion.

Provision for credit losses was \$52 million, up significantly from \$1 million in the prior year quarter.

As of Jun 30, 2020, total assets under custody and administration were \$33.5 trillion, up 2.3% year over year. Also, assets under management were \$3.1 trillion, up 4.7% from the prior-year figure.

Strong Capital and Profitability Ratios

Under Basel III (Standardized approach), estimated Tier 1 common ratio was 12.3% as of Jun 30, 2020 compared with 11.5% in the corresponding period of 2019.

Return on common equity came in at 12.1% compared with 10.1% in the year-ago quarter.

2020 Outlook

The company's outlook is based on certain assumptions. These include short-term rates and average equity market levels for the remainder of 2020 to remain at the current levels.

Given the impact of continued lower long end rates on the investment portfolio, management expects NII in third-quarter 2020 to decline 9-11% on a sequential basis. However, fourth-quarter NII is expected to be in line with the third quarter.

Fee revenues are expected to increase 1.5-2%, supported by a year-over-year rise in servicing fees. This is improvement from the prior outlook of a decline of 1-2%.

The company remains "laser focused on driving sustainable productivity improvements and achieving automation benefits". Hence, excluding notable items, overall expenses are expected to decline "at the better end" of the previously mentioned 1-2%.

Tax rate is expected to be closer to the low end of 17-19%.

Medium-Term Targets

Including the impact of the Charles River Development buyout, the company expects revenue increase of 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 06/2020

| Report Date | Jul 17, 2020 |
|------------------|--------------|
| Sales Surprise | 2.33% |
| EPS Surprise | 15.34% |
| Quarterly EPS | 1.88 |
| Annual EPS (TTM) | 7.04 |

Recent News

State Street and FNZ to Offer Wealth Manager Servicing – Jul 7, 2020

State Street is collaborating with FNZ Group on a new wealth manager servicing venture. Per the terms of the agreement, FNZ will acquire a majority interest in State Street's Wealth Manager Services business, with the latter retaining a minority stake.

The financial terms of the deal, still subject to regulatory approvals and other closing conditions, are not disclosed yet. The transaction is expected to close in fourth-quarter 2020.

FNZ is one of the leading "global platform-as-a-service provider" that offers digital, personalized, high-quality and low-cost wealth management services in collaboration with financial firms. It serves approximately 8,000 wealth management and financial advice firms across the U.K., Europe, and the Asia Pacific regions, and has more than \$700 billion in assets under administration.

Thus, the new venture will combine State Street's custody expertise with the international platform operated by FNZ. Notably, State Street will act as a sub-custodian to the custody assets belonging to Wealth Manager Services' clients.

Lee Jones, senior vice president of State Street, will join the new venture as CEO upon the transaction's closure. He said, "We will benefit from a significant investment in technology and people in order to expedite our growth strategy, and we are excited about the future."

CEO of FNZ, Adrian Durham, said, "This is the first step in a long-term strategy to expand our platform into the North American market. In the US, we see similar long-term drivers in relation to cost, transparency, digitization and personalization in asset and wealth management as other markets in which we operate."

Dividend Update

On May 21, State Street declared a cash dividend of 52 cents per share. The dividend was paid out on Jul 16 to shareholders of record as of Jul 1.

Valuation

State Street's shares are down 12.7% in the year-to-date period but up 39.8% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 33.7% and 15.7% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 14.9% and 4.9%, respectively.

The S&P 500 index is up 6.5% in the year-to-date period and 19.9% over the past year.

The stock is currently trading at 10.70X forward 12 months earnings, which compares to 13.16X for the Zacks sub-industry, 16.64X for the Zacks sector and 23.04X 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 12.02X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$73 price target reflects 11.30X 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 | 10.7 | 13.16 | 16.64 | 23.04 |
| | 5-Year High | 16.12 | 14.2 | 16.64 | 23.04 |
| | 5-Year Low | 6.47 | 8.01 | 11.6 | 15.25 |
| | 5-Year Median | 12.02 | 11.31 | 14.26 | 17.58 |
| P/TB TTM | Current | 1.9 | 1.53 | 3.36 | 13.5 |
| | 5-Year High | 3.68 | 2.68 | 4 | 13.5 |
| | 5-Year Low | 1.33 | 1.21 | 2.01 | 6.03 |
| | 5-Year Median | 2.44 | 2.11 | 3.48 | 9.59 |
| P/S F12M | Current | 2.12 | 2.8 | 6.23 | 3.76 |
| | 5-Year High | 3.41 | 4.59 | 6.67 | 3.76 |
| | 5-Year Low | 1.3 | 2.39 | 4.97 | 2.53 |
| | 5-Year Median | 2.45 | 3.59 | 6.06 | 3.05 |

As of 08/25/2020

Industry Analysis Zacks Industry Rank: Bottom 15% (215 out of 252)



Top Peers

| Company (Ticker) | Rec | Rank |
|--|------------|------|
| UBS Group AG (UBS) | Outperform | 2 |
| 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 | 5 |
| JPMorgan ChaseCo. (JPM) | Neutral | 3 |
| Northern Trust Corporation (NTRS) | Neutral | 3 |
| U.S. Bancorp (USB) | Neutral | 3 |

| Industry Comparison Industry: Banks - Major Regional | | | | Industry Peers | | |
|--|-----------|------------|-----------|----------------|------------|---------|
| | STT | X Industry | S&P 500 | BK | JPM | NTRS |
| Zacks Recommendation (Long Term) | Neutral | - | - | Neutral | Neutral | Neutral |
| Zacks Rank (Short Term) | 3 | - | - | 3 | 3 | 3 |
| VGM Score | D | - | - | B | D | C |
| Market Cap | 24.34 B | 32.48 B | 23.77 B | 32.48 B | 306.28 B | 17.48 B |
| # of Analysts | 8 | 9 | 14 | 8 | 10 | 6 |
| Dividend Yield | 3.01% | 4.01% | 1.65% | 3.38% | 3.58% | 3.33% |
| Value Score | C | - | - | C | C | C |
| Cash/Price | 4.15 | 2.52 | 0.07 | 5.89 | 4.30 | 3.00 |
| EV/EBITDA | -11.85 | -0.76 | 13.35 | -12.43 | -8.81 | -9.83 |
| PEG Ratio | 1.00 | 2.29 | 3.03 | 1.18 | 3.37 | 1.36 |
| Price/Book (P/B) | 1.09 | 0.85 | 3.17 | 0.83 | 1.31 | 1.67 |
| Price/Cash Flow (P/CF) | 6.48 | 6.39 | 12.81 | 6.39 | 7.16 | 8.83 |
| P/E (F1) | 10.66 | 14.53 | 21.72 | 9.43 | 16.86 | 14.53 |
| Price/Sales (P/S) | 1.89 | 1.89 | 2.47 | 1.64 | 2.21 | 2.61 |
| Earnings Yield | 9.38% | 6.88% | 4.45% | 10.61% | 5.93% | 6.88% |
| Debt/Equity | 0.70 | 0.88 | 0.75 | 0.74 | 1.35 | 0.49 |
| Cash Flow (\$/share) | 10.66 | 6.63 | 6.93 | 5.74 | 14.04 | 9.51 |
| Growth Score | D | - | - | B | D | C |
| Hist. EPS Growth (3-5 yrs) | 8.29% | 10.96% | 10.41% | 9.83% | 13.82% | 15.52% |
| Proj. EPS Growth (F1/F0) | 5.06% | -42.47% | -4.92% | -3.23% | -44.38% | -12.79% |
| Curr. Cash Flow Growth | -5.72% | 2.66% | 5.20% | -5.62% | 9.35% | -5.52% |
| Hist. Cash Flow Growth (3-5 yrs) | 5.53% | 9.49% | 8.50% | 5.07% | 10.67% | 10.90% |
| Current Ratio | 0.54 | 0.89 | 1.33 | 0.68 | 0.88 | 0.67 |
| Debt/Capital | 38.52% | 44.79% | 44.20% | 40.12% | 56.09% | 31.13% |
| Net Margin | 20.27% | 18.16% | 10.25% | 22.31% | 18.16% | 21.36% |
| Return on Equity | 12.74% | 8.52% | 14.66% | 10.34% | 10.75% | 14.21% |
| Sales/Assets | 0.05 | 0.05 | 0.51 | 0.05 | 0.05 | 0.05 |
| Proj. Sales Growth (F1/F0) | -1.17% | -1.23% | -1.45% | -3.68% | 0.15% | -0.13% |
| Momentum Score | C | - | - | B | C | D |
| Daily Price Chg | 0.19% | 0.44% | -0.03% | 0.74% | 0.44% | -0.31% |
| 1 Week Price Chg | -4.23% | -6.27% | -1.45% | -4.80% | -4.97% | -2.03% |
| 4 Week Price Chg | 9.48% | 5.29% | 3.76% | 1.66% | 3.27% | 8.95% |
| 12 Week Price Chg | 9.97% | 2.47% | 5.99% | -4.33% | 1.59% | 3.88% |
| 52 Week Price Chg | 39.82% | -16.23% | 4.07% | -10.45% | -4.96% | -0.58% |
| 20 Day Average Volume | 1,823,064 | 4,445,615 | 1,880,903 | 4,445,615 | 14,985,534 | 751,560 |
| (F1) EPS Est 1 week change | -0.19% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| (F1) EPS Est 4 week change | 0.54% | 0.24% | 1.03% | -0.48% | 1.02% | -0.37% |
| (F1) EPS Est 12 week change | 13.81% | 13.48% | 3.40% | 4.76% | 16.22% | 8.35% |
| (Q1) EPS Est Mthly Chg | -0.10% | 0.15% | 0.00% | 0.15% | 4.63% | -0.72% |

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 | 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.

Disclosures

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