

BLYTH FUND | STT BUY PROPOSAL

By Charles Najda

Date: 10-24-02
Proposal: Buy 75 shares of State Street Corp.
Ticker: STT
Current price: 40.91 (close 10-23-02)
Analyst: Charles Najda
Profile: State Street Corporation is a financial holding company that through its subsidiaries, reports two lines of business: Investment Servicing and Investment Management. State Street conducts its business principally through its subsidiary, State Street Bank and Trust Company. With \$6.2 trillion of assets under custody and \$775 billion of assets under management at year-end 2001, State Street is a specialist in meeting the needs of sophisticated global investors. Clients include mutual funds and other collective investment funds, corporate and public pension funds, investment managers, and others. Services are provided from 30 offices in the United States, and from offices in Australia, Belgium, Canada, Cayman Islands, Chile, Czech Republic, France, Germany, Ireland, Japan, Luxembourg, Netherlands, Netherlands Antilles, New Zealand, People's Republic of China, Singapore, South Korea, Switzerland, Taiwan, United Arab Emirates and the United Kingdom. (From *Yahoo! Finance*)

The Numbers:

Shares Outstanding:	324.0 mln	Market Cap:	\$13.27 bln
Median Target Price 12 months	\$47.00	EPS Growth – 5 years	14.0%
P/E ttm	19.71	PEG – 5 years	1.11
P/book	2.65	P/sales	4.91
Gross Margins	90.9%	Net Margins	30.2%
Cash:	\$1.96 bln	Debt/Equity	0.30
EPS (02)	\$2.21	EPS (03)	\$2.44
Dividend / Yield	\$0.48 / 1.40%	Cash Per-share	\$6.05

Earnings History:

	Sep 2001	Dec 2001	Mar 2002	Jun 2002	Sep 2002
Estimate	0.49	0.51	0.54	0.52	0.55
Actual	0.53	0.54	0.54	0.54	0.56
Difference	0.04	0.03	0.0	0.02	0.01
% Surprise	8.2%	5.9%	0.00%	3.8%	1.8%

Strong

Financials:

- STT has a very strong net cash flow and operating cash flow.
- State Street has a clean balance sheet, with over \$73 billion in assets and \$3.5 billion in net tangible assets.
- Over the last 2 years long term debt has remained stable at approximately \$1.2 billion.
- Although revenue ttm fell 14.07 percent, net earnings over the same period rose 18.97%.
- Companies with a strong balance sheet and growing earnings consistently raise their dividend. State Street raised its dividend from \$0.25 per share in 1998 to \$0.42 for 2002. Thus STT has consistently kept its payout ratio between 17 and 19 percent.
- STT's long-term debt/shareholder's equity ratio has stayed below its peers' average over the last five years. This signals that STT's management is not relying on debt to boost returns on equity.
- Over the last 10 years, investors have created \$3.64 in market value for every dollar in retained earnings. This signals that State Street has been recognized by the market for earning above-average returns on retained capital.
- STT's owner earnings have an average annual compound growth rate of 17.26% over the last five years. This is especially notable because STT has experienced different competitive forces and economic cycles during the last five years.
- 60% of State Street's fee revenue comes from servicing fees, 19% from management fees,

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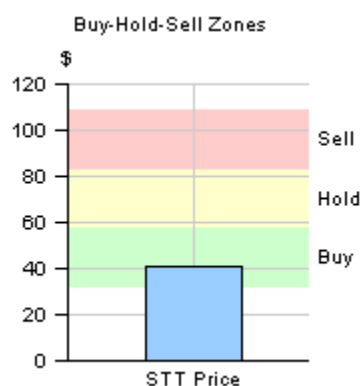
	and 11% from foreign exchange trading.
	• State Street derives 73% of its revenue from fees and the remainder from interest revenue. That interest revenue is a net value, and includes provisions for loan losses.
Definition of Owner Earnings:	• "Owner earnings"-- a company's net income from continuing operations plus depreciation, depletion, and amortization, less the amount of capital expenditures and an additional working capital that might be needed. This gives a more accurate picture of the company's long run performance than earnings per share or cash flow.
STT vs. MEL (Mellon Financial):	• Although Mellon's P/E is close to half of STT's, the PEG's are the same, which means that MEL is growing more slowly. • Over the last ten years State Street has seen 16.4% annualized revenue growth compared to Mellon's much lower figure of 5.4%. • Likewise STT's cash flows have been much stronger over the last ten years as well. State Street experienced 17.8% annualized growth in its cash flows over the last ten years compared to Mellon's growth rate of 8.6%. • Although Mellon's and State Street's dividend growth rates are almost the same, 13.7% and 15.1% respectively, Mellon's long term liabilities are much higher, which indicates that MEL's payout ratio may be too high. In fact, Mellon's long term debt/equity ratio is currently 2.19, while State Street's is much lower at 0.32. • State Street is more efficient with its employees. State Street's revenue per employee is 36% higher than Mellon's revenue per employee.
Small and Nimble:	• State Street is a relatively small financial compared to companies like C, JPM, and Fidelity, which is private. • Given its smaller size it will be a lot easier for STT to make its earnings growth targets than a large corporation, which has already saturated most of its markets. • STT's market cap is a moderate 11.1 billion dollars. In comparison, Citigroup's market cap is currently 153.9 billion, even after its recent fall. • STT's net margins are 5% higher than Citigroup's. Also, STT is much less leveraged than Citigroup. STT has a debt/equity ratio of 0.30 while C's is 1.34.
Customer Base:	• Former Blyth Fund Co-President Jon Wu recently told me that Qwest switched custodians for its pension plan from MetLife (MET) to STT. • State Street has approximately 40% of the public funds business in the United States. It's costly for large public funds, like retirement funds, to switch between companies providing particular financial services. Thus, unlike individual investors, public funds often use one service provider for an extended period of time. • State Street Corporation has been engaged by the Teacher Retirement System of Texas to provide a full range of custodial, securities lending and related services for its \$80 billion investment portfolio (September 4, 2002). • State Street has been selected to provide a full range of investment services to The Pension Fund for State Employees in Iceland (Lifeyrissjodur Starfsmanna Ríkisins - "LSR"), with \$1.4 billion in assets (October 4, 2002).
Deutsche Bank Deal:	• State Street has a strong cash position, with which it can make strategic acquisitions. • Deutsche Bank is in talks to sell State Street Corp. parts of its custody business, a move that would make the U.S. financial services firm the industry's biggest record keeper.
Closing Thoughts:	• State Street is a company that is world renowned for integrity. • Investment manager Edwin Walczak, whose Vontobel U.S. Value Fund to posted a stunning 42.43% gain from Jan. 1, 2000, through June 30, 2002, vs. the Standard & Poor's 500-stock index' decline of 30.44% has been recently purchasing STT. • As shown in the chart below, STT has provided shareholders with consistent returns over the long run. Like JNJ, STT has consistent returns and its management has a high level of integrity. • To emphasize management's commitment in the company: Since June of this year insiders only sold a total of 674 shares of STT. • State Street consistently beats the consensus estimates, which means that the \$2.21 2002

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earnings estimate is a conservative figure.

- Although STT is a smaller financial, it can be considered to be a blue chip company because institutions own 73.3% of STT's outstanding shares.



Right Time to Buy:

You can use historical high and low P/E's to project future stock highs and lows. Based on this range, you can establish 3 price zones - buy, hold and sell, shown in the chart to the left.

The Buy zone ranges from \$31.35 to \$57.40.

Key Ratios:

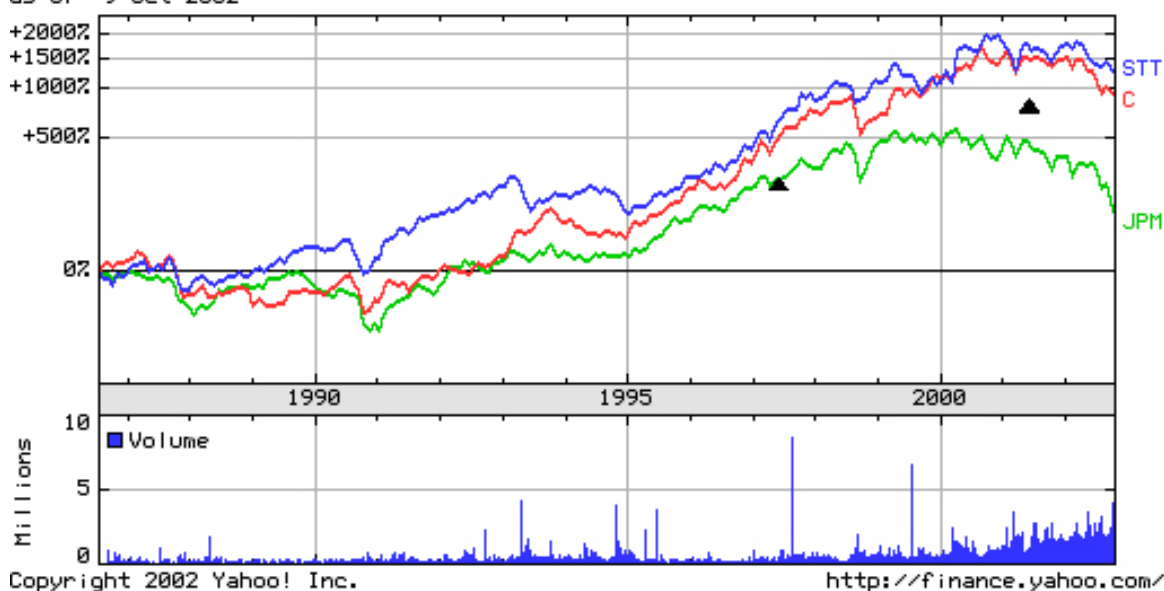
	Current	5-Yr. Low	5-Yr. High	Industry
Trailing P/E	17.40	13.50	37.60	22.70
Price/Sales	2.30	1.47	3.74	1.32
Return on Equity	16.60%	16.30%	23.30%	6.70%
Return on Assets	.90%	.90%	1.00%	.40%

15 Year STT Chart:

State Street (STT) trades like a financial, but over the long run it has been a better investment than leading companies like Citigroup or JP Morgan Chase.

State Street Corp
as of 9-Oct-2002

Splits: ▼



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