



## This Company Has the Tools to Outperform

With deep customer relationships and innovative solutions for future equipment needs, this global supplier has a durable business ready for a changing industry. Snap-on Services Corp (SNA: \$206/share) remains a [Long Idea](#) after 3Q21 earnings.

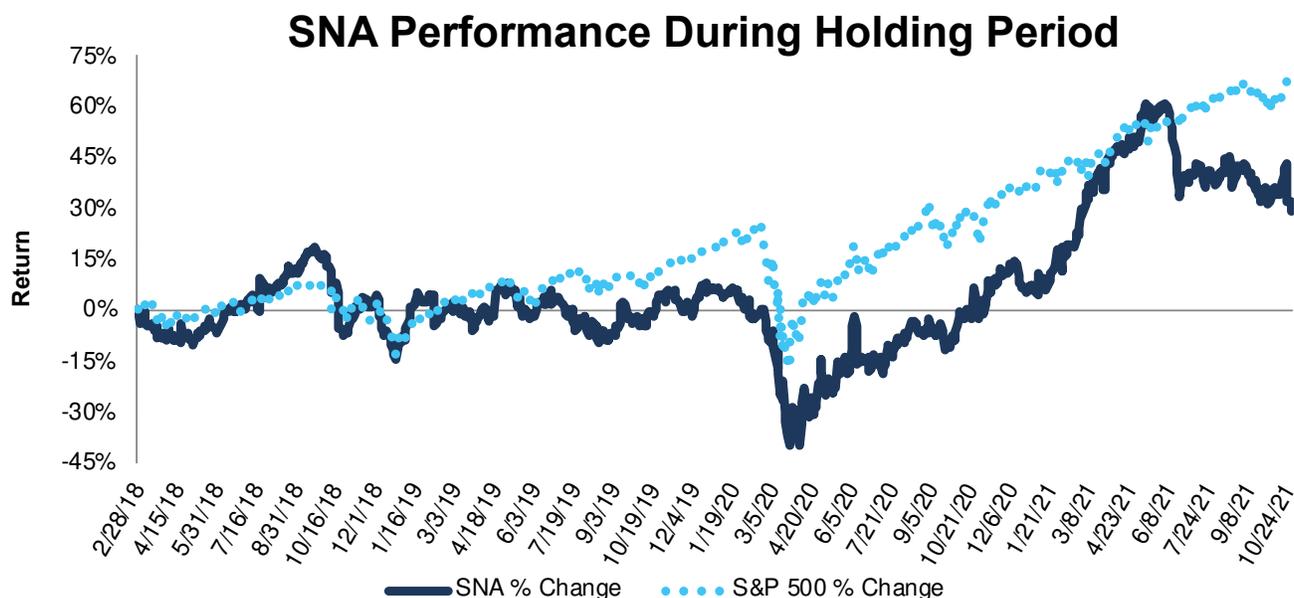
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We leverage more [reliable fundamental data](#), as proven in [The Journal of Financial Economics](#)<sup>1</sup>, and shown to provide a [new source of alpha](#), with qualitative research to highlight this firm whose stock present excellent risk/reward.

### Snap-on Has Very Attractive Risk/Reward

We made Snap-on a Long Idea in [February 2018](#) and the stock has underperformed the market by 39% since then. However, given the company's strong market position and cheap valuation, we continue to see upside in the stock.

**Figure 1: Long Idea Performance: From Date of Publication Through 10/26/2021**



Sources: New Constructs, LLC and company filings

**What's Working:** Snap-on beat on both its top and bottom lines in 3Q21. Total revenue in 3Q21 rose 10% year-over-year (YoY) and is 15% above 3Q19 levels. The company's Commercial and Industrial segment (30% of revenue in 3Q21), which expands its offerings beyond traditional auto tools and into the aerospace, power generation, and military markets, also showed signs of continued recovery from the pandemic as the segment's revenue was up 11% YoY from 3Q20.

While other businesses with more complex supply chains may struggle to maintain inventory levels, Snap-on's vertically integrated business enables it to better navigate the current global challenges. Snap-on's available inventory during the supply crunch is an advantage that will help the company keep existing customers and

<sup>1</sup> Our research utilizes our [Core Earnings](#), a more reliable measure of profits, as proven in [Core Earnings: New Data & Evidence](#), written by professors at Harvard Business School (HBS) & MIT Sloan and published in [The Journal of Financial Economics](#).



effectively compete for new ones as other tool and equipment suppliers struggle to maintain desired inventory levels. Management spoke to the company's advantageous supply chain position in its [3Q21 earnings call](#) when it mentioned that its vertically integrated business, "certainly puts us in a better position to grow and probably capture new customers who might not be serviced by these people (i.e. competitors)."

Snap-on benefits from long-term demand in the automotive repair industry as it supplies auto service technicians, auto service centers, and car dealerships with tools, equipment, and diagnostic tools. For years, the average age of vehicles on the road in the U.S. has steadily increased, which creates more repair opportunities for service providers. The [average age of a vehicle](#) in 2021 of 12.1 years is up from 11.9 years in 2020.

The proliferation of driver assistance systems provides more runway for Snap-on's diagnostic segment over the long run as demand for third-party repairs and system calibrations rise. Snap-on is already meeting this demand by offering diagnostic platforms that give repair shops the ability to make manufacturer-compliant calibrations to driver assistance systems.

Over the long term, the company's core operations are positioned in markets that have strong growth projections. The following is a list of market growth forecasts corresponding to Snap-on's core operations from various research providers:

- **global hand tools and woodworking tools:** 4% compounded annually from 2021 to 2026 according to [ResearchAndMarkets](#)
- **global power tools:** 6% compounded annually from 2021 to 2025 according to [Global Market Insights](#)
- **global automotive diagnostics:** 11% compounded annually from 2021 to 2030 according to [Allied Market Research](#)

**What's Not Working:** Faster revenue growth in the company's lower-margin undercar equipment drove Snap-on's operating margin down from 19.7% in 3Q20 to 19.4% in 3Q21.

Though the company saw strong revenue growth overall in 3Q21, not every segment saw positive trends. Lower sales to the military, aerospace industry, and natural resources industry partially offset the rise in sales from technical education, heavy duty, and general industry customers.

Driving demand still hasn't recovered to pre-pandemic levels, which is not good news for a company with large exposure to the automotive industry. While the trailing-twelve-months (TTM) number of vehicle miles traveled rose from 2.8 million in February 2021 to 3.0 million in July 2021, the TTM vehicle miles traveled is still 7% below pre-pandemic levels.

Though the transition of the automobile industry to electric vehicles (EVs) further weighs the stock down, it also creates new demand for EV-specific equipment. Snap-on is working with an undisclosed automobile manufacturer to develop equipment packages to market to dealerships for new EV models that are coming out.

Furthermore, while EVs theoretically should require less maintenance, overall maintenance costs for EVs are 1.6x more than traditional vehicles in their [first year of service](#). Service technicians also spend twice as long diagnosing and 1.5x longer fixing EVs compared to traditional vehicles. Clearly, service technicians will need more tools and diagnostic equipment to keep up with the growing demand for EV maintenance and repairs.

**SNA Is Still Priced for Permanent Profit Decline:** We calculate Snap-on's price-to-economic book value ([PEBV](#)) ratio of 0.9 based on its pre-pandemic three-year average net operating profit after tax ([NOPAT](#)) from 2017-2019. This ratio means that the stock is priced for profits to permanently fall 10% below pre-pandemic levels.

Below, we use our reverse DCF model to analyze the expectations for future growth in cash flows baked into different stock price scenarios for Snap-on.

In the first scenario, we assume Snap-on's:

- NOPAT margin falls to 18% (five-year average, vs. 19% TTM) from 2021 through 2030, and
- revenue falls by 1% compounded annually from 2021 to 2030 (vs. consensus CAGR of 10% for 2021-2022)

In this scenario, Snap-on's NOPAT falls by 1% compounded annually over the next decade and the stock is worth \$206/share today – equal to the current price. [See the math behind this reverse DCF scenario](#). In this



scenario, Snap-on's NOPAT in 2030 would be \$624 million, or its lowest level (excluding 2020) since 2016. For reference, Snap-on grew NOPAT by 16% compounded annually before the pandemic from 2009 to 2019.

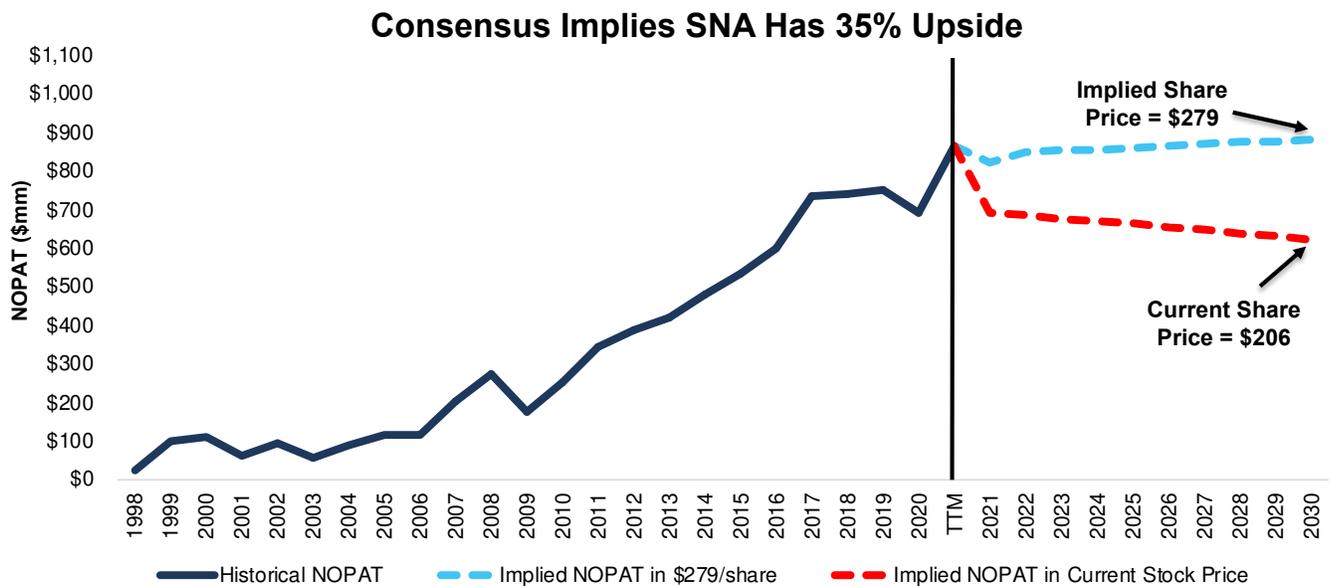
**Shares Could Reach \$279 or Higher:** If we assume Snap-on's:

- NOPAT margin falls to 18% (five-year average) from 2021 through 2030, and
- revenue grows at a 10% CAGR through 2022 (same as consensus 2021-2022 CAGR), and
- revenue grows <1% a year from 2023 – 2030, then

the stock is worth \$279/share today – 33% above the current price. [See the math behind this reverse DCF scenario.](#) In this scenario, Snap-on grows NOPAT by 3% compounded annually over the next decade. For reference, Snap-on grew NOPAT by 9% compounded annually from 2014-2019.

Should Snap-on grow profits closer to historical levels, the upside in the stock is even greater.

**Figure 2: Snap-on's Historical and Implied NOPAT: DCF Valuation Scenarios**



Sources: New Constructs, LLC and company filings

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*Disclosure: David Trainer, Kyle Guske II, and Matt Shuler receive no compensation to write about any specific stock, sector, style, or theme.*

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Key quotes from the paper:

- “[New Constructs’] *Total Adjustments* differs significantly from the items identified and excluded from Compustat’s adjusted earnings measures. For example... 50% to 70% of the variation in *Total Adjustments* is not explained by *S&P Global’s (SPGI) Adjustments* individually.” – pp. 14, 1<sup>st</sup> para.
- “A final source of differences [between New Constructs’ and S&P Global’s data] is due to data collection oversights...we identified cases where Compustat did not collect information relating to firms’ income that is useful in assessing core earnings.” – pp. 16, 2<sup>nd</sup> para.

### **Superior Models**

A top accounting firm features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg’s in [Getting ROIC Right](#). See the [Appendix](#) for direct comparison details.

Key quotes from the paper:

- “...an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [ as New Constructs does] can investors get an accurate calculation of ROIC.” – pp. 8, 5<sup>th</sup> para.
- “The majority of the difference...comes from New Constructs’ machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies.” – pp. 4, 2<sup>nd</sup> para.

### **Superior Stock Ratings**

Robo-Analysts’ stock ratings outperform those from human analysts as shown in this [paper](#) from Indiana’s Kelley School of Business. Bloomberg features the paper [here](#).

Key quotes from the paper:

- “the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant.” – pp. 6, 3<sup>rd</sup> para.
- “Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts.” – pp. 20, 3<sup>rd</sup> para.

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