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LONG IDEA 1/13/22

Focus List Outperformer We Still Like – Part 3

Our Focus List Stocks: Long Model Portfolio outperformed the S&P 500 by 35% in 2021. This report looks at a Focus List Long stock that outperformed in 2021 and is positioned to outperform again in 2022. Recently we highlighted three underperformers from 2021 that remain undervalued, which you can read here.

Buy the Focus List Stocks: Long Model Portfolio

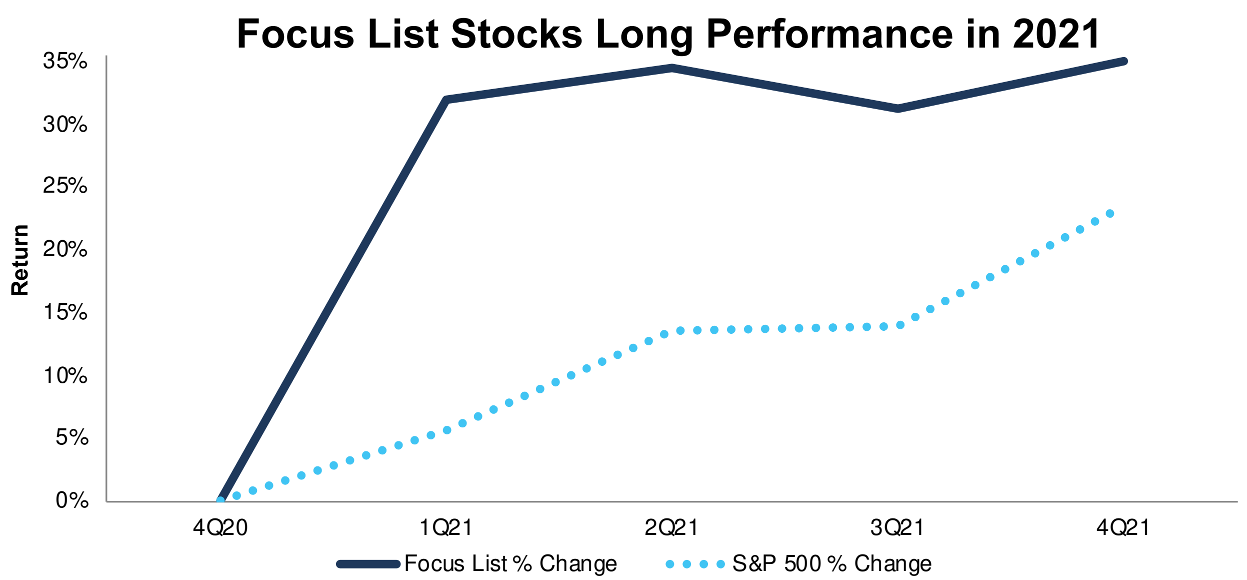
AutoZone inc. (AZO: $2,000/share) outperformed in 2021 and still presents quality risk/reward. We also feature two other Focus List stocks that outperformed in 2021, General Motors (GM) here and HCA Healthcare (HCA) here.

Focus List Stocks Outperformed in 2021

The Focus List Stocks: Long Model Portfolio contains the "best of the best" of our Long Ideas, and leverages superior fundamental data[1], which provides a new source of alpha. The current Model Portfolio is available here while real-time updates are available to Pro-and-higher members.

The Focus List Stocks: Long Model Portfolio returned[2,3], on average, 58% in 2021 compared to 23% for the S&P 500, per Figure 1.

Figure 1: Focus List Stocks: Long Model Portfolio Performance from Period Ending 4Q20 to 4Q21



Sources: New Constructs, LLC

[1] 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.

[2] Performance represents the price performance of each stock during the time in which it was on the Focus List Stocks: Long Model Portfolio in 2021. For stocks removed from the Focus List in 2021, performance is measured from the beginning of 2021 through the date the ticker was removed from the Focus List. For stocks added to the Focus List in 2021, performance is measured from the date the ticker was added to the Focus List through December 31, 2021.

[3] Performance includes the 1745% increase in GME stock price during its time on the focus list in 2021.

Because our Focus List Stocks: Long Model Portfolio represents the best of the best picks, not all Long Ideas make the Model Portfolio. We published 66 Long Ideas in 2021 but added just six of them to the Focus List Stocks: Long Model Portfolio during the year. Currently, the Focus List Stocks: Long Model Portfolio has 39 stocks.

Figure 2 shows a more detailed breakdown of the Model Portfolio's performance, which encompasses all the stocks that were in the Model Portfolio at any time in 2021.

Figure 2: Performance of Stocks in the Focus List Stocks: Long Model Portfolio in 2021

Number of Stocks	Number of Underperformers	Number of Outperformers	Avg Return	Avg S&P 500 Return	Avg Outperformance
45	24	21	58%	23%	35%

Sources: New Constructs, LLC
Performance includes the performance of stocks currently in the Focus List Stocks: Long Model Portfolio, as well as those removed during the year, which is why the number of stocks in Figure 2 (45) is higher than the number of stocks currently in the Model Portfolio (39).

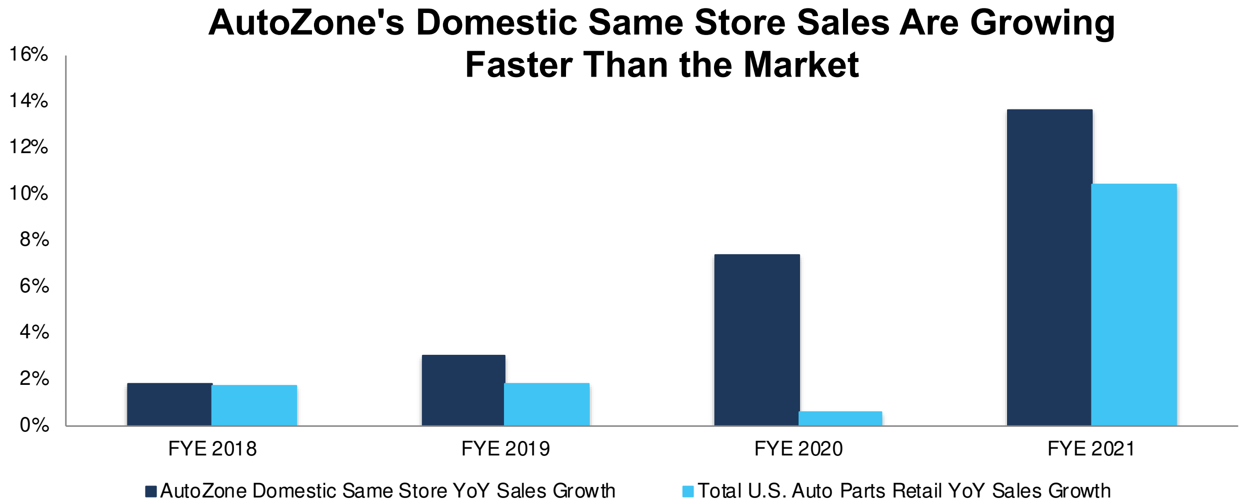
Outperforming Focus List Stock: AutoZone (AZO): Up 77% vs. S&P 500 Up 27% in 2021

We added AutoZone to the Focus List Stocks: Long Model Portfolio in November 2019, and the stock outperformed the S&P 500 by 50% in 2021. Despite large gains in 2021, we see more upside in the stock as the company is positioned to extend its decades-long profit growth even further. See our most recent report on AutoZone here.

Main Reason for Outperformance: Retail and Commercial Demand for Used Cars: In a year plagued by supply issues for new vehicles, demand (and prices) for used cars, which require more maintenance, soared**.** AutoZone is positioned to benefit from such growth in both retail and commercial markets. AutoZone has successfully leveraged its retail store footprint to drive sales growth in its commercial business, and, as of fiscal 1Q22, the company had expanded its domestic wholesale program to 86% of its retail markets.

Per Figure 3, AutoZone's strong domestic revenue growth has led to market share gains. In each year since fiscal 2018, the company has grown its domestic store sales faster than the U.S. automotive parts market.

Figure 3: Change in YoY Sales: AutoZone Vs. Total U.S. Market



Sources: New Constructs, LLC, company filings & FRED

Why AutoZone's Shares Can Drive Higher: Supply Network Is Increasingly Valuable: AutoZone relies on its large store network and customer service to grow its retail and commercial business. The firm's larger stores serve as both retail outlets and fulfillment centers that enable smaller stores to offer a larger inventory. This fulfillment network creates a widening moat for the business which is difficult to replicate especially in light of limited warehouse supply.

Furthermore, long-term tailwinds are favorable for the auto repair market. The average age of vehicles on U.S. roads has steadily climbed from 9.6 years in 2002 to 12.1 in 2021. Older vehicles mean increased demand for auto parts as vehicle repair costs tend to increase as cars get older.

The firm's durable business model has also enabled it to improve its profitability. AutoZone's ROIC over the past five years has improved from 22% in fiscal 2017 to 34% TTM.

It is also noteworthy that AutoZone reports the truth about its earnings. The firm's GAAP Earnings of $2.3 billion over the TTM are equal to its Core Earnings. Companies that report the truth about their earnings are more likely to outperform the market.

Priced for Permanent Profit Decline: AutoZone's price-to-economic book value (PEBV) ratio is 0.8. This ratio implies that the market expects AutoZone's profits to permanently decline by 20%.

Below, we use our reverse discounted cash flow (DCF) model to analyze the expectations for future growth in cash flows baked into AutoZone's current share price.

In this scenario, if we assume AutoZone's:

- NOPAT margin falls to 15% (five-year average vs. 17% TTM) from fiscal 2022 – 2031 and
- revenue falls by 1% (vs. consensus expectations for a CAGR of 5% from fiscal 2022 – 2024) compounded annually from fiscal 2022 – 2031, then

AutoZone's NOPAT falls 4% compounded annually over the next decade, and the stock is worth $2,000/share today – equal to the current price. See the math behind this reverse DCF scenario. For reference, AutoZone has grown NOPAT by 11% compounded annually over the past two decades.

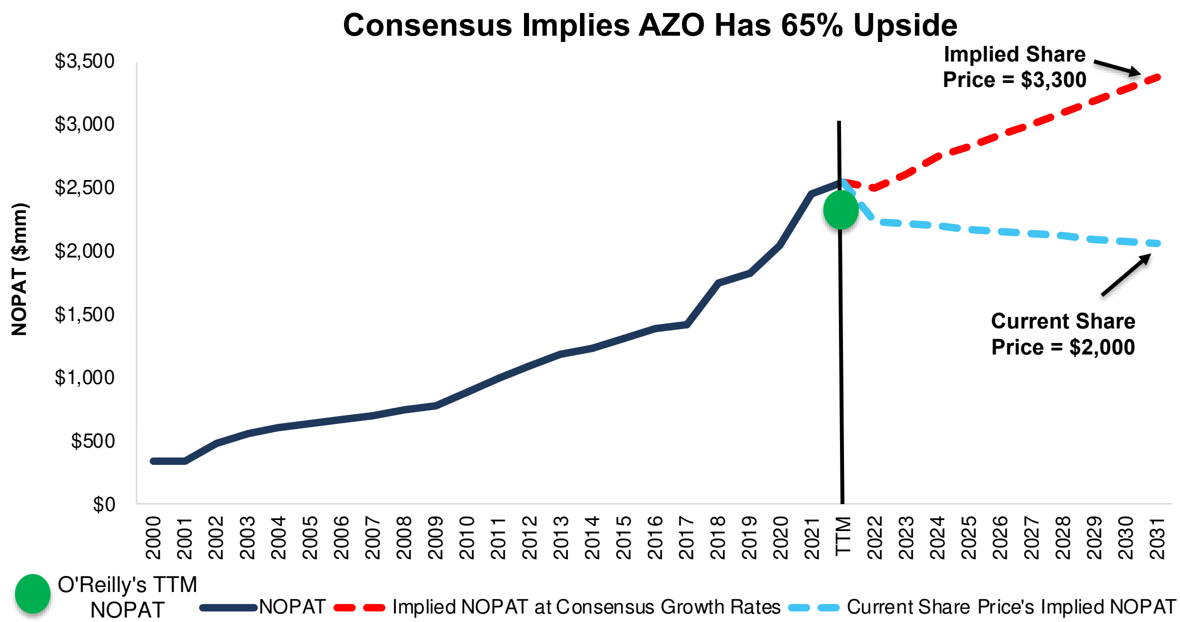
Shares Could Reach $3,300 or Higher: If we assume AutoZone's:

- NOPAT margin falls to 16% (three-year average),
- revenue grows at a 5% (equal to consensus expectations) CAGR from fiscal 2022 – 2024, and
- revenue grows by 3% (below its 10-year CAGR of 6%) each year thereafter through fiscal 2031, then

the stock is worth $3,300/share today – 65% above the current price. See the math behind this reverse DCF scenario. In this scenario, AutoZone grows NOPAT 3% compounded annually over the next decade.

Over the past decade, AutoZone grew NOPAT by 9% compounded annually. Should AutoZone grow profits closer to historical levels, the upside is even greater.

Figure 4: AutoZone'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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It's Official: We Offer the Best Fundamental Data in the World

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
2. Only our "novel database" enables investors to overcome these flaws and apply reliable fundamental data in their research.
3. Our proprietary measures of Core Earnings and Earnings Distortion materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

Forthcoming in The Journal of Financial Economics, a top peer-reviewed journal, Core Earnings: New Data & Evidence proves our Robo-Analyst technology overcomes material shortcomings in legacy firms' data collection processes to provide superior fundamental data, earnings models, and research. More details.

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, 1st 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, 2nd 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, 5th 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, 2nd 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, 3rd para.
- "Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts." – pp. 20, 3rd para.

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