

Ticker: AZO

Major Stock Index: S&P 500

Stock Picking Philosophy

With its cost- and tax-efficient investment approach Herges Capital invests in individual stocks from the U.S. and abroad. Subsequently avoiding fee-intensive mutual funds and even low-cost Exchange Traded Funds (ETFs). Unlike with funds dividends are received immediately and continuously. Also ethical investment considerations can be expressed and realized.

The quantitative stock selection process aims for firms whose earnings are less likely to surprise negatively. The expectation being that over the long term a diversified portfolio of those carefully-selected picks yields a higher return than the general stock market.

AutoZone (ticker **AZO**) is such top candidate in Herges Capital's selection process.

THIS IS NOT A STOCK PURCHASE OR SELL RECOMMENDATION.

INSTEAD THIS PIECE EXPLAINS HERGES CAPITAL'S STOCK SELECTION PHILOSOPHY GIVEN A CONCRETE EXAMPLE. IT IS MEANT TO FURTHER FAMILIARIZE HERGES CAPITAL CLIENTS WITH THE REASONING AND FINANCIAL DATA BEHIND A POSSIBLE SINGLE STOCK INVESTMENT. HERGES CAPITAL AND ITS CLIENTS MAY OR MAY NOT HAVE A POSITION IN THIS PARTICULAR NAME AT ANY GIVEN TIME.

About AutoZone

AutoZone is an international retailer of automotive replacement parts and accessories. The stock is categorized in the cyclical and therefore economically most sensitive **CONSUMER DISCRETIONARY** sector within the 'Automotive Retail' sub-industry. Main competitors are O'Reilly (ticker **ORLY**) and Advance Auto Parts (ticker **AAP**).

AutoZone runs over 6,000 stores predominantly in the U.S., but also in Mexico and Brazil. The company is committed to expand further abroad. Consequently, there is some exposure to developing markets' economy and currency.

That is the main difference to its competitor O'Reilly which is a pure national player. But even in the U.S. home market AutoZone is leading O'Reilly by number of stores (5,600 over 5,200) and employees (90,000 over 80,000).

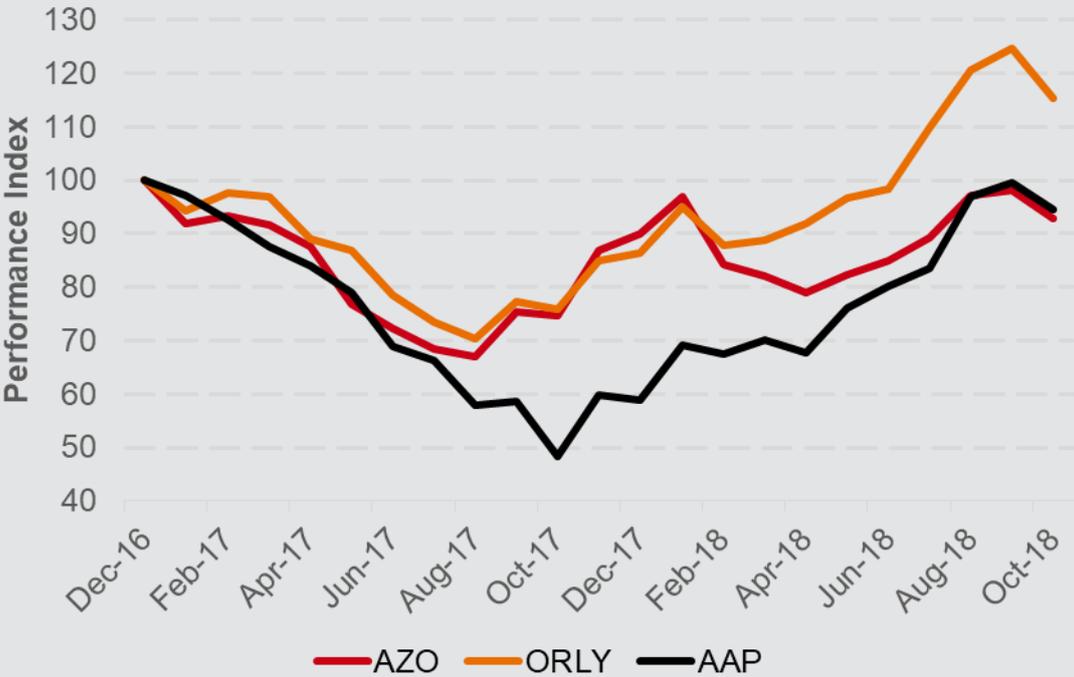


Chart 1: AutoZone under-performed its peers in 2018. Monthly data since Dec 2016. Source: investing.com

In the long run moving into other countries opens up additional business potential but also comes at a price. The weaker Mexican Peso did hurt U.S. Dollar profits and AZO stocks clearly under-performed its peers in 2018. See chart 1.

Quarterly earnings data do reveal that AutoZone’s business is highly seasonal. Q4 results are on average more than 35% above the previous Q3 quarter! Auto parts do fail more likely in extreme weather conditions, like freezing winters or extremely hot summers. Mild winters are not good for business.

Stable Earnings

One of the most influential factors in Herges Capital’s stock selection process is past earnings per share. Stable historical earnings reduce the risk of negative surprises in the future.

AutoZone’s historical earnings are constantly upward sloping, never corrected once even on a quarterly basis! While earnings per share cannot be compared directly between stocks of different prices, it is evident in chart 2 that Advance Auto Parts is more erratic. O’Reilly, on the other hand, is nearly as reliable as AutoZone. Don’t be confused by the higher absolute EPS number. It is a close call in percentage terms.

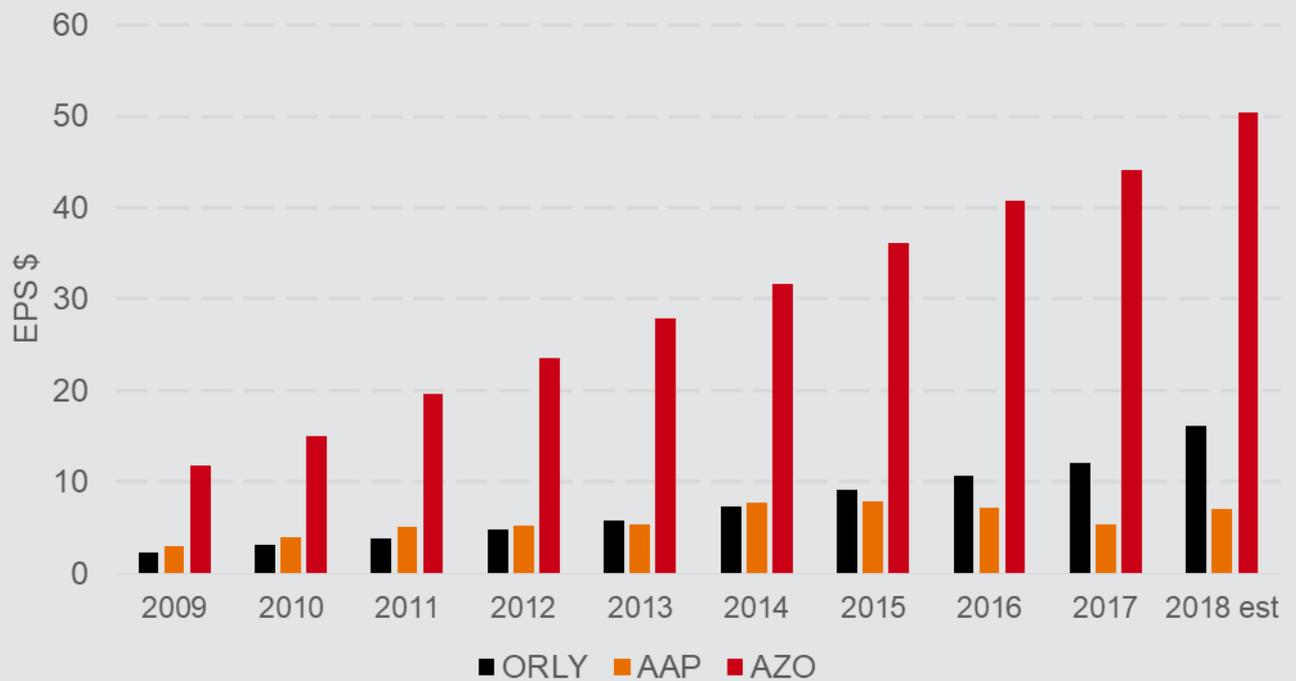


Chart 2: Historical Earnings per Share (EPS)

Source: fidelity.com

Dividends

AutoZone pays no dividend, just like its main competitor O'Reilly. Both firms rather finance further aggressive growth than directly distributing to investors. Even Advance Auto Parts pays a more symbolic and negligible 0.1% dividend yield.

Dividend paying abilities plays no role in Herges Capital's stock selection process. Dividends are only as safe as consistent earnings back them. So the primary selection criterion is earnings and not the derivative dividends.

Investors in need of cash distributions can always partially sell existing positions. The advantage being that they are able to do so at their own frequency and amount. In addition, investors holding multiple positions could choose sell candidates in a tax-efficient way. In contrast, dividend payouts typically necessitate the need to re-invest in order to reduce the cash drag.

Size, Index Membership and Ownership

AutoZone might be the biggest automotive retailer in terms of stores and employees, but its market cap of \$20.8bn is still behind O'Reilly's \$28.4bn. Both names are dwarfing the \$13.0bn Advance Auto Parts valuation.

However, all three automotive retailers are members of the prestigious S&P 500 stock index. O'Reilly is even part of the NASDAQ 100.

As it is typical for larger cap stocks, Blackrock and the Vanguard Group are main shareholders owning more than 15% of AutoZone's outstanding shares. But in addition, the company has a special investor:

- The largest U.S. bank **JP Morgan Chase** is holding close to 8% of AutoZone's stocks.

While such a prominent shareholder name is a vote of confidence, institutional owners reducing their significant positions could also potentially put pressure on the stock price.

History

AutoZone started operations back in 1979 with its first store in Forrest City, Arkansas. It came therefore long after the O'Reilly family founded its firm in 1957.

November 2018

Dr. Udo Herges
CEO



HERGES
CAPITAL MANAGEMENT

Herges Capital Management LLC is a State of California registered Investment Advisor (IA). Firm CRD #288600.