



## Position Close Update: Advance Auto Parts (AAP)

### Advance Auto Parts (AAP) – Closing Short Position – down 13% vs. S&P up 29%

We originally put Advance Auto Parts (AAP: \$139/share) in the [Danger Zone](#) on [December 17, 2018](#) because it had greatly outperformed in 2018, but looked overvalued going forward. This report, along with all of our research, utilizes our “novel dataset”<sup>1</sup> of footnotes disclosures to get the truth about earnings, as shown in the Harvard Business School and MIT Sloan paper, “[Core Earnings: New Data and Evidence.](#)”

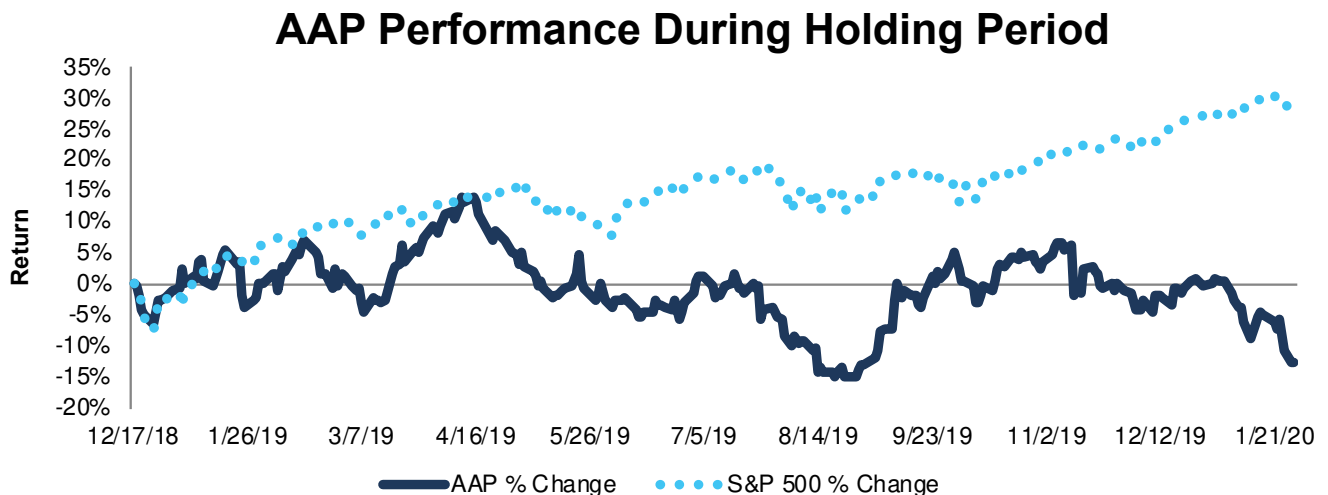
At the time of the report, AAP earned a Very Unattractive [rating](#). Our short thesis pointed out the firm’s misleading GAAP net income, declining return on invested capital ([ROIC](#)), and overvalued stock price.

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During the 408 day holding period, AAP outperformed as a short position, falling 13% compared to a 29% gain for the S&P 500.

Since our article, AAP’s after-tax operating profit ([NOPAT](#)) has grown significantly, and its ROIC has improved from 7% in 2017 to 10% TTM. The company’s improved fundamentals, combined with its lower valuation, means the risk in this stock has decreased. We believe it is time to take the gains and close this short position.

Figure 1: AAP vs. S&P 500 – Price Return – Successful Short Call



Sources: New Constructs, LLC and company filings

Note: Gain/Decline performance analysis excludes transaction costs and dividends.

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

Follow us on [Twitter](#), [Facebook](#), [LinkedIn](#), and [StockTwits](#) for real-time alerts on all our research.

<sup>1</sup> In [Core Earnings: New Data & Evidence](#), professors at Harvard Business School (HBS) & MIT Sloan empirically show that our “novel dataset” is superior to “Street Earnings” from Refinitiv’s IBES, owned by Blackstone (BX) and Thomson Reuters (TRI), and “Income Before Special Items” from Compustat, owned by S&P Global (SPGI).



## ***Footnotes adjustments matter. We are the ONLY source.***

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We provide ratings, models, reports & screeners on U.S. 3,000 stocks, 700 ETFs and 7,000 mutual funds.

**HBS & MIT Sloan research** reveals that:

- **Markets are inefficiently assessing earnings because no one reads the footnotes.**
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The HBS & MIT Sloan paper, [Core Earnings: New Data and Evidence](#), shows how our superior data drives uniquely comprehensive and independent debt and equity research.

This [paper](#) compares our analytics on a mega cap company to other major providers. The Appendix details exactly how we stack up.

**Learn [more](#).**

Quotes from HBS & MIT Sloan professors on our research:

### **Get better research:**

*“...the NC dataset provides a novel opportunity to study the properties of non-operating items disclosed in 10-Ks, and to examine the extent to which the market impounds their implications.” – page 20*

### **Pick better stocks:**

*“Trading strategies that exploit cross-sectional differences in firms’ transitory earnings produce abnormal returns of 7-to-10% per year.” – Abstract*

### **Avoid losses from using other firms’ data:**

*“...many of the income-statement-relevant quantitative disclosures collected by NC do not appear to be easily identifiable in Compustat...” – page 14*

### **Build better models:**

*“Core Earnings [calculated using New Constructs’ novel dataset] provides predictive power for various measures of one-year-ahead performance...that is incremental to their current-period counterparts.” – page 4*

### **Exploit market inefficiencies:**

*“These results ... suggest that the adjustments made by analysts and Compustat to better capture core earnings are incomplete. Moreover, the non-core items identified by NC produce a measure of core earnings that is incremental to alternative measures of operating performance in predicting an array of future income measures.” – page 26*

### **Fulfill fiduciary duties:**

*“An appropriate measure of accounting performance for purposes of forecasting future performance requires detailed analysis of all quantitative performance disclosures detailed in the annual report, including those reported only in the footnotes and in the MD&A.” – page 33-34*



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