# Three Boring Stocks to Consider

**With so many investors focused on well-known companies in the hottest sectors, it is hard to find stocks at bargain prices in these areas. One is more likely to find attractive investments among lesser-known, mundane companies such as Autozone, Graco, and Strattec.**

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After taking some swipes at my least favorite stocks in my last two columns, I'd like to shift gears and briefly discuss three stocks that I don't own, but am seriously considering. What makes them interesting? Though they have absolutely no sex appeal, they're well run, have solid (if not dominant) competitive positions and strong financials, are buying back lots of shares, and -- very importantly -- are reasonably priced.

I haven't bought them yet, however, because I'm not certain that they meet the much higher test investors should apply when choosing individual stocks rather than index funds or other instruments: Are they slam-dunk, no-brainer, pinch-me-I-must-be-dreaming situations? If not, I'll keep waiting for the perfect pitch.

**Autozone**
**Autozone** (NYSE: AZO), via its 2,915 stores in 42 states and 13 stores in Mexico, dominates the business of selling car parts and accessories to do-it-yourself customers. The company has solid financials and has demonstrated impressive growth. In FY 00 (ended August 2000), Autozone had a 6.0% profit margin (up from 5.9% the year before) and 23% return on equity (up from 19% the year before; the figure has ranged from 19% to 31% since 1991). Sales rose 9% in 2000, on a 7.5% increase in stores and a 5% increase in same-store sales. Earnings per share (EPS) rose 22.7%, thanks to a 9.3% increase in net income and a 10.9% decline in the number of diluted shares outstanding.

Sales and EPS have risen every year since 1990, compounding at an average rate of 21% and 27%, respectively. Analysts project EPS growth of 13% for each of the next two years. Yet Autozone's stock has been flat for nearly *eight* years, and at yesterday's close of $27.08, it trades near all-time lows of 13.1 times trailing earnings and 12.0 times analysts' estimates for FY 01.

These characteristics lead me to believe that Autozone is a good company whose stock is trading at a reasonable price. There are plenty of companies that meet this description. However, I think Autozone is particularly interesting for three reasons. First, the company is more effectively managing its working capital, freeing up cash. In FY 00, Autozone reduced its inventory per store by 9%, yet increased sales by 9%. This was the major reason operating cash flow rose 64.6% to $513 million.

Second, Autozone is using its robust free cash flow -- and is even taking on debt -- to buy back shares by the bushel. In the past six quarters, the company has spent $898 million repurchasing shares, reducing diluted shares outstanding by 22%. Finally, one has to be concerned about the impact of a slowing economy on any retailer. But Autozone actually stands to benefit from tough times, as people are both more likely to hang onto their cars rather than buy new ones, and are also more likely to do their own repairs rather than pay for a mechanic.

**Graco**
No, this isn't the Graco that makes the popular line of cribs, high chairs, and other baby products -- that's Graco Children's Products. **Graco Inc.** (NYSE: GGG), according to its annual report, makes products that "move, measure, control, dispense, and spray a wide range of fluids." Its products are used in more than 40 industries, ranging from painting contractors to aerospace.

It sounds pretty boring, but Graco's financial characteristics are anything but. Last year, the company grew its top and bottom lines by 10% and 18%, respectively. Net margins increased to 14.2% from an already-high 13.2% in 1999, and return on equity was a remarkable 81%.

Typically, when a company has such a high ROE, it's either due to lots of debt -- which substitutes for equity, thereby increasing ROE, but also risk -- or large share repurchases (when a company buys back and retires its own shares, its equity declines by the amount spent on the repurchases). Both explanations apply in Graco's case. In July 1998, Graco repurchased 22% of its outstanding shares from a trust that had been established by one of Graco's founders. To finance the $191 million purchase -- which essentially eliminated all of its equity -- the company took on $176 million of long-term debt.

I looked at the stock shortly after this transaction, and concluded that it wasn't cheap enough given the risk associated with the debt. But since then, Graco has used its strong free cash flow to pay down its debt to only $35.1 million (and the company has $11.1 million in cash). The company also appears to be weathering the economic slowdown without a hiccup -- so far anyway -- as it beat analysts' estimates of $0.81 for Q4 00 by a dime, as EPS grew 26%. Yet the stock remains reasonably priced, at 11.4x trailing EPS and 10.1x estimates for 2001.

**Strattec Security**
**Strattec Security** (Nasdaq: STRT) has been the world's largest producer of automotive locks and keys since the late 1920s, and currently has a dominant 65% share of the North American market for these products (and an estimated 20% world market share). The company supplies 86% of **General Motors'** (NYSE: GM) production, 66% of **Ford's** (NYSE: F), 98% of **DaimlerChrysler's** (NYSE: DCX), and 89% of Mitsubishi's.

When times are good, Strattec is highly profitable. In FY 00 (ending July 2), the company grew sales 11.0% and EPS 24.1%, had 8.2% net margins, and generated 30.6% return on equity, with no debt. The company used its substantial free cash flow to buy back 18.2% of its shares during FY 00.

But times are no longer good in the auto industry, and when Strattec's big customers sneeze, Strattec gets a cold. In its latest quarter, ending Dec. 31, Strattec's sales and earnings declined 11.9% and 30.6% year-over-year, respectively. Inventories rose, cash flow fell, and the company had to scale back its aggressive share repurchases. Earnings per share over the next two quarters are expected to be 10.7% lower year-over-year.

So why do I like this stock? First, it's cheap: At $30.69, it's trading at 8.9x estimated earnings for FY 01. Also, Strattec is my kind of cyclical -- even during today's tough times, it has no debt and is quite profitable (its net margin last quarter was 6.9%). Finally, there's no evidence of declining market share, and there are large growth opportunities.

**Conclusion**

I like these stocks in the order in which I have presented them: Autozone most because I think the company could actually benefit from an economic slowdown, whereas this would likely hurt Graco and Strattec. Graco gets the nod over Strattec despite its higher P/E ratio because it's much larger, has higher margins and returns on equity, and is more diversified geographically and in terms of customer base. Nearly all of Strattec's sales are to the Big Three automakers, which is a significant risk factor.

I welcome your thoughts and feedback on these companies and will write one or more follow-up columns if there is enough interest. More importantly, though, consider these three as evidence that diligent investors can find interesting opportunities anywhere -- even in non-tech industries during downbeat economic times -- by considering leading companies with powerful market positions, strong financials, and attractive valuations.

-- Whitney Tilson

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