# Looking Back: AutoZone

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INVESTMENT MANAGEMENT

## We aren't in 'Arkansas' anymore

Back in the 70s, while working in the retail division of his father's company, Malone & Hyde (an American Wholesaler). J.R. "Pitt" Hyde noticed a gap in the market, he saw a need for an automotive parts store with accessible products and excellent customer service. So, he, and some of Malone & Hyde's top leadership team started a company then known as Auto Shack, with one little store in Arkansas.

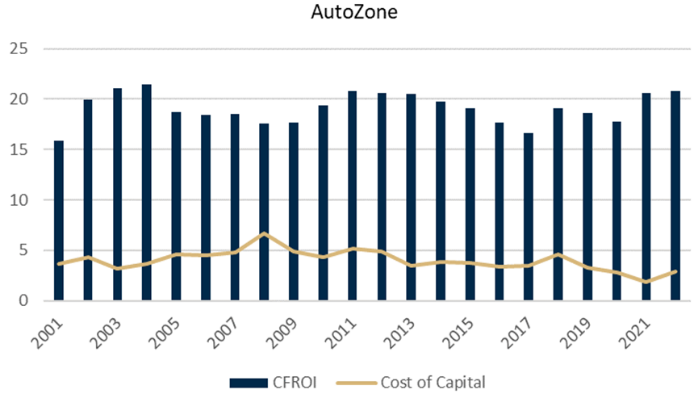
In 1986, Auto Shack was spun off as a freestanding company, of which Pitt Hyde served as Chairman and CEO and renamed it to AutoZone. The firm listed its shares publicly for the firm time in April 1991.

The company has never stopped evolving and has become the leading retailer of automotive replacement parts in the United States. Now ranked as a Fortune 500 company, AutoZone is one of the largest public companies in the world.

## AutoZone – Best of Breed Auto Parts Retailer

AutoZone boasts strong business fundamentals and a solid long-term operating history. With a 20% cash flow return on investment, 10-year growth rate of 18% (CAGR) and topped with price appreciation of 38% in the last year alone, it's hard to find fault with the company. The amazing thing is its valuation is also attractive at a 5% FCF Yield.

### Figure 1: Cash Flow Return on Investment




*Source: Credit Suisse Holt*

Besides great fundamentals, Growth opportunities are there too:

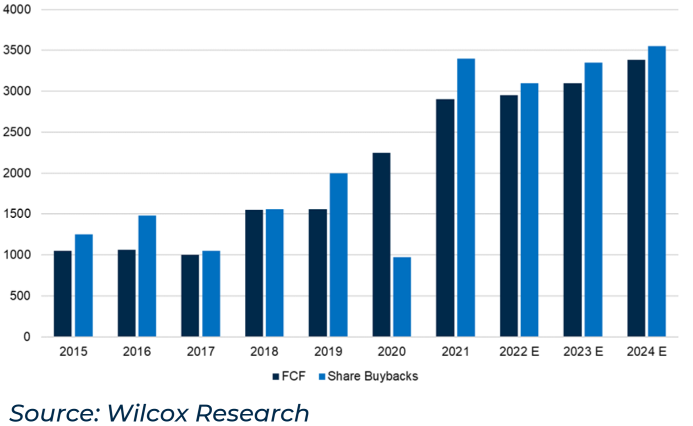
- **Expansion into Latin America:** The chief driver of growth for AutoZone in Brazil and Mexico will be an increase in store count. The market in these two countries is far from saturated.

- **Moving into the DIFM space:** While AutoZone is known for being the go-to place for do-it-yourself (DIY) repairs, they have become a force to be reckoned with in the DIFM (Do it for me) space as well. For those wondering, the difference between DIY and DIFM is that DIY is individual consumers, while DIFM is geared towards repair shops. At the end of 2021, AutoZone reported that DIFM grew 29.4% on a YoY basis.

- **Mega hubs:** AutoZone separates their stores into three groups: satellite stores, hubs, and mega hubs. Traditionally, AutoZone focused on satellite stores. They are now concentrating on hubs and mega hubs as they are more efficient and drive higher sales.

- **Share Buybacks:** AutoZone's share repurchase program has boosted shareholder value by directing the FCF at buybacks, while remaining at an attractive valuation. Unlike some companies who spend excess cash flow on dubious acquisitions, this company doesn't. In March 2022 AutoZone announced the repurchase of an additional $2.0 billion of the Company's common stock in connection with its ongoing share repurchase program. Since the inception of the repurchase program in 1998, and including the above amount, AutoZone's Board of Directors has authorized $31.2 billion in share repurchases.

### Figure 2: AutoZone FCF vs. Buybacks




*Source: Wilcox Research*



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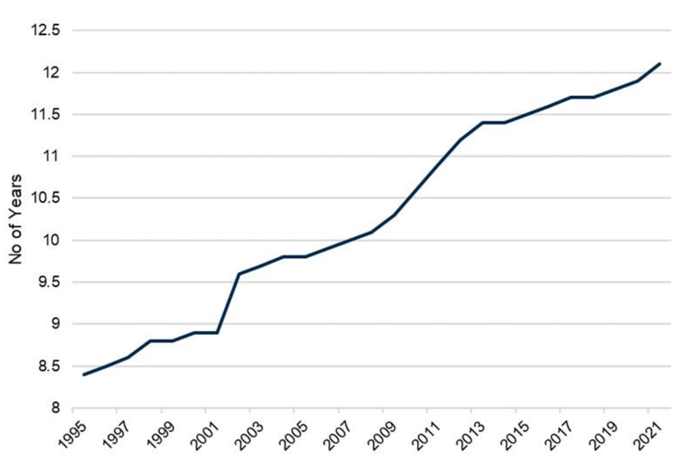
## Are Electric Vehicles a threat to AutoZone's success?

With the rise of Electric Vehicles should there be cause for concern about the future for AutoZone? Electric Vehicles have far fewer moving parts, no engine oil, many have no transmission fluid, etc. On top of that the U.S. government plans to end purchases of gas-powered vehicles by 2035 as they want to lower emissions and promote electric cars. This is great for companies such as Tesla and Ford, but a potential headwind for automotive retailers such as AutoZone. I mean, how long did it take for Blockbuster to go under after Netflix hit the scene? AutoZone will need to adapt their business to be able to supply parts for EVs. One thing to remember though, is electric vehicles may have different engines, but they still have windscreens, doors, wheels etc which still need to be maintained or replaced. Saying all of this, I think we are a long, long way off from electric vehicles replacing normal vehicles.

## AutoZone is setup for success in coming years

The Covid-19 pandemic with its supply constraints and a tough economic climate have supported the idea that automotive retailers are somewhat recession resistant. This is because stressed consumers are less likely to purchase new vehicles during economic hard times but will instead opt to repair and/or maintain their existing vehicles to save money. Considering the U.S. is currently teetering on the edge of a recession or may already be in one, this may be a driving force for AutoZone. The average age of the vehicle pool in the US continues to rise, hitting a new record with an average age 12.2 Years.

### Figure 3: US Total Average Age of Light Vehicles




*Source: Bloomberg*

History confirms this as AutoZone performed well in prior recessions. For example, during The Great Recession of 2008, AutoZone grew sales and its stock gained 16% while the S&P 500 dropped 37%.

### Figure 4: AutoZone Price History


*Source: Bloomberg*

AutoZone has been a better way to play the Automotive industry in the US, rather than buying companies such as General Motors and Ford and it seems AutoZone will continue to thrive notwithstanding inflation pressures or recession risk.

With performance history as reliable as an old Toyota - AutoZone is an example of slow and steady wins the race.