

Advance Auto Parts, Inc.

4Q Recap: Planning to consolidate supply chain to improve efficiency

Reiterate Rating: UNDERPERFORM | PO: 51.00 USD | Price: 66.42 USD

Margin contraction drove EPS miss

Advance Auto Parts (AAP) reported 4Q23 results. Comps of -1.4% were below BofAe -1.0% and consensus -1.2%. Total sales of \$2.465bn were above our \$2.461bn estimate and the \$2.463bn consensus. Gross margin contracted 504bp to 38.6% (vs. BofAe 40.5% and consensus 40.9%). This was driven by both business performance and atypical drivers, primarily attributable to a change in inventory-related items and elevated supply chain costs. SG&A deleveraged 176bp to 40.5% (vs. BofAe 39.1% and consensus 39.5%), driven by a year-over-year increase in occupancy costs and store labor. EPS of \$(0.59) was below BofAe \$0.21 and consensus \$0.21. AAP opened 10 new stores and closed eight locations in 4Q, bringing the total store count to 5,107. AAP expects to conclude the Worldpac sale process during 2Q24. The Canadian process is sequenced behind Worldpac.

Macro indicators are still favorable for the industry

AAP provided guidance for 2024, assuming continued pressure on the DIY (do-it-yourself) consumer, offset by DIFM (do-it-for-me) improvement and modest inflation. The company believes that the key industry drivers remain strong. Average age of vehicles continues to rise and is at 12.5 years. Miles driven is also projected to increase further. The company expects \$11.3-11.4bn revenue on flat to 1% comp, compared to \$11.3bn on (0.3)% in 2023. Operating margin is expected to be between 3.2% and 3.5%, expanding from 1.0% in 2023. EPS is expected to be in the range of \$3.75-4.25, and capex is expected to be between \$200mn and \$250mn. AAP also discussed its plan to consolidate its supply chain to a single unified network to improve efficiency.

Estimates and PO raised to reflect guidance

Given 2024 guidance, we raise 2024/2025 estimates by 22/11% and introduce 2026 estimates. We also raise our PO to \$51 from \$43 still based on 14x '24 P/E given the estimate change. We reiterate our Underperform rating, as we continue to expect peers to capture market share from AAP. AAP has been a long-term turnaround story that has yet to turn around. Scale is a material advantage in the US auto aftermarket due to the size and complexity of the vehicle fleet, and AAP will have even smaller scale after its divestitures. AAP's core US retail operations have consistently underperformed its larger peers in its per-store metrics.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	7.66	0.50	3.78	4.22	4.29
EPS Change (YoY)	-20.0%	-93.5%	656.0%	11.6%	1.7%
Consensus EPS (Bloomberg)			3.60	4.48	3.28
DPS	5.55	3.51	1.00	1.00	1.00
Valuation (Dec)					
P/E	8.7x	132.8x	17.6x	15.7x	15.5x
Dividend Yield	8.3%	5.3%	1.5%	1.5%	1.5%
EV / EBITDA*	8.0x	17.8x	11.0x	10.5x	10.4x
Free Cash Flow Yield*	7.5%	1.1%	6.8%	6.9%	7.0%

* For full definitions of *IQmethod*SM measures, see page 4.

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Timestamp: 28 February 2024 04:27PM EST

28 February 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	43.00	51.00
2024E Rev (m)	11,397.0	11,346.0
2025E Rev (m)	11,567.9	11,516.2
2026E Rev (m)	NA	11,688.9
2024E EPS	3.10	3.78
2025E EPS	3.80	4.22
2026E EPS	NA	4.29

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Stock Data

Price	66.42 USD
Price Objective	51.00 USD
Date Established	28-Feb-2024
Investment Opinion	C-3-8
52-Week Range	47.73 USD - 149.17 USD
Mrkt Val (mn) / Shares Out (mn)	3,952 USD / 59.5
Free Float	98.9%
Average Daily Value (mn)	94.64 USD
BofA Ticker / Exchange	AAP / NYS
Bloomberg / Reuters	AAP US / AAP.N
ROE (2024E)	8.6%
Net Dbt to Eqty (Dec-2023A)	50.9%
ESGMeter TM	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

iQprofileSM Advance Auto Parts, Inc.

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	7.5%	1.5%	4.0%	4.3%	4.2%
Return on Equity	16.2%	1.2%	8.6%	8.8%	8.3%
Operating Margin	6.0%	1.0%	3.4%	3.7%	3.7%
Free Cash Flow	298	44	267	271	276

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.6x	9.6x	2.2x	2.4x	2.3x
Asset Replacement Ratio	1.5x	0.8x	0.7x	1.1x	1.1x
Tax Rate	23.2%	6.6%	26.7%	26.7%	26.7%
Net Debt-to-Equity Ratio	42.4%	50.9%	39.4%	29.1%	20.2%
Interest Cover	13.1x	1.3x	4.7x	5.1x	5.2x

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	11,155	11,288	11,346	11,516	11,689
% Change	1.4%	1.2%	0.5%	1.5%	1.5%
Gross Profit	4,932	4,524	4,702	4,779	4,851
% Change	0.1%	-8.3%	4.0%	1.6%	1.5%
EBITDA	961	433	697	733	739
% Change	-17.2%	-54.9%	60.8%	5.1%	0.9%
Net Interest & Other Income	(66)	(83)	(83)	(83)	(83)
Net Income (Adjusted)	464	30	225	252	256
% Change	-24.6%	-93.6%	657.7%	11.7%	1.9%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	464	30	225	252	256
Depreciation & Amortization	284	306	306	306	306
Change in Working Capital	(134)	(51)	(87)	(9)	(10)
Deferred Taxation Charge	6	(48)	0	0	0
Other Adjustments, Net	102	48	47	47	48
Capital Expenditure	(424)	(242)	(225)	(325)	(325)
Free Cash Flow	298	44	267	271	276
% Change	-63.8%	-85.4%	511.2%	1.8%	1.7%
Share / Issue Repurchase	(621)	(15)	0	0	0
Cost of Dividends Paid	(336)	(209)	(60)	(60)	(60)
Change in Debt	333	415	0	0	0

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	271	503	711	922	1,139
Trade Receivables	684	800	804	816	829
Other Current Assets	5,060	5,073	4,988	5,058	5,134
Property, Plant & Equipment	1,690	1,649	1,567	1,586	1,604
Other Non-Current Assets	4,281	4,251	4,251	4,251	4,251
Total Assets	11,986	12,276	12,321	12,633	12,957
Short-Term Debt	185	0	0	0	0
Other Current Liabilities	5,236	5,307	5,140	5,213	5,291
Long-Term Debt	1,188	1,786	1,786	1,786	1,786
Other Non-Current Liabilities	2,778	2,663	2,665	2,670	2,676
Total Liabilities	9,387	9,757	9,591	9,669	9,753
Total Equity	2,599	2,520	2,730	2,964	3,203
Total Equity & Liabilities	11,986	12,276	12,321	12,633	12,957

* For full definitions of iQmethodSM measures, see page 4.

Company Sector

Retailing-Hardlines

Company Description

Founded in 1929 as Advance Stores Company Inc., Advance Auto Parts (AAP) is one of the largest auto parts retailers in the US with over 5,000 stores. AAP sells to both do-it-yourself (DIY) customers and professional installers (DIFM).

Investment Rationale

The deterioration of AAP's financial performance over the last decade is likely to require further investment in supply chain improvements and associate retention. Therefore a positive inflection in margins could take time to come to fruition, and we see more medium-term risks to the downside than to the upside.

Stock Data

Average Daily Volume 1,424,894

Quarterly Earnings Estimates

	2023	2024
Q1	0.72A	1.02E
Q2	1.43A	0.88E
Q3	-0.82A	0.87E
Q4	-0.59A	1.01E

Price objective basis & risk

Advance Auto Parts, Inc. (AAP)

Our price objective of \$51 is based on a 2024E P/E of 14x, a discount to the company's 10-year historical average, pre-COVID (16x). While AAP operates in a relatively defensive product category, it has lost market share to its larger competitors in recent years, and has experienced margin deterioration that is likely to persist as supply chain investments continue.

Upside risks to our price objective are: 1) a more significant downturn in new vehicle sales, resulting in a more aggressive aging cycle than our forecasts, 2) faster-than-anticipated comp and earnings recovery from restructuring initiatives, 3) significant improvements in supply chain management, closing the gap between AAP and its strongest peers, 4) a strategic combination with one of its larger peers, 5) material cash generation from planned asset sales, enabling share repurchases and debt paydown above our forecasts.

Downside risks to our PO are: 1) further market share loss, 2) inability to gain traction with margin growth initiatives, 3) larger than expected investments to improve performance, 4) expansion of leverage beyond our forecasts and/or credit rating deterioration, and 5) further cuts to AAP's dividend to preserve liquidity.

Analyst Certification

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US - Retail Hardline Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Arhaus, Inc.	ARHS	ARHS US	Jason Haas, CFA
	Boot Barn	BOOT	BOOT US	Jason Haas, CFA
	Driven Brands	DRVN	DRVN US	Jason Haas, CFA
	Five Below Inc.	FIVE	FIVE US	Jason Haas, CFA
	Floor and Decor Holdings, Inc.	FND	FND US	Robert F. Ohmes, CFA
	Genuine Parts	GPC	GPC US	Jason Haas, CFA
	Lowe's Companies, Inc.	LOW	LOW US	Robert F. Ohmes, CFA
	Mattel	MAT	MAT US	Jason Haas, CFA
	Mister Car Wash	MCW	MCW US	Jason Haas, CFA
	Ollie's	OLLI	OLLI US	Jason Haas, CFA
	O'Reilly Automotive, Inc.	ORLY	ORLY US	Jason Haas, CFA
	Petco	WOOF	WOOF US	Jason Haas, CFA
	PROG Holdings Inc	PRG	PRG US	Jason Haas, CFA
	Rollins Inc.	ROL	ROL US	Jason Haas, CFA
	Tempur Sealy International Inc.	TPX	TPX US	Jason Haas, CFA
	The Home Depot, Inc.	HD	HD US	Robert F. Ohmes, CFA
	Upbound Group Inc.	UPBD	UPBD US	Jason Haas, CFA
NEUTRAL				
	AutoZone Inc.	AZO	AZO US	Jason Haas, CFA
	Hasbro	HAS	HAS US	Jason Haas, CFA
	Sonos, Inc.	SONO	SONO US	Jason Haas, CFA
	Williams-Sonoma	WSM	WSM US	Jason Haas, CFA



US - Retail Hardline Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
UNDERPERFORM	Advance Auto Parts, Inc.	AAP	AAP US	Jason Haas, CFA
	Best Buy Co., Inc.	BBY	BBY US	Robert F. Ohmes, CFA
	Snap-on	SNA	SNA US	Elizabeth L Suzuki
	Tractor Supply Company	TSCO	TSCO US	Jason Haas, CFA
	Whirlpool	WHR	WHR US	Jason Haas, CFA

iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales

Basic EBIT + Depreciation + Amortization

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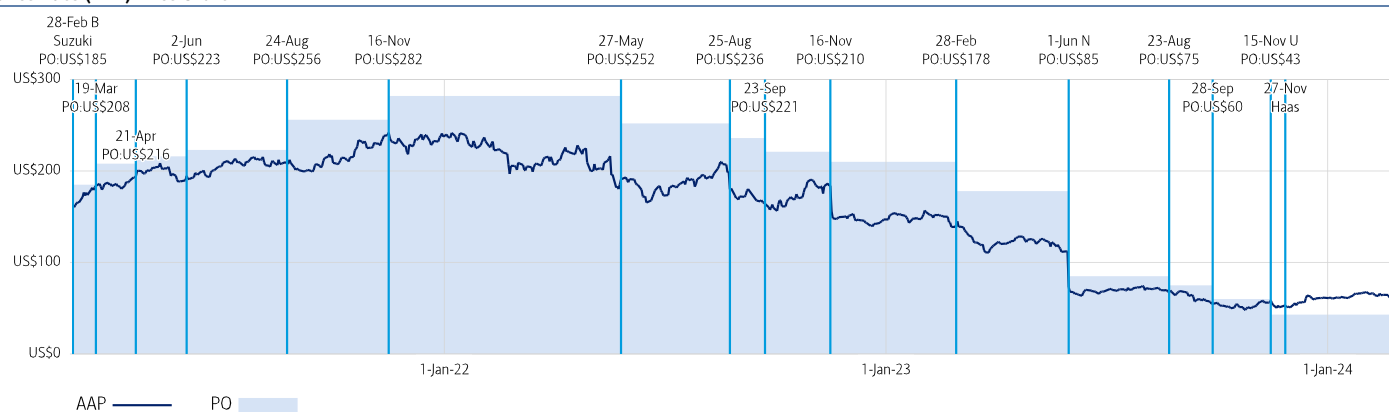
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Advance Auto (AAP) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.



Equity Investment Rating Distribution: Retailing Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	96	57.83%	Buy	39	40.63%
Hold	32	19.28%	Hold	12	37.50%
Sell	38	22.89%	Sell	18	47.37%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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