



# Advance Auto Parts (AAP)

Updated August 24<sup>th</sup>, 2021, by Eli Inkrot

## Key Metrics

<b>Current Price:</b>	\$211	<b>5 Year CAGR Estimate:</b>	4.9%	<b>Market Cap:</b>	\$14 B
<b>Fair Value Price:</b>	\$191	<b>5 Year Growth Estimate:</b>	5.0%	<b>Ex-Dividend Date:</b>	09/16/21
<b>% Fair Value:</b>	111%	<b>5 Year Valuation Multiple Estimate:</b>	-2.0%	<b>Dividend Payment Date:</b>	10/01/21
<b>Dividend Yield:</b>	1.9%	<b>5 Year Price Target</b>	\$244	<b>Years Of Dividend Growth:</b>	2
<b>Dividend Risk Score:</b>	B	<b>Retirement Suitability Score:</b>	C	<b>Last Dividend Increase:</b>	300.0%

## Overview & Current Events

Advance Auto Parts is a leading automotive aftermarket parts provider that serves both do-it-yourself and professional customers. It has 4,748 stores and 215 Worldpac branches in the U.S., Canada, Puerto Rico and the U.S. Virgin Islands. The company also serves 1,306 independently owned Carquest stores. The North Carolina-based business trades with a market capitalization of \$14 billion.

Advance Auto Parts has some striking differences from its two major peers, AutoZone (AZO) and O'Reilly (ORLY). While its peers have exhibited remarkable consistency, Advance Auto Parts has shown more volatile performance.

After a decades long frozen dividend payment streak Advanced Auto Parts increased its quarterly dividend from \$0.06 to \$0.25 in February of 2020 and from \$0.25 to \$1.00 in April of 2021.

On August 24<sup>th</sup>, 2021, Advance Auto Parts reported Q2 2021 results for the period ending July 17<sup>th</sup>, 2021 (the company's fiscal year ends the Saturday closest to the end of December). For the quarter net sales came in at \$2.6 billion, a 5.9% increase compared to Q2 2020, driven by a 5.8% gain in comparable store sales. Adjusted net income equaled \$221.5 million or \$3.40 per share compared to \$204.6 million or \$2.95 per share in the year ago period.

Advance Auto Parts also updated its 2021 guidance. For this year the company now anticipates sales of \$10.6 billion to \$10.8 billion (from \$10.4 - \$10.6 billion), comparable store sales growth of 6% to 8% (from 4% to 6%) and 80 to 120 new store openings (from 100 to 150).

## Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
<b>EPS</b>	\$5.11	\$5.22	\$5.67	\$7.59	\$7.82	\$7.15	\$5.37	\$7.13	\$8.19	\$8.51	<b>\$11.25</b>	<b>\$14.36</b>
<b>DPS</b>	\$0.24	\$0.24	\$0.24	\$0.24	\$0.24	\$0.24	\$0.24	\$0.24	\$0.24	\$1.00	<b>\$4.00</b>	<b>\$5.48</b>
<b>Shares<sup>1</sup></b>	72.8	73.4	72.8	73.1	73.3	73.8	73.9	72.5	69.2	66.4	<b>65</b>	<b>60</b>

The improvement in 2018 was a result of a one-time decrease in Advance Auto Parts' tax rate. However, the 14.9% improvement in 2019 and 3.9% improvement in 2020 amid the COVID-19 pandemic were impressive. Dating back to 2010 the company has grown earnings-per-share by an average compound rate of 8.0% per annum. In the past growth was driven by solid top-line growth and share repurchases, with the net profit margin oscillating around 5% to 6%.

Over the long-term growth can continue to accumulate in this manner. Advance Auto Parts can benefit from the ongoing auto part replacement need. Moreover, with a low dividend payout ratio, share repurchases could underscore at least a partial growth thesis. To this point the company presently has \$869 million remaining on its share repurchase authorization. The pandemic creates short-term uncertainty, but recent results have been especially encouraging.

We expect Advance Auto Parts to put together a solid 2021, with Q1 and Q2 results coming in very strong. In addition, we are forecasting 5% intermediate term growth, taking into account the growth opportunities available, the current uncertainty, the company's historical record and the now higher base.

<sup>1</sup> In millions.

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## Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	12.3	14.5	15.1	17.3	20.9	21.8	22.9	19.5	19.4	16.5	<b>18.8</b>	<b>17.0</b>
Avg. Yld.	0.4%	0.3%	0.3%	0.2%	0.1%	0.2%	0.2%	0.2%	0.2%	0.7%	<b>1.9%</b>	<b>2.2%</b>

Over the past decade shares of Advance Auto Parts have traded with an average P/E ratio of about 18 times earnings. We are using 17 times earnings as a starting baseline, given our belief that growth will become harder to formulate in the years to come. With shares currently trading near 19 times expected earnings, this implies the potential for a valuation headwind. Meanwhile, with two significant increases, the dividend is starting to play a meaningful role in investor returns.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	5%	5%	4%	3%	3%	3%	4%	3%	3%	12%	<b>36%</b>	<b>38%</b>

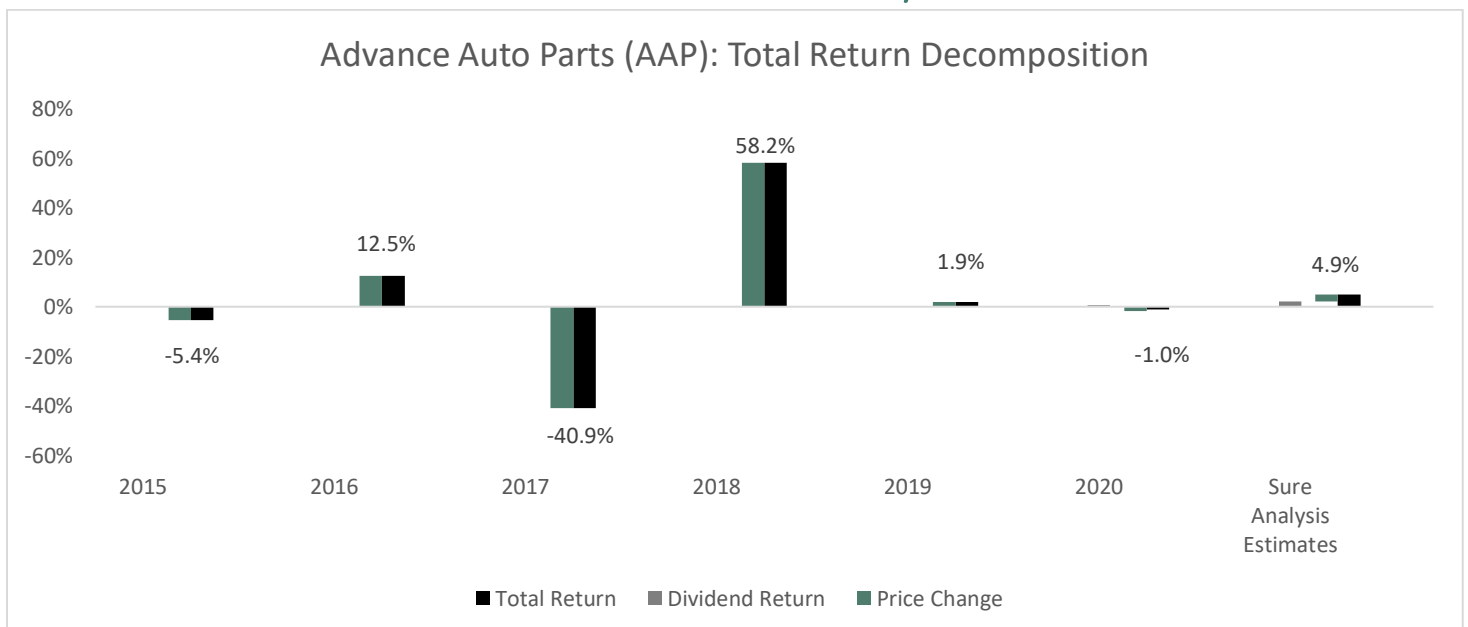
Advance Auto Parts operates in the profitable industry of auto parts, which is highly fragmented and thus provides ample room for consolidation and future growth. With that said, the volatile performance record of the company is not as impressive as the record of its peers and indicates the absence of a meaningful competitive advantage.

Advance Auto Parts repurchased a significant number of shares in 2010 and 2011 but had put this program on hold until recently. This is in sharp contrast to AutoZone and O'Reilly, which have aggressively repurchased their shares for years. As such Advance Auto Parts retained almost all its earnings and tried to grow via acquisitions and reinvestment in its business. Moving forward we expect higher dividends and share repurchases to play a larger role in capital returns.

## Final Thoughts & Recommendation

Shares are up 31% since our August 2020 report. Advance Auto Parts has significantly improved its business performance in the last couple of years. Total return potential comes in at 4.9% per annum, stemming from 5% growth and a 1.9% dividend yield, offset by the possibility of a valuation headwind. We are reiterating our hold rating.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Revenue</b>	6170	6205	6494	9844	9737	9568	9374	9581	9709	10110
<b>Gross Profit</b>	3069	3098	3252	4454	4423	4256	4085	4219	4255	4482
<b>Gross Margin</b>	49.7%	49.9%	50.1%	45.2%	45.4%	44.5%	43.6%	44.0%	43.8%	44.3%
<b>SG&amp;A Exp.</b>	2405	2441	2592	3602	3597	3468	3515	3615	3578	3732
<b>D&amp;A Exp.</b>	176	190	208	285	269	258	249	238	238	250
<b>Operating Profit</b>	665	657	660	852	826	788	570	604	677	750
<b>Operating Margin</b>	10.8%	10.6%	10.2%	8.7%	8.5%	8.2%	6.1%	6.3%	7.0%	7.4%
<b>Net Profit</b>	395	388	392	494	473	460	476	424	487	493
<b>Net Margin</b>	6.4%	6.2%	6.0%	5.0%	4.9%	4.8%	5.1%	4.4%	5.0%	4.9%
<b>Free Cash Flow</b>	561	414	349	481	468	264	411	617	395	702
<b>Income Tax</b>	239	236	235	288	279	279	45	131	151	158

## Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Total Assets</b>	3656	4614	5565	7962	8128	8315	8482	9041	11249	11840
<b>Cash &amp; Equivalents</b>	58	598	1112	105	91	135	547	897	419	835
<b>Accounts Receivable</b>	137	230	284	583	609	647	610	626	422	449
<b>Inventories</b>	2043	2309	2557	3937	4175	4326	4168	4363	4432	4538
<b>Goodwill &amp; Int. Ass.</b>	108	105	250	1744	1677	1632	1592	1541	1702	1675
<b>Total Liabilities</b>	2808	3403	4049	5959	5667	5399	5067	5490	7699	8280
<b>Accounts Payable</b>	1653	2030	2181	3095	3204	3086	2895	3173	3421	3641
<b>Long-Term Debt</b>	416	605	1054	1637	1207	1043	1044	1046	747	1033
<b>Shareholder's Equity</b>	848	1211	1516	2003	2461	2916	3415	3551	3549	3560
<b>D/E Ratio</b>	0.49	0.50	0.69	0.82	0.49	0.36	0.31	0.29	0.21	0.29

## Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Return on Assets</b>	11.3%	9.4%	7.7%	7.3%	5.9%	5.6%	5.7%	4.8%	4.8%	4.3%
<b>Return on Equity</b>	41.8%	37.7%	28.7%	28.1%	21.2%	17.1%	15.0%	12.2%	13.7%	13.9%
<b>ROIC</b>	30.3%	25.2%	17.9%	15.9%	13.0%	12.1%	11.3%	9.4%	11.0%	11.1%
<b>Shares Out.</b>	72.8	73.4	72.8	73.1	73.3	73.8	73.9	72.5	70.9	69.0
<b>Revenue/Share</b>	80.06	83.78	88.45	134.09	132.06	129.55	126.48	129.48	136.43	146.46
<b>FCF/Share</b>	7.28	5.59	4.76	6.55	6.35	3.57	5.55	8.34	5.55	10.17

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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