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Autozone: How Long Will They Be In The Zone?

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The New President and CEO

Bill Rhodes was named president and CEO of AutoZone on March 13, 2005; He had joined AutoZone in 1997 and during the next eight years held positions in finance, supply chain, and store operations. He was well regarded and seen as an excellent choice for CEO.

Rhodes had much to be proud of. He was now CEO of the number one auto parts retailer, with annual sales of $5.7 billion, 3,592 stores in 48 U.S. states, and 81 stores in Mexico (2005 annual report). AutoZone was founded in 1979 and listed on the New York Stock Exchange in 1991 under the symbol AZO. It had been in Standard & Poor's 500 since 1996 and had more stores, more sales, and better financial results than any other auto parts retailer. In the last 10 years, growth had been exceptional: total sales 15% CAGR (compound annual growth rate), EBIT (earnings before income taxes) 19% CAGR, and EPS (earnings per share) 24% CAGR. A vendor-owned inventory program had increased return on equity to 110%, far above that of any competitor.

In spite of all the good news, Rhodes had some concerns. Recent financial press coverage about AutoZone had not been favorable. In the January 2004 issue of *Aftermarket Business,* an auto parts trade monthly, financial investment columnist Herb Greenberg said, "AutoZone's a turtle dressed up like a hare and the costume is starting to fall off. This is now a mature company. It is no longer a growth company."[1] The article went on to say:

> Several analysts downgraded the stock as they questioned the quality of AutoZone's earnings, contending that the funds were gained mostly through internal cost-cutting by reducing warranty expenses and opting for a less expensive employee pension plan, rather than attracting more business through the front door.

[1] James E. Guyette, "Street Still Seeks More Oomph—AutoZone," *Aftermarket Business* (January 2004).

"Some market watchers believe AutoZone is losing share to competitors O'Reilly Automotive, Inc., and Advance Auto Parts, Inc.," the Associated Press reported May 12, 2005. Monarch Research analyst Cid Wilson told AP:

> From a customer standpoint, you see a new O'Reilly store and a new-looking Advance Auto store, and you compare that with AutoZone stores, where there hasn't been a whole lot of capital improvement in those stores.[2]

Rhodes was also worried about the press concerning AutoZone's largest investor, Edward S. Lampert. AP characterized him as follows:

> Edward S. Lampert is the wild card when it comes to AutoZone. Lampert has been a director since 1999. His investment firm, ESL Investments, Inc., owned a 26.8% stake as of October 27, making it AutoZone's largest shareholder. Some market watchers expect Lampert, who was instrumental in Kmart's acquisition of Sears, to see either that AutoZone goes private or is combined with Sears Holding Corp.[3]

But what got Rhodes really angry was the press about major competitor Advance Auto Parts, number two in the category. For example, Merrill Lynch analyst Danielle Fox characterized Advance Auto Parts as "a surprisingly top-line–focused company. We believe that Advance is picking up share at an accelerating pace, especially from AutoZone."[4]

Monarch's Wilson, too, cited Advance Auto Parts as a company to watch: "Advance is probably doing a better job of capturing the commercial market than any other auto parts company in the industry," he told the *Roanoke Times*.[5]

Rhodes had to ask himself: Were there any facts to support those stories? Was Advance Auto Parts really a threat to AutoZone? If it were a threat, what should he do about it? How should he compete against it? Rhodes realized this could be one of the major challenges he faced as the new CEO of AutoZone.

The Facts: AutoZone (AZO) versus Advance Auto Parts (AAP)

1. *Market Position.* AutoZone was the clear leader in store count and total sales. And it was far and away the leader in the direct-to-consumer "do-it-yourself" (DIY) market. But Advance Auto Parts had a larger market share than AutoZone in the commercial sales category known as "do-it-for-me" (DIFM). Why was Advance Auto Parts doing so well in DIFM?

[2] Associated Press, "AutoZone Needs to Boost Sales Growth," 12 May 2005.
[3] Associated Press.
[4] Danielle Fox, Merrill Lynch, analyst's report, 2005.
[5] Jenny Kincaid, "Advancements at Advance Auto," *Roanoke Times,* 8 May 2005.