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AUTOZONE (NYSE: AZO)

**BUY**

March 20, 2002

S&P Sector Consumer Discretionary

Specialty Retail

## MARKET DATA

Price	\$70.76
52 wk range	\$25.57-80.00
Price Target	\$87
Shares Out:	106.78 million
Market Cap:	\$7377.62 million
PEG	1.34
2Q EPS	\$0.58
Beta	0.59
Revenue 2001A	\$4,818 million
Net Income 2001A	\$175 million

## COMPANY OVERVIEW

AutoZone, Inc. is a retailer of automotive parts and accessories, primarily focusing on do-it-yourself customers. As of August 26, 2000, the Company operated 2,915 auto parts stores in 42 states and 13 in Mexico. Each auto parts store carries an extensive product line for cars, vans and light trucks, including new and re-manufactured automotive hard parts, maintenance items and accessories. Approximately half of its domestic auto parts stores also had a commercial sales program, which provides commercial credit and prompt delivery of parts and other products to local repair garages, dealers and service stations. The Company does not sell tires nor does it perform automotive repairs or installations. AutoZone sells heavy-duty truck parts and accessories through 49 TruckPro stores in 15 states, automotive diagnostic and repair information software through its ALLDATA subsidiary, and diagnostic and repair information through alldatadiy.com. In December 2001, the Company sold TruckPro. (source: Yahoo Finance)



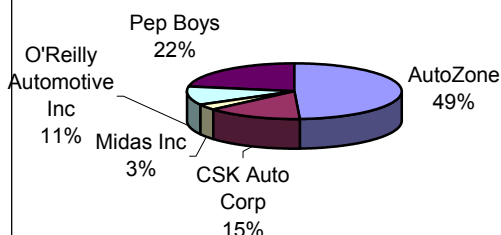
## INVESTMENT CONCLUSION

### SUMMARY

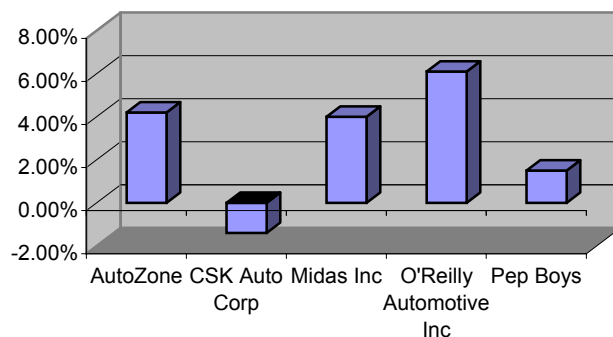
- ☐ Buy recommendation for 150 shares of AZO at market price
- ☐ DCF valuation of \$87 assuming 15% growth rate in sales and 4% growth rate in square footage over next 5 years.
- ☐ Growth rate assumptions based on historical performance of 17% 5 year CAGR of sales and 16% 5 year CAGR of EPS.
- ☐ DDM valuation at \$88, assuming a 14.7% growth rate for the next 7 years and 4.4% growth at maturity.
- ☐ AZO is currently market leader with revenues of \$4,931 million, followed by Pep Boys with \$2,223 million and CSK Atuo with \$1,457 million.

## INDUSTRY INSIGHT

Auto Parts Stores Market Share Data



Net Income Comparison



## INVESTMENT HIGHLIGHTS

### Industry Trends And News

As illustrated in the charts on the previous page, AutoZone is clearly the market leader with 49% of the market share. In terms of profitability, AutoZone has a 4.2% net income margin, behind O'Reilly which has a 6.1% net income margin. However, in terms of cash flow, AutoZone is in a healthier position with a P/CF of 17.4 compared to O'Reilly at 27.41. O'Reilly saw a sharp drop in cash flow from operations despite a higher net income margin, that could indicate a rapid but unsustainable growth in operations.

The slowing economy meant that more people have been replacing parts in their cars rather than buying new ones. This has helped the industry boost revenues. Further, higher horsepower SUV's and light trucks purchased in the mid 1990's are now at an age where they would require considerable maintenance. Many of these vehicles have been leased and would need even more maintenance than owned cars.

### Company Strategy and Discussion

The company had a 17% increase in the 5 Year Compounded Growth Rate for sales and a 16% increase in the 5 Year Compounded Growth Rate for EPS. Square footage and comparable store sales both increased 4% in fiscal 2001 as compared to 2000.

The company's market dominance can be attributable to a higher inventory turnover than its competitors which gives it a long term sustainable advantage. AutoZone has an inventory turnover of 2.39 times inventory as compared to O'Reilly that has a 1.52 and CSK Auto Corp that has 1.23.

The company underwent a restructuring that cost \$156 million before taxes in fiscal 2001. The company also sold Truck Pro, its heavy duty truck subsidiary in Dec 2001. They undertook changes in their marketing and merchandising strategies, that resulted in an "inventory rationalization charge" of \$28.0 million.

The company enjoyed a tremendous boost in revenue and earnings in the second quarter of 2002 with profits coming in 101% higher than a year ago. Earnings of 58 cents a share beat estimates of 50 cents, that caused analysts to revise their forecasts for the rest of the year. These results were due to a 12 % increase in same store sales. The company is expected to benefit from an increasing market of ageing cars and light trucks.

### Investment Risks And Concerns

#### ☐ Competition

The company faces competition from O'Reilly that has grown more rapidly with an 36% increase in sales and 22% earnings growth in the last 5 years. Its current market dominance could be threatened by O'Reilly that also has a better net income margin.

#### ☐ Shelf Registration Statement Filed on Feb 27,2002

Eddie Lampert and ESL Investments, a hedge fund, were early investors in the company when the price was \$15. ESL had a \$1.65 billion position in AutoZone. The shelf registration gave them the right to sell shares. Though this registration is to allow ESL's investors to cash in on some of the profits and diversify their portfolio, the filing sent the stock down 3.2% on the date of filing.

#### ☐ High Debt to Equity Ratio

Total debt as a percentage of common equity is at 140% which is higher than the industry ratio. However most of this debt is long term and there are no significant amounts of that falling due within the next year.

## FINANCIAL RESULTS

### Annual Income Statement (Values in Millions)

	8/2001	8/2000	8/1999	8/1998	8/1997
Sales	4,818.2	4,482.7	4,116.4	3,242.9	2,691.4
Cost of Sales	2,673.6	2,475.6	2,256.4	1,793.1	1,481.5
Gross Operating Profit	2,144.6	2,007.1	1,860.0	1,449.8	1,209.9
Selling, General & Admin. Expense	1,498.9	1,368.3	1,298.3	970.8	810.8
Other Taxes	0.0	0.0	0.0	0.0	0.0
EBITDA	645.7	638.8	561.7	479.0	399.1
Depreciation & Amortization	131.3	126.8	128.5	96.6	77.8
EBIT	514.4	512.0	433.2	382.4	321.3
Other Income, Net	0.0	0.0	0.0	0.0	0.0
Total Income Avail for Interest Exp.	387.7	512.0	433.2	382.4	321.3
Interest Expense	100.7	76.8	45.3	18.2	8.8
Minority Interest	0.0	0.0	0.0	0.0	0.0
Pre-tax Income	287.0	435.2	387.9	364.2	312.5
Income Taxes	111.5	167.6	143.0	136.2	117.5
Special Income/Charges	-126.7	0.0	0.0	0.0	0.0
Net Income from Cont. Operations	175.5	267.6	244.8	227.9	195.0
Net Income from Discont. Ops.	0.0	0.0	0.0	0.0	0.0
Net Income from Total Operations	175.5	267.6	244.8	227.9	195.0
<b>Total Net Income</b>	<b>175.5</b>	<b>267.6</b>	<b>244.8</b>	<b>227.9</b>	<b>195.0</b>

### Annual Balance Sheet (Values in Millions)

	8/2001	8/2000	8/1999	8/1998	8/1997
<b>Assets</b>					
Current Assets					
Cash and Equivalents	7.3	7.0	5.9	6.6	4.7
Receivables	19.1	21.4	25.9	44.4	18.7
Inventories	1,242.9	1,109.0	1,129.7	966.6	709.4
Other Current Assets	59.2	49.4	63.6	99.5	46.0
Total Current Assets	1,328.5	1,186.8	1,225.1	1,117.1	778.8
Non-Current Assets					
Property, Plant & Equipment, Gross	2,372.3	2,320.3	2,089.1	1,778.5	1,336.9
Accum. Depreciation & Depletion	661.9	561.9	450.6	351.0	255.8
Property, Plant & Equipment, Net	1,710.4	1,758.4	1,638.5	1,427.5	1,081.1
Intangibles	305.4	324.5	337.3	181.3	16.6
Other Non-Current Assets	88.2	63.5	83.9	22.2	7.5
Total Non-Current Assets	2,104.0	2,146.4	2,059.7	1,631.0	1,105.2
<b>Total Assets</b>	<b>3,432.5</b>	<b>3,333.2</b>	<b>3,284.8</b>	<b>2,748.1</b>	<b>1,884.0</b>
<b>Liabilities &amp; Shareholder's Equity</b>					
Current Liabilities					
Accounts Payable	945.7	788.8	757.4	683.4	449.8
Short Term Debt	0.0	0.0	0.0	0.0	0.0
Other Current Liabilities	321.0	245.7	243.1	176.5	142.7
Total Current Liabilities	1,266.7	1,034.5	1,000.6	859.8	592.5
Non-Current liabilities					
Long Term Debt	1,225.4	1,249.9	888.3	545.1	198.4
Deferred Income Taxes	0.0	0.0	0.0	0.0	0.0
Other Non-Current Liabilities	74.2	56.6	72.1	41.2	18.0
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total Non-Current Liabilities	1,299.6	1,306.5	960.4	586.3	216.4
<b>Total Liabilities</b>	<b>2,566.3</b>	<b>2,341.0</b>	<b>1,960.9</b>	<b>1,446.2</b>	<b>808.9</b>
Shareholder's Equity					
Common Stock Equity	866.2	992.2	1,323.8	1,302.1	1,075.2
Total Equity	866.2	992.2	1,323.8	1,302.1	1,075.2
<b>Total Liabilities &amp; Stock Equity</b>	<b>3,432.5</b>	<b>3,333.2</b>	<b>3,284.7</b>	<b>2,748.3</b>	<b>1,884.1</b>

**CHARTS / TECHNICAL****KEY RATIOS**

P/E	23.27
P/S	1.5
P/CF	17.41
ROE	22.6%
ROA	5.9%
Inventory Turnover	2.39

**DCF ASSUMPTIONS**

Sales Growth	15%
Square Footage Growth	4%
Debt	Regression of debt on square footage growth
Discount Rate	11%
Growth at Maturity	4%



## CHARTS / TECHNICAL

GRAB

Equity COMP

Hit 1<GO> for Options, Hit <Page> for table.

### COMPARATIVE RETURNS

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Range 2/28/97 - 2/28/02		Period	Monthly	60 Mo. Period
Securities	Crcy	Prc Appr	Total Ret	Difference Annual Eq
1 AZO US Equity	USD	168.12 %	168.12 %	118.08 % 21.79 %
2 SPX Index	USD	39.95 %	50.04 %	8.45 %
3 S5SPST Index	USD	-18.94 %	-18.94 %*	-68.98 % -4.11 %

(\* = No dividends or coupons)



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