



# LEGION PARTNERS

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Advance Auto Parts (NYSE:AAP)



VALUE x VAIL

June 2024

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# Legion Partners

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**Legion seeks to generate attractive long-term returns employing deep fundamental research, a concentrated portfolio and responsible, collaborative engagement as a catalyst for value creation**

## Overview

- SEC-registered investment advisor based in Los Angeles, CA; founded in 2012
- Employee-owned; first activist manager ever seeded by CalSTRS

## Strategy

- Value-oriented activist strategy, focused on small-cap companies
- Concentrated, high-conviction portfolio based on deep fundamental research
- Collaborative engagement with boards and management teams

## Experience

- Each co-founder has over 20 years of activist experience
- Disciplined, repeatable idea generation and execution
- Proven track record of effective shareholder engagement



# Stock Selection: Investment Universe

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***Small-cap market is less efficient, presents better opportunities for engagement and offers the greatest upside potential***



# Areas of Focus of Prior Engagements<sup>1</sup>

Strategy & Operations	 PRIMO WATER	NutriSystem®	 Genesco	 SPS COMMERCE INFINITE RETAIL POWER™
Capital Allocation	 MURPHY USA	 Genesco	 AutoNation	 KOHL'S
Leadership	 VONAGE	 BANC OF CALIFORNIA	 PRIMO WATER	PERRY ELLIS
Corporate Governance	 MATTEL	 the chefs WAREHOUSE	 KOHL'S	 BANC OF CALIFORNIA
Investor Communication	 boingo	 LBFoster	 SPS COMMERCE INFINITE RETAIL POWER™	 VONAGE
Strategic Alternatives	 Cincinnati Bell connecting what matters	 broadsoft	 VONAGE	 boingo

1. Logos represent examples of exited investments which were selected by Legion Partners Asset Management (LPAM) to illustrate prior engagements which focused on Key Areas outlined on slide #11.

# Effective Engagement

## Impact of Legion's Engagement on 49 Historical Core Investments<sup>1</sup>

Average Hold Period <sup>2</sup>	2.0 yrs
# of Board Members Placed <sup>3</sup>	77
Improved Governance	63%
Sale of Co./Assets	49%
Improved Communication	45%
Improved Capital Allocation	47%
Improved Operations	41%
C-Suite Replacements	35%

## Highlights

- Successfully placed 77 new board members at 27 of our portfolio companies since 2016 – over 50% have been women and/or ethnically diverse<sup>3</sup>
- Board changes at more than 50% of our core portfolio companies

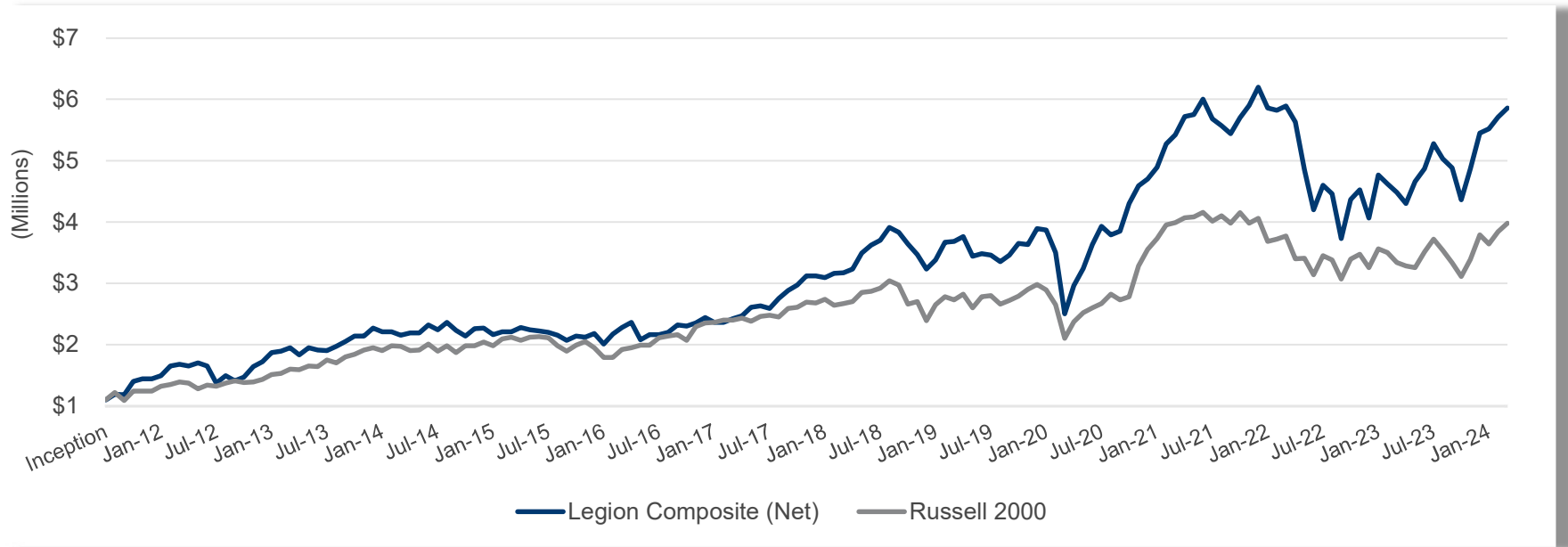
1. Information includes commingled investments and co-investments from January 2014 – March 2024; 2. Represents all core positions; Average Hold Period of 38 exited core positions is 1.8yrs; 3. This includes board members placed due to Legion settlements and/or agreements (42 directors), and board members added due to Legion advocating for board changes and/or through direct influence (35 directors) through March 2024

Determination of scorecard percentages are based on Legion Partners reasonable interpretation of indicated attributes



# Legion Composite<sup>1,2</sup> Performance as of March 31, 2024

## Growth of Investment Since Inception



	Q1 '24 (Net)	ANNUALIZED (Net)						Cumulative <sup>2</sup>
		1 YR	3 YRS	5 YRS	7 YRS	10 YRS	ITD <sup>2</sup>	
Legion Partners Composite <sup>1,2</sup>	7.7%	31.5%	2.7%	10.0%	13.9%	10.9%	14.9%	476.2%
Russell 2000 TR Index	5.2%	19.7%	(0.1%)	8.1%	7.7%	7.6%	11.3%	287.9%

1. Legion Partners Composite - a dollar and time weighted returns index of all Legion Partners Commingled Funds and Co-investments<sup>2</sup> dating back to August 22, 2011; 2%/20% fee model prior to 2014 when all capital was deployed via single-investment co-investment vehicles<sup>2</sup>; actual fees charged from 2014 onwards; see detailed Notes and Disclosures.

2. Includes three co-investment projects prior to 2014 Commingled Fund Launch, the projects of which may depart from the industry standard definition of a co-investment project  
Past performance is not indicative of future results



# ***Advance*** / <sup>®</sup> ***Auto Parts***





# Advance Auto Parts (AAP)



Advance Auto Parts is one of the 4 major auto parts retailers in North America, offering a broad selection of automotive replacement parts, accessories, batteries and maintenance items



4,477 stores

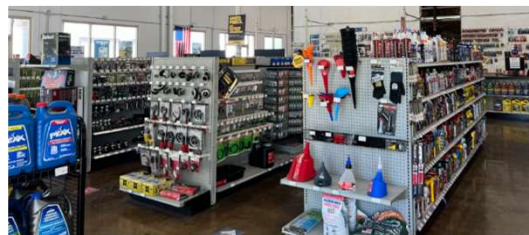
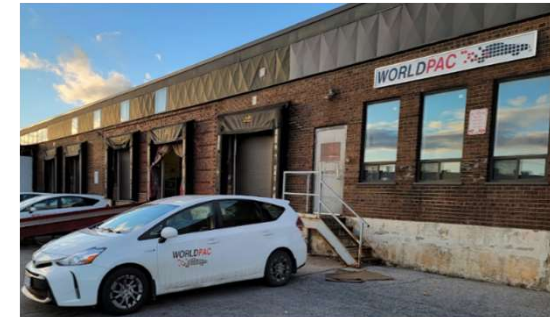
308 owned  
+  
1,307 independents

320 branches

DIY & Pro

Primarily Pro

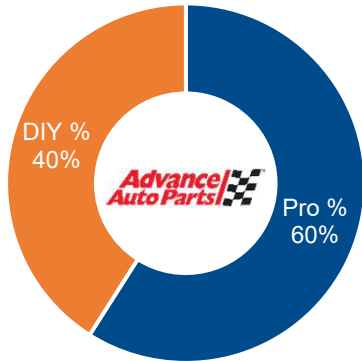
Pro (specialized in import parts)



# Business Mix vs. Peers

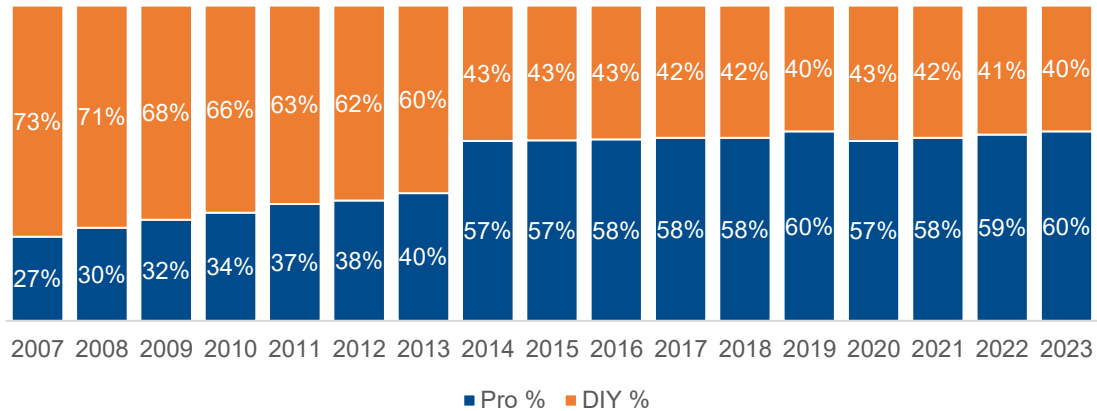


## AAP Mix (2023)



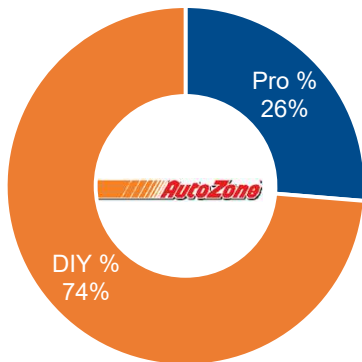
**TEV: \$5.5B**  
**Sales: \$11.3B / 4% EBITDA margin**

## AAP Mix Over Time

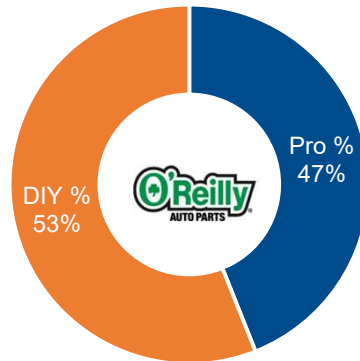


*GPI acquisition (Carquest & Worldpac) in 2014 increased AAP's Pro mix*

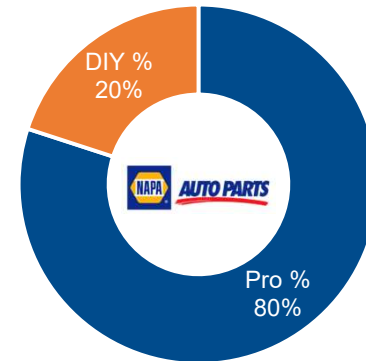
## Peer Mix (2023)



**TEV: \$58.5B**  
**Sales: \$17.5B / 23% EBITDA margin**  
**Stores: ~6,800**



**TEV: \$69.5B**  
**Sales: \$15.8B / 23% EBITDA margin**  
**Stores: ~5,700**



**TEV: \$22.9B (GPC WholeCo)**  
**Sales: \$14.2B / 9% EBITDA margin**  
**Stores: ~9,800**

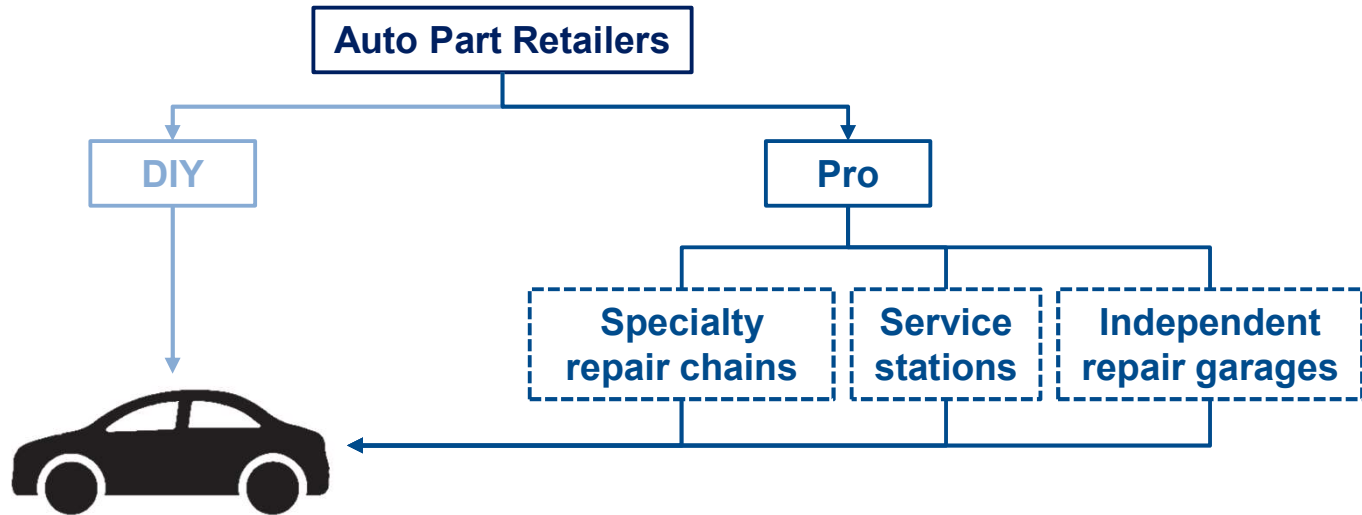


Source: SEC Filings, Company Presentations, Legion Partners' Estimates, Capital IQ (4/16/24)  
 Note: Pies represent full year fiscal data for each company. Note AZO's fiscal year end was 8/26/23.  
 AAP EBITDA margin represents adjusted numbers.

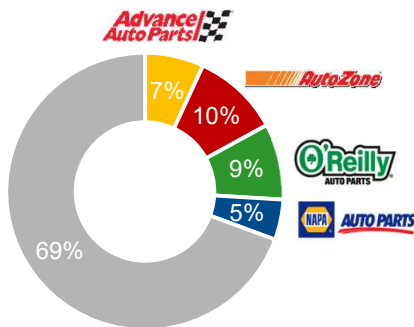
# Auto Part Retailer Industry Overview



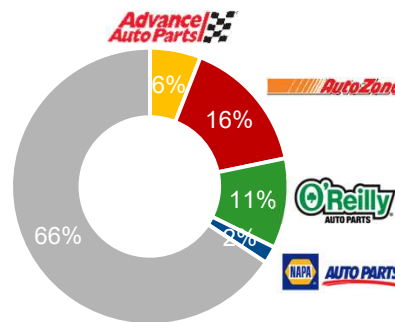
AAP's addressable market is approximately \$160B growing at 4% CAGR, which includes the auto parts share of professional service provider sales (wholesale) and DIY sales (retail)



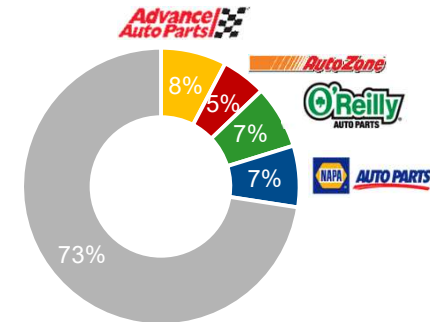
**Total Market: \$160B**



**DIY: \$75B**



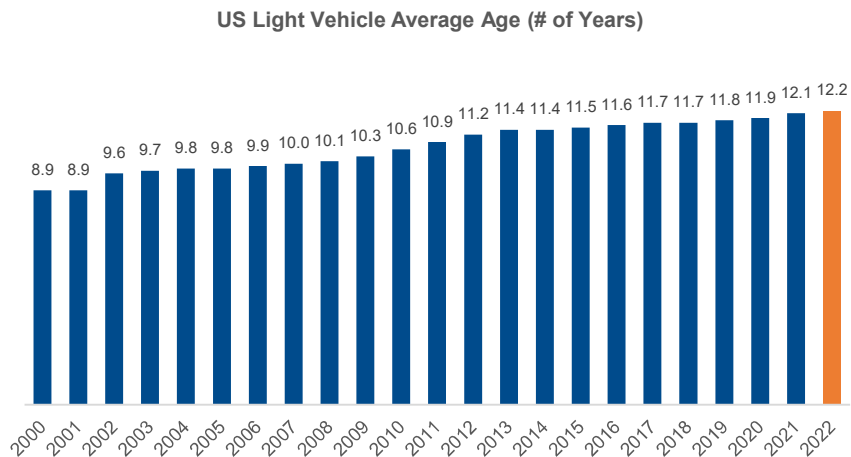
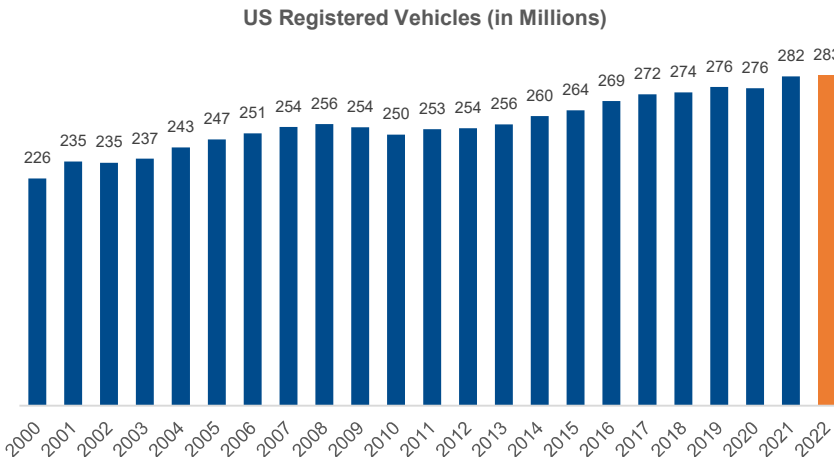
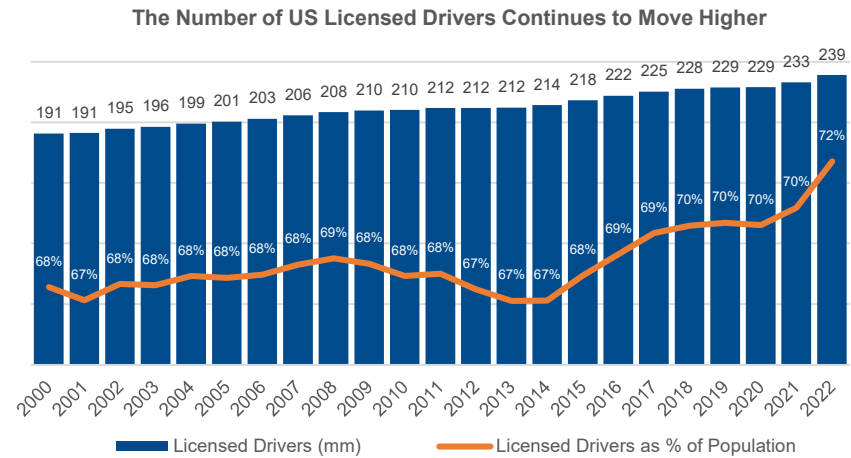
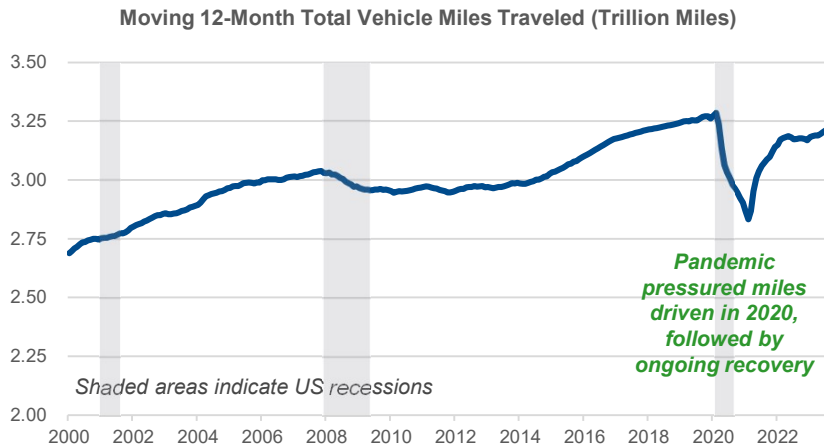
**Pro: \$85B**



# Strong Fundamental Drivers



The growth of US driver, vehicle population, and total vehicle miles traveled, along with the continued aging of US light vehicle, continue to drive greater need for maintenance and repair



Source: U.S. Department of Transportation, U.S. Department of Energy, U.S. Census

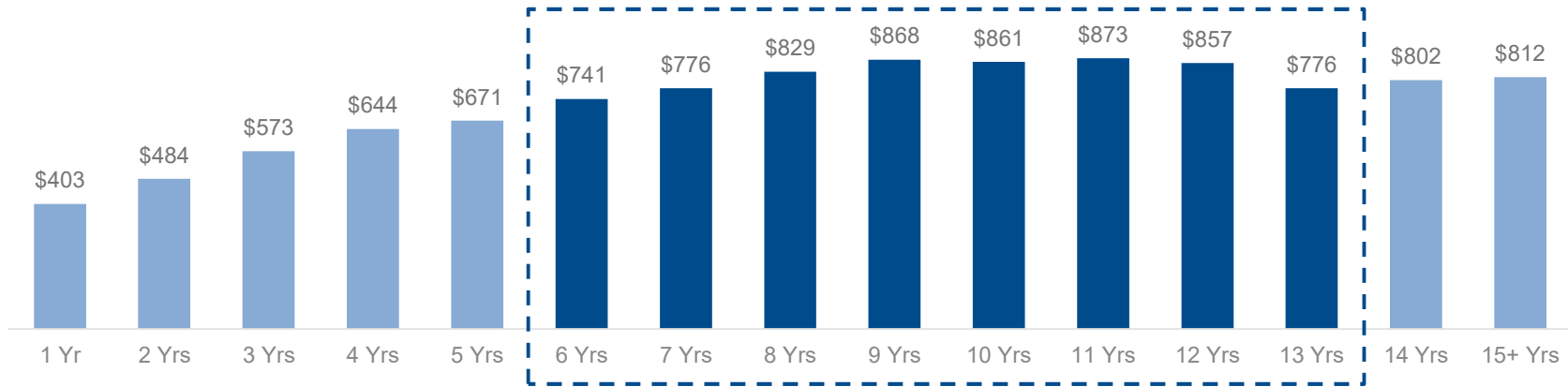
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# Aftermarket “Sweet Spot” = 6-13 Years Old



“Sweet spot” starts when a vehicle hits 6 years old (shortly after it comes out of the warranty, which is usually 3 or 5 years), and lasts till around 13 years old as the owner continues to see value in repairs

Average Annual Repair Cost



Spend Per Vehicle

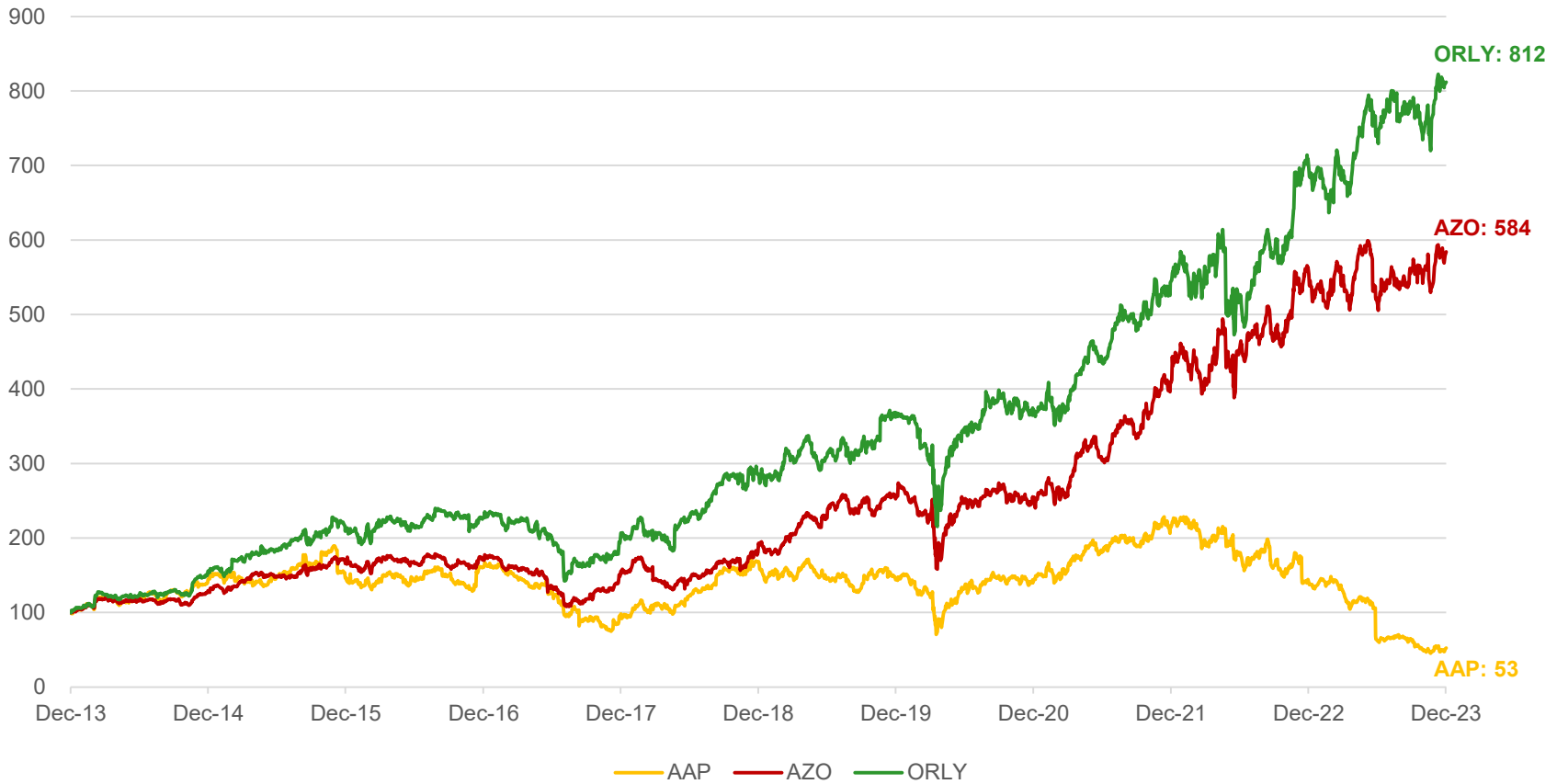


# If You Invested \$100 in AAP 10 Years Ago...



...It would be worth \$53 or down by 47% as of 12/4/23, while an investment in AZO would be worth \$584 (~6x) and an investment in ORLY would be worth \$812 (~8x)

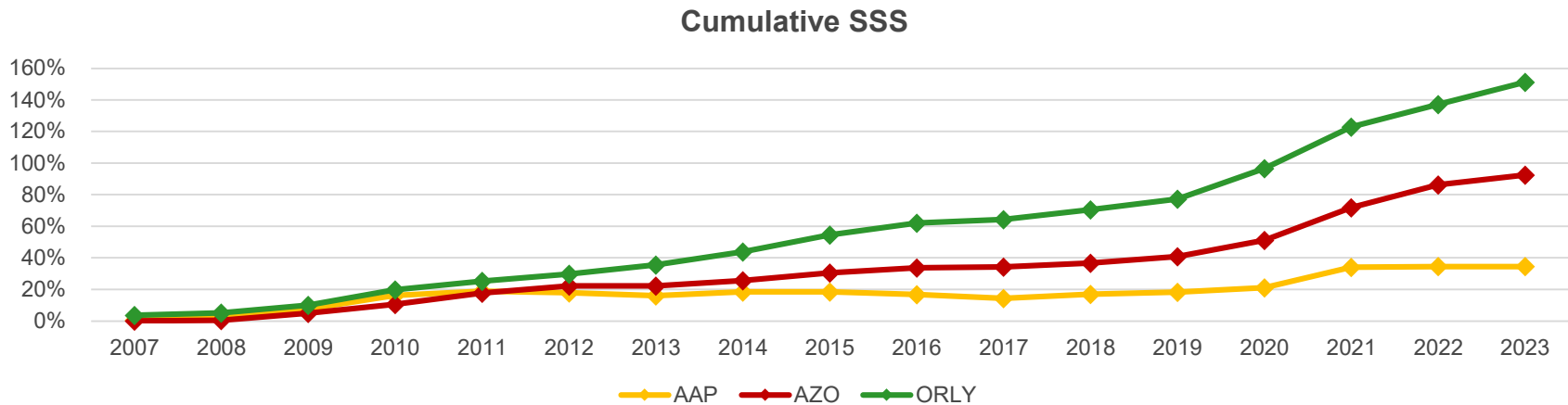
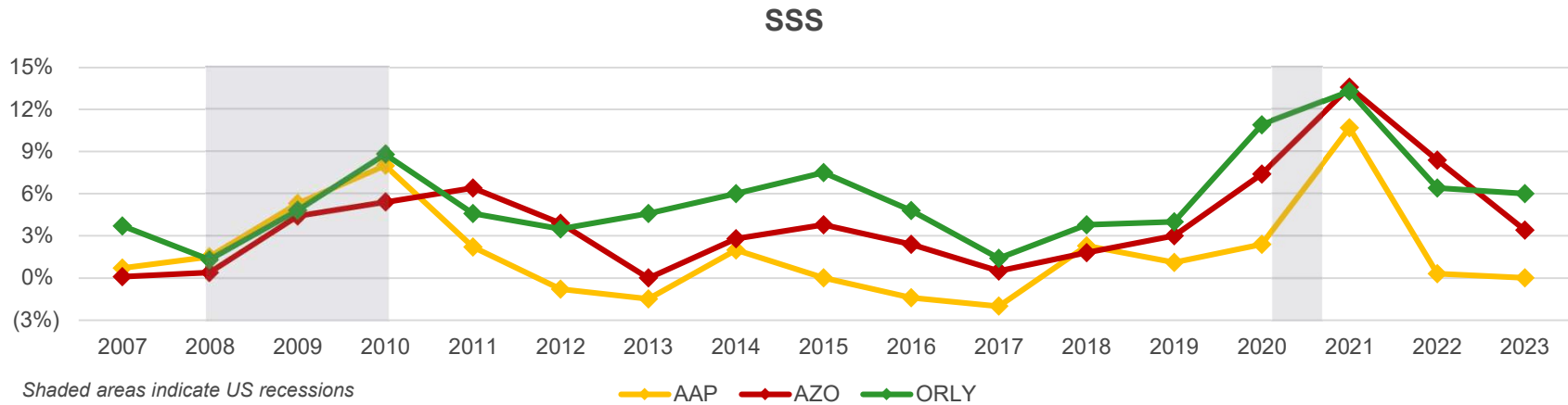
AAP vs. Peer Stock Performance (Indexed to 100 in Dec 2013)



# Same Store Sales Below Peers



AAP SSS started to lag peers in 2010, and the gap has recently widened

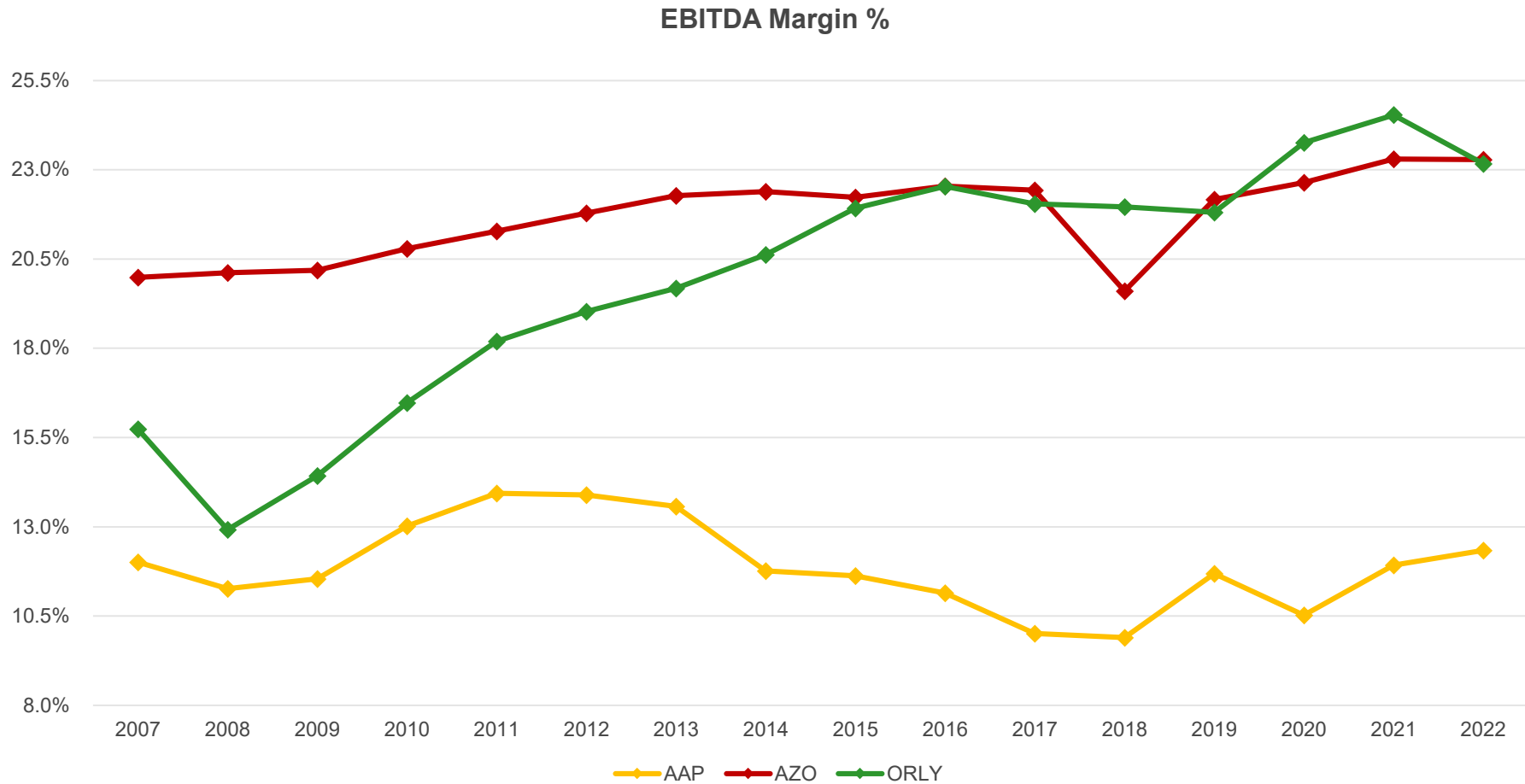


**Auto part retailers perform well in recessions as consumers postpone new car purchases and invest more in repair and maintenance**

# EBITDA Margins Below Peers



EBITDA margins show the same widening gap between AAP and peers





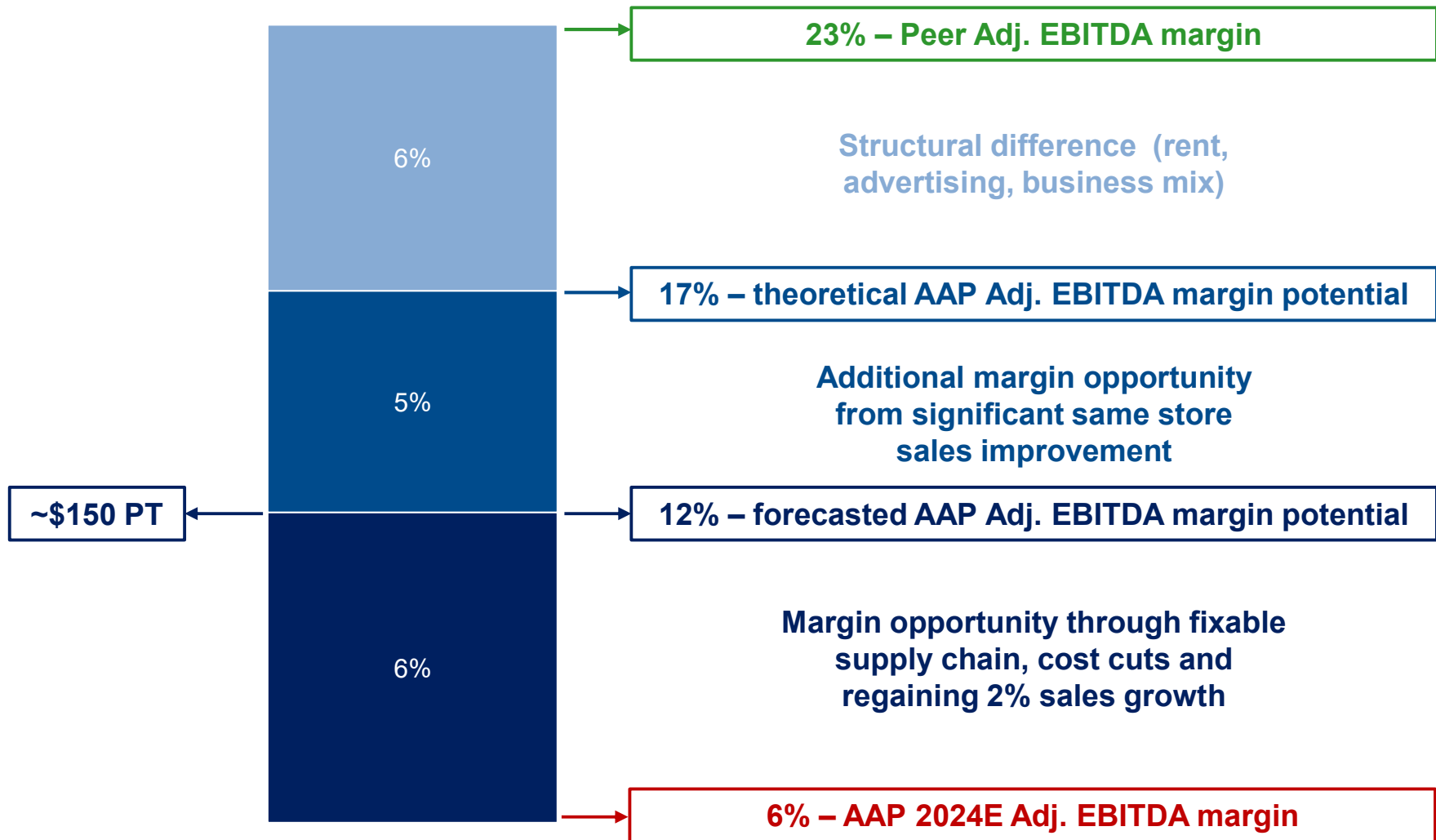
# AAP Supply Chain Has Major Issues Under Surface



	Advance Auto Parts	CARQUEST	WORLD PAC
DCs	12 DCs (Average 500k sq. ft)	34 DCs (Average 125k sq. ft)	4 DCs
	<b>← Cross banner replenishment →</b>		
Inventory	Separate SKUs	Separate SKUs	Separate SKUs
Systems	<i>Partially shared systems</i>		Own systems

**So far AAP has spent \$356mm on transformation over 6 years and has little to show for it**

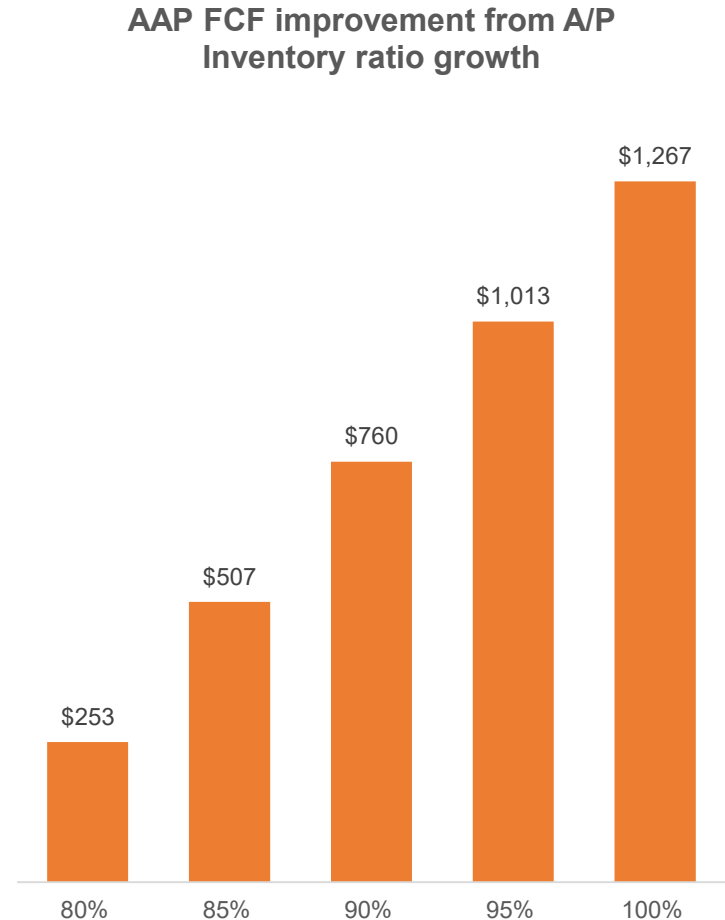
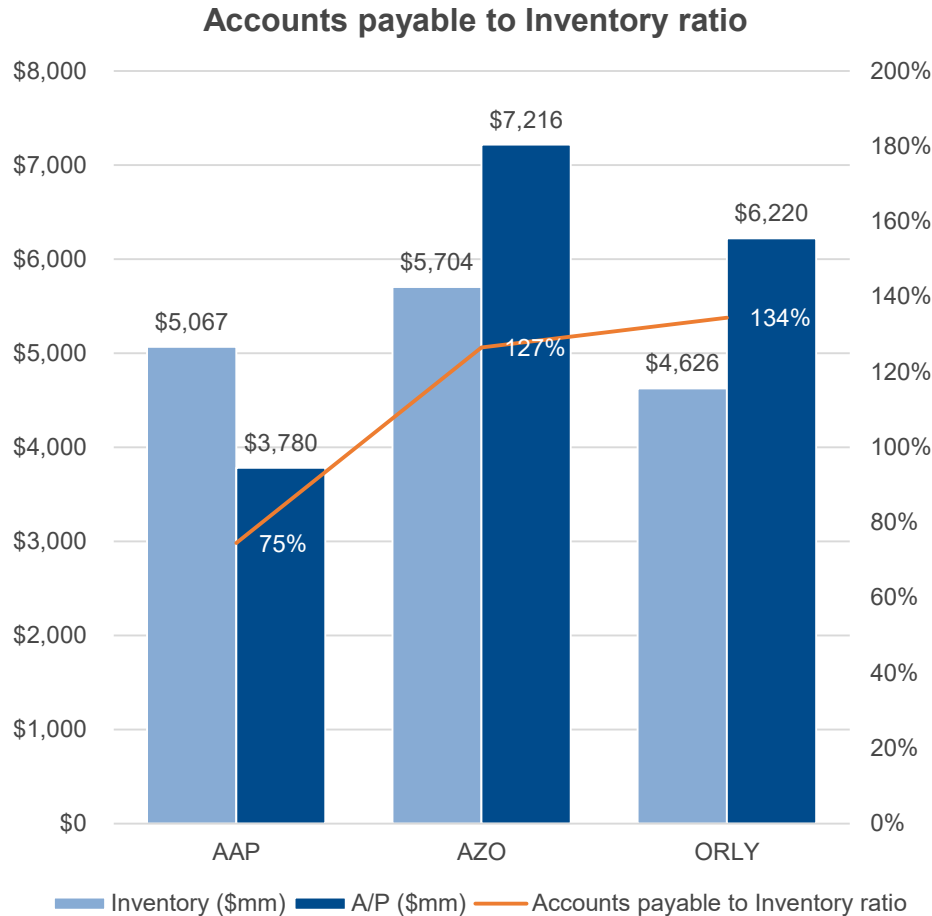
# AAP EBITDA Margin Potential



# FCF Opportunity – A/P Inventory Coverage



We assume Worldpac has ~20% A/P inventory coverage ratio, and if rest of AAP can achieve 120% (which is still below peers), AAP as a whole could reach 100%+



**By improving A/P inventory coverage to 100%, AAP could release up to \$1.3 billion of FCF**

# Potential Worldpac Sale Valuation



Worldpac is AAP's crown jewel – our conversations with pro customers show they appreciate Worldpac's product availability and service, and there's no close #2 in the industry

## Worldpac valuation range

(\$mm)

Sales	\$1,500	\$1,750	\$2,000	\$2,250	\$2,500
EBITDA margin %	7.0%	8.0%	9.0%	10.0%	11.0%
EBITDA	\$105	\$140	\$180	\$225	\$275
EV / EBITDA multiple	8.0x	9.0x	10.0x	11.0x	12.0x
Worldpac valuation	\$840	\$1,260	<b>\$1,800</b>	\$2,475	\$3,300

## Worldpac valuation sensitivity analysis at \$2bn sales

(\$mm)

		EBITDA margin %				
		7.0%	8.0%	9.0%	10.0%	11.0%
EV / EBITDA multiple	8.0x	\$1,120	\$1,280	\$1,440	\$1,600	\$1,760
	9.0x	\$1,260	\$1,440	\$1,620	\$1,800	\$1,980
	10.0x	\$1,400	\$1,600	<b>\$1,800</b>	\$2,000	\$2,200
	11.0x	\$1,540	\$1,760	\$1,980	\$2,200	\$2,420
	12.0x	\$1,680	\$1,920	\$2,160	\$2,400	\$2,640



# AAP – Legion’s Activism



## Recent Developments

- In August 2023, new CEO Shane O’Kelly is announced
- November 2023, new CFO Ryan Grimsland is announced
- November 2023, announces sale process for Worldpac and Canadian business
- November 2023, announces \$150M cost reduction program
- February 2024 announced additional \$50M cost reduction program
- March 2024, announced three new directors were added with significant supply chain and automotive aftermarket experience

## The Path Forward

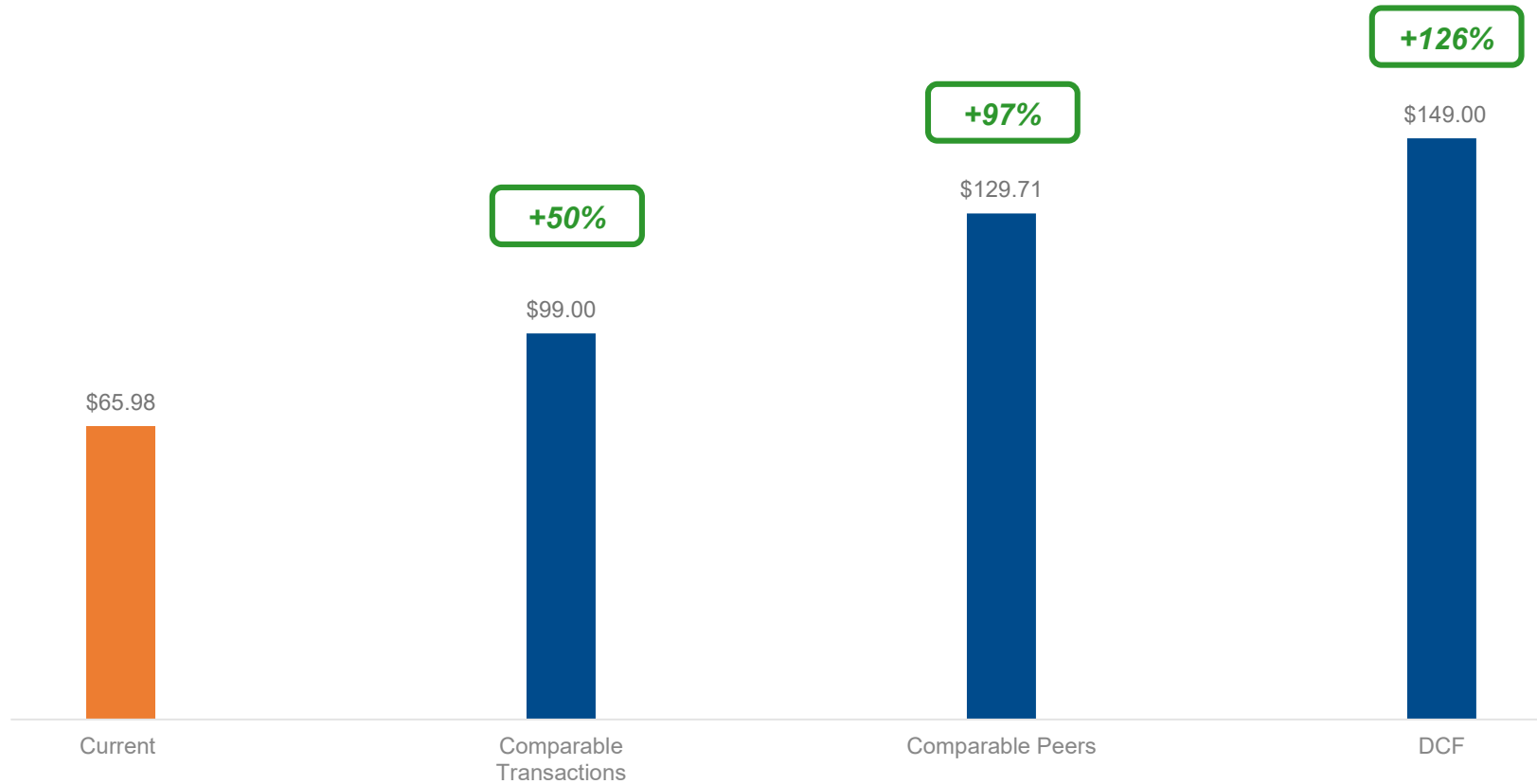
- Monitor sale process for Worldpac
- Hold management accountable for substantial margin improvement
- Ensure supply chain optimization proceeds with universal set of SKUs and streamlined distribution centers
- Return excess capital to shareholders



# AAP – Valuation



Peer analysis and DCF illustrate substantial opportunity for shares of AAP to rerate as turnaround unfolds



**We believe AAP’s valuation gap vs. peers and its intrinsic value will close as new management improves profitability and considers strategic alternatives**

# Notes and Disclosures

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