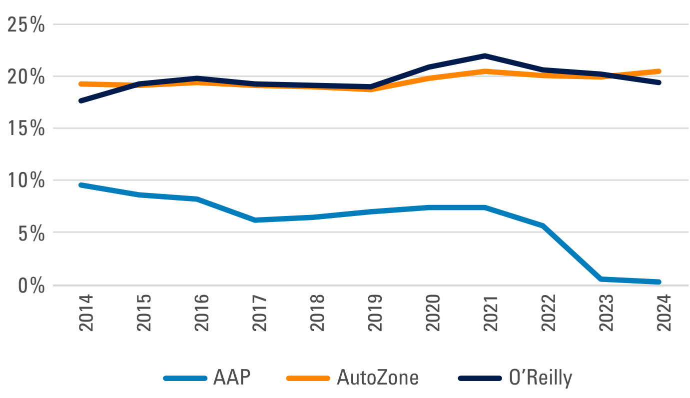
Advance Auto Parts is a classic turnaround story. After a dramatic collapse in margins and investor sentiment, green shoots are emerging that point to a path back to normalized earnings power.

Advance Auto Parts (AAP) is the third largest auto parts retailer in the U.S.[1], operating 4,300 Advance Auto Parts and Carquest stores and supporting another 900 independently owned Carquest locations. Through its two banners, AAP sells replacement parts, maintenance items, and accessories for cars and light trucks, with core categories including batteries, brakes, filters, spark plugs, and fluids. Its 100,000+ SKUs support its "blended-box" model that serves both professional repair shops (Pro) and do-it-yourself (DIY) customers from the same brick-and-mortar locations, with sales split roughly 50/50 between Pro and DIY.

Despite its size, AAP has failed to leverage the advantages of its scale. Years of mismanagement have driven its operating margin below 1%, a stark contrast to the ~20% margins earned by larger peers AutoZone and O'Reilly (Exhibit 1). AAP's prolonged underperformance stems from supply chain inefficiencies, under-investment in store operations, and a failed pricing strategy that triggered a full-blown crisis in 2023, sending the stock down more than 80% from its peak. Today, under new leadership, the company is executing a focused turnaround, with early KPIs improving, and a credible path back to 6%+ margins. At just 5.0x our normalized earnings estimate, we believe the stock is significantly undervalued.

Exhibit 1: Operating Margin



Source: S&P Capital IQ

		Earnings Per Share			Price/Earnings		
	Price	FY 25E	FY 26E	Normal*	FY 25E	FY 26E	Normal*
Advance Auto Parts	$46.49	$1.98	$3.21	$9.25	23.5x	14.5x	5.0x

Fiscal year ends on the Saturday closest to December 31 (52–53 week calendar).
**Pzena estimate of normal earnings.*
Source: S&P Capital IQ, Pzena analysis
Data as of June 30, 2025.

AUTO PARTS RETAILING: AN ATTRACTIVE INDUSTRY

The $160 billion U.S. auto parts aftermarket is highly fragmented, with scaled players steadily taking share from mom-and-pop competitors. The top four players hold roughly 30% of the market, leaving a long runway for consolidation-driven growth. Structural tailwinds, including an aging car fleet, a growing vehicle base, and rising vehicle miles traveled, continue to support long-term demand. Unlike most retail categories, auto parts remain resistant to e-commerce disruption, particularly in the Pro segment, where mechanics typically expect delivery within an hour to minimize downtime in their repair bays.

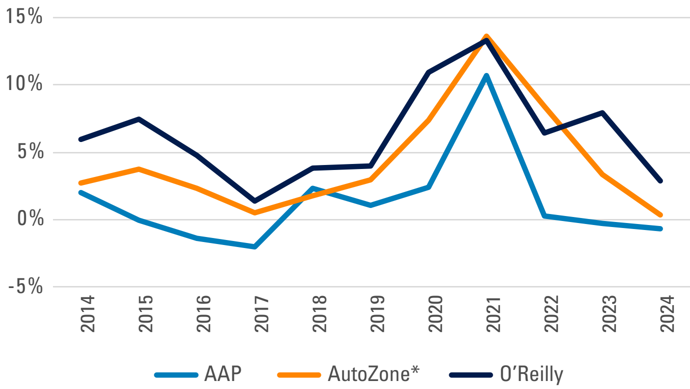
WHAT WENT WRONG: UNDERSTANDING THE DOWNTURN

AAP's troubles trace back to its 2014 acquisition of General Parts International, which brought in the Carquest and now-divested Worldpac banners. The company never fully integrated these acquisitions, and over a decade later, it was still operating multiple parallel supply chains, each with separate distribution centers and incompatible warehouse management systems. Success in this industry depends on parts availability, fast delivery, great service, and competitive pricing. However, AAP's fragmented network made consistent execution impossible. The resulting complexity led to stockouts and slower delivery times. These operational failures are reflected in same-store sales, which have trailed AutoZone and O'Reilly nearly every year for the past decade (Exhibit 2).

1. By number of company-operated stores.

HIGHLIGHTED HOLDING CONT.

Exhibit 2: Same-Store Sales



Source: Company filings, Pzena analysis
**Domestic SSS*

In 2016, a new leadership team took over and made a bad situation worse by prioritizing cost-cutting over fixing core operational problems. What followed were years of underinvestment in logistics, IT, and store operations, leaving frontline employees under-resourced, shelves understocked, and many stores still running on outdated point-of-sale systems. These shortcomings made it difficult to meet customer needs. The consequences are evident in store productivity: while AutoZone and O'Reilly generate over $2.5 million in sales per location, AAP lags at just $1.7 million, despite having similarly sized stores, highlighting the gap created by years of dysfunction[2].

While these operational missteps had weighed on margins for years, AAP's undoing came from a failed pricing initiative launched in 2022. Seeking to close its persistent margin gap with peers, AAP raised prices, first in DIY, then in Pro. Competitors did the opposite: AutoZone and O'Reilly lowered prices and took share. Pro customers, in particular, defected, and AAP's volumes declined significantly. After sticking with the strategy for several quarters, AAP reversed course in early 2023 and slashed prices to win back business, but it was too late. Lost volumes never fully returned, and the pricing whiplash led to a full collapse in margin.

The fallout was swift. By mid-2023, AAP had missed earnings, slashed its dividend, launched a strategic review, and begun searching for a new CEO. Around the same time, material weaknesses in internal controls came to light, further shaking investor confidence, and prompting the departures of both the Chief Accounting Officer and the Treasurer. Vendor relationships deteriorated, employee turnover rose, and the stock plunged, leaving a once-formidable retailer on the brink of failure.

A NEW CHAPTER: OPERATIONAL DISCIPLINE AND EARLY PROGRESS

Under the new CEO, Shane O'Kelly, AAP is taking decisive steps to improve execution after years of mismanagement. One of his first actions was divesting of Worldpac, a standalone e-commerce platform for import parts that operated outside AAP's brick-and-mortar blended-box model. This move significantly strengthened the balance sheet, transforming a $1.3 billion net debt position at year-end 2023 into an $80 million net cash position by year-end 2024. The resulting financial flexibility was crucial, enabling the company to make tough operational decisions and aggressively execute its turnaround strategy. With its failed pricing strategy now fully unwound and prices back in line with competitors, AAP is focused on restoring its competitive edge across three pillars: merchandising, supply chain, and store footprint.

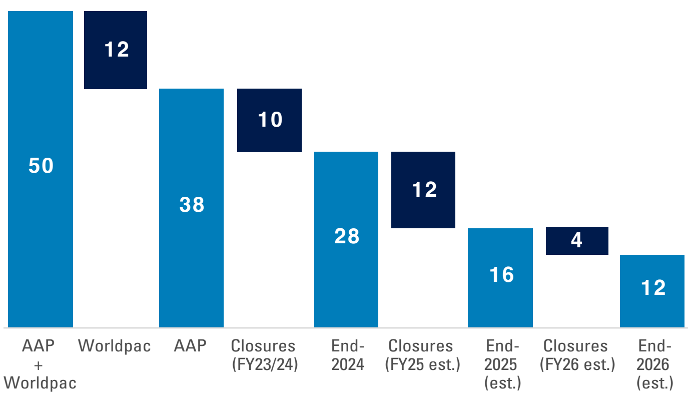
In merchandising, AAP is fixing a basic problem: stores did not have the parts customers needed. A new stocking model adjusts inventory based on local demand, prioritizing high-turn items by market. Parts availability has improved from the low-90% range in 2024 to the mid-90s in Q1 2025, with a target in the high-90s. Early test regions have already seen a ~50 basis point improvement in comparable store sales.

In supply chain, AAP is consolidating 38 legacy distribution centers (DCs) into 12 large regional DCs

2. Company filings, Pzena estimate

and adding 60 market hubs (large-format stores that carry expanded inventory and support deliveries to surrounding locations) to create a hub-and-spoke network modeled after those of AutoZone and O'Reilly (Exhibit 3). Fewer DCs means fewer ship points for vendors, streamlining inbound logistics, and creating leverage for better pricing. Over 50 basis points of annualized cost savings are expected to begin flowing through in the second half of 2025. Hub-served locations are already seeing a ~100 basis point improvement in comparable store sales.

Exhibit 3: Consolidating Distribution Centers



Source: Company filings, Pzena projections

In store footprint, AAP has closed over 700 underperforming and independent stores to concentrate its footprint in markets where it holds the #1 or #2 share. This denser network improves local scale, speeds up delivery, and strengthens in-store execution. Delivery times to Pro customers have improved from over 50 minutes in 2024 to around 40 minutes in Q1 2025, moving closer to AAP's 30–40-minute target.

THE OPPORTUNITY

Despite early signs of recovery, the market remains skeptical that AAP can close the margin gap with peers. While some of that skepticism reflects structural differences, such as AAP's higher mix of leased stores and independents, which carry lower margins, the bulk stems from lingering execution risk.

Skepticism is warranted, given AAP's history, but early results suggest real progress. With pricing reset, a new merchandising strategy, a restructured supply chain, and a denser store footprint, the company is positioned to recover lost productivity and rebuild margin. Before its missteps, AAP consistently delivered high-single-digit operating margins, a level we view as attainable again. Even at our more conservative 6% margin in our estimate of normailzed earnings, AAP would generate $9.25 in EPS, implying substantial earnings power relative to today's $46.49 share price. Years of strategic missteps created deep problems but also set the stage for meaningful value creation. With signs of progress emerging, we see a credible path to normalized earnings and a turnaround firmly underway.

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Advance Auto Parts was held in our Mid Cap Focused Value, Small Cap Focused Value, and other strategies during the second quarter 2025.

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