NORTHCOAST RESEARCH

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Automotive Aftermarket Retailers

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Independent Automotive Repair Garage Survey: June 2012

Overview

- According to the results of our survey, sales trends in the DIFM channel continued to be pressured during June, as our Current Sales Index finished at 44.8.
- As expected, the sales weakness appears to have been a function of soft traffic trends at the garages, which has been a recurring theme for several months now. This dynamic offset the benefit of a year-over-year gain in the average ticket.
- Additionally, respondents noted that the environment continued to be very promotional (at the wholesale level, as well as at the garages), which we continue to believe is symptomatic of the underlying weakness in demand across the industry.
- According to our contacts, deferred maintenance behavior continued to be a headwind to sales and traffic trends during June. That said, the severity of pressure appeared to have moderated for the second consecutive month.
- The Three Month Outlook Index rose 3.2% to close the month at 67.1. The improvement was driven by a decline in the percentage of respondents who anticipate soft sales trends over the next three months.

INTEGRITY

TRUST

VALUE

Conclusion

While we continue to appreciate the opportunity that the publically traded players in the automotive aftermarket have to gain market share in the DIFM channel, current valuations are not attractive enough to pique our interest, especially given the recent deterioration in sales trends and signs that the industry remains under some pressure. Furthermore, we have growing concerns over what a changing mix of automobiles in the nation's light vehicle fleet could mean for demand trends over the next 4 to 5 years. See our note entitled ***ORLY: Change in Light Vehicle Mix Likely to be a Headwind in Coming Years*** and our recent initiation on Monro for more details. As a result, we are maintaining our NEUTRAL ratings on Advance Auto Parts, AutoZone, Monro Muffler Brake and O'Reilly Automotive.

Symbol:	Price	Target Price	Rating	EPS Cur Qtr	EPS Cur Year	EPS Out Year	Mkt. Cap (M)
AAP	71.92	NA	N	$1.41e	$5.69e	$6.22e	5,287.1
AZO	$377.63	NA	N	$8.54e	$23.58e	$27.55e	$14,136.2
MNRO	$35.23	NA	N	$0.37e	$1.70e	$2.10e	$1,091.0
ORLY	$90.30	NA	N	$1.13e	$4.52e	$4.98e	$11,386.0

Rating Legend: B=Buy, N=Neutral, S=Sell

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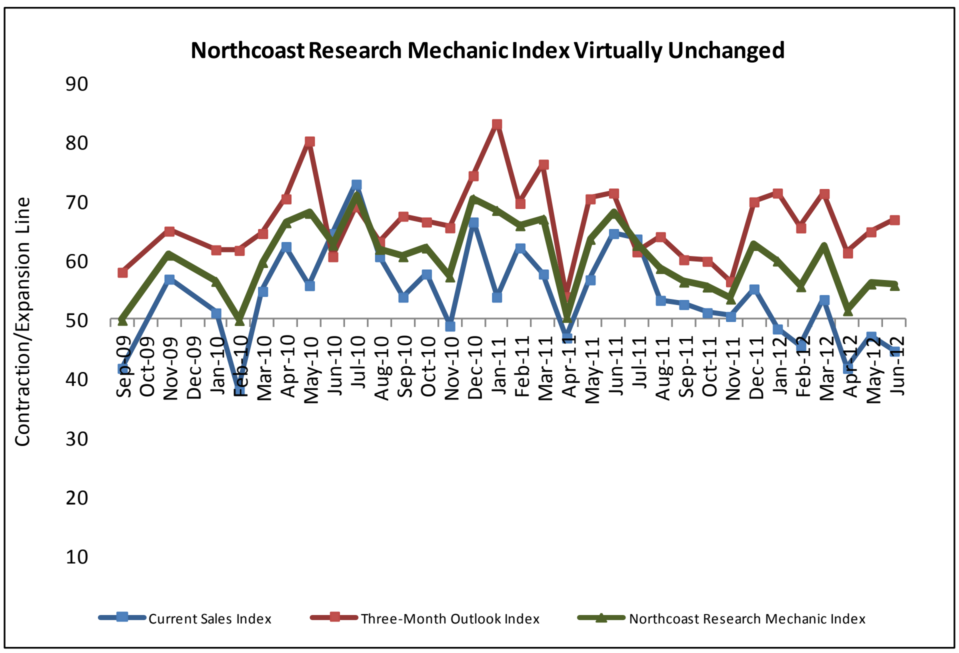
Independent Automotive Repair Garage Survey

Each month we publish the ***Northcoast Research Mechanic Index*** based on the results of our survey, which encompasses more than 100 independent repair shops operating in the top 10 states, based on the light vehicle fleet population and Advance Auto Parts, AutoZone, and O'Reilly Automotive's aggregate store count. The composite index is an equal-weighted average of two sub-indices–***Current Sales Index*** and ***Three Month Outlook Index***. Readings above and below 50 indicate market expansion and contraction, respectively.

The study is designed to capture the following factors in the DIFM channel:

- Recent business trends and the corresponding drivers
- Major inflection points in sales trends
- Expectations for demand over the next three months
- Major changes in consumer behavior
- Insight into market share trends and the relative rate at which installers are switching wholesale parts suppliers

Northcoast Research Mechanic Index–June Snapshot



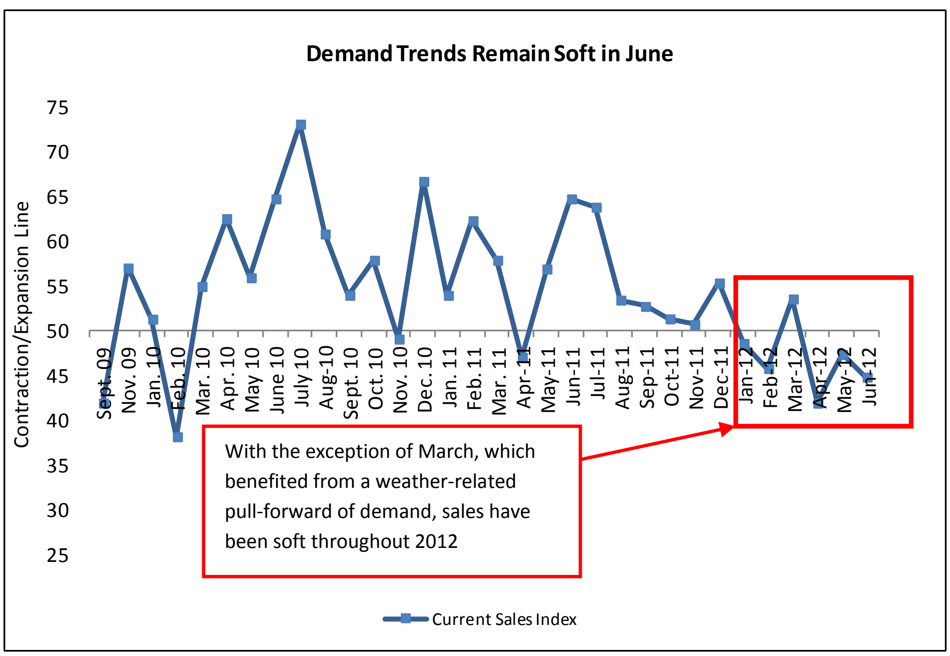
Source: Northcoast Research

According to the results of our survey, sales trends in the DIFM channel continued to be pressured during June, as our Current Sales Index finished at 44.8. As a reminder, a print below 50.0 implies that year-over-year demand contracted during the month. Moreover, it appears that the business environment deteriorated modestly on a sequential basis as we recorded a 47.3 in May. That said, the aggregate outlook for future demand improved slightly as the respondents are hopeful that pent-up demand will be released in the near future. All in, the slight deceleration in current sales trends, coupled with a modest uptick in the Three Month Outlook Index resulted in a 0.4% decline in the composite index in June to 55.9. We provide further details on the drivers of the two sub-indices below.

Slow Trends Continue Through June

The Current Sales Index fell 5.3% in June to close at 44.8. We were disappointed to see the sequential deceleration in demand trends, especially in light of favorable weather trends and near-term relief at the fuel pumps. As has been the case in recent months, respondents noted that the environment continued to be very promotional (at the wholesale level, as well as at the garages), which we continue to believe is symptomatic of the underlying weakness in demand across the industry. In other words, we believe many aftermarket participants are utilizing sharper pricing in an attempt to drive traffic in response to the recent slowdown in sales trends.

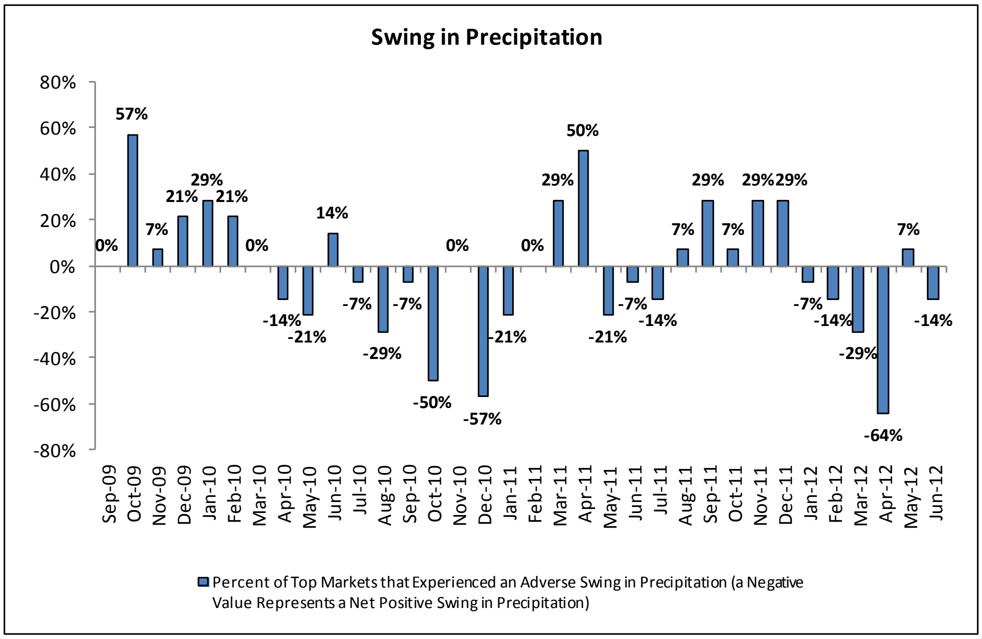
As expected, the sales weakness appears to have been a function of soft traffic trends at the garages, which has been a recurring theme for several months now. This dynamic offset the benefit of a year-over-year gain in the average ticket. In our view, the fact that consumers continued to defer routine maintenance during the month was the largest driver of the lackluster traffic trends seen across the industry. In fact, the net proportion of respondents reporting traffic declines rose in June, after moderating somewhat in May. Furthermore, the proportion of respondents experiencing higher average tickets continued to trend lower (i.e. the benefit from ticket is waning). In our view, this trend is extremely concerning given that ticket gains have been the primary driver of sales trends in recent quarters.



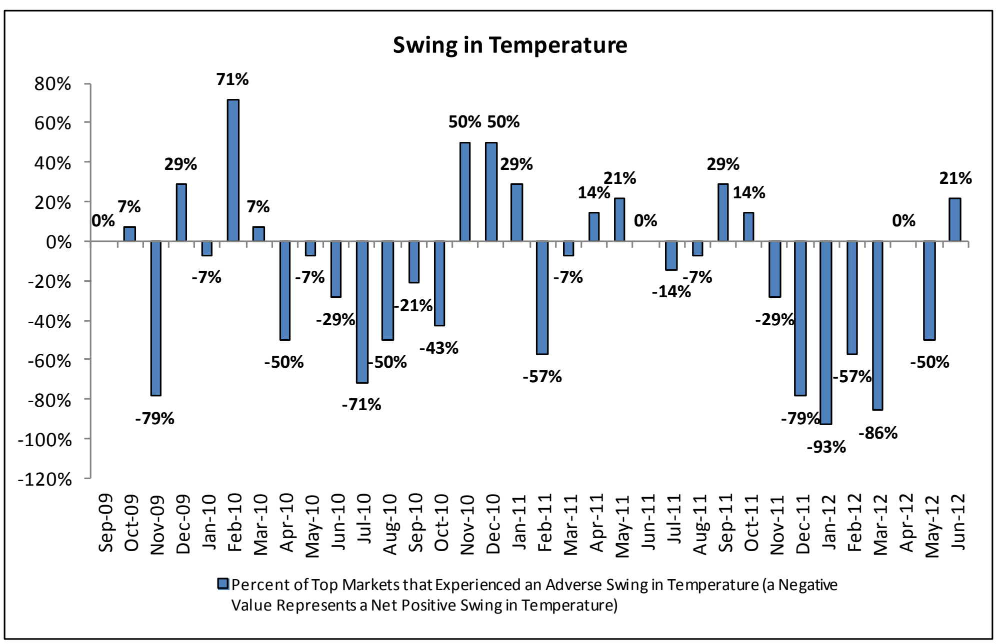
Source: Northcoast Research

Weather Screener

According to our proprietary weather screen, precipitation trends in the key markets of our survey were slightly more favorable relative to the prior year's period, while the favorable temperature trends that occurred in May reversed in June. Specifically, the first chart below illustrates that precipitation was lighter, as 14% of the markets witnessed less precipitation during the month, on a net basis. The second chart highlights the fact that temperature trends were a headwind as a net 21% of the territories experienced cooler weather in June relative to the prior year.

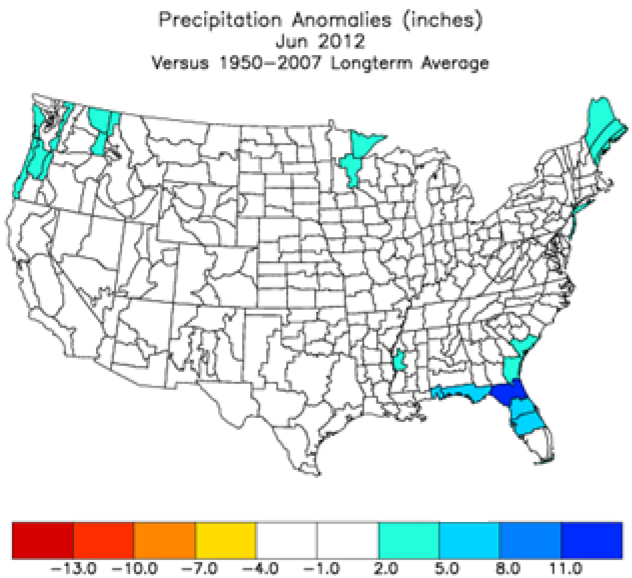


Source: Northcoast Research, U.S. Department of Commerce

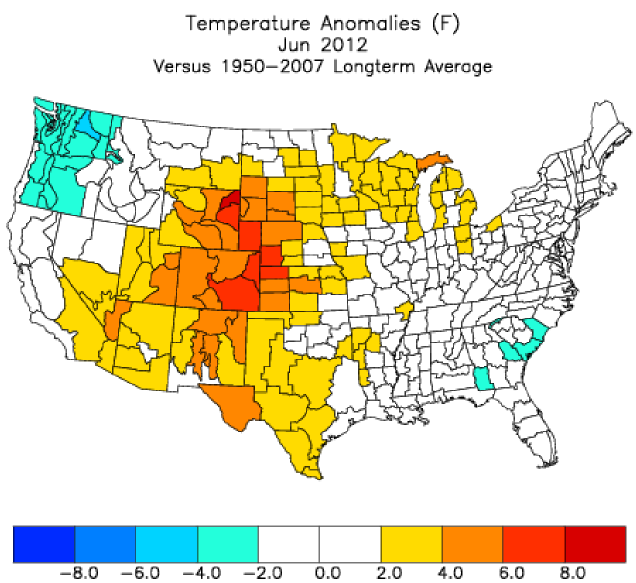


Source: Northcoast Research, U.S. Department of Commerce

The following two maps illustrate the most unusual precipitation and temperature trends during June 2012 relative to the long-term averages.



Source: U.S. Department of Commerce



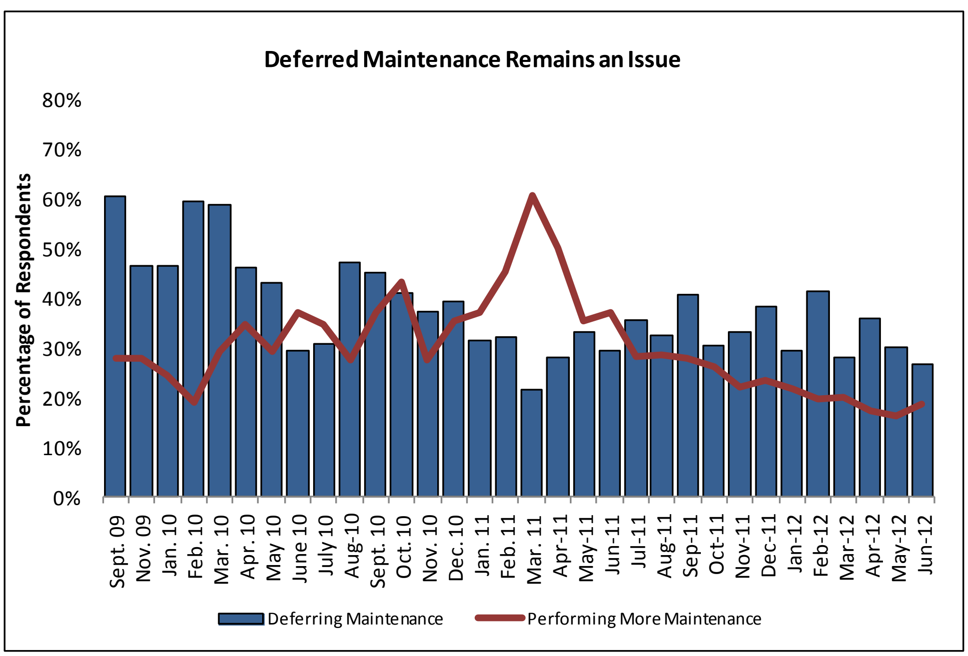
Source: U.S. Department of Commerce

Headwind from Deferred Maintenance Moderates Again

According to our contacts, deferred maintenance behavior continued to be a headwind to sales and traffic trends during June. That said, the severity of pressure appeared to have moderated for the second consecutive month. Specifically, 8.1% of the respondents, on a net basis, reported that their customer base was deferring routine maintenance versus a net 13.6% in May. While it is obviously beneficial to see deferred maintenance trends improve sequentially, we would point that the headwind during June was still above the average reading of 7.4% since the inception of our survey. In short, we continue to believe this metric needs to experience additional improvement before the overhang on demand subsides.

The chart below illustrates that the proportion of contacts noting that consumers are putting off preventative maintenance fell to 26.7%, versus 30.0% in May. Additionally, the percentage of respondents reporting that their customers were performing more preventative maintenance increased slightly to 18.6% from 16.4% in May. While consumers' inclination to delay maintenance appears to have subsided somewhat in June, we would be remiss not to point out that the percentage of respondents indicating that their customer base is doing more work was the third lowest that we have ever recorded. In other words, there is still a long way to go before maintenance behavior becomes a tailwind.

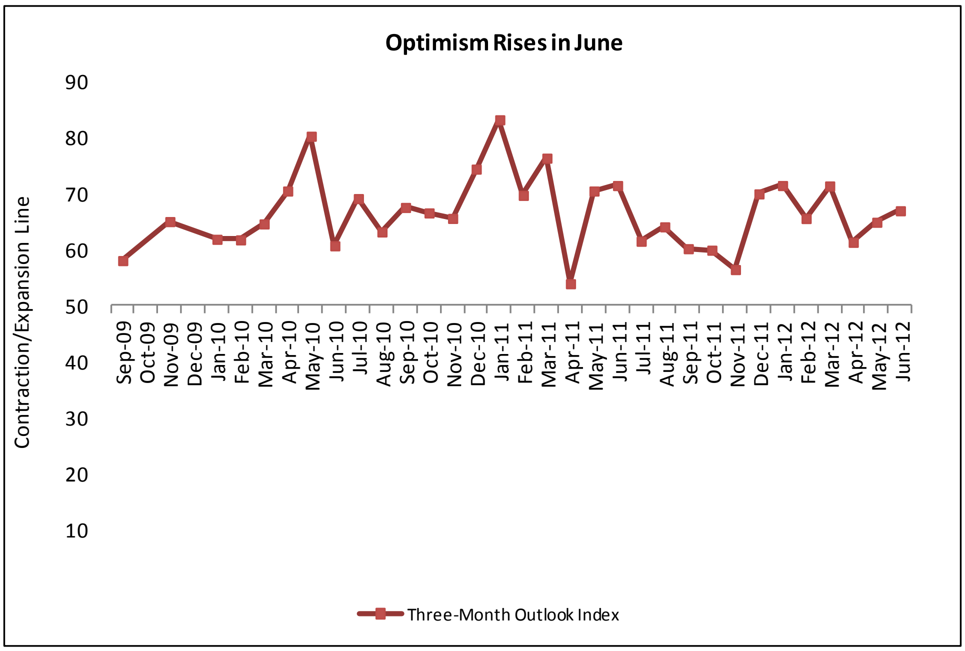
We continue to believe this behavior represents a headwind for the automotive aftermarket parts retailers as the maintenance category represents a significant portion of their sales mix. Specifically, we estimate that the average store generates 35% to 45% of its revenue from maintenance-related merchandise. Additionally, maintenance services, including brake work, comprise approximately 46% of the sales mix at Monro.



Source: Northcoast Research

Optimism Rises Slightly in June

The Three Month Outlook Index rose 3.2% to close the month at 67.1. The improvement was driven by a decline in the percentage of respondents who anticipate soft sales trends over the next three months (July, August and September). The reasons for the more optimistic outlook include: (1) some respondents noted experiencing pockets of strength towards the end of June and signs of stabilization in early July (however, demand is far from being on stable footing); (2) the unseasonably warm weather has shown no signs of dissipating (intense heat in the summer can be a huge driver of demand as it can accelerate the failure of select parts); (3) garage owners feel that the impact of lower gasoline prices will help spur demand; and (4) many respondents continue to feel that the soft demand trends of recent months should result in a release of pent-up demand in the near future.



Source: Northcoast Research

While it was encouraging to see another uptick in the Three Month Outlook Index, we would have liked to see a bigger surge in the mechanics' optimism given the favorable decline in gasoline prices in recent weeks combined with this summer's scorching heat. Specifically, the average price of retail gasoline declined $0.20 per gallon from May to $3.60 in June; this represented a year-over-year decline of 3.7%. We estimate that on an annualized basis, the average household benefitted from lower fuel prices by $158.

A Quick Look at Same-Store Estimates

Our research indicated that the soft sales trends that characterized the DIFM channel in April and May carried over into June. In short, we continue to believe that underlying demand trends remained weak across the DIFM channel, as our Current Sales Index has finished in negative territory in 5 of the past 6 months. At this point, we are maintaining our current 2Q CY12 and 3Q CY12 estimates for Advance Auto Parts, AutoZone and Monro until we gain more insight into trends in July. We would note that we already lowered our 2Q FY12 comp estimate for O'Reilly after the retailer lowered its revenue guidance on June 26th. The table below summarizes our comparable-store sales estimates:

Comparable-Store Sales Trends

Retailer						
	Oct-11	Dec-11	Apr-12	Jul-12E	Oct-12E	Dec-12E
Advance Auto Parts (AAP)	2.2%	2.9%	2.1%			
Northcoast Research Estimates				(1.2%)	2.0%	2.4%
Consensus				(1.6%)	1.6%	2.0%
	Aug-11	Nov-11	Feb-12	May-12	Aug-12E	Nov-13E
AutoZone (AZO)	4.5%	4.6%	5.9%	3.9%		
Northcoast Research Estimates					4.6%	4.3%
Consensus					3.6%	3.7%
	Sept-11	Dec-11	Mar-12	Jun-12E	Sept-12E	Dec-12E
Monro Muffler Brake (MNRO)						
Northcoast Research Estimates	(0.8%)	0.0%	0.7%	(5.7%)	0.5%	3.0%
Consensus				(6.3%)	1.7%	4.4%
	Sept-11	Dec-11	Mar-12	Jun-12E	Sept-12E	Dec-12E
O'Reilly (ORLY)	4.8%	3.3%	6.1%			
Northcoast Research Estimates				2.3%	2.3%	3.2%
Consensus				2.6%	3.3%	4.0%

Source: Company Reports, Northcoast Research estimates

Anecdotal Comments

Below are five anecdotal comments that best reflect what we heard from the survey respondents during the month.

- "My car count was still not where I would like it to be, however, I had a few high-ticket repairs that carried my sales for the month of June." (Pennsylvania)
- "June started off very slow, but stabilized through the month due to the extreme heat we experienced. We had above-average demand for climate control work, which supported our sales for the month. " (Alabama)
- "The suppliers in my region have cut back on their promotions a little bit over the last two months, as they realized minor discounts weren't enough to drive traffic." (New York)
- "I have noticed that my customers seemed to be more willing to take on additional repairs to keep their vehicles on the road last month. If you ask me it's because no one wants a car payment right now—not with all of the uncertainty surrounding us. That said, the deferral of maintenance is still hurting my business." (Georgia)

- "The soft business trends have been exacerbated by the fact that even my fleet accounts have been stretching the intervals between maintenance." (Alabama)

Conclusion and Investment Thesis

While we continue to appreciate the opportunity that the publically traded players in the automotive aftermarket have to gain market share in the DIFM channel, current valuations are not attractive enough to pique our interest, especially given the recent deterioration in sales trends and signs that the industry remains under some pressure. Furthermore, we have growing concerns over what a changing mix of automobiles in the nation's light vehicle fleet could mean for demand trends over the next 4 to 5 years. See our note entitled ***ORLY: Change in Light Vehicle Mix Likely to be a Headwind in Coming Years*** and our recent initiation on Monro for more details. As a result, we are maintaining our NEUTRAL ratings on Advance Auto Parts, AutoZone, Monro Muffler Brake and O'Reilly Automotive.

DISCLOSURES

Research is produced by Northcoast Research Partners, LLC Member FINRA(www.finra.org) and SIPC (www.sipc.org). Research is for institutional investor use only. Although we believe this information has been obtained from reliable sources, we don't guarantee its accuracy, and it may be incomplete or condensed. Past performance is not indicative of future results. A change in any assumptions may have a material effect on the projected results.

Securities are offered through Ancora Securities, Inc. Member FINRA (www.finra.org) and SIPC (www.sipc.org).

Ratings

BUY – The stock is expected to outperform the S&P 500 index over a twelve-month period.

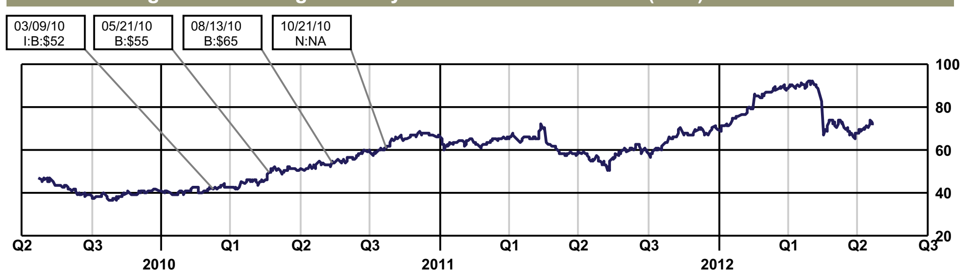
NEUTRAL – The stock is expected to perform in-line with the S&P 500 index over a twelve-month period.

SELL – The stock is expected underperform the S&P 500 index over a twelve-month period.

Valuation and Risks

Our price target as well as our recommendation is based on a 12-month time horizon; however, we cannot guarantee an investor will achieve these results. We use a variety of methods to determine the price target of individual securities including fundamental analysis. In addition, we employ numerous valuation methodologies which include, but are not limited to, price to earnings multiples, enterprise value to earnings before interest taxes, and depreciation (EBITDA), book value, free cash flow yield, discounted cash flow, and relative valuation. All securities are subject to various risk factors. Please reference the above text and our most recent report for specific company valuation and price target.

Rating and Price Target History for: Advance Auto Parts (AAP) as of 07-23-2012

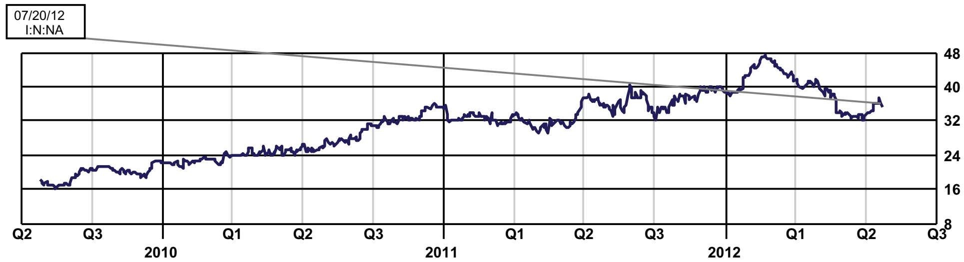


Created by BlueMatrix

Rating and Price Target History for: AutoZone Inc. (AZO) as of 07-23-2012

Created by BlueMatrix

Rating and Price Target History for: Monro Muffler Brake Inc. (MNRO) as of 07-23-2012



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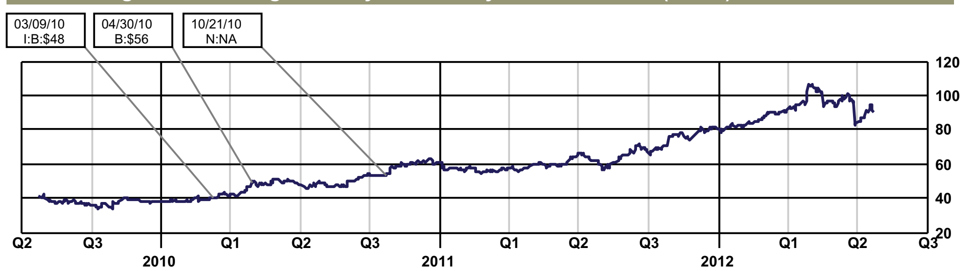
Rating and Price Target History for: O'Reilly Automotive Inc. (ORLY) as of 07-23-2012



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Rating Summary

Distribution of Ratings Table

Rating	Count	Percent
BUY(B)	72	48.65%
NEUTRAL(N)	75	50.68%
SELL(S)	1	0.68%
Total	148	

Analyst Certification

I, Nick Mitchell and Seth Woolf, certify that the views and opinions expressed in the research report accurately reflect my personal views about the securities and issuers mentioned in this report. Further, I certify that no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views contained in this report.