ASHEVILLE CAPITAL MANAGEMENT

June 27th, 2024

Auto Partner Investment Thesis

Summary Data			
Ticker	APR	Founder/CEO	Yes
Exchange	Warsaw	Insider Ownership	44%
Headquarters	Beirun, Poland	5Y Rev. CAGR	26%
Industry	Specialty Retail	5YR EBITDA CAGR	31%
Currency	Polish zloty	5YR EPS CAGR	31%
Share Price	24.1	P / LTM Rev	0.9x
Market Cap	3,148	P / LTM E	14.1x
Net Debt	321	EV / LTM EBITDA	10.0x
Enterprise Value	3,469		
EV / EBITDA	10,018.31		
Net Debt / EBITDA	0.93		

PLN, millions	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
Revenue	519	705	915	1,155	1,479	1,670	2,262	2,835	3,653
y/y		36%	30%	26%	28%	13%	35%	25%	29%
Gross profit	130	181	242	307	387	477	658	847	990
Gross margin	25.1%	25.7%	26.4%	26.6%	26.2%	28.5%	29.1%	29.9%	27.1%
Operating profit	26	44	55	81	84	150	239	281	303
Operating margin	5.1%	6.3%	6.0%	7.0%	5.7%	9.0%	10.6%	9.9%	8.3%
EBITDA		49	62	90	104	174	265	314	346
EBITDA margin		6.9%	6.8%	7.8%	7.0%	10.4%	11.7%	11.1%	9.5%
Net profit	16	34	35	59	59	111	186	207	224
Net margin	3.2%	4.9%	3.8%	5.1%	4.0%	6.6%	8.2%	7.3%	6.1%
Shares outstanding		117.00	129.45	130.13	130.52	130.62	130.62	130.62	130.62
EPS		0.29	0.27	0.45	0.45	0.85	1.42	1.59	1.71
ROA		10%	7%	10%	8%	14%	18%	13%	12%
ROE		22%	14%	19%	16%	23%	33%	24%	21%
ROIC		13%	9%	13%	11%	19%	23%	17%	16%

ASHEVILLE CAPITAL MANAGEMENT

One-Page Summary

Auto Partner is a Polish distributor of aftermarket auto parts. It is one of the largest distributors of auto parts in Europe with more than 15 million individual spare part items inventoried within 160,000 m^2 of warehouse capacity. These parts are stored and delivered to garages and retailers across Europe on a just-in-time basis with delivery to domestic customers occurring 3-5x per day.

Auto Partner offers its customers the industry's widest assortment of auto parts, available for delivery within hours of purchase, at competitive prices, with best-in-class customer service. This value proposition is superior to that of Auto Partner's primary competition (local parts distributors) which are unable to provide the same level of availability, speed, or service.

There is reason to believe that Auto Partner has a very long runway ahead of itself for the continued consolidation of market share and capital efficient growth of revenue, ***as Auto Partner continues to replicate, in its own unique way, a business model that has proven to be very successful in the United States over the last 50 years.*** Auto Partner has an estimated 10% market share in its home country of Poland but only around 0.5% market share in the rest of Europe, a region that it is growing quickly within.

Auto Partner is owned and operated by its founder, Aleksander Górecki, who continues to serve as President of the company, while retaining 44% of the shares outstanding. Aleksander takes a low salary (~$100,000 USD) with no variable remuneration. His two Vice Presidents, Andrzej Manowski and Piotr Janta, are long-time employees who have been with the company for 30 and 15 years, respectively. These VPs receive 92% of their annual compensation based upon fundamental performance and the growth of shareholder value. [1] All bonuses are paid out in cash as Auto Partner has not issued a single share in the last five years.

Lastly, Auto Partner trades between 10-12x FY24 earnings and 15-20x FY24 free cash flow. Auto Partner has grown EPS by >10x in the last eight years, at a 34% annual growth rate, and maintains a long reinvestment runway for the redeployment of capital into existing operations at similar, if not higher, returns on incremental capital.

I believe it is reasonable to project EPS growth between 18-25% over the next five years, and for mid-teens growth thereafter. If this were to occur, then our shareholdings would appreciate at a similar rate of return even in the absence of multiple expansion. A fundamental downside scenario of a slowdown in revenue or earnings is possible but unlikely, given that Auto Partner operates in a highly durable industry with a model that is allowing them to continue to take market share.

[1] Variable remuneration is determined via a fascinating formula that looks at enterprise value increments based upon a fixed EBITDA multiple being used to determine the growth in shareholder value. See the 2023 Remuneration Report, page 11, to explore further (link).

Overview

Auto Partner is closely comparable to that of AutoZone, O'Reilly Automotive and Advance Auto Parts in the United States. This is an enviable peer group when you consider that two of these (AutoZone and O'Reilly) are two of the most successful stocks of the last three decades, having compounded their share values at a 21% and 23% annual rate of return for more than thirty years! [2] AutoZone, O'Reilly, and Advance operate with simple business models. They sell auto parts across two main channels: Retail and Commercial. Auto Partner has no retail channel. Only Commercial. Therefore we will focus the majority of our attention here.

Commercial is an auto parts fulfillment service that sells to mechanics, auto parts retailers and wholesalers. Mechanics have a daily need for spare parts and do not have the time to visit a store, which may or may not have all of the inventory available that they need. That is why it makes sense for auto parts distributors to maintain the warehouse capacity and logistics capabilities that allow them to store and deliver auto parts as quickly as possible in order for the mechanics themselves to maximize garage throughput.

Mechanics' rank of priorities when ordering from a vendor goes as follows: 1) The **availability** of the item 2) **Speed** of delivery 3) The **price**. Price is not the top issue because garage throughput is the ultimate goal of the repair shop and mechanics bill customers based on a cost-plus model, thus allowing them to pass through parts prices to consumers who are not in a position to negotiate, nor are they able to price compare.

Importantly, after making hundreds of purchases per year, each mechanic has their own **preferred commercial partner**. This preferred partner almost always receives the vast majority of the order volume from that particular garage (between 60-80%), with second- and third-ranked distributors receiving significantly lower minorities alongside OEMs.

This preference is non-contractual (meaning mechanics can order from any distributor, any time) but *mechanics frequently elect to order from the distributor that offers them the most consistent level of availability, speed, and price.* [3] Therefore, the preferred auto parts distributor maintains a somewhat defensible position within that customers' mind as long as they continue to remain reliable. This means that there are no real switch costs in this industry yet mechanics tend to repeat purchase from their preferred distributor with a very high frequency rate.

It is similar, in a way, to my own tendency to visit Amazon.com whenever I need to purchase a general household item. Walmart has its own website and offers a similar selection of general goods at similar delivery speeds and prices, yet I continue to shop on Amazon for the majority of my household

---

[2] A purchase of one share in AutoZone at $7.53 in 1991 and one share in O'Reilly at $2.65 in 1993 would have resulted in $2,800 and $1,000 per share today, an increase of more than 396x and 416x, respectively. In other words, 400-baggers.

[3] One mechanic here in the Asheville area told me that she orders exclusively through O'Reilly unless a job requires body work, at which point she orders through the OEM. **Another told me that "O'Reilly gets well over half of his orders, with AutoZone getting maybe 15%"**. He only orders from AutoZone when O'Reilly doesn't have a product ready to ship within 24 hours, which sometimes happens but "most of the time O'Reilly has it."

purchases because after years of making hundreds of purchases on Amazon, I trust them to deliver. And going forward, unless the service deteriorates significantly, there is little hope for Walmart to capture a meaningful proportion of my family's household e-commerce spend.

That same dynamic is true for mechanics when purchasing auto parts. Each mechanic has their own preferred vendor and they rarely deviate from that vendors' online catalog unless they come to find that they can consistently receive a better service from another vendor via availability, speed, or price.

In Poland, and increasingly across all of Europe, Auto Partner has proven itself to be that superior vendor. Auto Partner has 250,000 SKUs, which is 100k more than the largest of its local parts distribution competition. Furthermore, it is able to deliver these parts 3-5x per day… within hours of purchase, thereby enabling garages to maximize throughput. Most local parts distributors are unable to match those delivery speeds, delivering within 24 hours on most purchases. This superior experience of increased availability and increased delivery speeds, coupled with competitive prices has led to the gradual migration of mechanics away from local parts distributors towards Auto Partner.

Once these mechanics begin shopping with Auto Partner as their preferred vendor of choice, they then funnel the majority of their order volume through Auto Partner much the same way that mechanics in the US will funnel the majority of their order volume through one of AutoZone, O'Reilly or Advance Auto Parts. Mechanics that shop with Auto Partner are increasingly difficult to win over because Auto Partner has made it a core focus of their business model to offer the best service that the industry has to offer. This consistent shopping behavior becomes engrained into the customers' shopping patterns and makes it so that insurgent competitors have a difficult time competing away order volumes in much the same way that Walmart currently has a hard time competing away my household purchases from Amazon.

In Poland, Auto Partner estimates that it has approximately 10% market share, based on PLN 1.8 billion of domestic revenues in 2023, thus implying an PLN 18 billion industry size. The vast majority of this market share is owned by these local parts distributors, which maintain the aforementioned inferior value proposition. Another ~20% is owned by Inter Cars, another scaled parts distributor that has performed well in consolidating market share alongside Auto Partner. Going forward, it seems likely that Auto Partner continues to gain market share at the expense of these local distributors.

But the true long-term growth driver is in the rest of Europe. Auto Partner generated PLN 1.8 billion of revenue internationally in 2023. Despite this international export business accounting for 50% of revenue, Auto Partner estimates that they do not have more than 1% market share yet in any of the 30 countries that they service. Auto Partner's value proposition of availability, speed of delivery, and price is similar to that of its domestic segment, and I do not see much of a reason why Auto Partner should not be able to gain well in excess of 1% market share, approaching towards the 10% market share that it currently has in Poland.

There are more competitors, to be sure, in Europe. Notably, LKQ (~PLN 23 billion of revenue), and GPC (PLN 14 billion) alongside Inter Cars as well (with ~PLN 11 billion of revenue earned internationally), but the European auto parts industry is approximately 20x larger than that of Poland (at PLN 360 billion or $89 billion USD), and there is still an incremental PLN 300 billion of market share that is owned by local parts distributors. This amounts to ~80x Auto Partner's existing scale. It is near-inevitable that this market share will gradually shift into the hands of the scaled auto parts distributors that can offer mechanics the better value proposition, much in the same way that market share has gradually shifted into the hands of AutoZone, O'Reilly and Advance Auto Parts over the last four decades that they have been in business. Today these three companies have approximately 40% of the American auto parts industry. [4]

Which brings an important topic to mind. That of barriers to entry. Not only is this business capital intensive, requiring close to $100 million USD in capital equipment and more than $250 million in working capital, but even more importantly, it requires the intelligent use of that working capital in a hub and spoke logistics model that allows for the most in-demand parts to be the most proximally located ones to the customers, thus ensuring minimal delivery times and maximal customer satisfaction. Perhaps most importantly, however, the primary barrier to entry is one of trust. It has taken Auto Partner more than 30 years to build up its customer base to what it is today, starting with Aleksander Górecki selling auto parts out of his home in 1994 and scaling up to today with thousands of garages, retailers, and wholesalers relying on Auto Partner to distribute parts to them, error-free, daily.

Other parts distributors (LKQ, GPC, and Inter Cars) have scaled these barriers to entry as well, but the barriers remain high and make it incredibly difficult for small insurgent competitors to attempt to enter and compete on a large scale.

Finally, while competition remains high, the likelihood of a price war (and declining gross margins) is unlikely, given that price is not the first, or even second, priority when it comes to making a purchase decision. That coupled with the aforementioned repeat purchase behavior being difficult to compete with, makes it likely that each of these competitors will have a steady-state proportion of market share at some point off into the distant future, and more-or-less gain or lose minimal market share from each other on an annual basis.

Capital Allocation

As previously stated, I believe Auto Partner is executing a very similar business model to that of AutoZone and O'Reilly, two of the most successful stocks of the last three decades. And I believe that Auto Partner has the opportunity to produce similar returns over the next two decades.

The operating business is capable of producing a similar 10% earnings growth rate over the next 20 years, like AutoZone has achieved over the last 20 years. But AutoZone is not distinguished for its earning growth, but for its share cannibalization.

Beginning in 1998, AutoZone did something quite unique. They used the excess cash flows available to them after reinvestment needs, and it used that cash to repurchase its shares. Over the last 25 years, it has repurchased 90% of its shares outstanding from 154 million shares in 1998 to only 17 million today.

[4] According to one long-time shareholder of AutoZone (link)

Auto Partner is similarly going to find themselves with an excess of cash flows after reinvestment and they have communicated a willingness to return capital to shareholders… most recently with an 8% payout in the form of a dividend.

I would rather see these cash flows utilized for the repurchase of shares outstanding given that dividends are taxable and share repurchases are not. This will have the dual effect of juicing earnings per share in addition to returning capital to shareholders, while dividends merely return capital to shareholders less taxes.

Although AutoZone *only* achieved a 10% growth in earnings over a twenty year period, by repurchasing 8% of its shares, this served to increase EPS by 18% per year, which is far superior that the otherwise 10% EPS growth that would have been achieved plus dividends less taxes.

So… Aleksander, Andrzej, Piotr, and Tomasz, if you are reading this… I think you have created a fantastic business and I think you have the potential to produce AutoZone and O'Reilly-like equity returns if you shirk dividends in favor of share buybacks at a regular cadence while shares remain reasonably valued.

Valuation

Auto Partner trades at 14x LTM earnings and ~12x FY24 Earnings. This is a relatively cheap multiple when you consider that earnings per share have increased by more than 10x in the last eight years and grown at a 31% CAGR over the last five years. Auto Partner is likely to continue to grow both domestically and internationally and has proven itself capable of doing this while maintaining its profit margins. There should be room for further improvement of profit margin, given that the international segment carries a higher operating margin and that there is a growing segment of private label items that now account for 20% of sales and carry with them a higher gross margin.

Auto Partner's cash flow statement is not nearly as smooth as its income statement. The lumpiness in recent years in cash flows has been due to a build up in inventory due to the supply chain crisis of 2021 and 2022. This inventory was purchased when the PLN was relatively weak, with the current EUR/PLN exchange rates being low. Further, there has been an investment in capital expenditures in recent years as the company is building out its last large warehouse until ~2029. This warehouse is on the border of Germany and should help to facilitate faster fulfillment of orders internationally.

This is precisely what we want to see Auto Partner doing to ensure the continued growth of revenue, earnings, and free cash flows while they can be gained capital efficiently. In future years, the hope is that the cash flow dynamics will be smoother than the last three years, but if investors' can ignore any lumpiness from transient things like foreign exchange rate fluctuations, supply chain disruptions, or pandemics (hopefully not), we should witness a steady continuation of what has already been happening… the continued growth in revenue, earnings and cash flows through the taking of market share via its advantaged business model in a deeply underpenetrated industry.

When asked to provide guidance, the management team has shied away from doing so, except to say that they believe 20% revenue growth per year is reasonable. On an inflation-adjusted basis, Auto Partner would have not achieved this in 2023 (having only grown 18%), and they have also reported 18% growth through Q1 of 2024, but I believe the management team will continue to execute on high growth, generally. My reason for conviction can be simply stated: The management team deserves a significant degree of trust. Not only are they well-aligned with shareholders, but they have also invested their entire careers into building this business and have proven themselves reliable through their financial performance to-date. I would love to see them consider returning capital to shareholders via the tax-advantaged channel of share buybacks but their ability to execute in terms of operations should be without question.

Regardless, if Auto Partner were to grow revenues at 15% per year for the next five years, we should expect a 15% rate of return. I think this is reasonable with limited true downside and significant upside through the growth of earnings, which are at a temporary low-point due to fx conversion weakness. On a constant currency basis, net earnings margins are 200-300 bps higher.

Most importantly, I view the durability of Auto Partner's business model and growth potential to be top-notch. Auto Partner can continue to grow at a mid-teens to low-twenties growth rate for the next decade and still have only 3-4% market share within its industry. Just like with AutoZone and O'Reilly, the durability of their business model and their growth have been surprisingly sturdy, especially when you consider all of the changes to the world economy that have transpired over the last thirty years. I consider it highly likely that the need for auto parts will continue into the future and that mechanics and retailers will continue to gravitate towards the distributor that offers them the best combination of availability, speed of delivery, and price. There is therefore significant confidence in the business model and we are buying it at a more than fair price.

Risks

Electric vehicles are the big risk to this industry over the long term, but the average age of vehicles is ~14 years in Poland and ~13 years in the rest of Europe. Those vehicles will not suddenly disappear from roads in the coming years even if electric vehicle sales were to ramp upwards. Perhaps that will happen, but this is a transition that will likely unfold slowly over time and nobody knows the extent to which all vehicles will become electric. Further, electric vehicles still require repairs and maintenance and auto parts distributors are well positioned to sell auto parts to these mechanics with the distribution capabilities that OEMs lack. This is a risk but not an existential one.

The other risk is that I am wrong about the priorities of mechanics in Poland and Europe and that price actually has a higher priority for mechanics. This could lead to a price war and declining returns on capital. If we ever see price cuts and gross margin reductions, this will be a clear sign that the competitive environment is higher than I suspect and the thesis will be damaged.

Lastly, Auto Partner has some debt on the balance sheet, about 1x debt/EBITDA. This is not a large amount, especially considering the highly durable nature of this industry. But if another pandemic were to occur and vehicles stopped being driven for an extended period of time, this could become a problem.

Conclusion

To summarize: Auto Partner operates with a compelling value proposition that is allowing it to take market share within an industry that it has only cracked the surface of. Barriers to entry are high and the current competitive environment is favorable considering that the majority of the market share is slowly being whittled away by Auto Partner and its scaled distribution peers. Over time, market share will stagnate, but that is likely many years away given the extreme fragmentation of the industry. Auto Partner appears to be the best-positioned of these, with the highest revenue growth opportunity in the most capital efficient manner. This has already seen EPS 10x since its IPO, eight years ago, with the potential for further growth at similarly high rates. Auto Partner is ran by a management team that is both well aligned and highly competent.