

# ***DRIVE*** ***FOR EXCELLENCE***

## **Dear Customers, AutoZoners and Stockholders,**

I want to thank all AutoZoners across the company for their hard work, dedication and commitment to Customer Satisfaction this year and every year. And, while our sales performance improved in fiscal 2018, we certainly felt there were ample opportunities to perform even better. I remain encouraged by the health of the consumer, the health of our industry and the health of our business. And, I remain bullish on our business for fiscal 2019 and beyond. Our teams continue to make good progress on initiatives that are aimed at improving our ability to say YES to customers' requests for parts and products more frequently, drive traffic to our stores and websites and accelerate our Commercial business.

Our largest business, U.S. Retail, is improving. Growth rebounded nicely from fiscal 2017, and I am optimistic about our prospects in fiscal 2019. And, our U.S. Commercial business growth is accelerating. Commercial grew 7.3% in fiscal 2018 versus 5.7% the year before. The more promising statistic is fourth quarter fiscal 2018 Commercial sales grew 8.8%. I am very enthusiastic about Commercial growth going forward.

We now have 6,202 stores in three countries, and 84% of our U.S. stores have a Commercial program. And, every store in Mexico and Brazil services Commercial customers. We continue to enhance the local market inventory availability by building, relocating or expanding existing facilities, and ended the year with 170 regular hub stores and 24 mega hubs. Additionally, a new distribution center was opened in Ocala, Florida and the Danville, Illinois distribution center went through a major expansion and nearly doubled in size.

Also, our new, highly innovative, Next Day Delivery Program was announced. This unique offering allows over 80% of U.S. consumers to purchase as many as 100,000 parts or products via autozone.com as late at 10 p.m. and have them delivered to their doorstep the very next day! This is the latest innovation from our team to build a tremendous Omni-Channel offering for our customers to meet them when, where, and how they want to be met.

## Summary of 2018 Results

During FY 2018, there were many successes. We reached a record \$11.2 billion in sales, with domestic same store sales up 1.8% over fiscal 2017, and the company delivered a record \$48.77 in earnings per share, up 10.7% over fiscal 2017.

We opened 199 net new stores with 153 in the United States, 40 in Mexico and six in Brazil. Additionally, 149 net new Commercial programs were opened in the U.S., ending the year with Commercial programs in 84% of our domestic store base and eight additional hub stores opened finishing the fiscal year with 194 hubs, including 24 mega hubs. And, our online offerings and functionality at [autozone.com](http://autozone.com) and [autozonepro.com](http://autozonepro.com) were significantly expanded and improved.

Return on Invested Capital (ROIC) was 32.1% for fiscal 2018, \$2.1 billion was generated in Operating Cash Flow, and a record \$1.6 billion in company shares were repurchased.

This success is directly attributable to approximately 90,000 great AutoZoners and their passion, dedication and commitment to living our Pledge and Values and leveraging our unique and powerful culture. I am so looking forward to 2019!

As mentioned at the outset, we also didn't fire on all cylinders in fiscal 2018. After accelerating our market share growth in the first half of the year, we encountered some challenges in the second half, and our market share gains subsided. In February 2018, we decided to cease our on-line only promotions as we were concerned about potential current or future "channel conflict" by having different pricing on ship to home merchandise versus in-store purchases. Additionally, we had numerous merchandise category changeovers, and several of them weren't executed to our standards, resulting in lower than acceptable

in-stock positions. And, with the opening of two new distribution centers over 15 months while expanding another and finalizing our frequency of delivery testing, our supply chain went through a tremendous amount of change. As of the beginning of fiscal 2019, most of these issues have been resolved and we believe we are well positioned again to accelerate our market share growth.

Finally, from a financial reporting perspective, we had several "adjustments" or unusual items in our results for fiscal 2018. Typically, we pride ourselves on very straight forward, easy to understand financial results, but that was not the case this year. During fiscal 2018, we had two business units, AutoAnything and Interamerican Motor Corporation (IMC) that were both impaired and sold resulting in pre-tax impairment charges of \$193.2 million. We purchased both of the businesses over the last several years in an attempt to expand our understanding of other sectors of the automotive aftermarket and develop new growth opportunities. In hindsight, those acquisitions weren't the right strategic decisions, because in both instances, they were too small to provide meaningful growth for our company, and they took time, resources and attention away from focusing on our core. Secondly, as a result of the Tax Cuts and Jobs Act of 2017 (Tax Reform), we revalued our deferred tax positions and experienced a lower effective tax rate. Finally, during the fiscal year, we terminated and liquidated our previously frozen pension plans, resulting in a pre-tax charge of \$130.3 million. We are very pleased to have eliminated any future charges, volatility or risks related to our pension plans. As we look to fiscal 2019, we expect to return to our more typical straightforward financial results, although the year will include a "53rd" week during the fourth quarter.

## The Automotive Aftermarket Industry

AutoZone operates in a remarkable industry. The long term resiliency of the automotive aftermarket is simply amazing. According to research by the Auto Care Association there will be plenty of vehicles to be serviced by our industry for years to come.

New car sales are back to near record highs and, because vehicles are made better and last longer, the U.S. fleet will grow by more than 10% over the next three years ending with more than 290 million vehicles on the road by 2021. And while the growth in average age of the fleet will slow some, it's forecasted to be 11 years and 8 months next year. More cars on the road, an aging fleet, miles driven on the increase and gas prices currently below \$3 a gallon all add up to a formula for a healthy automotive aftermarket industry.

This industry has one of the more robust and stable sales growth charts of any industry I have ever seen, growing about 4% annually in DIY and about 4.5% in Commercial for decades. But admittedly, the industry faces more "headline" risks today than I can ever recall. Namely – On-line Only Retailers, Electric Vehicles (EVs), Autonomous Vehicles and Ride Sharing.

We are well aware of each of these risks, and we continue to monitor and study them quite closely. Regarding the emergence of On-line Only Retailers over the last decade and a half, clearly they have grown their importance and gained share. But market participants are always emerging

and contracting. Our industry has seen tremendous competitive changes over the last several decades including the significant reduction of "Mom and Pop" players and the addition of Mass Merchants. Over time, we have been able to adapt our strategies and offerings and have very effectively competed and continued to gain share. Good competition only makes the strong better. Regarding vehicle technological innovation, we leverage many of our partnerships across the automotive industry to understand vehicle technology trends, forecasts and their potential implications to our business. As we have been studying these since their emergence or for more than a decade in the case of EVs, we have seen widely varying forecasts on their adoption levels. Our opinion is some, if not all of these will be factors at some level over the next many years or decades, but our opinion, at this time, is due to the size and average age of the vehicle park and our expectation on adoption rates, we don't see any of these vehicle technological innovations having a meaningful impact on the automotive aftermarket or our business for the foreseeable future.

In this age of technological innovation, things can change quickly and we will continue to monitor developments closely and adapt our operations and strategies appropriately. But, with some of the "doomsday" projections regarding the future of our industry, I'm reminded of AutoZone's first annual report in 1991. In that very first annual report, our team was trying to rebuke the myth that "DIY" was dying. Here is an insert from that annual report that we believe is instructive in today's environment...



1991 Annual Report

### The Future of the DIY Market

Is the DIY market likely to disappear as technological advances make cars too complex for even the most mechanically proficient DIYers?

As *Scientific American* put it: "The remarkable development in the automobile industry, and the swift advances in automobile construction within recent years, have produced unexpected and unforeseen conditions, and one of the most striking phases in the situation is the lack of men trained to manage and care for the high-powered cars."

*U.S. News & World Report*, under the subtitle "No more do-it-yourself", proclaimed: "Current models...defy even the most dedicated do-it-yourself mechanics. Professional service has become a necessity."

Sounds like AutoZone ought to be worried...but for one thing: *Scientific American's* article was published in 1908, and since *U.S. News & World Report* declared the DIY market dead in 1968, the Commerce Department estimates it has grown by more than seven-fold. Our point is that people have been predicting the demise of the DIY market for so long now that we are reminded of the statement that Mark Twain once made: "Reports of my death are greatly exaggerated."

## Our Future

So, it's hard to believe, but we are in FY 2019. So, what's new? There are some new and exciting things on the horizon. Our FY 2019 operating theme "Drive For Excellence" is all about leadership, flawless execution and WOW! Customer Service! As previously mentioned, we embarked on a tremendous amount of change in 2018 and didn't execute at our typical high levels. Rest assured, we are all highly committed to returning to our motto of evolution over revolution with flawless execution. And, as we provide more tools to our AutoZoners and less administrative burdens, the execution at the customer level will also improve. We continue to be intensely focused on having the parts and products customers demand closer to where they want them and easily accessible through a wide variety of methods. We...AutoZoners must take care of customers like never before – if we don't, somebody else will. We must provide the trustworthy advice that is a cornerstone of the AutoZone customer experience. There are choices customers can make on where to shop, and that cannot be taken for granted. Every interaction is an opportunity for a customer to be surprised and delighted. Conversely, an opportunity to disappoint a customer is an unacceptable outcome. The challenge for fiscal 2019 is to keep improving customer service.

Fiscal 2019 is going to be a year of intense focus on the basics while continuing to enhance our tools and focus on growing our Commercial business where our share is roughly three percent. Tax Reform has significantly improved our already robust cash flow characteristics. And, as we looked at our business preparing for 2019, we made the decision to invest a portion of those Tax Reform proceeds in the future of our business. We have decided to invest in additional wage and benefits for our most tenured hourly AutoZoners who are customer facing. And, we are going to invest in technological improvements aimed at accelerating our growth across the business but in particular, Commercial. We believe these investments will pay dividends for our business and our shareholders for years to come.

We have a proven, time-tested, solid business model that is built on delivering consistent financial results, and we are committed to a similar future. We are optimistic about our sales potential for fiscal 2019. We intend to continue to grow global new store square footage at an annual rate of about three percent, continue to grow our Commercial sales at an accelerated rate, leverage our historically strong and now enhanced, due to Tax Reform, cash flows to repurchase shares to grow our earnings per share. But our primary goal is to continue to invest in our AutoZoners and initiatives that provide us with an appropriate return. As our ROIC, at 32.1%, is one of the best in all of hardlines retailing, our commitment remains to be good stewards of capital because we understand the capital we deploy is your capital.

I want to thank all AutoZoners for their dedication and hard work in fiscal 2018. Over the years, the company's success is entirely due to their consistent commitment to going the extra mile to help their customers. They embrace the AutoZone culture and continue to provide our customers with an exceptional experience. I would also like to thank the vendors for their ongoing commitment to our collective success. Additionally, I would like to thank you, our stockholders, for the confidence you have placed in our team by your decision to invest in AutoZone. We remain committed to managing your capital wisely, achieving an appropriate return on incremental projects and returning excess cash through an orderly share repurchase program.

I would also like to take a moment to thank a few very special people who have meant a tremendous amount to our success for decades.

First Rod Halsell, Senior Vice President, Supply Chain, will be retiring after a stellar 33 year career. In his career, he started as a 16 year old part-timer and emerged as a tremendously passionate leader who led many teams to incredible success. We wish Rod and his wife Barbara much happiness in their next chapter!

Second, Bill Graves, Executive Vice President, Mexico, Brazil and Store Development has decided to retire after 25 years of service. Bill served two amazing organizations in his career – the United States Army and AutoZone, and both were very fortunate to have his steady hand at the helm. Bill's ability to consistently deliver impressive results has been amazing. We all wish Bill and his wife Jamie all the best in their new adventures!

Finally, and with tremendous gratitude, respect, admiration and love, we say thank you to the person who had the vision to create this amazing organization dedicated to providing the motoring public with a new, trusted partner in maintaining and enhancing their vehicles. On July 4th, 1979, our Founder, Pitt Hyde and his team, opened the very first AutoZone in Forest City, Arkansas. After a lifetime in the family businesses and nearly 40 years of leading AutoZone, Pitt has decided to not stand for reelection to our Board of Directors. Pitt will be sorely missed as a member of our Board but in his typical fashion, he has promised he is only a phone call away. And, I promise to our stockholders, his phone will continue to ring frequently as he has been a tremendous leader, advisor, mentor, coach and friend to me and so many other current, former and I'm sure future AutoZoners. Pitt, we can't thank you enough for building this amazing organization, that because of you, we all have had the honor of helping continue to nurture and grow. We do stand on the shoulders of giants, and we thank you for being our foundation for nearly 40 years! We wish you and Barbara all the best, and we thank you both for your passionate leadership of AutoZone, Memphis and philanthropy all these years!

At AutoZone, we have a unique and powerful culture that Pitt and team developed in our earliest days that has been refined over the years. We remain passionate about our Pledge, Values, and culture to earn our customers' business every day. I continue to believe our best days are ahead. Thank you for staying in the Zone with us for all these years!

Sincerely,



Bill Rhodes  
Chairman, President and CEO  
Customer Satisfaction