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O'Reilly Automotive, Inc. (ORLY)

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CORPORATE PARTICIPANTS

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Brad W. Beckham
Chief Executive Officer, O'Reilly Automotive, Inc.

MANAGEMENT DISCUSSION SECTION

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All right. Next up, we are lucky enough to have O'Reilly Automotive, one of the largest distributors and retailers of aftermarket parts in North America. Joining us today is CEO, Brad Beckham and CFO, Jeremy Fletcher. As previously mentioned, O'Reilly is a customer to many of the presenters today. So, of course, another interesting conversation.

The company has about 59 million shares at $1,200, market cap of $70 billion, and net debt of $5 billion. Brad, Jeremy, thank you for being here today.

Jeremy A. Fletcher
Executive Vice President, Chief Financial Officer, O'Reilly Automotive, Inc.

Thank you.

Brad W. Beckham
Chief Executive Officer, O'Reilly Automotive, Inc.

Yeah. Absolutely.

QUESTION AND ANSWER SECTION

Q

So, Brad, thank you for being here, as you're, as the first, full CEO, time is yours as the CEO. If you could just give a very brief overview of the company?

Brad W. Beckham
Chief Executive Officer, O'Reilly Automotive, Inc.

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Yeah. Absolutely. So, good afternoon, everybody. Brad Beckham. I've been with the company for 28 years, literally grew up with the company, so thankful to be here. And yeah, we have about 6,200 stores, been in business since 1957. We have brick and mortar auto parts stores, just over half of our revenue, close to $17 billion is done through the DIY channel, so do-it-yourself automotive retail, and then the remainder, basically, the other half of our business is what we call the do-it-for-me side of our business, which is the professional customer, the professional installer, garages, cities, municipalities, body shops, things like that.

So, we have this somewhat unique model, a 50/50 model. We started out as a wholesaler back in the 1950s, 1960s, and 1970s, and 1980s and 1990s, saw the opportunity to make better margins and capitalize on our professional parts people and our industry-leading parts availability by servicing the DIY customer as well. And we found this great niche with our 50/50 model.

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Perfect. And then just to kind of delve deeper into your customer, can you kind of talk about the customer's needs and how you kind of how you service needs the best?

Brad W. Beckham
Chief Executive Officer, O'Reilly Automotive, Inc.

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Yeah. So, we work in a very non-discretionary market. It's really exciting. It's a great business. Our stores have a very fairly small portion of our square footage of our stores is the showroom floor that would be wash and wax and more discretionary type of products. But our bread and butter is what we consider our hard parts which are behind the counter. And it's very much a consulted visit. You know, when somebody comes in our store, our parts people, it's not like working the counter at a CVS or a Walgreens or something like that and just checking somebody out there or like a gas station. Think about our professional parts people, really is almost the doctor and the pharmacist.

They have to be able to help diagnose somebody's vehicle, go out in the parking lot, check a battery, check an alternator, check a starter, check – help somebody change out their wiper blades and it's, again, very non-discretionary. The – but far majority of our business is non-discretionary. We have well over 1 million SKUs in our auto master. It's very SKU heavy, very complex, in a good way. And then we have obviously this model of basically a regional distribution center to hub store to spoke. And we obviously have, decades of science that allows us to ensure that we have the right part at the right place at the right time. So, an average store would have roughly 22,000 SKUs and then a hub store would be north of 70,000 SKUs, sum up over 100,000 SKUs. And then a regional distribution center would hold approximately 175,000 SKUs on average.

And again, the way that a DIY consumer shops is that they're working on their car out of necessity. This is a lower income consumer, a kind of lower to middle income consumer that can't quite necessarily always afford to have it worked on at a repair shop. And so, they're coming in our store out of necessity to do their own brake job, to change out their own battery, to do light maintenance on undercar and underhood on the vehicle. And then on the professional side with the repair shops, time is money. You know, our repair shops, we see a lot of them this week here in Vegas. You know, they – the way they make money is turn-in their bays every day.

Whether that's an independent repair shop, whether it's a like a strategic type account, a national account, a body shop, the times money, they're trying to get a car off the rack for a man or woman that needs to get back to their – to their life. And that's a higher income consumer, the end consumer. And so, time is money. And so, what we do is obviously we have to have a competitive price, but it's all about having that right part at the right place at the right time and then having the service levels at the store to get that – really get that bay turned within 20, 30 minutes because those mechanics that are working on those jobs in the shop, they don't get paid hourly, they get paid what we call flag time, which means that the more jobs they can do in a day, the more money they can make.

And if a shop owner can't ensure that they turn the bays by being with the right parts partner, their technician is going to take their toolbox and roll it down the street to another garage where they actually turn the bays. And so, really, really exciting industry and, very non-discretionary, very SKU intensive, very complex in a good way. And all – really all about service and relationships.

Q

Yeah. And O'Reilly has been a top competitor in this industry for a very long time. You outcomp your peers, but yet we continue to see you invest in this network that you're talking about. You talked about some new DCs on your call, your most recent call and extending your hub network. If you could just talk about those investments.

Brad W. Beckham
Chief Executive Officer, O'Reilly Automotive, Inc.

A

Sure. Yeah. One, one unique thing that's lost a lot of time on analysts and investors is that we've had this model built in from day one where we have these regional distribution centers, these facilities that have 150,000-plus SKUs that are these hard to find, parts to get these cars off the rack. One thing that's very different versus us and our competitors is when we started out in 1957, and in the 1950s, 1960s, and 1970s, we had a distribution center in Springfield, Missouri. We went to put in our second distribution center, and we put it in Kansas City. Third, Oklahoma City. Fourth, Houston, Dallas Fort Worth, Atlanta, Georgia, Chicago, Boston, LA. And we've had this this pretty expensive model to have these regional distribution centers that are actually in the metro markets where the people are, where the vehicle population is. And, that's very unique.

On top of our hub network is we have 30 – in North America, we have 32 now regional distribution centers with the addition of Mexico and Canada, as well as the as the incremental projects that we were just asked about. But all of these distribution centers, it's more expensive for us to go in the metro market and put these in that metro market versus a lot of our competitors have a lot less regional DCs and they're out in rural markets where you can get free land and tax breaks and it's more of a distribution and a replenishment play. We've decided that our distribution centers not only serve as a replenishment node, but those 175,000 SKUs are available in Atlanta, Georgia, in Chicago, in Boston, in all these metro markets in the US where we have these distribution centers.

We run routes five, six times a day, depending on what traffic will allow. Small trucks out of those facilities for special orders as well. And that's really been a competitive advantage for us. That is very hard to replicate by our competitors. And so, really, we just continue to play from a position of strength when it comes to having these regional distribution centers in these metro markets and in the projects that again, we were asked about was just a relocation of our original DC in Springfield, Missouri, we're opening a state-of-the-art facility that's a relocation in Atlanta, Georgia. A lot more store capacity, some goods to person automation. And then, we're also opening a greenfield site in Northern Virginia, one of our big gaps in the footprint, kind of the last one here in the United States has been that kind of that upper mid-Atlantic in between Northern Virginia and New England.

And so, the exciting thing for us in that footprint is that, depending on where you draw the line, that can be about a third of the population of the US that we still have a huge opportunity here in the US. A lot of vehicles, a lot of people, and we're really excited about that Northern Virginia facility that will enable that growth into the upper mid-Atlantic.

Q

Great. And then just for reminder purposes, you've got one-third that you can still grow into. What can one DC kind of service in terms of store count?

Brad W. Beckham
Chief Executive Officer, O'Reilly Automotive, Inc.

A

Yeah. So, our average distribution center would service approximately 250 locations. And it would also just by chance service about a 250-mile ring. One thing that is, also that's unique about our distribution model that is a little bit different than some of our – well, all of our retail competitors, I believe, is that we replenish our stores five nights a week and so we run a little bit smaller ring having those 30 DCs. So, we run about a 250-mile ring and we replenish our stores five nights a week where a lot of retailers are doing that once, twice a week. And again, that's a more expensive model.

But we've always felt like the way we built our business on service, getting that car off the rack, being there for the DIY and DIFM consumer, the way we replenish allows us to have breadth of SKUs in our 6,200 stores and not depth. And so, we have an advantage, we feel, when it comes to having that unique coverage, not only in the DCs and the hubs, but our average store because they replenish five nights a week and that allows that to be unique coverage in those stores versus having depth to get through the week.

Q

So, within the market, over 50% probably have shares from these regional or local WDs. How can they compete against what we just discussed?

Brad W. Beckham
Chief Executive Officer, O'Reilly Automotive, Inc.

A

Yeah. So, that's one thing too, that's often missed on the DIFM side, even though the DIY business in the United States is, is extremely consolidated, for the most part between, us AutoZone, Advance, and NAPA. And, but on the DIFM side, it's still an extremely fragmented market. And, we often talk about the fact that over 50% of the share, or the way we measure it in the United States is actually done by independent competitors that a lot of people have never heard about. You know, it's companies like Parts Authority and FMP and Xsell. These are what we call warehouse distributors or just independents that have more of a two-step distribution model. Where we'd be – we would be a three-step distribution model.

These are very well-ran businesses, and they can actually compete with us fairly well because their heritage, the way they built their company, is on that professional customer. And that is very – it's high service, but it's also very high relationship. People buy from people. And because they have this two-step distribution model where they're going from a manufacturer to their warehouse directly to the professional installer, they can actually compete to a large degree on price on the street because of the differences in the distribution model. We obviously feel like there's a few Achilles heels that they have that allows us to continue to get after that market share. But that's really a positive. We believe that the professional side is still so very fragmented and that there's all these opportunities through greenfield expansion, through continued M&A and just taking share from these mom-and-pop operators.

Q

And then, we discussed kind of that white space in the US as a growth opportunity. But Mexico, we missed Mark. Can you tell the opportunity in Mexico?

Brad W. Beckham
Chief Executive Officer, O'Reilly Automotive, Inc.

A

Yeah. So, one of our competitors that's there in Memphis, they've done an incredible job. You know, they're in the Mexican market. They have a 25-year or so jump on us. We've been there now for five years. But I think I think AutoZone went down to Mexico in 1998, and they they've honestly paved a really great way down there. They have an amazing business model. They're a heck of a competitor. The average age of a vehicle in the US is about 12.5 years. The average age of the vehicle in the Mexican market is 16.5 years. And, not so great roads. There's 285 million light-duty vehicles in the US. I think there's about 30 million, 37 million or 38 million light-duty vehicles in the Mexican market.

It gets a little – the data gets a little bit funny talking to all the sources that we have in Mexico, there's actually some certain population of vehicles that actually aren't registered in Mexico. So, we actually feel like the opportunity is larger than that 36 million, 37 million number, obviously, not near as large as the US, but obviously with our number one retail competitor that's done an amazing job down there, almost 800 stores, big business, going down to the Mexican aftermarket is really like going back in the US, 20, 30, maybe 40 years, extremely fragmented, a lot of mom-and-pops, a lot of consolidation opportunities, a lot of M&A opportunities, but just tremendous greenfield expansion opportunities for us. And we feel like there's, even AutoZone's done such a great job there, down there, there's a tremendous opportunity for us.

Q

And another opportunity seems to be – sorry, that you discussed some additional store openings this year. Can you just kind of talk about your annual store openings, some of the growth opportunity that you released in your most recent earnings call?

Jeremy A. Fletcher
Executive Vice President, Chief Financial Officer, O'Reilly Automotive, Inc.

A

Yeah. I can probably jump in and let Brad take a breath. He's been – it's talking season for Brad for everybody that saw him this morning, but, we will open 190 to 200 stores this year. We announced on the last quarter's call that, that globally we'll open 200 to 210 in 2025. One of the advantages I think we've seen is as our footprint has gotten bigger is a potential to open really across our network and to find lots of successful opportunities to open stores. And so, you see our growth that's pretty spread out, obviously a little bit more concentrated in some of the greenfield areas where we don't have the density or where we're expanding contiguously from our existing markets to enter into new markets.

But we also have a substantial number of stores that we continue to open and backfill markets. Texas is a big contributor for us every year and in lots of different states that we've been a long period of time.

The ability for us to take a measured phase and how we think about store growth, to be able to have that be pretty distributed across our footprint is – it's critically important for us, because the success of a new store is highly dependent upon the quality of the team that you start that store with. And having the strength of our chain and the culture and the ability to build a bench internally puts us in a great position as we open new stores to open them with strong teams to be very successful as they come off the ground. And it's put us in a position where our new store performance continues to improve even as the overall average store volumes of our company have grown significantly over the last few years.

The productivity of how we think about new stores and the returns on new stores continue to be as strong as they've ever been. So, it's a positive situation that we're in. And it's still a very highly prioritized use of our capital.

Q

Great. And according to our estimates, it looks like, revenue per store is up nearly 50% from $1.9 million to $2.7 million over the last five years. Does that kind of impact some of that investment decision?

Jeremy A. Fletcher
Executive Vice President, Chief Financial Officer, O'Reilly Automotive, Inc.

A

Yeah. Absolutely. You know, we've seen strong returns on new store growth for a long time. You know, for sure, over that same period of time, the cost of new store projects is – has grown, pretty substantially as well.

Q

Yeah.

Jeremy A. Fletcher
Executive Vice President, Chief Financial Officer, O'Reilly Automotive, Inc.

A

But our ability to compete as well as we do, and to consolidate the industry and to grow share, gives us lots of confidence that we can open in lots of different types of markets and with lots of different types of store formats. So, you still see us opening a substantial number of hub stores every year and in larger hubs that are good contributors to how we think about new store returns.

Q

And did you have a question?

Q

I want to go back to Mexico. For some reason.

Jeremy A. Fletcher
Executive Vice President, Chief Financial Officer, O'Reilly Automotive, Inc.

A

We feel Mexico is great.

Q

When you think about the constitution of the car park down there, it seemingly would lend itself more to a DIY business. Clearly, you've been able to make those adjustments in various markets, but how do you think about that, that sort of mix and what you all do so exceptionally well from being effectively a dual market provider of parts in a market that really is predominantly DIY?

Brad W. Beckham
Chief Executive Officer, O'Reilly Automotive, Inc.

A

Yeah. Great. Great question. Definitely more DIY heavy. I do think that there's still a tremendous opportunity on the professional side, though, it's more of a [indiscernible] (00:18:12) type mechanic than a more sophisticated national type account. But you know, obviously our roots are in the – on the professional side, we obviously have an amazing DIY business, but I think, a lot of those markets, compare, compare very well to a lot of the markets in the lower income parts of the US. You know, we have an incredible business in California. You know, we have an incredible business in Texas. Really all across the south. Our brand has resonated very well with the Hispanic customer.

Just so happen when we went down to Texas, we started doing some advertisements with Mexican soccer, football and things like that. And that – the studies that we did in Mexico, the Mexican customer really recognizes. O'Reilly and a lot of them shop in our stores along the southern border in the US. And we feel very strongly about our opportunities on the DIY side, you know. So, we feel really good about it.

You know, it'll be interesting to see over the next a couple of decades. I think a lot of our locals that are Mexican nationals feel like that the kind of the middle-income consumer in Mexico is going to continue to get better and potentially there's going to be a bigger opportunity on the professional side. But yeah, we see no reason that we can't go down there and take a tremendous amount of retail share.

And I think the last thing I would say is that there's a tremendous amount of retail share being done actually by the mom-and-pops. You know, when you go down there, even if you took AutoZone share in Mexico out of the equation, you go down there and you're walking through kind of a strip mall and this little supplier selling rotating electrical, this one's selling filters, this one's selling brakes. And there's 10 or 12, 20 people stacked up buying from that mom-and-pop. And so, I think there's a big need for a kind of a one-stop shop with our full-service stores. So, we're really excited about the DIY.

Q

Great. [ph] Brett. (00:20:11)

Q

Thank you. Yeah. If you have talk about the fast auto acquisition, and sort of what you see the opportunity up there being obviously a bit more of a consolidated market already with NAPA and bumper to bumper.

Brad W. Beckham

Chief Executive Officer, O'Reilly Automotive, Inc.

A

Yeah. Thanks, [ph] Brett. (00:20:29) Well, I think, as we've talked, we've known we wanted to go cross the northern border for a long time. Mexico made more sense for us in terms of the overall vehicle population, the overall population, the overall opportunity. We knew we wanted to do both. You know, both directions made a lot of sense for us. Canada isn't to [ph] Brett's (00:20:51) point, quite the opportunity overall is Mexico, but there's no reason we can't have an amazing business in Canada. The car park different from Mexico. I didn't mention this earlier. The car park is very different. The vehicle registration is very different, different makes and models in the Mexican market.

The Canadian vehicle registration is very similar. It's all the vehicles we already have parts for. So, there was some more synergies in terms of product lines and in products we are – already sell. Even though the Canadian market is consolidated in a lot of ways, not – never say never that an AutoZone or another big retailer wouldn't go to Canada. And we still feel good about it if they did. But there there's a lot of opportunities out there. You know, GPCB and NAPA, they have almost I think they have over 500 stores, in the Canadian market. The vehicle population up there is not too far off what's in Mexico.

The difference is the off center is the age of – the average age of vehicles up there is closer to 10 years. So, it's a, a later model vehicle. But really, what we've seen is that there's a lot of the Canadian markets, obviously, the metro markets have a huge opportunity for DIFM. It's going to be less of an opportunity for DIY simply due to weather patterns and those type of things. But what we found in Canada is that when you get out in the rural markets of Canada, it's a lot like the markets where we founded our company. You know, you get in, oilfield up there, you have a lot of construction, even though we have this big light-duty business as us founding our company in Missouri, Oklahoma, Kansas, Arkansas, we sell a lot to farmers. We sell a lot to grading companies, construction companies, paint body companies, body shops and things like that.

And you get out in some of those rural markets in Canada. You know, I was out in the market two months ago, I think, and we were out, east of Montreal. And we walked in one of the stores and the guy, I never would've thought this, but I walked in, and he had a big belt buckle and boots on. I thought I was back in Missouri. And, they were – they had farmers in their store buying fleet batteries, tractor batteries, and we sell all that stuff. And so, even though there may be a little bit less of selling wash and wax and DIY retail people doing brake jobs in their driveway, Canada's full of blue-collar people that are working on stuff.

And so, we feel really good about the DIFM opportunity. And we feel like there's a DIY niche. You know, a lot of you probably know that market well. And you know, Canadian Tire, even though there's not a US retailer, Canadian Tire is out there doing a huge retail business in auto. And we feel like there's an opportunity. You know, if you go in Canadian Tire, it's a big box, place and to go park at Canadian Tire, and go in Canadian Tire is a lot like going in a Walmart or a big box here in the States. And, we've had a lot of customer feedback. We feel like the market is ready for a smaller box, more neighborhood type of parts store in the rural markets and the metro markets that people can get in and out of very quickly.

And, vast was pretty much 100% people platform for us the leadership of the vast team is going to stay on board with us long-term. They have a great understanding of the markets both Québec out in the Atlantic and getting into Ontario. And they have a good understanding of the competitive landscape and things like that as we go west, and so, we couldn't be more excited about it.

Q

Great. And so, over the, from 2021 to 2023, we probably saw three-year growth rate above 20%, 25%. But what we're seeing right now and in all the aftermarket is a little bit of slowing down. Can you talk about your consumer or what you think is happening, what's happened in the past when the consumer's been pressured and then, and the opportunity for going forward?

Jeremy A. Fletcher
Executive Vice President, Chief Financial Officer, O'Reilly Automotive, Inc.

A

Yeah. Absolutely. And I don't know that we've got, any comments that would be novel to what everyone else has probably talked about with this group over the last couple of days. You know, for sure we've come off of a couple of very, very strong years within our industry. I think there were years when the consumer has very much highly prioritized taking care of their vehicles, not deferring any types of maintenance or repair, where there's been a great incentive because of the scarcity of new vehicles and the high price and value of used vehicles, that helps to justify those investments.

And I think we've, we're coming off of those as challenging years and in difficult comparisons. You know, as we look today, we still feel like we have a consumer that's relatively healthy. We don't think that there are dramatic pressures that they see, but we do sense that there is just a lot more cautiousness in a lot of what we're seeing is a consumer is trying to save money where they can and defer where they can.

We've been pleased that, some of our repair types of categories have still performed well. But we're kind of in a season within the industry that we see on a periodic basis as we cycle through these things where there's just a little bit less of a likelihood to take care of those things, that that might – a consumer might have the ability to hold off on as they tend to be cautious.

You know, we've been I think, fairly forthright in saying that we do believe that's a short-term outlook for our industry and that over the course of time, we've just seen it through cycle and cycle. And eventually the type of work that may not be performed this year ultimately gets done within the industry. That the core drivers of how consumers use their vehicles, the need that they have the wear and care that, that those miles driven cause, the necessity to repair them.

And then, just as importantly, the quality that vehicle fleet in the US. And the real value proposition to invest in vehicles at higher and higher mileages and higher ages because of the quality of the vehicles means that there's a just a great feedback. But it's a good thing to keep an existing car on the road. It's a positive economic return. All of those things contribute to an industry that's been resilient over the course of time, and we think will be, as we move out of this, this cycle.

Q

Great. And then, Jeremy, I guess another question for you. You repurchased about $3 billion of stock in 2023. What about 2 times net debt to EBITDA, or you generate over $2 billion easily in cash a year. What are some of your capital allocation preferences? And then even with that $2 billion per year, is there something larger that you could do in the future?

Jeremy A. Fletcher
Executive Vice President, Chief Financial Officer, O'Reilly Automotive, Inc.

A

Yeah. We're in a fortunate place. We have the flexibility to be able to address whatever opportunities that we see, and in our allocation of capital for our stock, for the last decade plus, it continues to be the same. And we're going to invest in our existing stores, make sure that they look good, that they're well operated, that we have the inventory that we need within those stores. We're going to invest in growth. We talked about store returns earlier. We will be opportunistic from an acquisition perspective when we see those opportunities arise. But it is, it is very much in an opportunistic game.

It's got to be the right situation at the right time. And we're very disciplined in how we think about those opportunities and that will final how we think about capital and then we generate a substantial capital and have felt like that that the share repurchase program has been an effective way of returning that to shareholders because of our ability to execute it very consistently over the course of time at the same time that we try to be opportunistic where we can.

Q

Great. And then last question, just about looking at the numbers, maybe you're about 220 days or so of inventory versus 260 in 2019. What's – is that the optimal level or is there further ability to optimize fill rates?

Jeremy A. Fletcher
Executive Vice President, Chief Financial Officer, O'Reilly Automotive, Inc.

A

Yeah. It's a great question. I don't know that we would ever say that there is a perfectly optimal level. We have conviction around always being at an industry leading position or from an inventory perspective. So, I know this is we've being webcast with our inventory control guys can hold this against me, but we are going to invest against that. Now, it's always important that it's productive and that it turns well. But we also understand, I just think is a core strategic conviction that we need to be the best in the industry at that and we'll invest dollars against it.

And fortunately, that has proven to be, I think, the right strategy and the right decision not just for us, but for our supplier partners who support us in making sure that we have their inventory positioned in the exact right place that it needs to be to fill the customer needs when it occurs.

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Great. So, we have jumped up against the half hour, but Jeremy, Brad, thank you so much for being here. As always, it's really – it's great to have you. So, thank you.

Jeremy A. Fletcher
Executive Vice President, Chief Financial Officer, O'Reilly Automotive, Inc.

Thank you.

Brad W. Beckham

Chief Executive Officer, O'Reilly Automotive, Inc.

Thank you.