THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

ORLY - O'Reilly Automotive Inc Analyst Day

EVENT DATE/TIME: AUGUST 08, 2017 / 1:30PM GMT

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

CORPORATE PARTICIPANTS

Brad W. Beckham *O'Reilly Automotive, Inc. - SVP of Central Store Operations and Sales*

Gregory D. Johnson *O'Reilly Automotive, Inc. - Co-President*

Gregory L. Henslee *O'Reilly Automotive, Inc. - CEO*

Jeff M. Shaw *O'Reilly Automotive, Inc. - Co-President*

Mark Merz *O'Reilly Automotive, Inc. - VP of Investor Relations, Financial Reporting and Planning*

Thomas G. McFall *O'Reilly Automotive, Inc. - CFO and EVP of Finance*

CONFERENCE CALL PARTICIPANTS

Alan Michael Rifkin *BTIG, LLC, Research Division - MD and Retail Hardlines and Broadlines Research Analyst*

Bret David Jordan *Jefferies LLC, Research Division - Equity Analyst*

Brian William Nagel *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Yani Alexio *MoffettNathanson - Analyst*

Daniel Ray Wewer *Raymond James & Associates, Inc., Research Division - U.S. Hard Line Goods Analyst*

Elizabeth Lane Suzuki *BofA Merrill Lynch, Research Division - VP*

Michael Herbert Lehrhoff *RBC Capital Markets, LLC, Research Division - Associate VP*

Michael Lasser *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

Seth Ian Sigman *Credit Suisse AG, Research Division - United States Hardline Retail Equity Research Analyst*

Simeon Ari Gutman *Morgan Stanley, Research Division - Executive Director*

Steven Paul Forbes *Guggenheim Securities, LLC, Research Division - Analyst*

Taylor Finch *Century Management - Analyst*

Matthew J. Fassler *Goldman Sachs - Analyst*

Seth Basham *Wedbush Securities - Analyst*

PRESENTATION

Mark Merz *- O'Reilly Automotive, Inc. - VP of Investor Relations, Financial Reporting and Planning*

Good morning, everyone, and welcome to our 2017 O'Reilly Analyst Day. My name is Mark Merz. I'm our Vice President of External Reporting, Investor Relation -- no, Vice President of Investor Relations, Financial Reporting and Planning. It's a new title for me. I'm sorry.

Before we get started, I want to welcome everyone who's joining us via webcast as well as everyone who has made the trip down to San Antonio to see us.

Before we get started, I need to read our forward-looking statement disclaimer. We claim the protection of the safe harbor for forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. You can identify these statements by forward-looking words such as expect, belief, anticipate, should, plan, intend, estimate, project, will or similar words. These forward-looking statements are based on estimates, projections, beliefs and assumptions, and are not guarantees of future events and results. Such statements are subject to risks, uncertainties and assumptions. Please refer to the Risk Factors section of our annual report on Form 10-K for the year ended December 31, 2016, and recent SEC filings for additional factors that could materially affect our financial performance. Forward-looking statements speak only as of the date they were made, and we undertake no obligation to publicly update any forward-looking statement.

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

Okay. With that out of the way, real quickly, we want to talk about the agenda for the day. If anyone has been to any of our Analyst Days before, and I know there are many familiar faces and you have, what you're going to find today is strikingly similar to the previous days that you've attended. These days aren't days where we provide new information. These aren't days where we update any type of guidance. These aren't days where we provide any new initiatives. These are just days where sell-side and buy-side has the opportunity to come and meet with management in person if they desire to do so. So that's why we host these days. So the presentation, strikingly similar to previous information that we've put out for previous presentations.

We'll start the day with about 2 hours worth of formal presentations and Q&A session. After that's over, we'll take a distribution center tour. When that's over, we'll come back into this room and we'll have a light lunch. We'll bring in some boxed lunches, and the management team will sit down, and have the opportunity to eat lunch and visit with the management team. Then we'll jump on a couple of buses, and we'll go out and see some of our stores, 2 of our stores, and that's where the rubber hits the road. That's where the magic happens. That's where our competitive advantage exists. And then after that, we'll head to the San Antonio airport to drop everybody off.

One of the things that we think that separates O'Reilly from every other company in the world, certainly every other company in our industry, is our team members and our culture. For us, it is the most important thing. I know a lot of companies talk about culture. A lot of companies have fancy culture statements. O'Reilly is a company that lives our culture. What sets us apart is our competitive advantage. Our culture is pretty simple. We are committed to our team members and our customers. We are enthusiastic, hard-working professionals dedicated to teamwork, safety and excellent customer service. We will practice expense control while setting an example of respect, honesty and a win-win attitude in everything we do. Those aren't just words for us. It's who we are, and that's what we do. Before every major meeting that we have in the company, before every executive committee meeting, before every corporate managers' meeting, before every senior managers' meeting, somebody is assigned a culture statement. And what that means is they have to pick one of these 12 culture values. You see it on the wall here in the DC, examples of the culture on these other walls in the DC. Somebody has to pick one of these culture statements and describe what that culture means to them and how they've seen that culture exhibited in the company. So today, I am fortunate enough to get to do our culture statement.

My favorite culture is excellent customer service. A lot of people think since I work in finance, it should be expense control, but it's excellent customer service. That's because at the end of the day, that's what makes the difference. We're going to talk about a lot of things here today, stuff that you -- that everyone has heard before. We're going to talk about our distribution network, and we're going to talk about our inventory availability. We're going to talk about our technical training of our team members, and you're going to hear Jeff get up and brag it up and talk about leadership and training. All of that is there to provide excellent customer service. That customer that picks up the phone and calls us, that customer that walks into our store, that professional customer that needs something, what sets us apart is we go above and beyond every day to never say no, to get that customer whatever they need to get their job done. And I've personally seen this culture exhibited multiple times whenever I've needed parts because I've got 4 kids and I buy them old cars because, well, kids are going to wreck their cars. So there's no reason to buy an expensive car. So I've got '99 Jeep Cherokee and 2000 Honda Accord. So I'm in our stores a lot buying parts. And I am not an expert mechanic. And I need those store team members to help me figure out what's wrong with my kids' cars, so I can keep them rolling, keep them out there. I've also seen it exhibited setting up this Analyst Day. Mindy and Natalie, 2 of the individuals, 2 of our team members that you met when you came in today, they've been working on setting this up for you guys for 2 months -- for 3 months. And they were excited to do it. How many people can you think would be excited to get 100 people coming in and disrupting their operation to host an event like this. Well, these guys are excited to do it. They were happy to do it. They were thrilled. They want to show off the operation. That's a great example of excellent customer service that we see every day. And that's what O'Reilly is all about and that's what sets us apart.

A couple of housekeeping items before we turn it over to our team here to talk about all of the things that we've talked about in the past. First is name tags. Everybody needs to make sure that they have their name tag on and they keep it on all day. If you don't have a name tag or if you didn't get one when you came in the door, just raise your hand and Eric or I will come and get you a name tag. They're very important. Our security people, if you're running around the building and you don't have a name tag, they're going to stop you, and they may escort you out of the building. So make sure you keep your name tags on all day long.

Also, restroom facility. If you go out the back door to the room here, there's restroom facilities just to your left. So feel free, over the course of the next couple of hours, if you need to get up and use the facility. There's also drinks in the back and snacks in the back if you get hungry or thirsty during the event.

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Client Id: 77

Just real quick on this facility that you're in. It's one of our newest distribution centers. This distribution center has actually only been open for about 14 months. A lot of people ask why did you need a fourth distribution center in Texas since we have 3 already. Because Texas is an extremely fast-growing market. There's a lot of opportunity for us to provide a high level of service to a lot of customers here in Texas. And we had a distribution center in Dallas and another one in Houston, and they were just over capacity. They were servicing too many stores to be efficient. And it's a long way from Dallas or Houston to get all the way down here to Austin and San Antonio. So we needed to put parts closer to the customer. So we made the decision to build this distribution center. When we do our DC tour later today, you'll notice that the distribution center might look somewhat empty. It's because this distribution center is only servicing 174 stores. It's only been open 14 months, and it's servicing 174 stores. I think by the end of this year, it's going to be somewhere around 185 stores. So this is a very fast-growing market that we're servicing out of this distribution center. Over the next several years, this distribution center is probably going to add about another 80 stores. This distribution center capacity is 250 stores. So this is a great market for us. We're excited about this market and this facility is great. David, you've done a great job getting this facility ready for us, and we sure appreciate that.

So with that, I'll turn this over to Greg Henslee to get the day started. Thank you.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Thank you, Mark. Well, good morning, everyone. This is the -- by far, the best turnout we've ever had in any Analyst Day. So the takeaway I have from that is when our comps aren't as good, more of you show up. Is that what the deal is? Well, I'm going to start off by just introducing those that will share the presentation. I'm not doing the majority of the presentation, our team is. And I've got a list here of the individuals that are in the room with us today, some of which will be participating in the presentation with us. I think what you'll find today, even -- when you get to the 620, our hub store here in San Antonio, if you happen to ask one of our ISSs or someone how long they've been in the business, I think you'll be impressed at the tenure of people in our company, pretty much across the board, and the knowledge of auto parts -- the auto parts business that they possess, the depth. Here with us today, of course, and sharing the presentation is Greg Johnson, our Co-President; and Tom McFall, our Chief Financial Officer; Jeff Shaw, our other Co-President; and Brad Beckham, our Senior VP of the central area of the country, sales and store operations. And then additionally in the room is Keith Childers, Keith kind of -- you'll all want to turn around, I promise you. Keith Childers is in the room, he's Brad's counterpart. He is the western half of the country, Senior Vice President of Operations and Sales; and then Jeremy Fletcher, who some of you know, our VP -- SVP of Finance and our Controller; Diego Santillana, who's our DVP for this area; Jacky Floyd, our RM for Austin, Texas, which this distribution center -- the reason it's placed north of San Antonio is so that it can provide same-day service to not only San Antonio but also to Austin. So in effect, by having this distribution center here, we're able to touch about 97 stores right now and growing multiple times a day. And I know you heard me talk about this many times in the past, that one of our key strengths is the number of times that we can touch a store each day. Even at this hub store, you'll go to second with this Store 620, which we have in San Antonio. That store has, let's say, 75,000 SKUs, or maybe 73,000 or something like that. It's a big SKU store, and we do a lot of business there. Still, there's stuff they don't have, so working out of a 135,000 SKU inventory is a big deal for them. And the stores -- the regular stores that stock 20,000 to 25,000 SKUs, having access multiple times a day to a distribution center inventory is just paramount. It's what allows them to be dominant in our business. And then Jacky Floyd, of course, our RM for this area is in the room; Joey Schrupp, our RM -- actually, Jacky is in Austin and Joey is here in San Antonio. Marcus Boyer, our Regional Director for distributions, and this is one of this DCs. And then David Pickrel, who managers this distribution center.

This -- like Mark said, when you walk out into this -- when we walked out here yesterday, I forgot why we're walking them into a place that didn't have many parts in it. It's because there is a bunch of storage shelves out here where we stock bulk stuff that -- this DC is not at capacity yet, so that's for expansion. When you get into the DC, you'll see the shelves are packed with parts, and we have a number of SKUs that I described, and we do a lot of business. They should be busy this morning with the out-of-town orders and stuff like that. But again, we're only servicing 174 stores; we have the capacity of 250. Most of the time, our capacities are underestimated. Greg always says that because we -- but actually it's Jeff's now. Jeff -- Greg always says that. Maybe Jeff does now. But we generally can service more than what our capacity is in Houston, where we were servicing the stores that are now serviced out of this distribution center. We were way, way overcapacity there. And if you looked at that distribution center, they would say that it might service, what, 300 stores, something like that, and we're servicing much more than that. And some of the stores that it serviced were incredibly high-volume stores or are incredibly high-volume stores based on the tenure of the stores and the fact that they're in markets like Houston, San Antonio and Austin, which are fast-growing markets.

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

Just a quick overview of things that you already know. At the end of the second quarter, 4,934 stores. We'll open our 5,000th store later on this year. 27 strategically placed distribution centers. I was being asked earlier about some of AutoZone's comments about backing off of the 5-nights-a-week replenishment, 5-nights-a-week delivery to the stores. I can tell you that the reason we do that is because having access to parts quicker than a competitor is a major, major issue in our business. And being able to invest the inventory dollars that you want to invest in breadth of inventory and the number of SKUs you carry as opposed to the depth that it takes to support weekly or twice a week replenishment or whatever the case maybe, has value. And that's the reason that we've always done it that way. So these DCs are strategically placed in markets where we feel like that we can best leverage the inventory on a same-day basis to give stores more access to parts than they might otherwise have. And in many cases, more access to parts than what our competitors have, which is (inaudible). 75,000 team members; last 12 months sales of $8.8 billion; total assets of $7.3 billion; market -- an updated market capitalization of $18.2 billion; and our do-it-yourself, do-it-for-me mix is 58-42 as of the end of last year.

Year-to-date, we've opened 105 new stores on our plan to open 190 new stores this year. As you know, we backed off a little bit on our new store growth this year, to support the conversion of the Bond stores up in the Northeast, which is very close to being completed, and we're in a position up there now where we can execute the business model that we execute in the rest of our stores, and have switched their service over to our Devons distribution center, which is right outside of Boston, which has given them better access to inventory and over time will put us in a position to gain market share up there. 1.3% comparable store sales this year on top of the 5.1% that we had generated in 2016; 52.4% gross margin versus the 52.1% in 2016; 19.4% operating margin; $5.93 EPS versus $5.24 last year. And we generated $451 million in cash flow, and we've repurchased $1.34 billion in shares under our share repurchase program so far.

I get asked a lot about what's changing in our industry, what the drivers of our industry are. And most of you know, it's real simple; it's just miles-driven. When you're stuck -- (inaudible) stuck in traffic in San Antonio trying to get down to 620, and while it's an aggravating thing, it's a great thing. All these cars are just stop and go, and stop and go, and stop and go. You have cars just take off and never have to stop, it's not a good thing for us. You want them to accelerate real hard and stop, accelerate real hard and stop. So that miles driven has been on a climb for some time now. It was at, what, 3.5% in 2015; 2.8%, 2016; and 1.7% this year. So we've had a little bit of a declining trend and that's contributing, I think, to the softer sales, is one factor. That's -- miles driven is affected mostly by gas price. When gas prices spiked during the recession, miles driven decreased a little bit. People started getting creative in how they get to work, they carpool, do different things that decrease miles driven. But in effect, the yield of auto parts sold per car is driven by the miles driven and the age of that vehicle. The miles driven on older cars yield more part sales, whereas miles driven on newer cars don't, but it gets to the point that they will. So it's just part of the evolution of a car's life.

The vehicle population continues to grow, 265 million vehicles now, and forecast to continue to grow as new car sales continue to increase and scrappage rates continue to be stable. The cars are going to be driven at older ages than ever before. It's because of the quality. And it's not just the drivetrain and the mechanical parts of a car that will cause this. It's that cosmetically cars are more appealing to drive at higher mileages. They've solved a lot of the rust problems that they had in markets where they use salt to clear the roads. The interiors are built better, so that the seats don't come apart when springs show. The clear coat that they put on the paints now causes the car to look better without being waxed frequently. There's a lot of things that are better about cars beyond the mechanical part of them. If the mechanical part of them is better, and some may say, well, isn't that -- doesn't that work against you in the auto parts business that the cars are mechanically that much better? Well, the fact is, it really doesn't. The parts that keep the car on the road are the engine and the transmission and the differential or the transaxle of the front-wheel-drive car. Those things have never been a huge part of our business. They were bigger back years ago than they are today, but the biggest part of our business is brakes and batteries and belts and hoses and ignition and emission and fuel systems and things like that. And while those have evolved and changed, they're materially the same. The way a car stops is almost exactly the same as it was 20 years ago. The difference is there are sensors now that keep the wheel from locking if you brake too hard and kind of maximizes the braking power because a sliding tire doesn't stop as good as the tire that's being braked well without sliding. But the sensors that allow that to happen are now replacement parts, too. So those -- a lot of this technology is really a good thing. And the fact that the drivetrains are so much better than they used to be allows these cars to stay on the road longer, requiring more maintenance cycles for these things that we service, the things that we do. So that's a positive thing. So we would expect that to continue to increase. I think the cars that are the 2017 models were better than the 2016 models and the 2015 models. I think we'll continue to see that happen.

I get asked a lot about electric vehicles. It's such a minor part of the vehicle population right now. And this year, I don't know what the number is going to be, but somewhere in the 16 million to 17 million area on new car sales. The vast, vast majority, 98%, 99-some-odd percent are going to

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

be internal combustion engines or hybrids. They're not going to be electric vehicles. Can electric vehicles over time be more dominant? Yes, possibly. It's going to take a long time for that to happen. And there's going to have to be a lot of changes in the electric grid. And there's a certain purpose for those things. A lot of things -- if you look around here, almost everybody drives big pickups or a lot of people drive big pickups just because they pull trailers and boats and stuff like that. The central U.S. is a lot different than some of the big metro areas where people are just driving to get to work. You can plug in a car and maybe get to work and then get home on electric power whereas in many markets in the central U.S., you've got longer commutes and use your vehicle for different things than just what you would use to commute with. You pull things with it. You use it on farms and stuff like that. So I would say that while electric vehicles -- obviously, Tesla is growing or their stock wouldn't be trading at what -- I mean, somebody has confidence in their ability to do what they're going to do. And I saw that they're getting $1.5 billion more money during the next week or 2 to develop the Model 3 or to get the Model 3 going. Internal combustion engines are going to be the way people in the U.S. are transported from point A to point B for a long period of time to come.

Industry landscape. Our industry has consolidated a lot over the last few years. As you can see, half the stores now are represented by the top 10 auto parts chains, which is a big change from 40% back in 2007. That consolidation has happened in a multitude of ways, us buying CSK, Advance buying Carquest. There's not a quarter goes by that we don't have some minor acquisitions of independent jobbers in different businesses around the country that we decide to buy, and I think that will continue to happen. I think that in many cases today, some of the smaller players are probably in a worse position than they were 2 or 3 years ago. The ones that are doing okay are the ones that have adapted to a different business model that allows them to be a strong regional player. And those are, what I call, 2-step warehouses. They're undercar warehouses. They're companies like Excel Automotive or Full Service in San Antonio or White Brothers in Atlanta. They're kind of undercar warehouses. They service just the do-it-for-me side of the business, and they're a good regional player. And over time, it may make sense that some of us start consolidating them into our business, even though we have geographic overlap. And we'll look at that as time goes on. But on the do-it-for-me side, we've always had really good competitors. And these guys are our good competitors now in addition to Genuine Parts who's always done a good job on the wholesale side, and now with Advance buying Carquest and them trying to get -- they're going to be more dominant in the wholesale side. I mean, they're a competitor, and then AutoZone's entry into this, which is somewhat maybe not as successful as some of the other guys just because of availability standpoint. Their distribution was built to support a rebuild business model, and it's a difficult adoption that makes that business -- that distribution model work for the do-it-for-me side because availability is so important.

One thing, I get asked a lot about online stuff. My brother runs a ten bay shop in Springfield and he was -- his son's birthday party was Sunday night and he was like, why do you guys talk about Amazon and these online guys so much. We don't. I said we get asked about it. And he goes, well, do you think these shops are going to buy parts from Amazon? And I go, well, I'm going to have a whole room full of them, that we sell them. And he goes, well, how does that work? And I go, you tell me, you run a shop. And he goes, well, what happens is the customer brings the car in. They never know what's wrong with it. Customers don't come in and say, yes, put brakes on my car. They come in and say, my brakes are squeaking or I hear this noise when I put my brakes on. And the tech brings the car -- brings the car in, takes the wheels off, kind of takes -- halfway disassembles the car to determine what it's going to take so we can give an accurate estimate. And guess what the tech doesn't want to do? He doesn't want to put it back together without fixing it. You know what I mean? He wants to put it back together with the new parts when the car is done. And so if parts are available in 30 minutes to do that repair, why in the world would they buy parts online and wait longer than that? And I know that one could argue that over time some of these online guys could position themselves to deliver quicker to shops, but if they do that, would it make that much difference in what we are? And wouldn't we be competing more on a level playing field than we would be today from a price standpoint, assuming they have aspiration to make a margin? So anyway, he views the world very small in his ten bay shop. But it's a question I have to ask myself is, gosh, on the do-it-for-me side, is there really much of an online threat? I mean, we do a lot of online business, but it's because we get the part to the customer in 30 or 45 minutes. And I think that will -- that kind of thing is going to be the expectation of shops for years and years to come. That's not to say that there isn't these outlier shops that might know that -- maybe a car comes in with a seeping radiator, not a leaking radiator, but a seeping radiator. And the individual can't afford to get a radiator put in yet. And they put the job off for a while and the shops says, well, when they call, hey, I am going to come in a week from now and get the radiator fit in. Maybe they could make the decision to order a radiator online for a scheduled job like that. But that is, by far, the outlier versus what typically goes on from a repair standpoint. And it's the same thing on the DIY business in our stores. A lot of times when the customer walks in, they're not walking in and saying, "Hey, I need a throttle position sensor." They're saying, "Hey, my car is doing this, and I think it's this sensor right here. What do you think about that?" And the check engine light's on, so we'll pull the codes off the car and say, yes, you're getting a signal from your throttle position sensor. It could be that, could be some other things. We give them help in figuring it out. Seldom does a customer know exactly what they need. We're helping them solve problems. So it's just a -- it's a business that's hard to adopt very much of the business to online, although, obviously, some of it could and some of it has. There's some business

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

done online; it has been for years. RockAuto is -- has done business online pretty successfully for some period of time. Not as much on hard parts as one would think, but some on hard parts. They're -- at Dorman, they're publicly traded and some of you may be shareholders of Dorman. They just recently implemented a kind of a pricing, minimum advertised price deal that they have, and RockAuto is very agitated about it. We read their homepage last week, and they've said a lot of threatening things to Dorman and they even made a sort of link on there that said, it's because of the comp store sales, the brick-and-mortar stores they did this, and they planted a link to our pre-release, which aggravated the heck out of me. But they -- which I -- we haven't even talked to these guys. I don't know why they're aggravated with us. But anyway, my point is that while discounting online is -- could be attractive to consumers if they knew exactly what they're after, and obviously, Amazon has proven this over and over and over again, that on many products, people will opt to have things delivered to their house. Auto parts is kind of a stretch for that from our perspective. But I know we'll talk about that more in the question and answer.

So anyways, there's a way our industry lays out Top 10. AutoZone is still the largest, Advance if you include all the different brandings they work under, then we're third, and then it drops off pretty quick to NAPA. Pep Boys includes their stand-alone shops. That number ten-sixty-nine includes some of their stand-alone shops, not just their auto parts stores, and then Fisher, Auto-Wares. And it really drops off to, I call them Crow-Burlingame, it's Replacement Parts out here. They operate out of Central Arkansas and then APH up in the upper Midwest and then Hahn Automotive out in the east -- the size of the aftermarket, we show on here, is $161 billion. I view it as smaller than that. That includes some things that we don't sell like glass. And that includes valuing the price, the products that are sold by a shop to an end user. That's the price they're sold at which is double what I sell them to a shop for. So that's an inflated number. I would view it more -- the products that we sell -- I think the business in the products we sell is more in the $85 billion to $90 billion range, something like that.

Okay. So we're going to have plenty of time for question-and-answer. We'll talk about anything you all want to talk about, but now I'll turn the presentation over to Greg Johnson to go over some other things.

Gregory D. Johnson - *O'Reilly Automotive, Inc. - Co-President*

Thanks, Greg. Welcome, everyone. Again, thanks for being here this morning. I'm going to talk primarily about our inventory deployment strategy. I'm going to talk about our branding. I'm going to talk about marketing and advertising initiatives, including an update on our O'Rewards program. I want to close talking about our omnichannel strategy. I know there's a lot of questions surrounding omnichannel and e-commerce. So I want to close with that. I'm also going to open and close with a key theme, and that is some of our competitive advantages. And 2 of our main competitive advantages that we realize are: one, our inventory strength and our inventory deployment strategy; and two, it's our professional parts people and the level of service we provide every day to our customers.

So I'll start off talking about our inventory deployment strategy. Jeff will go into more detail about the frequency of delivery. So with 27 distribution centers across the nation and now we've added 7 hub stores since we met last year in Boston, have a total of 312 hub and superhub store locations across the U.S, just again to strengthen that inventory position, to make the inventory available to our 4,900-plus stores out there for the customer. It's making sure that we got the inventory deployed at the right place throughout the supply chain. If you envision, and I've used this analogy before, if you envision a product life cycle for an individual SKU as a bell curve, the traditional bell curve, managing where that product is deployed within the life cycle is really critical for us. We've got so much space in our stores and our DCs, and we've got to make sure we keep the inventory deployed and positioned accordingly based on where it is. New cars are introduced into the marketplace. The first product we obviously have to get out to the field and into our stores are those maintenance-type items. So things that are going to occur in maintenance very quickly as a few miles are put on the autos. And then you get into the wear-and-tear items down the road. So if you look at that bell curve, we have to look at how we deploy inventory as a part moves into its life cycle for new vehicles. We may deploy that inventory to a DC first. And as demand grows, we'll push it out to a hub system. And then initially -- eventually, we'll get that out to our stores - to our spoke stores.

Another piece that we've really focused on over the past few years is the back side of that life cycle. We've got a good, better, best product offering. So we offer premium products for the customers that want to buy the premium product, and then there's consumers that want the budget or the lower-cost, still high-quality parts for their car, which may be the good or the better product. So what we have to do is to manage based on VIO and all the metrics that we capture for demand to make sure that we not only deploy our inventory accordingly as it grows within the life cycle, but also pull that inventory back within the supply chain appropriately as demand falls off, as there's fewer of those vehicles on the road. So what we'll do is if you've got the 10-, 11-, 12-year-old vehicle that there's a, pick a category, a suspension part or what have you, that we had a good,

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Client Id: 77

better, best offering, we may, over time, lower that to where there's at the spoke store, there's only a good or better product offering, and we pull the best product offering back a layer, back to a hub store, for example. And then eventually, we may pull that back to the DC. It's still available next day for our stores for the consumer that may want that best product offering. So my point is, you have to manage both sides of that bell curve to make sure that by pulling the products that are not selling as quickly for the older vehicles back within the supply chain, you're freeing up space to push the newer SKUs for newer applications out. So it's a balancing act. It's a continual [process]. We got a department that focuses on nothing but our inventory deployment, inventory position for all of our stores every day.

From a supplier standpoint, especially on our private label line, we are leveraging multiple suppliers for our private label brand. And we're doing that for several reasons, but one of the main reasons is the risk mitigation. We may have a private label category where we have vendor A and vendor B. Vendor A may supply the product for half of our DCs and vendor B for the other half, and that way, for whatever reason, whether it's poor availability -- product availability or just being able to fill and keep up with demand, we can shift that as needed to make sure that we continue to have product available and have quality product, and that allows us to do a better job in negotiating our cost on that product.

Vendor financing program. We talked about that on the call. We continue to work with our suppliers to extend our terms with our suppliers. And as you heard on the call, our AP to inventory ratio was around 104.5. Now it's down a little bit, primarily because of our inventory position is a little higher because our sales have been a little softer, but we continue to work with our suppliers to extend our terms.

Talk a little bit about branding. We continue to drive our proprietary brands in the marketplace. Our proprietary brands have become well known in the marketplace as a quality product. Right now, our private label brands -- our proprietary brands make up over 45% of our total sales, and Import Direct is our fastest-growing brand that we offer.

If you look at the brands that are on the slide, a couple of things to point out. One, the national brands. You've seen a lot of those before. On the proprietary brands, you see some familiar names there. One of the things I want to point out there aside from Import Direct, BrakeBest, MasterPro, those -- there's a couple of those brands, Murray and Precision, that not too many years ago, those were national brands. Now they're brands that are exclusive, and they're our brands. They're our proprietary brands. So we own the rights to those brands.

Import Direct. Specifically, we talked a lot about Import Direct. Import Direct is a category that we sell for import vehicles, primarily Asian and European vehicles. There are a lot of shops out there that are import specialists. They focus on import vehicles. And those import specialists don't only need to see fit, form and function like all of our parts are, but they're very critical of the appearance and the look of the product. The product has to look exactly like the product that they're replacing. They don't want something that's really improved or changed. They want it to look exactly like it's replacing. So if you look at the categories on the right-hand side of the slide, we're adding later this year power steering hoses. And that's a great example of a category, where we need that product to look exactly like what came off. Our previous product offering was more of a component assembly where different pieces had to be put together to do the complete job, and you had to use some of the factory fasteners and grommets. With this new program, it is exactly the same assembly that is coming off the car. All the grommets, all the fittings, all the fasteners are there. You don't reuse anything. So again, it is the OE look, fit, form and faction -- or function rather.

Shift to marketing a little bit. I'm not going to go into a great deal of detail. Many of you have seen this slide before. This is just kind of an overview at a high level of some of the focus areas for our marketing team. If you start at the bottom there, you'll see sales events and flyers and advertising radio is still a major advertising medium for us. Some of the areas that we're focusing more on today is digital and social. That's becoming a major avenue for marketing and advertising. We're doing more Facebook, Twitter, Instagram communication with our customers. We're also doing that on the recruiting side from an HR standpoint, just trying to make O'Reilly Auto Parts visible out there in the digital world.

Promotions. We still do a lot of promotions. A lot of themed promotions, which I'll talk about in the slides coming up.

Event sponsorship. I'll talk more about that, but we've continued to promote and sponsor everything from very small community dirt track, to car shows, to major national race events. And then the O'Rewards program. We continue to grow that program, and I'll talk more about that specifically here in the upcoming slide.

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Okay. Let's talk about some of the marketing activities. One, digital. I talked a little bit about that. With the digital channel and all of our marketing channels, we are trying to drive traffic to our stores and our website and build the O'Reilly brand as a whole. We want to build that brand, the O'Reilly brand, in the marketplace. We're shifting to a mobile-first strategy. A few years ago -- or last year, we redeveloped our mobile site as a stand-alone site as a bridge until we got our new website up. And I'll talk more about our e-commerce on that new website in a moment. But e-commerce is moving to mobile devices. 2/3 of our traffic on our website today is on mobile devices, not desktop. So rather than design for the desktop and adapt that to a mobile device, we're seeing a shift. And now we're just taking a mobile-first shift and really focusing on what can we do to optimize that mobile device and still keep the desktop available. We're doing a pre-roll video on YouTube, kind of an extension to radio. You see more and more shift to Netflix, Hulu, YouTube today than the traditional television. And then I'll talk about social media.

Motorsports. We still sponsor a lot of grass roots events, as I said. We still sponsor a lot of car shows, dirt track races. This year, we sponsored our first Cup Series Race in Dallas this spring, The O'Reilly Auto Parts 500. We've sponsored the Saturday night race there for a few years now, but this was our first year to sponsor a national cup race. And we're sponsoring 14 NASCAR and 10 NHRA tracks. We're promoting do-it-right rebate. Do-it-right rebate is the rebates where our consumer's a lot of times with a proprietary brand, but we want to make sure that our consumers have everything they need to complete the job. So an example of the do-it-right rebate would be, you walk into our store to buy a set of brake pads for your car, and we give you an incentive to buy the complete job. So an example -- a specific example is, do-it-right rebate, you come in to buy a set of brake pads, and we sell you the brake pads and the rotors, and we give you $25 off in a card to do that. So it's just a way to promote the entire job to give the customer a discount for doing the entire job and also making sure they have everything to complete the job correctly.

Themed retail events. Proprietary events, we'll talk more about that here on the next slide. I'm not going to go into the bullet points there, okay. So on themed retail events and promotions, you saw this slide last year. Not a lot's changed here. These are examples of themed events that we use, and we promote these themed events across all channels. So we're running a spring break deal down in the bottom. As the weather starts to turn warm, that's when people are more prone to do brake jobs and repairs on their automobiles. So in the spring, we'll run a promotion on brake components, and we'll promote that on digital media, we'll promote that on radio and we'll promote that in print. So each of these are just seasonal events. October, batteries. After the heat of the summer, you start to see your failure. When the weather cools off, and we promote batteries then. All themes, all very targeted to specific seasons.

On the professional side, we continue to promote and market to our professional customers as well. Three examples of those communications to our professional customer, we do an annual catalog for our professional customer where we feature the various programs we have and brands, both national and proprietary brands. On a quarterly basis, we do what we call a toolbox, and that's really a multipage catalog of things they need to do to their jobs and do their business. So it may be diagnostic tools, everything from lift, jack, anything you need to run your business is in that catalog. And then monthly -- on a monthly basis, we publish a 2- to 4-page flyer that will have promotions. And it could be a commodity flyer, where we're promoting oils and chemicals. This example is a Shop Specials where we're promoting certain components where if you buy a set value, you get something in return. Not only a discount, but this one, for example, is an O'Reilly Trash Can. We'll do clocks and counter stools, things like that.

O'Rewards. We talk a lot about O'Rewards. O'Rewards is almost 4 years old now. We started this program in 2013. 3 or 4 years ago, when we talked about O'Rewards, our focus was trying to get our customers signed up for the program. It was all about the numbers. It was all about getting the numbers so we can capture the data. We're still pushing to drive more and more customers to the program, but now our focus has really shifted to how do we best utilize that data. So our marketing teams, being marketers and very crafty, they've developed these catchy names for various segments for our O'Rewards customers.

So what we're able to do now is to segment these customers, and based on their buying habits and their buying frequencies and their various preferences, we break them down into different segments. And we're able to analyze the buying habits by segment. We're also able to analyze buying habits by brand preference. So for example, if you got a customer that, if we run an oil change special and every 90 days they come into our store and they buy an oil change special, exclusive of what brand of oil is running, we know to promote to them based on frequency. Take customer B, that they come in and they buy oil change specials every time we have Castrol on sale. Well, now we have a way to promote to them and remind them when we're running a special on Castrol. So unlimited opportunities for it. We're really focused on it. We're bringing all that data in-house. We had it with a third party prior. We're bringing all that data in-house, and we've got the ability to really dissect that data and use the

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

O'Rewards data from our point-of-sale to drive custom promotion to those O'Rewards members, both in e-mail form and in snail mail form in some cases.

The last slide is omnichannel. A lot of conversation, I know, about omnichannel. We -- I kind of opened up with those key differentiators for us, and that is inventory deployment strategy, having our inventory deployed across 27 DCs, 312 hub stores, a total of almost 5,000 stores, having that product very close to the consumer, and also talked about our focus on customer service and training our parts professionals. We launched our new website on July 13. I hope you guys have taken an opportunity to look at it. It is far superior to anything we have had in the past. It is a responsive design, as we said, which means no matter what device you access our website to, it optimizes for that device. That was a huge improvement. Much more robust search capabilities, Google-type searches, both for part types and autos and different applications. So much more robust search than we had before. Better encryption on data security on the website today and improved content delivery. From a content delivery standpoint, if you looked at our website a few months ago, all of our servers were hosted in Springfield, Missouri. The farther out you got from Springfield, Missouri, the more latency there was in the network and the slower the refresh times were as you went from page to page on our website. Today, we've deployed that workload out to multiple servers across the U.S. We've contracted a company to do that. They've cached a lot of that data to make it much more responsive no matter where you're accessing that data from.

So my last point here about omnichannel is our desire, from an omnichannel perspective, is to replicate that shopping experience that you get in our store, no matter where our customers decide to buy a product, whether they decide to start that transaction in our store or they decide to start that transaction via the telephone or they decide to start that transaction online and buy online, pick up in store; buy online, ship to home. We want to make that the same type of experience for the customer where they have the same benefits, no matter how they decide to buy products. At the end of the day, we want to drive as much of that volume into our store as we can. Ideally, if we can get that consumer into our store, we stand a better chance of increasing our shopping cart. But there are consumers out there that we've learned that just don't want to come into a store. They want to do all their transactions online. So we're working very hard, try to improve that experience -- that online shopping experience to have it more closely resemble the experience that you have in our store.

So with that, I will turn it over to Jeff Shaw.

Jeff M. Shaw - *O'Reilly Automotive, Inc. - Co-President*

Thanks, Greg. Good morning, everyone. It's a pleasure to speak with you this morning. And Brad and I are going to discuss -- take a few minutes this morning to discuss the operations side of our business and talk a little bit about the O'Reilly business model. Now if you ask any of the operators in the back or really any of our management team, our goal in store operation is to execute our mission statement of being the dominant auto parts supplier in all of our market areas. And those are tall words, but it's what we all focus on and work hard at every day. There are several areas that we feel are competitive advantages for us, and we'll review and expand a little on each of them.

First, obviously, being our dual market strategy, our industry-leading parts availability. I'll touch a little bit on our growth focus, and then Brad will finish up talking about our culture-driven leadership and really everything that goes into our top-notch customer service.

Our dual market strategy. We've been committed to our dual market strategy for over 30 years now, and we really have a proven track record of success on both the DIY and the professional side of our business. Something else about our dual market strategy is that by us targeting both sides of the business, it allows us to expand in all sides of the market and most importantly, be able to run profitable stores in those markets. It also leverages our strategically located distribution network across the country, which is really a requirement for the professional side of the business, but it benefits our DIY customers as well. We also expect our store managers to take ownership of their customer service levels and equally drive both sides of the business, so the retail business as well as the professional business.

Now on the professional side of the business, they're represented by a sales force of over 750 team members that are out there in the field calling on customers every day. And when you think about it, the quality of service that it takes to support our professional customers truly helps our retail customers as well.

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Now I'll talk a little bit about our industry-leading parts availability. When you think about the competitive environment, really, it's always been this way. When you think about the competitive environment today, I mean, parts availability and, really, almost immediate parts availability is critical to our success. And with our company evolving from a very traditional background over the years, high inventory availability has really always been a requirement of doing business for us. And we've spent many years fine-tuning our current DC and hub model. We now have 27 -- you've heard this already, 27 strategically located DCs across the country. Now all of these DCs stock an average of 148,000 SKUs and all of our DCs are linked to what we call regional DCs that carry roughly 170,000 or more SKUs. Our DCs deliver to our store -- deliver stock orders to our stores 5 nights a week, and we deliver those stock orders on our fleet of 652 over-the-road trucks. Over -- now over 90% of our stores receive multiple deliveries a day from either their DC or their local hub store. And all of these stores now receive weekend deliveries as well. To supplement our DC network, we have 312 hub stores around the country, deploying that harder-to-find inventory even closer to our customers. And our hubs stock an average of 45,000.

Before I turn over to Brad, I'll touch on our store growth just a little bit. As you can see on the slide here, we have a long track record of aggressive greenfield growth year-over-year. And this year, we plan to open 190 new stores. Now with our -- as I mentioned earlier, with our network of strategically located DCs, we now have the ability to open stores all across the country without overloading store ops in any one given area. Now what this allows us to do is spend more time recruiting and developing our new store teams, and really a good example of that would have been last quarter, when we opened stores in 23 different states.

We've also grown by acquisitions over the years, and we've always been an opportunistic buyer. And this may be old news to most, but just a quick history of our key acquisitions over the years. In 1998, we acquired Hi/LO Auto Supply based in Texas, basically effectively doubling the size of our company overnight. And then we followed that up in 2001 with the acquisition of Mid-State based in Nashville. So this gave us the presence and distribution to grow from in the Southeast. And then in 2005, we acquired Midwest Auto Supply based up in Minneapolis, once again giving us distribution and the ability to start our expansion in the upper Midwest. And then the big one, in 2008, when we basically doubled the size of our company again with the acquisition of CSK Auto. Now CSK gave us a solid footprint on the West Coast and really the ability with the infrastructure and the distribution to start our expansion in the western half of the United States. And then we entered the Northeast in 2012 with the acquisition of VIP Auto based out of Maine. And we followed that up last year with the -- December last year with the acquisition of Bond Auto based out of Vermont. And, as Greg mentioned, we just completed resetting the showroom in the Bond stores, and we're in the process of adding backroom inventory in those stores now.

As you can also see on the slide here, we still have several untapped domestic markets, mainly up in the Northeast, as well as possible international expansion as we continue to grow in the future. So with that, I'll turn over to Brad to finish up on operations.

Brad W. Beckham - *O'Reilly Automotive, Inc. - SVP of Central Store Operations and Sales*

Thanks, Jeff. Good morning, everybody, and welcome. Well, it's my honor to stand in front of you today. I want to tell a bit about my background. A few of you I've met, most of you I haven't, but I look forward to store visits and talking a little bit more. But really, the one thing I wanted to talk about, Mark started out talking about our culture and Jeff talked a lot about our business model, as did Greg and Greg, but one of the things I know a lot of you have heard us talk about for a long time, but me as an operator and growing up with the company, feels like this is probably behind our inventory availability and a lot of other things, the most important part of our success in the past and moving forward is our promote from within culture. I started in 1996 with O'Reilly. It's the only full-time job I've ever had. Started out as a 17-year-old kid, sweeping floors and putting up freight in a pretty rural market in Oklahoma, and I had the opportunity to become a parts specialist and then a night manager, running nights and weekends for the company, and then had an opportunity to be an assistant manager there in Oklahoma. And then when we bought Hi/LO in 1998, I had the opportunity to move down to the Texas market, run my own store, become a district manager. That would be kind of our next rung in management leadership, overseeing 10 or 12 locations, same things as the structure is today. And then in 2001, like Jeff mentioned, when we bought Mid-State out in Nashville, I had the opportunity again just to do whatever the company needed me to do as a young man. Not having a family yet, moved out to the Kentucky and Tennessee market to -- really just laterally from Texas as a district manager. And then when we decided to put a distribution center in Atlanta, Georgia in 2004 to open up in 2005, had the opportunity to move to the Atlanta market and kick off our first couple operational district sales force and all those things there in the Atlanta market. And then had the opportunity to run our -- at the time, in 2007, was our third operational division. We had 3 divisions that ran our company. Quite amazing to me growing up with the company, now we have 10 in almost 5,000 locations. But really just grew up running parts stores for O'Reilly, overseeing our Eastern operation. And if we had time, a

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

Client Id: 77

lot of you had the opportunity to meet my counterpart on the West Coast. While we were growing out East, obviously, buying CSK, Keith Childers oversaw our Western part of operations and sales. And then this time last year, just through growth and success and acquisitions, Keith and I rolled out our counterpart, Robert Dumas, who's based out of Atlanta now, and I relocated to the Springfield market to oversee the center part of the country. So the thing I wanted to talk about with promote from within is our business is, in my opinion, this is all I know, but in my opinion is very different from retail. We've -- we talk to a lot of different people, the competitors and with other retail companies. And auto parts isn't just retail is retail. In the auto parts industry, what we've really found is, and I think for each of you that will go out on store visits, will see if you talk to some of the team members and watch how they interact with customers, whether it be retail customers, DIY customers or do-it-for-me type customers, when you go in the back of the store and you talk to our parts people, they grew up in this business. They grew up working on their own stuff, they grew up working in parts stores and something that they really need is they have to work for somebody that they know, knows the job they're currently in. Meaning that, I wake up every day and I'm based out of Springfield and I go out and travel a lot, but there's not a day that I don't wake up and don't realize that I don't have a job if it's not for those team members out in the stores taking care of our customers every day. And I've been in their shoes, as Keith and Diego and Joey and all the guys you'll meet today, Jacky, that oversee our locations, that promote from within really sets us apart from other companies that may hire that management in from outside that really doesn't understand exactly how the business works day in and day out. Those guys and gals in our stores, they have a very tough job. When people are looking for advice, when they're looking for fast delivery service on the professional side, they're trying to get the car fixed so they can go to work the next day on the retail side, that professional service really ties into our promote from within culture and having these guys and gals that run our stores that know exactly what those customers, those team members are going through every day.

One thing that's really changing in our business, as is all businesses right now in the world, is really the workforce today. And at my age, kind of being not the oldest guy in the room and not the youngest guy in the room, I spend a lot of my time cusping between our leadership and the team members in our stores, millennials. And so one thing that's changing a lot when it comes to the development of our future leaders is we're -- they want to learn a little bit different. I'm going to talk about training here in just a minute on the next slide. But when it comes to leadership development and us having parts people running our company, one thing that we've had to adapt to is the way that we teach the next generation how to lead, how to manage and how to be the next generation of our company. And we have a lot of great things in place for that in our, basically what we call our lead program, which is Leadership Enhancement and Development.

The 3 phrases that we have on this next slide here, we talk about a lot at O'Reilly, just like Mark said this morning with our culture. These aren't just words on a piece of paper or words that are up on a poster on the wall. When we think about and talk about professional -- or excuse me, being the friendliest parts store in town, professional parts people and rolling out the red carpet for every customer that chooses to do business with us, those type phrases go all the way back to the O'Reilly family. These 3 specifically were Charlie O'Reilly. These were some of his favorite quotes that really built our company and has to continue to be a big part of what we do in the future.

Never say no. I think you heard maybe Greg and Mark and even Jeff talk a little bit about never say no. This is absolutely paramount in our business. When you think about a do-it-for-me type shop that calls for a brake job, Greg mentioned the brake pads and the rotors. When they do a brake job, they want to replace everything while they have that car or truck apart. Especially when you get up in the Northeast and colder climates, things rust and you literally have to cut everything off and replace the brake hoses, a lot of suspension parts and things like that, and a lot of those brake jobs have 4, 5, 6, 8 components. And though we do a phenomenal job having all the parts closest to the customer as we possibly can, if we have a brake job that takes 8 parts, it's very often that we may only have 5 or 6 of those parts. And if we're not willing to go the extra mile and maybe go get that brake hose at wherever it may be, obviously, at first we go to our DC or the hub, another O'Reilly location, but our stores are empowered to go, if they have to go get that brake hose from an OE dealer, to make that $300 or $400 brake job sale, we don't just say no to the brake hose and miss the entire job, and that's extremely, extremely important in what we do.

Talked a little bit about technical training and team member development on the training front again. Just the workforce and our customers are ever-changing. Millennials want to learn in a different way. We spend a lot of time really figuring out how the O'Reilly team member of today wants to learn, how customers want to learn how to work on things. People ask me all the time or I hear the thing that maybe the next generation doesn't want to work on their own cars and to me, that's absolutely false. It's that they don't know how. And they didn't quite grow up in an environment where their parents worked on their own stuff and taught them what to do. And so it's our job as a supplier to make sure that we are sharing things in a way that our customers can learn from and continue to work on their own stuff.

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Client Id: 77

But one thing that Greg Henslee mentioned this morning and I want to talk about on the professional side of our business, is how one of our installers or professional customers, how they make money. And I think we all know, and just like Greg mentioned, is they make their money through productivity, through turning their bays, getting that car off the rack, that soccer mom is in the lobby, getting that car off the rack for her -- him or her that much quicker. And one of the things a step further that I always take it is, one of our jobs is these traditional shops that are the bulk of our repair facilities in the U.S., obviously, the national accounts, the Firestones, the Goodyears and the regional-type players that are spread out across the U.S., they're actually -- the way that things are consolidating, they're a threat to the mom-and-pop shop. And so it's our job as a supplier to make sure that these mom-and-pop type garages that have this great history can continue to be successful right along with the national accounts that we continue to partner up with. But those type shops, their threat is the national accounts. And really, the biggest job that they have as the mom-and-pop shop to be successful is obviously turning bays but a step further is to retain technicians. Technicians are kind of like parts people in our industry. They're pretty tough to find a great technician in -- especially in a smaller market, and they're all competing for that technician. And so if that shop cannot have productivity for that technician, get a car off the rack, they lose that technician. That technician is out there turning wrenches. They make their money on flag time. If they can't turn out a certain amount of cars during the day, they're going to go work for another garage. And so when we talk about the relationship we have with our independent shop, it is all about time and ROI and that ability, not just for their benefit, but to make sure they can retain the best technicians and that's all be a win-win situation, and that is so critical to what we do every day.

Real-world training. I think everybody knows we talked about this for many years. It's our way of partnering with the shops, partnering with our suppliers to create an environment of training multiple times a year in every market. As you can see, we continue to improve the way we train our technicians. That would be a facility just like this, where we bring in all the technicians for the San Antonio market to help them stay on the cutting edge of innovation in everything we do and everything they do every day to make sure they can get that car off the rack.

So we're kind of running behind, so I'm trying to blow through this to get to Tom, and know that everybody's ready to see the financial model, get to Q&A. So again, thanks for everything, all the support, and see you here in a little bit.

Thomas G. McFall - *O'Reilly Automotive, Inc. - CFO and EVP of Finance*

Okay. Well, Mark was nice enough to give me a few slides, but he told me, "Tom, whatever you do, make sure we're done at 9:30." Mark -- so we're going to go through these quick. If I go the right direction, that is. Okay, Mark, our slides are gone. Well, that's -- I should have gotten directions from Brad. Oh, there we go, okay.

So here's our store and revenue growth, obviously, a long track history of successful growth on building per unit volumes. As Greg mentioned earlier, we'll hit our 5,000th store here probably sometime in the fourth quarter; guidance for the year, $8.9 billion to $9.1 billion.

Comparable store growth. So obviously, this has been a slower year for our industry and we've talked a lot about it. And I'm sure we'll talk a lot about it here in a few minutes, but coming off 4 really solid years of strong comparable growth, positive comparable store growth since we've been a public company.

Operating profits. As we talked about, we run a multi-unit specialty retailer, a lot of fixed costs, especially when you talk about the service aspect that Jeff and Brad have talked about. Our long-term commitment to our customers in that service level in good times and in bad times builds those relationships. So with that high fixed cost and the slower sales environment, we're going to see a little bit smaller operating profit percentage this year. Our guidance is 9.1 -- 19.1% to 19.5% versus 19.8% last year, still an incredibly strong operating profit profile.

EPS. So over the last 10 years, we've had a 23% compounded annual growth rate. This year, we're looking at $11.77 to $11.87, which everybody is up to date on.

Free cash flow. This slide is in here to show you we're a company that consistently generates a strong level of free cash flow. We have a consistent CapEx that we spent to grow stores and grow DCs but remain our -- maintain a lot of discipline around that. And if we look over the last 4 or 5 years, we've been very effective at reducing our working capital commitment.

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Last slide, use of capital. This remains unchanged for us. Our #1 priority with the use of capital is to continue to invest in our existing store base to make sure that we have the inventory, tools and distribution to continue to outwork and outhustle our competitors and take market share. Two is going to be new store growth, and Jeff talked about that. Three is going to be opportunistic acquisitions where we see bolt-on acquisitions or other opportunities to grow our brand and make a good return. That's going to be our third priority for capital. And then the last was whatever we have left over, we're going to return to our shareholders via buyback, and we can see our buyback statistics up here.

With that, we're going to go right on to the question-and-answer session.

QUESTIONS AND ANSWERS

Thomas G. McFall - *O'Reilly Automotive, Inc. - CFO and EVP of Finance*

Michael, you've got your hand up. I haven't even finished the answer part yet.

Thomas G. McFall - *O'Reilly Automotive, Inc. - CFO and EVP of Finance*

Okay, we'll turn it over to Mark.

Mark Merz - *O'Reilly Automotive, Inc. - VP of Investor Relations, Financial Reporting and Planning*

Okay. We're going to spend the next 40 or 50 minutes doing Q&A. Since this event is being webcast, we're just going to cycle through the room. We'll just go up and down the aisles, and we'll bring you the microphone so that participants who are listening off-site will be able to hear the question. Eric Bird is going to help me with this. He's going to take this half of the room, and I'm going to take this, the left half. Eric is actually our External Reporting and Planning Manager. So he's come along today as help me out. One of his counterparts back in Springfield, Amanda Hare, who couldn't make the trip today because somebody's got to close the books. And even though we're not in a quarter close time, this is actually monthly close week for us. So half of our finance team had to stay back in Springfield and close the books. So I just wanted to tell those guys thanks and -- while we get the opportunity to come out here and interact with you and have a really fun day. So we'll just start at this end of the room and we'll kind of move back, and we'll bring you the microphone. You can ask the questions, and then we'll go forward. So Matt's got his hand up first. So we'll start there.

Matthew J. Fassler - *Goldman Sachs - Analyst*

Thanks a lot. Greg, you seem to want us to ask us questions about online. So I'm happy to oblige.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

I really didn't mean that.

Matthew J. Fassler - *Goldman Sachs - Analyst*

I don't want to disappoint your brother-in-law -- or your brother, excuse me. So 2 questions on the online business. First of all, one of the questions we get about Amazon as an emerging competitor is the information that they seek out about the consumer's car to kind of get it into the database. What level of precision do you seek out from your loyalty customers in particular? And what do you think the wisdom is of trying to get to know the customer in that way? The second question is, just as we think about the online business that you do today, what does the hard parts versus front end mix look like for online? And given that there are clearly logistical challenges to online hard parts to the extent that there is any direct delivery to consumer rather than buy online, pick up in store, how do you manage those challenges?

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Okay. Well, first on the vehicles that our customers have and the way we track that, every point-of-sale transaction that we do, the information related to that transaction, whether it's O'Rewards, we have the information, obviously, of the customer, we know what vehicle it was, and we keep all that. And that's all important data to us for 2 reasons: One, we can -- we plan to leverage that more as time moves along in the way we treat customers online and the way we give them access to information, maybe even provide them things that we would send them about their car. If there was a technical service bulletin or a recall or something like that, then we might be able to notify them. So that's very important data to us. We have every point-of-sale transaction back to -- gosh, I don't know when. We keep buying new...

Thomas G. McFall - *O'Reilly Automotive, Inc. - CFO and EVP of Finance*

Depends on how far you want to go back.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Yes, it goes way back. And accompanying those point-of-sale transactions are all the information we have from the customer, the vehicles. [AAIA], the standards by which parts are looked up, tracks it down to a very specific car type and even to the engine and the trim on the car and stuff like that. So we have all that. That's very, very important to us, and we feel like that's going to be further leveraged in the future. I don't think that anyone would have more data than we have on that and really has the ability to, because at the end of the day, the information you can have about the car, the most dissected level is this AAIA table which assigns a specific index number to every possible variation of a car. And once you get to that index number, that's all you need to know about that car. So we have all that. And then relative to the mix online, most of our business online is buy online, pick up in store. People like using their mobile phones, especially younger people. I put mine away because I knew if I sat there with it, I'd fiddle with it. You know what I mean? So I decide to put it away. People -- these are used for a lot of things, mainly for research. Most of us feel like that if you go into a -- if you're going to -- I do this more at Lowe's, Home Depot because I've -- I do some home DIY repair and stuff. I'm not that as good at that as I am in cars, but I'll research online before I go to a Home Depot or Lowe's to buy things just to get information. I think a lot of customers do that. From a business extent, I think we're about 75% pick-up in stores. Is that right?

Thomas G. McFall - *O'Reilly Automotive, Inc. - CFO and EVP of Finance*

75%.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Yes, 75% pick up in stores. 25% buy online. The mix of business -- I'm not that versed in what our mix is. A lot of things that would be DIY stuff, that would be front of the store, they don't ship well to online customers. You know what I mean? It's oils and anti-freeze and stuff like that. It doesn't make sense to ship a 10-pound gallon of anti-freeze that sells for $7 or $8 UPS. I mean, that's more -- and a lot of our volume on retail out front stuff is that kind of stuff, but a lot of that stuff is bought and picked up in the store. But I don't have a percentage on the -- what we've put upfront.

Thomas G. McFall - *O'Reilly Automotive, Inc. - CFO and EVP of Finance*

If we looked at our online category sales, it wouldn't be very representative of what's sold online because so many of the things that are great online used to be great catalog. When you look at performance, you look at dress-up, you look at accessories, that's never been a huge part of our business. So if you looked at what our mix was compared to the online mix, it would be different just because we don't carry a lot of those parts because they've never been great parts store parts. If you look at performance parts, we have a performance section. And when you go out there today, you'll see some performance items, but it is a small drop in the bucket of what potentially you could get if you were a car enthusiast working

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

on an old muscle car or European car or you wanted to soup up your car or get a drift car. So our mix is going to be more focused on things that we carry.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Yes?

Seth Ian Sigman - *Credit Suisse AG, Research Division - United States Hardline Retail Equity Research Analyst*

Seth Sigman, Credit Suisse. My question is around pricing. So Greg, you talked about Dorman and the move to MAP pricing. How significant of a change is that? And are there indications that maybe some of the other suppliers could follow?

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

This is being webcast. I'm trying to be cognizant of that. It's significant. They're a large supplier. Dorman, as some of you may know, because they're publicly traded and they supply a lot of things in the aftermarket, it wouldn't typically be aftermarket parts. They seek out products that are failing at the OE level under warranties, and they produce those parts into the aftermarket. They've been very helpful to us and my competitors in growing the aftermarket share of the business. Really, what they did is they did under pressure from all of us who represent that brand, recognizing that some of the online players are less worried about the margin they make on a product and more worried about leveraging really the only strength that I feel like they have, and that is they sell at a price lower than a brick-and-mortar retailer. And an example I use is a situation where it was brought to our attention that an intake manifold had sold for a price of, say, $40 online when our cost was like $116. We sold it for significantly more than that. And that was kind of the model. We talked to Dorman and said, "You know what? Something's going to change here. We got to think about the way we source products." And what is realized, which many of you know if you're familiar with Amazon and others, is they use these spiders to go around and find the lowest pricing and so forth. A used manifold had sold on eBay for $40, and that drove Amazon's system to price this manifold that they were buying through a warehouse distributor paying more than what my cost is significantly, for $40. So why are you going to lose that much money making a transaction? Well, it's a very systematic thing, and it's their business model. Dorman doesn't want that kind of issue to affect their relationship with the customers that represent 90%, high 90s percent of their business. So they did this. They hired a consulting firm. A consulting firm interviewed me and, I assume, all my competitors and others. And this is the solution they came up with. So I like the solution, and we'll see how it plays out. But it's significant to us just from the perspective that if customers look online for Dorman products and see a price that's lower today, we could potentially get a question about it in the store. That does not happen as often as one might think, but the potential exists and they're just simply protecting themselves against that. So we like it. And yes, I would think that we'll see other suppliers do that. Many of our suppliers -- I've got a list in my briefcase of our suppliers. We monitor and ask our suppliers, and I put pressure on our suppliers, frankly, to not allow the value of their products to be eroded. And many of our suppliers just don't sell online. They just don't allow it with these online-only retailers. They do allow it with the brick-and-mortar retailers who also sell online because they want to protect the value of their brands. If all of a sudden -- I don't know, WIX filters or Gates were sold online for significantly less than what I sell them for, would I be as enthused about selling those brands? Well, maybe not. And frankly, we've helped build those brands. And could I buy a product that wasn't branded, maybe put it in a private label box and sell it for less than I sell WIX or Gates? I absolutely could. Do I want to do that? No, I like Gates and WIX. But would I do that if we were put under pressure from a price standpoint? I might. So I think most suppliers are pretty cognizant of that. And we've made it very clear, kind of our desire from a supplier standpoint, and I think our competitors have done the same thing.

Gregory D. Johnson - *O'Reilly Automotive, Inc. - Co-President*

If I could add to that [a little bit], Greg. We continue to preach to our suppliers about our concern for them commoditizing their brands, and we -- our suppliers are really focused on the value of their premium brands. And by allowing their branded products to be sold on the Internet for these significantly reduced prices, all they're doing is commoditizing those brands. Dorman is a pioneer in this. Dorman's had a MAP pricing program for a couple of years but it only represented a couple of thousand SKUs. Their new program is actually an MRP program. It's not MAP pricing. It's minimum retail price where you can't get to the shopping cart and bypass that, and it's across the majority of their product line. So they've told us

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

that they have teeth in the program and it's a program that will stick, and we've got a lot of confidence in that program and hope some of the other suppliers follow.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Holley is another supplier that did this. They did it before Dorman did. And they've ended up taking most of their products off of some of those -- the types of online players that we're talking. They've taken their products off those sites because they wouldn't abide by the MAP pricing, which will ultimately be what Dorman will do because there's a good chance that these sites will not abide by the new rule. Yes?

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

Michael Lasser from UBS. Greg, why isn't 20% margin the right level of profitability for this business, especially when you just mentioned that some of your competitors are not willing to earn a profit?

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Now, why is what margins?

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

A 20% operating margin the right level of profitability for the business?

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Well, I don't know if it is right. It's what we've achieved at different points quarterly. We're mid 19s now. I've worked my whole life to get to that. So it's -- I don't know if it's the right operating margin or not, but it's kind of where we've arrived. And it's kind of like when you climb that mountain, you don't want to slide backwards and then climb again. It's what we're trying to maintain. And if we can incrementally grow that through more operating efficiencies and better cost of goods and managing our price, then that's great. But it's not necessarily right. When I -- I remember back in -- it would have been maybe the late '90s or something like that, David O'Reilly and I having a conversation when I was first made Co-President, and our target then was an 11% operating profit. We've been afforded this growth in operating margin as we've improved, growing through scale and developed better relationships with vendors because frankly, we're a pretty valued customer with most of our suppliers. We represent their brands well. I think the O'Reilly brand in general represents quality and knowledge and good customer service, and people like to have their brands aligned with us. And I think because of that, we've benefited from better acquisition cost than some of our other competitors, maybe even smaller competitors, which scale plays in there significantly. But yes, I wouldn't say it's the right operating profit. I will just say it's what we've been able to achieve.

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

And just a quick follow-up either for you or Mark. Does your algorithm work? Can you continue to expand your operating margin if the comp is maintained at this 2% level that you guided to at the midpoint for the rest of the year?

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Over an extended period of time, as cost of operation continues to increase through lease increases, payroll increases, all those kinds of things, you've got to have comp. 2% is probably the tipping point right in there. Yes?

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Thomas G. McFall - *O'Reilly Automotive, Inc. - CFO and EVP of Finance*

We're probably 2.5% to leverage, obviously depends on what we did last year. Michael, what I would tell you is that we are not -- percents are a derivative of the numbers, right. So we're focused on comp gross margin dollars. We're focused on operating profit dollars. And if we look at our history, the most effective way for us to do that is to continue to take market share profitably. And to return into a stronger comp store sales path is important, and continuing to grow our brand and extend the reach to customers is where our opportunity is to continue to grow operating profit dollars.

Simeon Ari Gutman - *Morgan Stanley, Research Division - Executive Director*

Simeon Gutman, Morgan Stanley. My question is on gross margin. You made a pretty compelling case why the channel shouldn't get disintermediated from online. But I think the fallout, the risk is probably greater on the gross margin side through price transparency. Can you talk about how often that's occurring in the business? Is there room on the vendors to sort of -- to take cost of goods down or to share in this? Is it a recurring issue? Is it -- does it present itself in any of the numbers today?

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

We had a pretty robust price matching policy. We have for a long time. And customers aren't shy about asking us to reduce price if they find a price lower, even though -- and we advertise this. We advertise that we have this low price guarantee and so forth. Somewhere around -- on the DIY side, somewhere around 1%, maybe just slightly -- we have right around 1% of our sales are price matched. And that would include if we were asked to lower price because of an online discount or something like that. It's not that common of a conversation. We do more price overrides on the do-it-for-me side, but it's not because of online. It's because we have a lot of competitors who are -- they mistakenly feel like the way to develop a relationship with a repair shop is to beat everyone's price. And we've just learned over the years that, that just doesn't work. At the end of the day, these guys -- like Brad was talking about, what drives these customers to buy parts from any single supplier is the service relationship, how quick can you get them parts. They're so challenged to maintain employment of these expert technicians. And these expert technicians -- Brad used the term flag. I don't know if you all know what that means. What it means is these guys are on commission. They simply make a portion of the labor that's charged on the job. And ideally, what a shop can do is if a technician works 40 hours a week, if they can flag and get paid for 60 hours a week, then they've got a good relationship with that technician. That doesn't work if they don't have a great parts supplier. The price they pay for parts are, sure it's important, but it's not paramount. The paramount issue is how quick can you get me the parts. So if you can have a competitive price and give them the parts in 30 minutes, you're in a really, really good position.

Simeon Ari Gutman - *Morgan Stanley, Research Division - Executive Director*

My follow-up is it seems like some of the national service chains are consolidating the service side of the industry a little faster than they were before. So how do you see the structure evolving? O'Reilly traditionally hasn't gone out of its way to service the large national chains. It's been a lower margin profile. Would that -- could that change down the road especially if that growth continues?

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Yes, I think you will see us be more aggressive on these national accounts as there continues to be some consolidation. There's been -- it's a very fragmented business, and it continues to be today even with what Carl Icahn has done. He still has, what, maybe -- not even quite 1% of the total shops. Some of the best shops are owner operators. They're guys that -- they were a dealership technician. They decided to go out on their own. They're highly trained. They're -- highly trained technicians like to work for owners that are highly trained, and that's where they go. So some of our best customers are those types of shops. But on the lighter, do-it-for-me side are these national chains like Pep Boys and BSRO and Christian Brothers and all these other high-quality shops that do a great job but they service a different portion of the industry than some of the privately owned shops. But yes, I think you will see us be more aggressive on some of these national accounts in the coming years as that consolidation continues to happen. And again, as Tom said, our focus is really about the gross margin dollar yield, not so much the percentage. And if the industry

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

starts -- continues to go that way from a consolidation standpoint, then of course, we would want to have good relationships and more focus on these national accounts.

Brad W. Beckham - *O'Reilly Automotive, Inc. - SVP of Central Store Operations and Sales*

I think, Greg, the other thing I'd say, on the national accounts, one thing you guys wouldn't see that may surprise you is how much business we do with the national and regional accounts even if we're just second or third call. Just because we didn't get the first call deal doesn't mean that we don't do a lot of business with those guys. On a local level, no matter what deal we make with the bigger corporations on the DIFM side, it's still -- when it gets down to the local level at a Firestone, Goodyear, whatever the case may be, it's all -- it's still all about time, productivity, ROI and turning -- and getting that car off the rack. And so our local store manager, their local store manager, we still have first call in a lot of the cases though we may not have the corporate first call deal. And then overall, we may have second call, but that's still worth a lot of money. And so we actually do a really good job on the national and regional accounts even though we may or may not be first call. The Northeast hurts us a little bit from being coast-to-coast. We're not quite yet. Obviously, we're working on it every day with our growth and expansion in the Northeast. So that's inhibited us a little bit from having that overall first call deal, but that's going to just continue to be better and better for us.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Really, just to add to that, again. That was kind of our strategy for a long time. So on the first call it gets kind of expensive. And if you can get the second call because of relationships and service, you can do as much volume and have better yield and it can be a better relationship. The -- sometimes the kind of first call on these national accounts can be bought and -- but it doesn't mean that that's what the store managers that are running the shops are going to do, simply because they're trying to maintain technicians. They're doing what our store managers do. You'd have to block and tackle every day and do things that make customers happy. And it's going to be hard to explain to a customer it's going to take 6 hours to get a part that I could get in an hour because I can buy it cheaper from this guy, and this is going to save you $10 versus the other guy. You know what I mean? So...

Brian William Nagel - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Brian Nagel from Oppenheimer. My question is on private label. And given what we're talking about today with, I guess, let's say, a growing influence of Internet in your business and then maybe even some of the actions that Dorman take -- has taken with the pricing, has that shifted your thinking towards private label? How should we think about the private label offering at O'Reilly evolving from here?

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Yes. Well, here's what I'll tell you. Online is shifting my -- is not shifting my thinking on anything. It is -- I talk about it more with analysts and investors than I do with anyone else other than our IT folks. Josh Estep that runs our e-commerce site, I talk to him occasionally. And we spend time on this just because we know that people are going to source information about us and, in the future, more and more information on how to repair their cars and things like that online. And then B2B, we have this big business, but it is not something with -- that we spend a lot of time on. Last night at dinner, there's 12 of us at dinner here, our big managers in our company. And how many we talked about online? Once. It's just not -- it's not as prevalent as you all think it is. I know it's top of mind to you all because Amazon has gotten so big and they're so powerful in so many pieces of retail. It's just not that big of a piece of our business other than B2B. So private label products really wouldn't play into what we do there, although they are advantageous. A lot of our private label products typically aren't sold online from anyone but us. That's not to say that you couldn't google Amazon brake pads and a picture of one of our brake pads is going to come up. I have no clue why. I did it yesterday in the car because somebody had mentioned that they had -- one of you all had asked that question and said they could see that, and I thought, that's got to be wrong. And then sure enough, I did it and there's one set of brake pads on Amazon. I don't -- I think if you ordered it, you wouldn't get it. Some things you order on Amazon, you never get. I found this out with my granddaughter on these -- I'll just call them the sky lanterns. You light and they blow, go up in the air. I ordered some of those and I kind of forgot I ordered them. And 3 months later, they showed up. I didn't realize they were coming from China and then -- but it's -- some things are like that. Why our brake pads would be on there, I have no idea. We're going to continue to expand

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

our private label strategy just because it's a good strategy. It works well for us. We don't like the fact that some of our brick-and-mortar competitors have like brands as us in many cases, and will use those as a means to garner relationships by using price as kind of a weapon on the brands that we've helped develop. And we feel like we're better off protecting our gross margin and the quality and the sourcing of products. With a private label, we've gotten big enough that if a manufacturer has problems with one part -- and we've had this on, I remember, fuel pumps a few years ago, where we had one manufacturer and they had a problem with certain GM fuel pumps in production. And if you've got one supplier, you've just got a problem. And so we had multiple suppliers in their private label box, and it just helps us from many perspectives. Plus unlike Import Direct, where it's so important that you manage the fit, form and function of the product, one manufacturer just is not going to do a good job on that. They're going to end up buying some things out because they don't want to spend the CapEx, the tool to make something that's exactly like the OE. They may buy it outside. And you just have a better opportunity to control quality and the things that you represent the product as being if you've mixed suppliers into a private label package. That doesn't mean that we don't have some really, really good national brands that it would be very hard for us not to carry. I can't name them all, but some would be like WIX filters or Gates belts and hoses. There's just a number of them, Standard Motor Products ignition and emission. Some of those would just be hard to get away from. And we have no reason that we would ever want to get away from them. They're good managers of their brand. They produce great products, and they're quick to market with late-model coverage and things like that.

Mark Merz - *O'Reilly Automotive, Inc. - VP of Investor Relations, Financial Reporting and Planning*

Greg, do you have something to add?

Gregory D. Johnson - *O'Reilly Automotive, Inc. - Co-President*

Yes, if I could add to that. Greg pretty much made my point there at the end. But I think sometimes, there's a perception that our proprietary brands or private label products are associated with our entry-level product offering. And that's just not the case anymore. I mean, some of -- a lot of our private labels now are our premium products. And what you'll find is our merchants make multiple trips a year to China to visit factories and make sure that the quality is there and we're buying from the leading-edge factories. And there are several cases where the manufacturer that's manufacturing our private label product may be the same manufacturers manufacturing a national branded product or the OE product. So our private label or proprietary brands are high-quality products today.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

They're picking you guys. So I'm not...

Yani Alexio - *MoffettNathanson - Analyst*

This is Yani Alexio for Greg Melich at MoffettNathanson. So talking about margins and comps a bit further, how are you thinking about margins moving forward? And I know you're not guiding beyond maybe what we would all want to know. But we saw a mild winter on top of another mild winter, and it looks like a mild summer now. Moving forward, would you be willing to give up a little bit of margins to get customers through the door and boost traffic?

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

You mean by lowering prices?

Yani Alexio - *MoffettNathanson - Analyst*

Yes.

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Well, that -- we don't have any plan to do that. Bill Rhodes said this the other day, and then I've had the same experience, "I have yet to ever lower prices that I saw a good result." You know what I mean? Lower prices on hard parts really don't drive more customers to come buy those parts. These are failure parts. They're parts that just -- when they fail, people have a problem they have to solve. And many times, it's solved do-it-for-me. Sometimes, it's solved DIY. You have to be competitive with your competitors. Our plan is absolutely not to initiate lowering prices on hard parts as a way to yield more customer traffic. I just -- one, I don't think it would do it; and two, if you're trying to solve a sales problem, well, it gets a lot harder if you've got to increase units significantly to make up for the dollars you lost by lowering prices. I don't know, Tom, if you have any additional comments on that.

Thomas G. McFall - *O'Reilly Automotive, Inc. - CFO and EVP of Finance*

When we look at the scale of the companies, we had a competitor in the early '90s that's significantly bigger than we were and then what Advance was, Pep Boys, and they did a very good job of -- they had a significant buying advantage and they used that retail price to grow their brand. Now that the big 4 chains are about the same size, we buy in the same area. So when we look at what that pricing is, to the extent that you went out and try to grab market share by reducing price, we would see a reaction from everyone that would be equal. When we really look at what customers' buying patterns are, number one is availability, number two is service, and number three is competitive price. When we look at the things that we advertise, and we and our competitors advertise the same types of seasonal commodities and run similar programs because people are driven to go to stores for different repairs at certain times of the year, when we run those, what we're really trying to do is establish that relationship with the customer. So when they have a failure part, when their water pump breaks, they have a store preference. They've been there before. They've met the person at the counter and they've had a good experience. When that failure part happens, which is a huge part of our business, that you're top of mind and you have that relationship.

Steven Paul Forbes - *Guggenheim Securities, LLC, Research Division - Analyst*

Steve Forbes, Guggenheim. So you talked about the growing and aging vehicle population, but can you expand on the demographics of the fleet? So the way I kind of think about it is if you look at the vehicle in those core maintenance years, is there a make or model or subset that make up a disproportionate amount of the fleet? As we try to think about how nontraditional competitors can enter or target a subset of the population to be disruptive, I mean, is that a risk as you think about the evolution of the industry and how those nontraditional competitors like Amazon are going to be a bigger threat, right, as the market evolves?

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Yes, yes. If there are any unusual circumstances relative to the population, I'm unaware of those. The evolution of the car population in the U.S. has been that the percentage of vehicles that are represented by the U.S. manufacturers has been decreasing as Asian and Europeans have been increasing. So that has been a change, and that's pretty significant from an inventory deployment standpoint. The reason Import Direct exists and the reason we put so much emphasis on that brand is because many of the technicians that work on those cars are technicians that want to use OE fit, form and function products. So we've really had to kind of change our strategy. The aftermarket exists in large part because back years ago when the OE dealers made their money selling cars and weren't as interested in service and parts, the aftermarket kind of came in and filled that need. And many times, the OE parts really weren't that great and there were a lot of improvements that could be made in the aftermarket to the parts. And the aftermarket kind of existed to sell better parts. The chassis parts that we sell were beefier and better than the parts that came on the cars, the shock absorbers. You may remember your parents maybe putting Monroe shocks on the cars that's better than the OE. And today, the OE parts are pretty good. So if you're OE equivalent, then you're doing pretty well, especially on Asian and European cars. So that's the biggest change that's taken place. None of those things are more -- I guess, make online better than brick-and-mortar with the exception of, early on in this transition, WORLDPAC came into existence. And WORLDPAC did a really nice job early on not of only providing a good electronic access to these parts via their speedDIAL product but also putting these OE parts out there available to the aftermarket. I think that us and AutoZone and others are caught up to that. And obviously, WORLDPAC wasn't a big business when it was for sale. I think everybody knows that it was about $1

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

billion in sales. So it's a good-sized business but isn't a huge amount of the transaction. But I think most of us have kind of copied what WORLDPAC deployed, and that is this OE fit, form and function. Ours is called Import Direct. Yes?

Steven Paul Forbes - *Guggenheim Securities, LLC, Research Division - Analyst*

And then just a quick follow-up. So you talk about improving quality right across your private brand and exclusive offering. So as we try to digest, right, the margin structure question and just where the business is evolving, how's your thought process around reinvesting margin benefits, right, that you may accrue over time through direct sourcing or in private brand penetration? The percentage of reinvestment back into quality, has your thought process around the long-term benefits of that changed given what has transpired?

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Greg, do you want to take that relative to the product? Or do you want me to take it?

Gregory D. Johnson - *O'Reilly Automotive, Inc. - Co-President*

You take it.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Okay, I'll take it. Greg manages our merchandise department, as I mentioned. Quality is paramount for us. The products that we put in the box is one of the most important things that we look at, one, from just a consumer safety standpoint; and, two, just a brand reputation standpoint. So yes, I think that -- well, I think what you've seen, even though we have achieved these better gross margin yields that we've achieved since buying CSK, I think that we could have achieved significantly more have we not already done what you mentioned, and that's reinvesting in the quality of the product. I think back to -- well, brake rotors. Brakes is a huge category for us. The steel part of brakes is almost a commodity of steel. There's a certain price the steel is worth, and a good way to take cost out of that brake rotor is to decrease the amount that you put in. Guess what many of our competitors did? They took steel out of the rotor. If it -- rotors. They call it stack height. If you put 2 brake pads together and the rotor had to equal a very specific height in order to fit into the brake caliber and you can -- but you can change what the makeup of that height is. You can -- and you can't really do it with the pads because you never knew -- know what brand a pad a customer is going to use. But you can do it in the rotor. If the wall thickness of each side of the rotor was supposed to be, I don't know, let's say, 3/8 inch but it's a lot more technical than that, but let's say 3/8 inch, could you cut it to 1/4 inch each to make the veins in the middle wider and say you're doing it to make the rotor cool better because it allows more air in? You could. And many people wouldn't even notice that you did it. Does it create a safety issue? Yes. It doesn't cool better if there is not as much metal to dissipate heat. So it becomes a safety issue. Could you do it and get away with it? Yes. Most people don't maximize their brakes. Most people are just driving their cars. If it's a minivan that maybe the parents use to haul kids to games and stuff like that, the brakes are never really taxed. If you ever got in a bad situation like you took it on vacation up in the Rocky Mountains and you're going up Monarch Pass, yes, you might have a problem. And we just -- we didn't do that. As a matter of fact, we went the opposite direction. We went and bought the OE equivalent, beefiest rotors you could buy, and represented that we're not going to do what the other guys did. And we put -- equipped all of our salesmen with these rotor and pad stacks to show the difference. And many of our competitors have since kind of gone away from that because they were embarrassed of what they've done. So yes, we've already done what you've mentioned. You bet.

Alan Michael Rifkin - *BTIG, LLC, Research Division - MD and Retail Hardlines and Broadlines Research Analyst*

Greg, it's Alan Rifkin from BTIG. You mentioned some weakness, though, from some ethnic groups. I was wondering if you can help dimensionalize that, what the real exposure is and what are you doing to combat that.

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Well, we really don't know what the exposure is. We know it's real. Diego, who sits in the back of the room there, he lives down here. And we deal with this -- he deals with this all the time. [Jaime], our RFSM -- I'm sorry, our DSM, I was talking to yesterday down here. There's areas where there were Hispanic shops in neighborhoods that are most prevalent Hispanic. Many of the shops just closed. People have -- they're just -- I'm assuming that they were not registered in the U.S., weren't legal in the U.S. and they're worried about being caught and deported. It's had an effect in markets that are heavy Hispanic. And it's not just something that we've seen. It's something that's most retailers have seen. I don't know who else is talking about it. The only 2 I've heard talk about it are Target and Walmart and those in our business. It's a conversation in our business among other competitors. NPD, who most of you are familiar with, I don't know how much -- if you buy data from them or not, I assume they sell you data. Well, they give it to me because I'm a contributor. But Don Unser that runs that will tell you, if you -- I don't know if he sells the data or gives it again. He might make you pay him to get it, but he would show you on a map where the heavy Hispanic population areas are in the United States and how all the contributors of data to what they aggregate shows the performance of those markets versus markets that aren't heavy Hispanic. And I think it's a material difference. So I think it's been a factor. My perception is -- and I think that these that operates stores -- I know Keith Childers in back of the room, we've talked about this a lot. I think it's one of the most significant contributors to the softness that we have in comp store sales right now.

Alan Michael Rifkin - *BTIG, LLC, Research Division - MD and Retail Hardlines and Broadlines Research Analyst*

So what are you doing to combat that?

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Well, there's not a lot I can do. There's not a lot we can do. I've heard that there are some grocery stores and others in some of these markets that are opening later at night than they did before, but we've not done that. We really have done very little to remedy, thinking that it's one of those things that -- because I feel like it's politically driven, that over time, it kind of cures as maybe things settle down, and some of the campaign promises and platforms kind of erode as they seem to do through a presidency's tenure, but that has not been the case yet.

Alan Michael Rifkin - *BTIG, LLC, Research Division - MD and Retail Hardlines and Broadlines Research Analyst*

Okay. And my follow-up. Last quarter, for the first time in a long time, DIY outpaced the DIFM. I was wondering now that you've had more time, what do you think is behind that? Did DIY accelerate at a greater rate than DIFM? Or what is really behind that phenomenon? And how sustainable do you think it is?

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Well, I think -- our DIY business has been pretty good for a long time. We were really surprised at the softness in the do-it-for-me business. I think part of it is related to this Hispanic issue, part of it the soft winter, things like that. Brad or Jeff, I don't know if you guys have any comments on that. But when it comes to our do-it-for-me business currently not performing as well as what our DIY is just from a percentage standpoint, what would you say the primary drivers are?

Jeff M. Shaw - *O'Reilly Automotive, Inc. - Co-President*

What we hear from our sales force is just that -- talking to the shops and we've got 750 TSMs out there, what we read in recaps and hear from the sales force is just the shops are slower. They're just not having the traffic. The cars aren't in there like they were the year before. Their business is just off and been off. And there again, there's no doubt that weather has got something to do with that. The Hispanic customer, they're challenged -- or for one reason or another. But I don't know that we've got just a great answer for what is driving that.

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

And here in San Antonio, it's pretty good. Two stores we were at yesterday were busy. They're both comping pretty well. There's areas in the country where that's not the case. Most of those areas are Hispanic-dominant areas. And in some cases, it's where shops -- some of these Hispanic-owned shops have just closed their doors for now.

Thomas G. McFall - *O'Reilly Automotive, Inc. - CFO and EVP of Finance*

Alan, to answer your other part of your question. We would say this is an anomaly over the long term because of vehicle complexity primarily because of the age of the population. We would expect do-it-for-me to continue to be the faster grower, but it kind of shows the cyclical nature of our business and how weather-driven events can change the overall long-term dynamics for short periods of time.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Yes. Well, and something else I'd add. And again, I hate talking about politics. Every time I turn on the TV, that's all I hear. But I think a little bit of the political headbutting that we have in the country now comes from economic uncertainty among lower-income people. Many of our customers are lower-income customers on the DIY side. On the do-it-for-me side, of course, you have the worry of some of the shop owners that may not open their door because they may not -- they shouldn't be in the U.S. to begin with, or they have team members or employees that shouldn't be in the country to begin with. So I think that's -- part of what we're seeing is a little bit of deferral of some of the maintenance that could be being done on cars. I said this on the call. When we had -- we were running 6%, 7% comps, I think we were kind of benefiting from some of the maintenance that have been -- maintenance or repairs that have been deferred and we may be building some deferral right now as opposed to benefiting from it.

Mark Merz - *O'Reilly Automotive, Inc. - VP of Investor Relations, Financial Reporting and Planning*

Greg or Jeff, I think Bret may have a question for you.

Bret David Jordan - *Jefferies LLC, Research Division - Equity Analyst*

Yes. Greg, this is Bret Jordan, Jefferies. You commented earlier about you can buy first call on DIFM. And are you seeing any brick-and-mortar competition that -- increasing on price? Obviously, Advance is trying to bring their business back, their brands back into the stores. I've talked to some independent distributors. You're talking specifically about Texas becoming pretty aggressive on price. Are you seeing much competitive change out of them? And I guess is the brand or price mix a headwind at all?

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Well, I could tell you Texas is an incredibly competitive market with XL in Houston, Full Service here in San Antonio, just different competitors that have -- and XL is growing into DSW now. So yes, it's competitive and it's always been price-competitive. Service always wins, but you have to be close on price. I don't think I've really seen a significant change over the last year or 2. I think it's pretty much the same as what it was. One difference is XL has changed ownership in the last year or 2. They went to a private equity company owns them now, and Mike Odell has now been hired from -- he used to run Pep Boys and now runs XL. So they're under a little bit different management. But we've not seen a significant change in the way they price. What we have seen is a change in the way they service. I think they -- XL was pretty strong on price for really their whole existence. What they've realized, I think, is that it's hard for them to penetrate the market as deep as they would ideally like to out of the number of locations that they had. Having the part closer to the customer matters most in being able to provide that 30-minute service, and they simply put in more smaller satellite locations in order to increase the level of service that they can give customers, really kind of emulating the model we have in a

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

different way. They don't do much retail, but they're off the beaten path locations. There's more of them now than they were a few years ago just to provide better service to customers.

Mark Merz - *O'Reilly Automotive, Inc. - VP of Investor Relations, Financial Reporting and Planning*

I think Eric's going to catch a question up front, but Jeff Shaw and Greg Johnson are sitting here and they look really tired. So we need to ask them.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

You guys need to answer a question.

Taylor Finch - *Century Management - Analyst*

Greg, Taylor Finch with Century Management. Two questions for you kind of on descriptive sales mix. Firstly, here in this DC, I know we've got -- you mentioned 132,000 SKUs. I forget what the typical store has, if it's 50,000 or 70,000 or something like that.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

It's not quite that many.

Taylor Finch - *Century Management - Analyst*

Okay, okay. But I know a huge part of your advantage is the daily delivery out of the store, 3x daily. What portion of your sales -- if you could gauge that, come from that longer tail past what's stocked in store, what kind of comes into the -- what this DC is able to get that other players aren't able to get that day?

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Yes, okay. Well, here's the way it lays out. The -- a typical store would be somewhere in the 22,000 to 24,000 SKUs, something like that. Hub stores, we would average 44,000, I think, but we would have big hub stores that would have more in the 70-plus thousand SKUs. Most of our DCs would be in that 132,000 to 150,000, 160,000. When they get to full capacity, they seem to have more SKUs where they're servicing a more diverse population. The business that is not sold -- the best parts are stocked in the stores. The 22,000 SKU inventory would be the very best movers. And by far, the majority of our volume is done out of those. And I don't have percentages for you. Let me take you where I'm going. The SKUs that we have that we pick up from a hub, or a hub store has a service per regional area where you pick up from a DC, they would represent a -- really a small portion of our sales in the scheme of things. I would -- I'm just going to guess the number, but let's say it represents 10% of a typical store's business on these pick-ups. But it's paramount in managing the relationship. If -- when a customer calls a shop and the answer is, "I have this part in the store. I can have you the other one in 1.5 hours," and your competitor says, "I have this one in the store," because we all stock similar inventory, "and I can have the other one for you tomorrow," guess what the shop does? "Okay, thanks. I'll call you back." And they call us and say, "I'll take the 1.5 hours." So time always wins. So the reason I'm telling it to you this way is that it's hard to justify what we do from a hub store and a distribution standpoint based solely on the sales of these slower moving parts because if we didn't have these slower moving parts, we wouldn't sell the other stuff -- as much as the other stuff. AutoZone back in their -- early in their life, they focused just on being the best and lowest priced and most aggressive on like an 18,000 SKU mix. So we hired one of their product managers named [Don Stirbeck] years and years ago. And what he told us was their strategy was, "Sell what we got and let's not focus on this other stuff because it just doesn't matter. We can make a fortune selling the stuff that we have." And they did pretty well, but the reality is you can't be in the do-it-for-me business doing that because the shop just eventually just says, "You know what, I don't have the time to call these guys to find out that I'm going to get it tomorrow. I've got to be able to get it today." Because -- and it's available today. So that's kind of the justification for the additional inventory.

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Jeff M. Shaw - *O'Reilly Automotive, Inc. - Co-President*

And the other (inaudible) and what that means.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Yes, that's right, yes, yes. I was trying to mention both there, yes.

Taylor Finch - *Century Management - Analyst*

Yes. Second question -- and again, so my question -- you guys, you say that you're top sellers of brakes and batteries and hoses and...

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Motor oil.

Taylor Finch - *Century Management - Analyst*

Yes, things that come with that. Just kind of thinking about electric cars, they need -- still need brakes and batteries but won't need as much as the other stuff. I don't know exactly what they need, but...

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

I could tell you if you want to hear about it.

Taylor Finch - *Century Management - Analyst*

I do in fact, so just curious if you think about your sales mix, about things that are applicable to internal combustion engine versus things that are applicable to every car, whether electric or internal combustion, do you have any kind of sense of what -- is there any kind of big disproportionate mix, think internal combustion? Or what would be the mix of something that could be applicable to every car on the road?

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Well, a big part of our business is steering, suspension, braking, those kinds of things. But another part of our business is cooling, emission, fuel, and those 3 things don't exist -- and ignition. Those 4 things don't exist in electric cars. So you basically don't have the under-hood type of repairs in an electric car that you would have in an internal combustion engine car. But you still have the brakes and steering and your ride control, stuff like that -- and drivetrain. So yes, you give up a lot when you -- if the population were to, over some number of years, switch to all electric cars, then yes, you give up a lot. We're a long ways from that happening. I -- you guys probably know a lot more about Tesla than I know. But Tesla is heavily subsidized by the government to produce cars at a loss. You know what I mean? And frankly, most people in the center part of the United States and many of the more rural areas, electric car just doesn't work under current technology. Not that a better technology can't exist, but if the 265 million cars today were all electric, guess what happens when they all plug in to charge? The grid doesn't support it. So I mean, there's just major, major changes if electric is the answer. Frankly, I don't think electric cars are the ultimate answer to replace internal combustion. I think there would be something else that will come along that will be the propulsion method to replace internal combustion engines as emissions and things like that get worse. But the reality is today, a lot of the internal combustion engines, and there are several of the manufacturers have led this, they're able to generate a lot more power out of a lot smaller engine, use a lot less fuel using technology. And Ford has been a real leader in this in these

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Client Id: 77

small V6 motors. Like the Ford Raptor, a big pickup that they put a V6 in that, I think a 4.2-liter V6, which is a relatively small motor but it generates 450 horsepower, replacing a 6.2-liter V8 that was a powerful motor that only generated 420 horsepower. So they're able to generate a lot of power out of smaller internal combustion engines. And frankly, the 17 million cars that are sold this year -- I don't know how many Teslas are sold and how many Chevrolet Bolts are sold. There's not very many. And 16,900-something is internal combustion, and the people who bought those are going to drive them. They're going to be on the road 12, 14 years. So we're way down the road before we get to electric cars. But when they do, I bet we'll be the best electric car provider for parts that there is.

Mark Merz - *O'Reilly Automotive, Inc. - VP of Investor Relations, Financial Reporting and Planning*

Greg Johnson, I think we have a question for you.

Michael Herbert Lehrhoff - *RBC Capital Markets, LLC, Research Division - Associate VP*

Mike Lehrhoff from RBC. I know it's a small portion of the business, but I was wondering if you could talk a little bit more about the promotional strategy that you rolled out online with discounts for ship-to-home versus in-store?

Gregory D. Johnson - *O'Reilly Automotive, Inc. - Co-President*

Sure, sure. So with the new website, it allowed us to have a more powerful promotion engine that we didn't have in the past. So we're really focused, to your point, on the ship-to-home piece. So our first promotion was -- that started about a week ago, was $25 off a $100 purchase, which were qualified for free shipping as well. We've got a road map through the end of the year. And what our focus is for the remainder of 2017 is to run various promotions -- not to get into a lot of detail because our competitors are listening obviously, but to run various types of promotions and measure the success and see which promotions work best. And then we are really focused on that in the future.

Mark Merz - *O'Reilly Automotive, Inc. - VP of Investor Relations, Financial Reporting and Planning*

Okay. I think we have time for one more question. So Dan?

Daniel Ray Wewer - *Raymond James & Associates, Inc., Research Division - U.S. Hard Line Goods Analyst*

Dan Wewer at Raymond James. So there have been, probably the last 15 years, 2 periods when same-store sales weakened unexpectedly, 2008 and 2012. And in both occasions, business rebounded strongly the following 3 or 4 years. Is there anything different about this current period compared to 2008 or 2012 that would suggest that in 2018, we're not going to see a significant recovery?

Thomas G. McFall - *O'Reilly Automotive, Inc. - CFO and EVP of Finance*

Well, it's the new normal, right, but we're in a different environment. But what we would tell you is that the long-term driver of business for us is miles driven, and although miles driven increase year-over-year, it isn't as strong as it has been the last few years, still a good number. And that will continue to drive vehicles to break and need to be repaired. In short periods of time, when we look back to those periods and we look in retrospect, what you saw was a deterioration in consumer confidence. And we saw an increase in deferral. When that was relieved, then we saw that deferral rate come down and benefit the business. So over the long term, to the extent that business is being deferred now, we would expect to recapture that in a future period. When that starts, that's kind of a hard question. On the Hispanic, when does it stop? We'll see. On the changes in the specific SAAR years, that's been offset by the aging of the vehicle fleet, maybe with more, more vehicles coming in from those lower periods. We're seeing either less of a tailwind from the aging or a little bit of a headwind, but that will turn around. So our expectation, and we talked about it on the call, is that our business is not going to comp a 2% over the long term. That's not our intention. That's not what we're built to do. The industry is going to grow, DIY, probably 1% to 3% over time; professional, 2% to 4%, 2% to 5%, to give you a 2.5%, 3% growth rate. Our expectation is we're going

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

to continue to take market share and comp beyond that. So we would anticipate that yes, we will return to a stronger comp trajectory in the future. We have given guidance twice that we haven't achieved, and no one here at O'Reilly likes to overpromise and under-deliver. So I think you'll see us continue to hustle on the street and get all the business we can get, and that will be the long-term driver of our business and our value that kind of what we guide to.

Mark Merz - *O'Reilly Automotive, Inc. - VP of Investor Relations, Financial Reporting and Planning*

One last question.

Elizabeth Lane Suzuki - *BofA Merrill Lynch, Research Division - VP*

Liz Suzuki from Bank of America. You talked about the scrap rate being stable. And if we continue to see used vehicle pricing coming down to the point where it costs more to repair a vehicle than replace it, could we start to see that impact your business?

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Go ahead.

Thomas G. McFall - *O'Reilly Automotive, Inc. - CFO and EVP of Finance*

When -- the scrap rate is a byproduct of, is it cost-effective to replace that last vehicle? [And that's kind of weird.] What we tell you is that as long as -- and Greg mentioned it earlier, the engine, the drivetrain, either the transmission or transaxle are operational, the cost of repair is going to be something that's a benefit for someone. Typically, we don't see vehicles scrapped until one of those have major failure and you've got to buy a $6,000 repair on that vehicle. So we would tell you that that's the driver, not the cost of used cars is the driver. For some of our -- like LKQ, when they look at that scrapping out cars and taking parts, that may be a driver of their business. But for us, it's going to stay on the road as long as those powertrain pieces are in workable condition.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Something I might add to that is what we like about used cars being sold, especially when they're like 7, 8 years old, the original drivers many times will buy a new car and they just kind of drive it until starts to get to that maintenance cycle. They're like, "Look, I'm done with this, going to buy another, a new one." And when somebody buys a used car as their primary driver, they're willing to take it through this full maintenance cycle to end up with what they think is kind of a new car, which it really is if it's fully maintained, kind of like a house. The people that sell a house, they didn't maintain all the stuff. Somebody else buys it and they completely refurbish the house and it looks great again. We kind of like the fact that used car prices are coming down, and there's going to be more of -- more people buy used cars than new cars here for a little while. I think it's a positive thing for us.

Mark Merz - *O'Reilly Automotive, Inc. - VP of Investor Relations, Financial Reporting and Planning*

Well, we went just a few minutes over on the prepared comments. So maybe we'll go just another question or 2, because I know there's a lot of them out there. I know Jeff Shaw and Greg Johnson are eager to answer a question. So it has to be a question that would be directed towards them. So does anybody have a question for our 2 Co-Presidents, the leaders of our company into the future? We have one here in the back. We'll catch this one, then we'll come to the back.

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Client Id: 77

Unidentified Participant

This one could certainly be for anybody. So if Greg or Jeff wants to answer. The 2-steppers -- Greg actually talked about this but he doesn't have to answer the question.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Okay.

Unidentified Participant

Teed up a little bit of maybe consolidating the 2-steppers, even though there's geographic overlap and we know they are very good competitors, how do you think about consolidation on the DIFM side potentially going forward from here?

Jeff M. Shaw - *O'Reilly Automotive, Inc. - Co-President*

Well, I mean, it would just have to make financial sense. [I don't think I'm on here.] It would have to make financial sense. I mean, with most of the 2-steppers we compete against, now the Northeast would be different if we can make financial sense of it and be able to have finance do the model where it would pencil out, then we would obviously entertain it. I mean, it would be really accretive to our comp growth. Most of those would end up being consolidations. And consolidations, as long as you retain the people, the relationships, you can back them up with the inventory availability, the service levels they're used to, you can retain that traditional business. Now there may be other footprints in the Northeast or markets we don't operate in where an acquisition of a 2-stepper might make a lot more sense.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Something I've always said on acquisitions is there is some price when every single acquisition makes perfect sense. You know what I mean? Now many times, that price is not something that the owner of the business is willing to listen to, but I've been surprised over time how much more capable of listening some of these individuals become. You know what I mean? So as their -- the prospect for their business under and overlap situation maybe changes their outlook to the future, I think many times that the point that a -- that we could buy a geographically overlapped business, I think that, that makes more sense. I was just talking to an individual the other day that's owned a business for a long time that when we were interested in buying, we didn't have stores there. Now we have stores all over the place. And now he's come to me and said, "Hey," -- you still have that conversation. "Oh my gosh, we've put stores like across the street from you everywhere you have a store." And he goes, "Well, I know. It just wasn't the right time for me then and now I think it is." I bet that's it. It's a timing thing, right, and -- so anyway, things change over time. I think you'll see more consolidation in these geographically overlapped businesses over some period of time.

Mark Merz - *O'Reilly Automotive, Inc. - VP of Investor Relations, Financial Reporting and Planning*

Okay, last question this time, promise. Seth?

Seth Basham - *Wedbush Securities - Analyst*

My question is for Greg Johnson, I guess, on branding and private label. You mentioned 45% plus of your sales mix is private label. What's the breakdown between DIY and DIFM?

Gregory D. Johnson - *O'Reilly Automotive, Inc. - Co-President*

Not that I know the breakdown...

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

On what?

Gregory D. Johnson - *O'Reilly Automotive, Inc. - Co-President*

Private label between DIY and DIFM.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

I don't either. Tom might know.

Thomas G. McFall - *O'Reilly Automotive, Inc. - CFO and EVP of Finance*

I don't know the exact percentage, but when we look at the amount of fluids that we sell on the DIY side of the business, which -- our private label that's going to skew to that side. If we look at our brands, the true private labels are sitting mostly at the good level, which is the higher DIY percentage. Although as Greg talked about, when we look at our house brands and we look at brands that have a national following that we've acquired and we put high-quality, professional grade products in there, those are going to skew more towards the professional business.

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Yes. For instance, our best-selling brake is a private label brake. Our batteries are -- our very best-selling batteries are private label even though we carry some -- often a branded battery. Most of our categories that are major hard parts categories, we deployed a private label that, over time, becomes the dominant brand. But that's offset on the DIY side by the fact that most of the fluids that we sell -- many of the fluids that we sell are DIY.

Seth Basham - *Wedbush Securities - Analyst*

If we talk theoretically about what Dorman and Holley have done in terms of MAP pricing, some pricing is equivalent online versus off, do you think that there's a risk that we see more private label from online players to be more competitive against your product over time?

Gregory L. Henslee - *O'Reilly Automotive, Inc. - CEO*

Yes, I think you will. I think that's probably the path that some will go if more of the branded suppliers go that way. The challenge with Dorman is, and RockAuto said in their newsletter -- and I'm not quoting them directly because it's what I ascertained from what I read, is that they're going to not do business with Dorman and go to the suppliers. Well, Dorman makes their living supplying stuff that is just not available, in many cases, from other aftermarket suppliers. They carve out the stuff. That's going to be hard for them at Dorman. Now with -- Holley is kind of a performance brand that's recognized. So that's a difficult one, too. But in many products, if, for instance, they wanted to sell private label brakes or private label ignition, all of those things are available -- private label chassis. Those are all available in most categories. They could do private label. In those 2 particular categories, it would be difficult.

Mark Merz - *O'Reilly Automotive, Inc. - VP of Investor Relations, Financial Reporting and Planning*

Okay. Well, that concludes the webcast portion of our event today. We'd like to thank everyone who has dialed in or listened online for doing so. At this time, you may now disconnect.

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Client Id: 77

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2017, Thomson Reuters. All Rights Reserved.

©2017 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS