Co. reported 1Q18 EPS of $3.61. Expects Full-year 2018 EPS to be $15.30-15.40 and 2Q18 EPS to be $3.95-4.05.
Corporate Participants

Gregory D. Johnson  O'Reilly Automotive, Inc. - Co-President
Gregory L. Henslee  O'Reilly Automotive, Inc. - CEO & Director
Jeff M. Shaw  O'Reilly Automotive, Inc. - Co-President
Thomas G. McFall  O'Reilly Automotive, Inc. - Executive VP of Finance, CFO & Principal Accounting Officer

Conference Call Participants

Anna Carolina Jolly  G. Research, LLC - Research Analyst
Bret David Jordan  Jefferies LLC, Research Division - Equity Analyst
Christopher James Bottiglieri  Wolfe Research, LLC - Research Analyst
Christopher Michael Horvers  JP Morgan Chase & Co, Research Division - Senior Analyst
Elizabeth Lane Suzuki  BofA Merrill Lynch, Research Division - VP
Gregory Scott Melich  MoffettNathanson LLC - Partner
Matthew J. McClintock  Barclays Bank PLC, Research Division - Senior Analyst
Matthew Jeremy Fassler  Goldman Sachs Group Inc., Research Division - MD
Michael Allen Baker  Deutsche Bank AG, Research Division - Research Analyst
Michael Lasser  UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines
Scot Ciccarelli  RBC Capital Markets, LLC, Research Division - Analyst
Seth Mckain Basham  Wedbush Securities Inc., Research Division - SVP of Equity Research

Presentation

Welcome to the O'Reilly Automotive Inc's. First Quarter 2018 Earnings Conference Call. My name is Jenny, and I'll be your operator for today's call. (Operator Instructions) Please note that this conference is being recorded. I will now turn the call over to Tom McFall. Mr. McFall, you may begin.

Thomas G. McFall  - O'Reilly Automotive, Inc. - Executive VP of Finance, CFO & Principal Accounting Officer

Thank you, Jenny. Good morning, everyone, and thank you for joining us. During today's conference call, we will discuss our first quarter 2018 results and our outlook for the second quarter and full year of 2018. After our prepared comments, we will host a question-and-answer period.

Before we begin this morning, I'd like to remind everyone that our comments today contain forward-looking statements, and we intend to be covered by, and we claim the protection under the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. You can identify these statements by forward-looking words such as estimate, may, could, will, believe, expect, would, consider, should, anticipate, project, plan, intend or similar words.

The company's actual results could differ materially from any forward-looking statements due to several important factors described in the company's latest annual report on Form 10-K for the year ended December 31, 2017, and other recent SEC filings. The company assumes no obligation to update any forward-looking statements made during this call.

At this time, I'd like to introduce Greg Henslee.
Thanks, Tom. Good morning, everyone, and welcome to the O'Reilly Auto Parts First Quarter Conference Call. Participating on the call with me this morning are our Co-Presidents, Greg Johnson and Jeff Shaw; as well as Tom McFall, our Chief Financial Officer; and David O'Reilly, our Executive Chairman, is also present.

Hopefully, everyone has had a chance to read our first quarter earnings press release last night. I'll make just a few brief comments on our first quarter results before turning the call over to Greg, Jeff and Tom.

I'd like to begin by congratulating Team O'Reilly on a solid first quarter and by thanking our team of over 76,000 dedicated team members for their continued commitment to providing the excellent service that earns our customers' business every day.

Our team was able to deliver a solid comparable store sales increase of 3.4% and a 28% increase in earnings per share in the first quarter, both of which were above the midpoint of our guidance ranges and are a testament to the relentless focus of our professional parts people on taking outstanding care of our valued customers.

I'll let Greg provide more color on our results and outlook for the remainder of the year during his prepared comments, but I will add that we were pleased with our start to the year and remain confident in the health of our business and our team's ability to provide industry-leading customer service and drive profitable growth in 2018.

As we announced in February, Greg Johnson will be promoted to the position of Chief Executive Officer in conjunction with our annual shareholders' meeting on May 8, and I will continue my career with O'Reilly both on an executive role and board member as Executive Vice Chairman subject to election by our shareholders. I have a lot of confidence in both Greg and Jeff Shaw, who will be promoted to Chief Operating Officer in conjunction with Greg's promotion. Greg and Jeff are outstanding examples of our company's culture of promoting from within, and I'm very confident in their ability to lead our company and I'm very excited about what our future holds under their leadership.

This succession plan continues to progress very smoothly and as a result, this quarter's conference call represents my last call as CEO. And from this point forward, I will be present during the calls along with David O'Reilly, but will not be an active participant during our prepared remarks and Q&A, similar to the role David has played for many years. As such, it is appropriate for me to leave the bulk of our discussion of our first quarter results to Greg, Jeff and Tom. But before I turn the call over, I would like to thank our shareholders, many of which have been loyal owners of our company since I assumed the role of CEO, for their outstanding support of our company.

I would also like to again thank Team O'Reilly for their excellent work and commitment to our customers during my tenure as CEO. It's been my honor to have served as Chief Executive Officer of our incredible company the past 13 years, and I look forward to our company's continued success in the future.

I'll now turn the call over to Greg Johnson, who will be hosting our question-and-answer session following the remainder of our prepared comments. Greg?
Both our professional and DIY sides of the business were positive contributors to our comparable store sales growth with professional performing better as we saw strong ticket count growth on that side of the business in the first quarter. Average ticket continues to be a strong contributor to our comparable store sales increase, driven by the increasing complexity of vehicle repairs and favorable overall business mix and continued effective pricing management, which benefited from some inflation on same SKU pricing, primarily on seasonal items similar to what we saw in the fourth quarter of 2017.

On a category basis, we saw strength in winter-related categories throughout the quarter in most of our markets, partially offset by some pressure late in the quarter for typical spring maintenance categories as a result of the continued cool wet weather we experienced much across the country.

When we look at our sales progression during the quarter versus our expectations, our comparable store sales increase was consistently solid throughout the year, with the best performance realized in January as we benefited from normal winter weather. As winter extended well into the quarter, we saw some pressure from the delayed arrival to spring at the very end of our first quarter, but in aggregate, March results were still very solid and in line with our expectations.

Our professional business performance was consistently solid throughout the first quarter and, as we would expect, the weather resulted in significant volatility on the DIY side of our business. As we look ahead to the second quarter, we are establishing our comparable store sales guidance at a range of 2% to 4% and reiterating our full year guidance at the same 2% to 4%.

In establishing our guidance for the year on last quarter's earnings call, we discussed our major assumptions for our industry for 2018, which included our expectation that we would see modest improvement in miles driven as the employment and economic outlook for consumers remain stable with the potential for any increase in gas prices pressuring lower income consumers and constraining the growth of miles driven. We still feel these assumptions continue to be appropriate, and remain confident in our full year guidance after a solid start to the year in the first quarter.

Also included within our sales growth assumptions is an expectation for normal winter -- or for normal weather and that's exactly how we would characterize what we saw this winter. After very mild winters the previous 2 years, much more inclement weather this winter season should help drive business throughout the year. However, while the comparison to the past 2 years is much more favorable, we really view this as a normal winter and our assumptions for the benefit we received throughout 2018 are in line with the typical failure-related demand driven by normal winter weather.

As I mentioned previously, we did experience some pressure to our DIY comparable store sales performance at the end of March as a result of the delay of typical spring weather and that pressure has continued into April as we continue to see very unseasonably cold and wet weather throughout many of our markets. While we don't provide specific details for such a short time frame, I can't say that our performance so far in the quarter outside of these easily identified weather impacted specific days on the DIY side of our business is in line with our expectations, and we continue to be pleased with the performance of our professional business, which is much less impacted by the delay in spring weather. While we certainly are ready for spring to finally arrive in all of our markets, we've experienced this kind of volatility in mother nature's timing several times before, and we remain confident in our outlook for the second quarter as we move past this temporary pressure.

For the quarter, our gross margin of 52.6% was within our expectations and our full year gross margin guidance of 52.5% to 53% of sales. The improvement of 17 basis points versus the first quarter of 2017 was driven by a modest improvement in merchandise margin and a lower LIFO charge, which was partially offset by pressure from the increased transportation cost.

We continue to see rational pricing within our industry and are leaving our full year guidance for gross margin unchanged.

As we outlined when we provided our 2018 guidance on the fourth quarter 2017 conference call, we are significant beneficiaries of tax reform and feel it appropriate to allocate some of these savings back into the business to continue to improve the levels of service we offer our customers.

The cost of these investments were in line with our plan in the first quarter and we’re pleased that our teams were able to generate a solid 5% growth on operating profit dollars, while also investing in our business. We continue to expect our full year operating profit for 2018 to be within
our previously guided range of 18.5% to 19% of sales. This unwavering commitment to profitable growth also resulted in a 28% increase in our earnings per share to $3.61 for the first quarter, which reflects our solid sales and operating profit growth as well as the benefit of the lower tax rate and reduced share count.

For the second quarter, we are setting our earnings per share guidance at $3.95 to $4.05. We are also updating our full year EPS guidance to a $15.30 to $15.40, an increase of $0.20 at the midpoint, reflecting our first quarter results and the shares we have purchased through the call today.

Tom will discuss our tax rate in detail in a few moments, but I would remind everyone that our full year guidance includes the impact of shares repurchased through this call, but does not include any additional share repurchases.

To close my prepared remarks, I’d like to add my thanks to the team for solid performance in the first quarter and their continued dedication to our customers. Greg leaves some very big shoes to fill as CEO, but I’m extremely excited for the opportunities that lie ahead for Team O’Reilly and I’m fully committed to the company’s continued success. I’ll now turn the call over to Jeff Shaw. Jeff?

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

Thanks, Greg, and good morning, everyone. I’d like to echo Greg’s comments and thank our team members for their hard work and dedication to providing top-notch customer service. Our team’s high level of dedication was more apparent than ever this past quarter as we experienced a normal winter after 2 years of mild winters and our team members battled the elements to keep our stores open to take care of our customers, as many of our stores experienced multiple rounds of inclement weather.

We certainly welcome the sales demand created by the typical winter weather, but without our store team’s efforts to keep our stores open for our customers and our DC team’s hard work in completing their routes and keeping our stores in stock, we wouldn’t have been able to capitalize on this demand.

As significant as the sales we pick up is the lasting goodwill that we earn from customers when we're the only parts store in town able to meet a customer’s critical needs during bad weather.

Now I’d like to spend a few minutes discussing our SG&A results for the quarter. For the first quarter, we delevered 34 basis points with an average SG&A per store growth of 2.7%, which was driven by the portion of the tax savings that we're allocating to the incremental operating expense dollars in 2018 to further enhance our best-in-class customer service.

The incremental investment in the first quarter consisted primarily of enhancing our team member benefit plans and was in line with our expectations. We remain confident in the opportunities we have to strengthen our industry-leading customer service through redeploying a portion of the tax savings, and we continue to expect to follow the plan that we outlined on our fourth quarter 2017 conference call.

We had some other puts and takes in SG&A during the quarter, including a benefit we realized on the positive outcome from the settlement of a long-standing litigation with a former service provider, which was offset by incremental SG&A expense associated with the charge for a change in direction on a specific technology innovation project under development.

In total, our SG&A for the first quarter was in line with our expectations and our guidance for the full year growth in SG&A per store is unchanged at 3% to 3.5%. Our expense control focus is a key component of the Team O’Reilly culture and each of our managers is held accountable for the profitability of their individual store, DC or corporate department.

Moving forward, we will remain diligent in scrutinizing every operating expense dollar we spend with the top priority continuing to be enhancing the customer service in each of our stores by ensuring we attract and retain outstanding team members who have the desire to live the O’Reilly culture and gain the automotive knowledge that’s required to be a professional parts person and supporting those teams with the tools they need to deliver excellent customer service each and every day.
Now I'd like to spend some time talking about our store expansion during the quarter and our plans for the remainder of the year. In the first quarter, we opened 78 net new stores, which was just shy of our planned openings for the period. Not surprisingly, the extended winter weather disrupted construction on some of our projects, however, we continue to be confident in our plan to open 200 net new stores for the year.

During the first quarter, we opened stores in 25 different states as we continue to identify great opportunities to open stores across all of our market areas. Our coast-to-coast footprint allows us to be very selective in new store site selection and, more importantly, it allows us time to develop and train great teams of parts professionals who are ready to provide top-notch customer service from day 1.

We continue to be very pleased with the performance of our store openings and very optimistic about our future growth prospects as we continue to identify attractive new store locations, staffing those stores with great teams and taking share in the new markets.

Before I finish up today, I'd like to once again thank our store and distribution teams for their continued dedication to providing the best customer service in our industry.

We're off to a solid start in 2018, and we're well positioned to continue to provide our customers top-notch customer service and the best parts availability in the industry. Our teams are committed to winning our customers' business each and every day by outhustling and outservicing our competition and I'm confident in our team's ability to deliver an outstanding year in 2018.

Now I'll turn the call over to Tom.

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**Thomas G. McFall - O'Reilly Automotive, Inc. - Executive VP of Finance, CFO & Principal Accounting Officer**

Thanks, Jeff. I would also like to thank all of Team O'Reilly on a solid first quarter. Now we'll take a closer look at our quarterly results and update our guidance for the full year.

For the quarter, sales increased $126 million comprised of the $72 million increase in comp store sales, a $53 million increase in non-comp store sales, a $2 million increase in noncomp nonstore sales and a $1 million decrease from closed stores. For 2018, we continue to expect our total revenues to be $9.4 billion to $9.6 billion.

As Greg mentioned earlier, our gross margin was up 17 basis points and benefited from a lower LIFO charge, which totaled approximately $1 million in the first quarter of 2018, compared to a charge of $7 million in 2017, with the lower charge driven by price decreases from vendor negotiations, mostly offset by commodity cost increases.

We expect to see a LIFO charge in the second quarter of around $5 million, but our actual results will be driven by our ongoing negotiations with suppliers and potential cost inflation. The Tax Cuts and Jobs Act of 2017 had a dramatic impact on our first quarter earnings and will continue to have a significant positive impact on our tax rate on a go-forward basis. Our combined effective tax rate for the first quarter was 22.9% of pre-tax income, which included a benefit from tax deductions for share-based compensation, which totaled approximately 1.6% of pretax income. Excluding the tax benefit from share-based compensation, our effective tax rate of 24.5% was in line with our expectations.

Our first quarter 2018 tax rate compares favorably to the tax rate of 31.2% for the first quarter of 2017 as a result of the lower federal tax rate, partially offset by a smaller benefit from share-based compensation.

For the full year of 2018, we continue to expect our tax rate to be approximately 23% to 24% of pretax income and continue to expect the quarterly tax rate to be relatively consistent. However, the change in tax benefit from share-based compensation will create some fluctuations in our quarterly tax rate as a percent of our pretax income.

Now we'll move on to free cash flow and the components that drove our results for the year and our guidance expectations for the full year of 2018.
Free cash flow for the first quarter was $311 million, which was a $68 million increase from the prior year, driven by higher income and a smaller increase in our net inventory investment than in the prior year. For the full year, we are maintaining our free cash flow guidance of $1.1 billion to $1.2 billion. Inventory per store at the end of the quarter was $599,000, which was flat from the end of 2017. Our ongoing goal is to ensure we grow per store inventory at a lower rate in the comparable so sales growth we generate, and we continue to expect our -- to grow our per store inventory in a range of 1% to 2% this year.

Our APV inventory ratio at the end of the first quarter was 106%, which was where we ended 2017. We anticipate a slight improvement to 107% by the end of 2018, which will be driven by the higher level of sales. Finally, capital expenditures for the first quarter of the year were $115 million, which is up slightly from the same period of 2017 and in line with our expectations. We continue to forecast CapEx at $490 million to $520 million for the full year of 2018.

Moving on to debt. We finished the first quarter with an adjusted debt-to-EBITDA ratio of 2.18x as compared to our ratio of 2.12x at the end of 2017. The increase in our leverage ratio reflects incremental borrowings on our unsecured revolving credit facility and is in line with our targeted range of 2 to 2.25x.

We continue to execute our share repurchase program and, year-to-date, we have repurchased 2.6 million shares at an average share price of $248.80 for a total investment of $636 million. We remain very confident that the average repurchase price is supported by expected discounted future cash flows for our business, and we continue to view our buyback as an effective means of returning available cash to shareholders.

Finally, before I open up our call to your questions, I'd like to thank the O'Reilly Team for their dedication to the company and our customers.

This concludes our prepared comments and at this time, I'd like to ask Jenny, the operator, to return to the call and we'll be happy to answer your questions.

**QUESTIONS AND ANSWERS**

**Operator**

(Operator Instructions) And we have a question from Matt Fassler from Goldman Sachs.

**Matthew Jeremy Fassler** - Goldman Sachs Group Inc., Research Division - MD

My question relates to margin. Obviously, your sales performance was quite solid relative to expectations. I know that for Q1, it looks like EBIT margin was towards the low end of the range with sales above the midpoint of the range, and you seem to be guiding Q2 operating margin, just comes from a bottoms up perspective, to show bigger decline than it did in Q1. So can you talk about how cost pressures or any other factors impacting margin are evolving as you move through the year?

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

Tom, you want to take that one?

**Thomas G. McFall** - O'Reilly Automotive, Inc. - Executive VP of Finance, CFO & Principal Accounting Officer

Sure. When we look at our operating margin guidance, just for the full year, when you look at the balance of other sales, the first quarter is the lowest average daily volume based on the seasonality of our business and we have a relatively high fixed cost business model. So that's why you see us at the lower end of our range. Typically, the second and third quarters are higher operating profits because of the higher sales dollars.
Matthew Jeremy Fassler - Goldman Sachs Group Inc., Research Division - MD

And can you talk about how factors like shipping, for example, whether it's diesel or freight rates, et cetera, are revolving relative to expectations? Or are they intensifying? Or have they leveled off as you think about the remainder of the year?

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

When we look at those, we call that out on our fourth quarter call that our expectation was we were going to see pressure in those areas and that's why we wouldn't get more leverage out of our DC cost on higher sales and those costs have been in line with our expectations thus far this year.

Operator

And our next question comes from Michael Lasser from UBS.

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

Greg, congratulations again on taking a step back or a step up. My question relates to your commentary around quarter-to-date trend in the second quarter. You kind of went to lengths to talk about some of the weather impacts and softness in the DIY business. So is that -- are we to assume that it's worse so far quarter-to-date than you saw in March when there were similar weather impacts that impacted the DIY business?

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

Michael, we're not going to share any details over a very short period of time thus far in the quarter. But as we said on our prepared comments, weather has impacted us late in the first quarter, leading into the second quarter. And at the end of the first quarter, our DIFM business continue to be strong and in the markets where we had good spring-type weather, our DIY business was strong. In markets where we had and -- where there were a lot of weekends, during the month of March that the weather was okay, and in the weekends, resulted in snow and cold weather again, which impacts the DIY side of our business. So what I'll tell you is this, that what we've seen thus far in April supports our 2% to 4% guide and we feel good about our guidance for the quarter.

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

Okay. My follow-up question is on the longer-term margin outlook for the business, there's a lot of concerns about price transparency and the potential for gross margins to come down. We have seen that your operating margin will be under a little pressure that's due to some investments. So can you just provide a bit of a framework on how we should think about, once we get past this year, what does the longer run margin outlook for O'Reilly look like?

Thomas G. McFall - O'Reilly Automotive, Inc. - Executive VP of Finance, CFO & Principal Accounting Officer

Michael, this is Tom. I'll take that one. We've given guidance for this year, we think that when you look at the value proposition that our business provides customers, it continues to be very strong. It will be strong in the future. To give margin expectations beyond this year is not something that we typically do, but I would tell you that we remain very comfortable with the long-term opportunities for our business.

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

In comfortable, would it mean that you're not expecting it to go down meaningfully over time?
Thomas G. McFall - O'Reilly Automotive, Inc. - Executive VP of Finance, CFO & Principal Accounting Officer

We are -- we think that our business model will remain similar as it has for the past decade. Obviously, retail continues to evolve, but we're comfortable with the value proposition that we provide.

Operator

And our next question comes from Christopher Horvers from JPMorgan.

Christopher Michael Horvers - JP Morgan Chase & Co, Research Division - Senior Analyst

Curious, you talked about the DIY volatility at the end of the quarter, but could you shed some light on the commercial performance? Were trends relatively consistent over the quarter in an absolute sense or sort of relative to your own expectations? And does the timing of spring tend to impact that side of the business as well as -- do people bring their cars in for oil changes and tire changes as weather breaks historically?

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

Yes, Chris. I'll start that one and then I'll turn it over to Jeff and see if he wants to add a little more color. But generally, what I'll tell you is across the country throughout the quarter, our DIFM was stronger than our DIY for the reasons we talked about in our prepared comments and what I said earlier. From a weather perspective, because most of our DIY customers do their repairs outdoors, in their driveway, what have you, they're more susceptible to weather than the DIFM customers. DIFM customers, the shops can do the work no matter what the temperature is, no matter what the level of precipitation is. So the DIFM side is less dependent upon weather or contingent upon whether than the DIY side project. Jeff, do you want to add something to that?

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

Yes, yes. I would say that we look, and looking back at 2017, our professional business was just really soft throughout the majority of the year, and we knew at some point it would have to pick up, which we start seeing that in the fourth quarter. And those trends continue well into the end of the first quarter and there's no doubt that the more normalized winter weather benefited our professional customers and that's kind of carried through. They're not near as impact, as Greg said, by the cold spring. But we're pretty excited over what the rest of the year holds as far as, hopefully, some pent-up demand from the more normalized winter and longer-term demand created by that. I was reading an article the other day on pot holes. I think it was a AAA article. It was talking about the damage, I think it was like $3 billion of damage that's done annually from pot holes. Obviously, that would be more the case with the kind of weather that we've had. And the average repair is somewhere in the neighborhood of $300. So we'd hope to see some more of that throughout the remainder of the year.

Christopher Michael Horvers - JP Morgan Chase & Co, Research Division - Senior Analyst

That's a great segue to my follow-up, which is what do you -- from an evidence point that the weather and the car park theses, like, what are you seeing in -- under car suspension, brakes, that sorts of demand that would support the view that there should be a good a lag impact from the weather or maybe that's just too early?

Thomas G. McFall - O'Reilly Automotive, Inc. - Executive VP of Finance, CFO & Principal Accounting Officer

Chris, it's really playing out exactly as we would've thought. When you look back in January, early in the quarter, where we had the biggest impacts of winter weather, we were selling categories you would expect to sell. We're selling winter-related, weather-related categories, lighting and batteries and wipers, things like that, some rotating electrical spike back in January. And as you move through the quarter, and we get into March
where you typically see warmer weather, and you see the long-term effects of the harsher or more normal winters than we've had and the pot holes that Jeff spoke about, later in the quarter, the encouraging part is on the DIFM side of the business. We've started to see growth come back in steering, suspension, chassis type lines, which is what we would typically in the spring, and we expect that to follow on the DIY side as the weather cooperates.

Operator

And our next question comes from Bret Jordan from Jefferies.

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

Could you talk a little bit about regional performance? I got on a couple seconds late, so maybe it was in the prepared remarks. But maybe talk about market strength versus weakness and maybe what the spread was between the best and the worst markets.

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

Sure. Jeff, you want to take that one?

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

Well, really, it's about what you'd expect. I mean, early weather was good in most markets and then as we move kind of later into the quarter, the markets that weren't as affected by the cold snowy weather performed better than the markets that were affected from kind of the lingering weather. As Greg said earlier, I think in all markets where we've seen normal spring-type weather, our business has been pretty decent.

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

Okay. And then a question on your inflation comment. I guess some of the same SKUs that are going up, and we saw it in batteries, I guess, in the first quarter, there were some supply shortage and pricing went up. Have those inflationary prices held? And I guess, from a inflation standpoint from your suppliers, what are you hearing from folks that are seeing labor costs coming up in Asia and metals costs and factoring costs going up? I was to talk from the end of supply chain about inflation on a full year basis.

Thomas G. McFall - O'Reilly Automotive, Inc. - Executive VP of Finance, CFO & Principal Accounting Officer

Yes, Bret, there's talk about inflation. There's talk about tariffs. We're talking about all those things. From an inflation standpoint, we have seen a bit more inflation on the input side this quarter than we've seen in previous quarters. Most of it is commodity driven, but we've started to see some. We've been able to mitigate most of that by passing that along to end user pricing.

Operator

And our next question comes from Scot Ciccarelli from RBC Capital Markets.
Scot Ciccarelli - RBC Capital Markets, LLC, Research Division - Analyst

The other question about kind of the commercial versus DIY, I guess. So commercial outpaced DIY. The question is really, would you assume that means that the worst of maybe the car park issues are behind you at this point? Or do you think that performance still was really just driven by weather and based on what you see by region, by product category, it really suggests weather was the primary reason we saw that difference.

Thomas G. McFall - O'Reilly Automotive, Inc. - Executive VP of Finance, CFO & Principal Accounting Officer

This is Tom, Scot. We talk to the fact that we really felt like in 2018, the light SAAR years entering the (inaudible) of our business, which tends highly to the professional side of the business, was going to stop being a headwind and flatten out. It’s what our numbers showed us. So we think it’s the combination of that vehicle population dynamic, along with weather that’s helping drive that professional business to better results and have more opportunity on that side of the business than we have last year.

Scot Ciccarelli - RBC Capital Markets, LLC, Research Division - Analyst

All right. So hard to delineate at this point. And then the second question is, with the debt leverage ratio approaching your target, should we assume interest expense largely flattened at the current run rate? Or should it continue to drop down?

Thomas G. McFall - O'Reilly Automotive, Inc. - Executive VP of Finance, CFO & Principal Accounting Officer

Well, we would expect our interest rate to -- expense to be relatively flat for the first quarter to the extent that we don’t issue additional bonds or incur additional debt. So I would plan for it to be the same. When we look at our guidance, we don’t plan for additional debt or additional share repurchases in our guidance.

Operator

And our next question comes from Mike Baker from Deutsche Bank.

Michael Allen Baker - Deutsche Bank AG, Research Division - Research Analyst

Longer term picture question here. Just what -- has something changed in this business in that you’re guiding to 2% to 4% this year, which is certainly better than last year. But weather and -- or I should say the winter was more normal, the car park is -- the pressure there has peaked. 2% to 4% is a good number, but below the 4% plus that you guys generated for years. So what’s changed bigger picture? Is it more competition? Is it less inflation? Is it less share opportunity? Or some other guys maybe have stopped believing as much? Just curious, your thoughts there.

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

Tom, do you want to speak to the guidance?

Thomas G. McFall - O'Reilly Automotive, Inc. - Executive VP of Finance, CFO & Principal Accounting Officer

When we look at our guidance, when we look at -- we have some ups and downs in our business over the years and we've all been in the business for a long time and we're going to see years where comps, because of customer demand and vehicle dynamics, run higher and some like last year, where it runs lower. And we feel 2% to 4% comp guidance is the prudent guidance to give. We've delivered right in the middle of -- middle of that range in the first quarter, and we're comfortable with our guidance for the second quarter and the full year.
Michael Allen Baker - Deutsche Bank AG, Research Division - Research Analyst

And I presume you're not going to be talking about years beyond this year, so we can't -- any color on whether that's sort of the right outlook longer term as we try to model out beyond the next 3 quarters or is that something that you talk about at a later date?

Thomas G. McFall - O'Reilly Automotive, Inc. - Executive VP of Finance, CFO & Principal Accounting Officer

Well, we see -- when we look at that demand drivers for our business, number of vehicles down the road, miles driven, the population increases. We expect those drivers to continue to increase and drive demand in our business over the long term. And I think if you look at the AIA, they look at 1% to 3% DIY growth year-after-year and a 2% to 4% on the professional side over a long time horizon, and we expect to continue to outperform the market.

Michael Allen Baker - Deutsche Bank AG, Research Division - Research Analyst

Okay. One more if I could. This is for Greg Johnson. Any thoughts on -- any big changes to the strategy? Maybe 1 thought, perhaps a little bit more aggressive M&A, tuck-in acquisitions, anything along those lines that you think the company will evolve towards under your leadership?

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

Mike, I think we've got a very sound business model we've executed on for years under David's leadership, under Greg's leadership. Market changes, retail changes, we'll adapt. Fundamentally, we're going to continue to do the same things we've done, which has been very successful for us. From an M&A standpoint, we continue to look for acquisition candidates, both inside and outside the U.S. borders. It's what we've been doing for a few years now and we'll continue to do those things. There'll be some change and we'll adapt to a changing retail environment, whether Greg's our CEO or I'm our CEO. But fundamentally, we feel like our business model works and works very well, and I don't see any substantial changes.

Operator

And our next question comes from Greg Melich from MoffettNathanson.

Gregory Scott Melich - MoffettNathanson LLC - Partner

I wanted to step back just a little bit. I think you gave a lot of good information on -- how the pro did better and was more durable. And it sounds like inflation is back at least a bit. But what is -- we're growing transaction counts in the quarter? I mean, if we look at that comp, was there positive transactions and is that true in the DIY as well?

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

Ticket count grew more on the DIFM side as well as the ticket average on the DIY side. Growth was in ticket average.

Gregory Scott Melich - MoffettNathanson LLC - Partner

Okay. So overall traffic transactions might have been up 1%, and then the rest was ticket. Would that be a fair way to think about it?
Overall, ticket counts were slightly down.

Okay. And if we think about the growth in the basket, was -- how much of that would have been inflation versus, let’s say, mix? I think you mentioned a lot of -- more undercarriage and those sort of higher ticket item parts.

Yes, it is more so mix. We haven’t seen enough inflation to really move the needle on that yet.

And our next question comes from Liz Suzuki, Bank of America.

So growth in miles driven has started this low. Is there any concern that consumer travel trends are changing in a structural way and that it could be a headwind for the auto parts industry probably? Or do you think it’s more of a temporary impact from higher gas prices?

It is probably a temporary deal for gas prices. We’ve seen this trend before. As gas prices grow and as gas prices really grow over time, consumers will do a really good job of adapting to that and changing their budgets accordingly. When gas prices spike very quickly, sometimes that’s not the case, but I feel like today, the miles driven is a result of slight increases in gas prices and we’re watching that very closely. And it -- frankly, we baked this into our plan. We budgeted for a little higher gas price, fuel cost into our 2018 plan.

If I could add to that, Greg. In ’14, ’15, ’16, we saw average miles driven at the high end of the average range. So on a year-over-year basis, it’s not growing as fast, but it continues to be pretty close to the long-term average and continues to be a driver of our business in solid positive territory.

Great. And how competitive do you think the pricing environment has been for national brand products that you can find online or at Walmart or at other auto parts change? And what percentage of your sales and profit do you think are in the more competitive product category?

Yes. I don’t know about percentage per se, but we’re competitive with our peers, our brick-and-mortar peers, absolutely. And then in most cases, we’re competitive with the online retailers. There are certainly examples where online national pricing, someone will have it less than us and someone will have a higher price than us. But from a brick-and-mortar perspective, our national brand pricing would be in line with our competitors. And most of our online business results in the transaction ending in our stores. We’re driving more footsteps to our stores through our online business, and we get the consumer in our store. We have a very competitive product offering even when we have an online retailer that may have
a lower price point on the national brand. We will have a comparable product often in a private label offering that would have an equal to or lower price point even than the lowest priced online retailers. Jeff, do you want to add to that?

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

Well, yes. I’d say that one other thing to remember is that the national brands would be more of our premium offering and that's what most of our professional customers prefer. And there again, with the professional customers, it's all about availability and how quick you can get it into the shop and help them turn their base.

Operator

And our next question comes from Carolina Jolly from Gabelli.

Anna Carolina Jolly  
-G. Research, LLC - Research Analyst

Just one quick one here. It looks like you might have 2 suppliers consolidating in the near future. Do you have any thoughts on how that might affect the business, including, I guess, supplier incentive or availability to new brands?

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

Sure. I don't know about availability to new brands, but you're speaking of Tenneco acquiring Federal-Mogul. We've had a long-term relationship with both of those companies. Both of those companies have been good suppliers for us. We've got a great relationship with Tenneco. One of the things that we like about this acquisition is there's really no competitive overlap between the 2 product offerings. They're really complementary of each other and not competing with each other. So we feel like Tenneco's leadership will be good for the overall company, and we look for good things to come from that relationship.

Operator

And our next question comes from Chris Bottiglieri from Wolfe Research.

Christopher James Bottiglieri  
-Wolfe Research, LLC - Research Analyst

I have a long-term strategic question I wanted to pick your brain on. A lot of your closest peers are attempting to evolve their DC strategies using hub strategies, mega hubs, or if you want to call them cross-docking. I believe you don't currently use mega hubs. Can you tell us more about the advantages and virtues of your direct from DC strategy and why a megahub strategy would make sense for O'Reilly? And just lastly, kind of, like, what are trade offs and what does all those mean for O'Reilly's market share in commercial?

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

Sure. I'll start this and let Jeff add to it as well. We started out really focusing on the professional side of the business where a lot of our competitors started out focusing on the retail side of the business. So since day 1, we've had a very strong supply chain, a very strong DC footprint. Since day 1, we have serviced our stores with replenishment and special order needs on a nightly basis. So the strength of inventory between a distribution center, SKU count and a hub store SKU count, the DC inventory's going to win out every time. Our DCs will have somewhere between 140 to -- or 175,000 SKUs. Our hub stores will be closer to 70,000, 80,000 SKUs and our competitors may have up to 90,000, 100,000 SKUs in some of their larger hubs. But we've kind of got that cost baked into our model. We've worked over several years to reduce our distribution cost and as a percent of
sales. And we just feel strongly that having that overnight availability to inventory at a DC SKU level is a significant advantage over the hub model. Jeff, do you have anything to add?

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

Yes. I'd just add that we've been delivering 5 nights a week to our stores for 60 years and back when it wasn't a fashion and people thought it wasn't the right thing to do and it's panned out pretty well for us. Obviously, when you're in the DIFM side of the business, availability is absolutely key. I mean, get that part in the shop and helping them turn their base is really how you earn the business and keep the business. And honestly, to an extent, the more SKUs you have readily available, the more times you can say yes versus no. So we've always pride ourselves in a high-level of inventory availability. There again, we kind of meet what the market bears when it comes to service levels. I mean, it could be overnight in some rural stores, but it's up to 7 or 8x a day in metro markets. It's really what the market demands to provide the service to be able to earn the business and keep the business.

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

Over the past years, we've also added weekend service out of our distribution centers.

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

Yes. And just one last item to note. We've run a significant hub network that augments our regional DCs, so availability is critical to success in our business and we feel like we do a great job at it.

**Operator**

And our next question comes from Matt McClintock from Barclays.

**Matthew J. McClintock - Barclays Bank PLC, Research Division - Senior Analyst**

I wanted to follow up on just the national brand conversation that we're talking about earlier. You have some M&A going on. You have a competitor that just put together a somewhat exclusive deal with a national brand and you're kind of seeing this in other segments of retail where 1 retailer will try to create an exclusive with a national brand try to compete more effectively with another retailer. Are we seeing like an evolution in the way that your competitors think? Or are we on the cusp of some type of new evolution in competition created by the suppliers created by these brands? And just how do you think about this over the next several years being a potential threat to your business and your dominance?

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

It's national brands versus private label has really evolved over time. We were -- most of our business, as recently 7 or 8 years ago, was national brands. National brands, there's a competitive component. To Jeff's point, most of our national brands are our premium products and we'll have, in most cases, a good, better, best offering, at which point our national brands would be the best and we'd have one or more layers of private label under that. So we've evolved from mostly national brands to a mix, a healthy mix of private label and national brands, which allows us to compete with both brick-and-mortar and online retailers. So I think things continue to evolve. A lot of our private label brands are supplied by national brand providers. The example that you're speaking of in your example there, I think, that's a category where we have created a national brand. And some of our national brands that we own that are proprietary brands once were national brands like Precision, for example, or Murry Air Conditioning, and we own the rights to those brands and they're now our private label brands. But in the case of other categories like, battery is a good example, Super Start, and BrakeBest in brakes have become essentially, national brands. So we're happy with our strategy of having a healthy mix of good, better, best, and mixing in private label and national brands.
And our next question comes from Seth Basham from Wedbush Securities.

My question is on gross margin. Excluding LIFO in both periods, you saw your gross margin turn down year-over-year again this quarter. I just wanted to understand a little bit better if there are anything that were outside of your expectations impacting gross margin this quarter.

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

We have some puts and takes in gross margin. It was within our guidance. When we look at our expectations, we have a little less inventory than we usually -- in the first quarter with -- and had some cap headwinds to us, but we remain comfortable with our gross margin guide and our -- and we look at our POS margin without all the other items that go into it, we continue to be pleased with that.

Got you. And if we think bigger picture, there's been some conversation about price competition. And we've seen one of your largest competitors introduce a free overnight shipping offer for online orders over $25. Is that something that you think is material that you'll need to respond to? Or is it too a small piece of your business to matter?

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

Yes, Seth. It is a small part of our business, but we try to make sure we’re competitive with our competitors in the products they offer and their programs like this. I saw something last week where one of our competitors was rolling out a test in select metro markets to provide overnight deliveries. I assume that's the one you're speaking to. What we worked on is, over time, and as a matter of fact, over the period of last quarter, we have expanded our shipping points to include all of our DCs and we'll also probably be layering on some of hub store locations. So a significant portion of U.S. households today we're able to touch overnight with UPS ground shipping. And we've got a mid-range to long-term strategy to leverage that and use that as a selling advantage online. So we may not mirror exactly what our competitors do from an approach standpoint, but we want to make sure we have a comparable service level.

Got it. And lastly, Tom, housekeeping question. LIFO expectation for the year now?

Thomas G. McFall - O'Reilly Automotive, Inc. - Executive VP of Finance, CFO & Principal Accounting Officer

I'll have -- let me get -- that number is probably in the $10 million to $15 million range. Again, that -- to follow up on that, Seth, that's highly dependent on what inflationary pressure is we see.

We have reached our allotted time for questions. I will now turn the call back over to Mr. Greg Henslee for closing remarks.
Gregory D. Johnson - O'Reilly Automotive, Inc. - Co-President

This is actually Greg Johnson. Thank you very much, Jenny. We would like to conclude our call today by thanking our entire O'Reilly Team for their continue dedication to customer service in the first quarter. I'd like to thank everyone for joining our call today, and we look forward to reporting our 2018 second quarter results in July. Thank you.

Operator

Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.