THOMSON REUTERS STREETEVENTS

# EDITED TRANSCRIPT

ORLY - O'Reilly Automotive Inc Analyst Day

EVENT DATE/TIME: AUGUST 07, 2018 / 12:30PM GMT





THOMSON REUTERS

## CORPORATE PARTICIPANTS

**Brad W. Beckham** *O'Reilly Automotive, Inc. - EVP of Store Operations & Sales*

**Chris Mancini**

**Eric Bird**

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

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

**Kris Johnson**

**Larry Gray**

**Mark Merz**

**Mike Wright**

**Robert Allen Dumas** *O'Reilly Automotive, Inc. - SVP of Eastern Store Operations and Sales*

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

## CONFERENCE CALL PARTICIPANTS

**Benjamin Shelton Bienvenu** *Stephens Inc., Research Division - Research Analyst*

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

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

**Colin R. Ducharme** *Sterling Capital Funds - Sterling Capital Equity Income Fund - Portfolio Manager*

**Harrison Vivas**

**Jason Daniel Haas** *BofA Merrill Lynch, Research Division - Analyst*

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

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

**Michael David Montani** *MoffettNathanson LLC - Senior Research Analyst*

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

**Seth Mckain Basham** *Wedbush Securities Inc., Research Division - SVP of Equity Research*

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

## PRESENTATION

**Mark Merz**

Good morning, everyone. Welcome to the 2018 O'Reilly Auto Parts Analyst Day. Thanks for everyone for making the trip, and everyone who is listening via webcast, welcome.

I'm getting ready to get started here. My name is Mark Merz. I'm our VP of IR, reporting and planning. I'm going to have a couple of housekeeping items to get started today, and then will introduce the management team that'll be doing the presentation for you today.

Before we get started for everybody at home and everybody here, we do claim the safe harbor for forward-looking statements for everything that we're going to speak to today. I won't read the entire statement, but we do claim that safe harbor. So please take a few minutes to read that.

Our agenda for today is going to be very similar to how it's been in previous years, and it's great to see a lot of familiar faces here. As most of you are aware, these days aren't events where we put out new information. We don't update guidance. We don't put out new long-term strategies at these events. They're just an opportunity to come and have a chance to meet the management team. So that's what today is going to be about. You're going to see a lot of information you've seen in prior years. We have a pretty vanilla business. We provide great service and we sell parts, and that's about all that we do. And we think we're pretty good at doing that.

So we're going to start it out. There'll about a 2-hour session that is a prepared presentation and then a Q&A session. After that, we're all going to head out for a DC tour so you can see our new expanded facility. We had our Analyst Day here 8 years ago at this time a year after this DC opened. This last year and Jeff will talk about this and his team will talk about it. We expanded the distribution center. This DC is now about 500,000 square feet. So when we get out there, you'll see that it's a great big box, a great facility. After the DC tour, we'll come back in here, and we'll have a light lunch, so we'll have some box lunches and opportunity to visit with management, and then we'll jump on some buses and go see a couple of stores and see where the rubber hits the road and how we really differentiate ourself from our competition.

A couple of just quick housekeeping items. If you don't have a name tag when we have a break, if you could be sure and go and get one before we enter the DC. If you don't have a name tag, our security people are going to tackle you and throw you out of the building. So please make sure you have a name tag on all day. There's restroom facilities right outside his door and to the right. Feel free to get out during the presentation portion if you'd like and run to the bathroom. There'll be refreshments here and outside as well.

As most of you know who have been here before and who've been to our offices and know about O'Reilly, culture is extremely important for us. It's what makes us different and what sets -- it sets us apart. It's what's made us successful for over 50 years. When the O'Reilly family started the company to today, that's still what makes -- sets us apart from everybody else. And as many of you are also aware, before every meeting that we have as a company, someone is assigned a culture statement. So they pick one of our culture values and have the opportunity to speak to them. I've done our culture the last several years, and you guys are probably tired of hearing me do it, so this year, Eric Bird is going to do our culture segment for us.

Many of you have met Eric in the past. He was at our Analyst Day last year. Eric will tell a little bit about himself, but Eric is our external reporting and planning manager, and Eric's getting involved into the IR side. I know you guys are tired of talking to me all the time when you call, so now if I'm not available, Eric's going to be there to help with some of those calls.

So with that, I'll go ahead and turn it over to Eric.

---

**Eric Bird**

Thank you, Mark. Well, yes, I'm Eric Bird. I'm External Reporting and Planning Manager, and I've been an O'Reilly team member for about 2 years now after having spent about 6 years in public accounting. However, in high school, I was very fortunate to have spent a couple years working as a store team member and, at a very young age, learned how important it is to have a strong company culture. And as Mark mentioned, our company culture is one of our greatest competitive advantages, and we work hard day in and day out to translate this intangible value into economic value.

You step into any one of our given stores, and you'll experience the same strong company culture just like you would in any one of our corporate offices or one of our distribution centers as is being demonstrated to you all here today by our team here in Greensboro.

Perpetuating this culture is why we start these meetings with a culture statement. So for my culture statement this morning, I selected the culture value of expense control. Now we spend a lot of time at our company talking about excellent customer service and rightly so. We're all extremely passionate about it, but expense control is one of my favorites as well for a couple reasons.

First off, expense control for us is not simply just spending less dollars. It is -- and just as importantly, spending the right dollars. We go to great lengths to make sure that every single dollar that we spent as a company will generate the greatest returns. Secondly, expense control, very few things exhibit buy in by all of your team members to a corporate culture like expense control. It's something that can be practiced at every level of the company, and just like excellent customer service, it requires our team members to go above and beyond every day.

One of our largest expense line items is payroll. So every team member at our company has the ability to practice expense control every day simply by coming in and utilizing their time well for our company, remaining focused on our company goals and furthering those company goals. The growth that we've accomplished as a company has come through a lot of hard work, but the profitable growth that we have achieved is something that's required the intense focus from our entire team in -- through great practice of expense control.

So that's my culture statement for today. I will turn things over to our Co-President and CEO Greg Johnson. Thank you.

---

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

Thanks, Eric. First slide today -- let me see. Where's the flipper here? Is an introduction slide. I want to take a minute to introduce the O'Reilly team.

I'm going to do this a little different than what we've done in the past. I'm going to introduce the team here that's going to be presenting to you, and I'm here to let our field team introduce themselves. We talk a lot about our secret sauce or key differentiators of O'Reilly Auto Parts from some of our peers being things like our strong culture values that Eric just spoke to, our professional parts people and our promote from within philosophy. And everybody in the room is an example of promote-from-within, and I want these field guys to take a minute and tell you their story.

But first, kind of going through the list, I am Greg Johnson. Appreciate you guys being here today. Welcome to Greensboro. Again, it's a tight room. So just try to do your best. I know everybody's going to be fidgety 2 hours from now, but we'll work through it.

Also with me is Jeff Shaw. I think everyone's met Jeff. Jeff is our Co-President, Chief Operating Officer. Tom McFall, CFO, Executive VP of Finance; Brad Beckham. He's our Executive Vice President of Store Operations and Sales. And who else? Jeremy Fletcher in the back of our room is our SVP of Finance, Controller. You've met Mark. I think that's everyone except for the room.

So I want to take a moment here and allow Chris and Robert, who are here from store operations, and Larry, Mike and KJ to introduce themselves, tell you a little bit about their story, and then we'll get on with our presentation.

So who wants to start?

---

**Robert Allen Dumas** - *O'Reilly Automotive, Inc. - SVP of Eastern Store Operations and Sales*

I'm Robert Dumas. I'm the Senior VP of Eastern Stores. I started off at O'Reilly Auto Parts 17 years ago. I was part of the Mid-State acquisition. I was a -- at that time, I worked the back counter, taking care of our professional customers, and then O'Reilly Auto Parts bought us out, and I worked myself up to store manager, district manager and VP and then Senior VP.

So before that, I started out -- right out of high school an independent in DAPs based out of Pensacola, Florida. DAPs later was acquired by Mid-State Automotive, and then O'Reilly Auto Parts acquired Mid-State in 2001, and then 17 years later, here we are. Thanks.

---

**Chris Mancini**

I'm Chris Mancini, Mid-Atlantic Divisional Vice President, oversee the Northeast, too. I started with the company 15 years ago as a installer service specialist in the back of the store, same as Robert, taking care of our professional customers. Moved up to store manager for 4 years and became DM in, I guess, you'd call the Tri-Cities area of Tennessee. Then had an opportunity to move to Richmond, Virginia, as a regional manager. I was a regional manager For 5 years, and then just 3 years ago, promoted to DVP.

---

**Larry Gray**

Good morning. Larry Gray, Eastern Division DC Ops. I've been with the company since 1991. Started back -- we had one DC back then. Stocking shelves, sweeping floors and worked my way up through different management positions. Been in -- lived in Nashville, Tennessee; Houston, Texas; Des Moines, Iowa. Currently back in Springfield, Missouri, and it's -- I guess, that's about it. So thank you.

---

**Mike Wright**

Good morning, everybody. My name is Mike Wright, Region 5 Director. Been with the company for 31 years. Actually started out, for anybody that's familiar with the Michigan/Ohio area, started out with Murray's Discount Auto. That was purchased by CSK, and then O'Reilly purchased CSK, probably the best day of my life. But actually, July 10 is my birthday. July 11 is when we were purchased, so that is my birthday present every single year.

Started out kind of the same thing as everybody else. Came in, started working as an hourly team member on the shipping dock. Worked through every single one of the departments. Became supervisor. Worked through all those departments, eventually operations manager, DC manager, and where I am today as Regional Director. So I oversee the Boston DC, Greensboro and Detroit.

---

**Kris Johnson**

Good morning, everybody. I'm Kris Johnson. Everybody just calls me KJ. I'm the Distribution Center Manager for DC 19 here in Greensboro. I started out in Springfield, Missouri, DC 18, as a supervisor in training a little over 10 years ago. Moved to Lubbock, Texas. Helped start that distribution center up as a supervisor. Moved to Seattle, the Puyallup, Washington, distribution center. Helped start that one up as a supervisor. Got the chance to move into operations manager and training program. Went down to Mobile, Alabama. Worked in Mobile, Alabama, as both the inbound and outbound operations manager. Then went back to Seattle as the distribution center manager for 3 years, then Moreno Valley for -- distribution center manager for a year, and then over here for a year. So that's my story.

---

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

Great. Great. Thanks a lot, guys. I just did the math while they were talking, and this group represent 245 years of experience in the automotive aftermarket, so I wanted you to just kind of get a feel for -- from the people that have been a part of leadership that has been a result of promote-from-within to hear their story.

So let's continue into our presentation. So several slides this morning, a lot of them, again as Mark said, similar to what you've seen in the past. I'll talk through these first few slides and then turn the presentation over to Jeff.

Company overview. 5,147 stores in 47 states as of June 30. We operate 27 strategically placed distribution centers across the U.S. Jeff will speak more to that here in a few minutes. We have over 79,000 team members at O'Reilly today. The last 12 months sales $9.3 billion as of the end of June 2018. Total assets of $7.8 billion, again, June 30, 2018. Our market cap as of close of business last Friday was $26 billion. And our DIY/DIFM split maintains around that 58% DIY, 42% DIFM. That was as of the end of last year, but it stayed very close to that band.

Results year-to-date. So far this year, we've opened 128 net new stores and are on track to hit our target of 200 stores by the end of the year. 4% comparable store sales increased this year-to-date through the first half of the year on top of a 1.3% comp in 2017. Our operating margin so far this year is 19%. Our diluted EPS of $7.89 compares to $5.93 in 2017. We generated $632 million worth of free cash flow and repurchased $966 million worth of our stock.

We talked about this on both of our conference calls this year. I think we announced on the first quarter call that we did expect to see a benefit from the Tax Cut and Jobs Act. We expect that benefit to be somewhere around $215 million for the year, and as we've said, we plan to reinvest a portion of that back in the business, primarily into areas that will continue to improve and enhance our customer service levels. We've broken that out into 3 buckets. The 3 buckets of reinvestment include enhanced benefits and store wages; accelerated omnichannel investments; and investing in technology in our stores. So we expect that to result in about 70 basis points of headwind through our operating margin line and $30 million of CapEx.

Let's talk a little bit about industry drivers next. This chart, a lot of the people in this room are from metropolitan areas where there is mass transit available. Throughout most of the United States, there's just not a good mass transit system available. So the average American depends on their automobile to take them anywhere they need to go from a transportation standpoint. Over the last 20 years from 1997 to 2017, miles driven has increased by 25%. And if you look at the chart on this slide, the green bars represent miles driven and the blue line represents fuel prices. So we put this chart up to really show the correlation.

If you look at '97 up through around 2007, you saw miles driven continue to increase. As fuel prices increased 2002 through 2006, over that extended period of time, it started to have an impact on miles driven and started to taper down 2008 and flatten through really 2013. Now as everyone is aware, we were facing macroeconomic pressures during that year, recessionary years. That was a part of it as well. And then as fuel prices began to drop and we came out of that in 2014, miles driven began to stabilize to a more historic rate, and that's what we've seen.

Now fuel prices again have started to rise. As of the end of July, fuel prices, the national average was $2.77 a gallon, and if that trend continues and we see a longer-term increase in fuel cost or sudden spikes in fuel cost, it could have an impact on miles driven. But again, historically, those are ebbs and flows. Fuel prices go up, miles driven are impacted over time, and as fuel prices come back down, miles driven typically begin to rise again. So with the exception of that dip in the middle, you see a pretty consistent trend on miles driven.

More industry information here. The chart on the top shows light-vehicle population for the green bars. The blue line is the SAAR for new car sales. So what you see here, again, you're really starting this slide with that period of macroeconomic pressures, 2008 through 2014. If this slide was shifted to the left, you would see that blue line and the green bars be higher. Again, as you enter that period of some recession, the light-vehicle population stabilized, and new-car sales dropped off for a short period of time and then begin to rise again. So really 2014 through current, we've seen the light-vehicle population grow, and would expect that to continue, assuming the SAARs maintain stable as does the scrap rate for automotive vehicles.

On the bottom of this slide, this shows the age of the light-vehicle population. It's a 10-year CAGR of 2.1%, and as you see the age of the vehicle continues to grow -- and that grew at a more aggressive pace when car sales were softer, again, back in those years '08 through, really, '12/'13. But the average age of vehicles continues to grow, and the reason that is, one of the primary reasons is look how the vehicles are just built better today. They last longer. They got longer maintenance intervals, and I think we just expect the vehicles to be on the road longer. We don't expect to see this trend reverses. We expect the age of vehicles to continue to grow over the future years.

Industry landscape slide. This is another slide that most of you have seen before. If you look at the blue line on the top, that's from 2008 through 2017. Over that 9-year period, you'll see that the store count in the auto parts industry really hasn't moved a lot. It stayed very close to 36,000 stores. Yes, it's moved down to the mid-35s. It's moved up to the mid-36s, but across that 9-year period, it stayed very close to 36,000 stores within the U.S.

What has changed over that 9-year period as represented in the yellow bar is the percentage of ownership of those 36,000 stores by these top-10 auto parts chains in the U.S. So if you look at these top-10 chains with AutoZone at 5,540 stores down to Hahn at 94, a lot of disparity from #1 to #10. Really, you look at the top 3 -- AutoZone, Advance, O'Reilly -- they're all pretty tight there in the 5,000s, and then it starts to drop off. But the point of this slide is to show that, in 2008, the top-10 chains owned about 42% of the auto parts stores in the U.S., and in 2017, that's grown to 54%. So that just represents the consolidation that's taken place in our industry over the past 9 years.

If you look at the bottom of the slide, that pie really represents the value of the aftermarket from a sales perspective. Auto Care Association estimates that the total market value of -- in sales of the automotive aftermarket is $286 million (sic) [$286 billion]. If you immediately strip out the red box, which is labor, and tire sales, the blue box, that gets you down somewhere in the $165 billion -- I said million, I meant billion, I apologize, billion there. And then of that, really, we feel like the addressable market for O'Reilly and what we do is around $90 billion. So if you take that yellow and green box and you strip out things like automotive glass, body panels, collision parts, the things that we don't sell, you get down to a number around $90 billion. We feel like that's our addressable market, and our sales represent somewhere in the 10% range of the addressable market.

Obviously, DIY is more consolidated as represented in that chart and more fragmented on the professional side. We still have a lot of regional competitors that are these little too small 2 steppers that are smaller chains that really cater to the professional customers. So it's much more fragmented and gives us greater opportunity to grow that side of our business.

A little bit about branding strategy. Again, we've talked about this for the last several years, and I'd like to just start this by saying I think there's a perception out there sometimes that our national brands are our premium offering, and our private-label brands are our value offering. And that's just not the case. Our national brands are typically our premium offering, but within our proprietary brands, we have value offerings and premium offerings within our proprietary brands. I also like to point out that some of our proprietary brands today that we own used to be national brands, examples being Murray and Precision on this chart, where those were national brands that we now own those brands exclusively at O'Reilly Auto Parts.

So when you look at these, there's different levels within Super Start batteries. You've get premium. You've get extreme. You've get platinum. So while Super Start's our private-label brand, it's really become a nationally known brand for batteries, and we've got 3 levels of batteries within the battery program. So we've really got a good, better, best program within our premium or private label program there. And if you look at other categories like, if you looked at control arms, for example, we'd have a MasterPro product that would be our entry-level or value product, and then we'd have that same application in a Precision, which would be a premium product for that application. So really, what I'm trying -- the point I'm trying to make here is all of our proprietary or private brands that we sell are not value products. They're not all at the good level. Our proprietary brands represent products at the good, better and best level in many categories.

So proprietary brands make up over 45% of our total sales, looking back 12 months and private-label brands are going faster than national brands. Our fastest-growing brand continues to be Import Direct, and we continue to look for opportunities to expand our proprietary brands and our Import Direct brand.

My last slide is omnichannel. Our goal has been and continues to be to build the O'Reilly brand and drive footsteps to our stores through our omnichannel initiatives. We sell parts online every day, but really, what we try to do with our website is to build that brand for O'Reilly Auto Parts and drive footsteps to our stores.

So a couple of things here. Our biggest focus this year has been to improve search and content. We started focusing on search, and at the same time, working with our suppliers to make sure that we had rich, robust content on our site that was able to be searched over, both on our website and through search engine optimizations like Google out on a more broad perspective on the internet.

So some of the things we've been working on, not necessarily in the same sequence, are on-site search enhancements, improving the algorithms for search on our website, improving the data structure to make it more searchable on our website, implementing machine-learning-type tools on our website to add predictability to searches, things like that. Content and images, we talk about that, working with our suppliers, making it mandatory that they provide us content and product images from multiple views, which has become the standard for e-commerce.

We've implemented ratings and reviews. You may wonder why we implement ratings and reviews, why that's important for search. Well, one of the things I learned, I'm not a big e-comm guy, but one of the things I learned is Google likes ratings and reviews. That's one of the things they have that they can search over. So sites that have ratings and reviews information under product information, Google likes that. It gives them one more thing they could search over. So a few months ago, we implemented ratings and reviews, also year, make and model. Historically at the top of the page, when you look up a part, we show the part type and the part description. Now we show that information as well as year, make, model, again, to give Google more data to search over.

We've improved our buy online, pick up in store process. We're advertising buy online, pick up in store on radio. We're advertising buy online, pick up in store on our website, and we're advertising buy online, pick up in store in our stores. We have signage in our stores promoting the pick up in store aspect. If you look at our e-commerce growth over the past year, about 2/3 of our sales are buy online, pick up in store. So most of our sales is being driven into our stores, which is where we like that transaction to end because, again, it gives us the ability to interact with the customer. It gives us the ability to add value to the customer, to add -- to help them make sure they have everything they need to complete the job, to give them advice on making the repairs. All of those things that we talk about that are important.

Value add. This year, we're up to about 30 DIY videos on our website. Those are also replicated on our YouTube channel. Again, just common repairs that we're putting out there to help the DIY customer understand how to make those repairs. Social media sharing. Nowadays, people want to share everything they do on social media. So if someone's shopping on our site and wants to click on a button and say they're looking at this part on our site, we've made that available.

And lastly, the expanded shipping points is my last point before I turn it over to Jeff. Last year at this time, we were shipping from 8 or 9 DCs across the U.S. In the first quarter, we announced at the end of the first quarter that we had expanded our shipping points to all 27 distribution centers. And then since then, we've also added, I think, 3 hub stores and 1 additional distribution center is shipping broken case products.

One of the challenges we have shipping from our DCs is we ship a lot of things out of the DCs in case quantities to our stores. So it's not easy for us to pull a bottle out of a case. We got to do something with the remainder of that case. So historically, when we sold broken case products, we were doing that out of one location. We're expanding that to additional DCs. We've got stores in 7 or 8 of our DCs, we're going to expand that process to those DCs as well as some hub stores just to balance out the shipping points, reduce shipping cost and be able to get that product to the customers more quickly.

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

---

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

Well, good morning, everyone. This? Okay. It's a pleasure to speak with you this morning. Brad and I are going to spend a few minutes this morning discussing the operations side of our business and talk a little bit about the O'Reilly business model.

Now our goal in store operations has always been to execute our mission statement of being the dominant auto parts supplier in all of our market areas. Now those are tall words, but it's what we focus on and work hard at every day in all of our stores across the country. Now there's several areas that we feel are competitive advantages for us, and we'll review and expand a little on each of them. First being our dual market strategy, our industrial leading parts availability. I'll talk a little bit about our growth focus, and then Brad will cover our culture-driven leadership as well as top-notch customer service and also expand a little bit on our O'Reilly First Call program.

Our dual market strategy. We've been committed to our dual market strategy for over 35 years now, and we have a proven track record of success serving both the DIY and the professional customer. And by us targeting both sides of the business, it allows us to open stores in all sizes of markets and, more importantly, to be able to run profitable stores in those markets. It also leverages our strategic located distribution network across the country, which is required for our professional customers, but it benefits our retail customers as well. Now we also expect our store managers to take ownership of their customer service levels equally driving and supporting both sides of the business: the retail and the professional. Now on the professional side, they're supported by a sales force of almost 800 team members after calling on customers every day in all of our markets across the country. And really, the quality of service that it takes to support our professional customers benefits our DIY customers as well.

Now to talk a little bit about our industry-leading parts availability. It's no secret in today's competitive business environment, parts availability is truly critical to our success. Now with our company evolving from a very traditional background over the years, high inventory availability has really always been a way of doing business for us. We now operate 27 strategically located DCs. These DCs stock an average of 157,000 SKUs with all of our DCs linked to what we call a regional DC, which carries over 170,000 SKUs.

Our DCs also deliver stock orders to our stores 5 nights a week with our own fleet of 740 over-the-road trucks. Now over 90% of our stores also receive multiple deliveries a day from either their servicing DC or their local hub store. And these stores would receive weekend service as well. To supplement our DC network, we have 341 hub stores located across the country, deploying that hard to-find-inventory even closer to our customers. And these hubs stock an average of 48,000 SKUs.

Now I'll talk a little bit about the supply chain side of our inventory availability. We as a company, we continually monitor the demand curve of all of our SKUs to ensure that we have our inventory deployed appropriately throughout our supply chain. Example of that would be maybe a new late-model SKU that we may only have placed in our DCs and our hub stores to start with, and then as demand increases for that SKU, we would deploy it in the appropriate stores. And on the other side of that is as a SKU reaches the kind of the backside of the demand curve and starts telling down, we would be working to pull that SKU out of stores back up in the supply chain. Our inventory control team just does a really great job of tailoring our individual store inventories to the individual market areas that we operate in to ensure that we have the right products on the shelf in our stores.

As Greg mentioned earlier, we also have always offered a good, better, best product strategy, catering to both our DIY customers as well as our professional customers. Now we also maintained relationships with multiple suppliers on the same lines to help mitigate a risk but also to ensure product availability. We also believe that our vendor financing program has been very successful for us over the years, and we feel that our current level is sustainable.

Before I turn over to Brad, I'll talk just a little bit about our store growth. We have a very long track record of aggressive greenfield growth year-over-year, and this year, we've stated that we plan to open 200 new stores. Now 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 our store ops team in any one given area. And what I mean by that is it just allows more time for our operators to recruit and develop our new store teams, so when we open those new stores, they hit the ground running. A good example of that would actually be this year. So far, year-to-date, we've opened 128 new stores, but that expansion has been spread across 29 different states. Now we've also grown by acquisitions over the years, and we've always been a very opportunistic and strategic buyer.

And this may be old news to many of you that's followed us for a while, but just a quick history on our key acquisitions over the years. In 1998, we acquired Hi/LO auto supply based out of Houston, Texas, and this basically doubled the size of our company. We followed that up in 2001 with the acquisition of Mid-States based in Nashville, giving us a presence and distribution and the ability to grow -- to start our growth in the Southeast.

Then we followed that up in 2005 with the acquisition of Midwest Auto supply based out of Minneapolis, once again, giving us distribution and the ability to expand up in the Upper Midwest. And then the big one was in 2008 when we basically doubled the size of our company again with the acquisition of CSK. CSK give us a solid footprint on the West Coast, and really, the ability to -- with the distribution infrastructure, the ability to expand out West. And then in 2012, we entered the Northeast with the acquisition of VIP Auto based up in Maine, and we followed that up in 2016 with the acquisition of the Bond Auto Parts stores, increasing our footprint in the Northeast.

Now as you could see on the slide here, we still have several untapped domestic markets, mainly up in the Northeast, as well as exploring international expansion as we continue to grow in the future.

So with that, I'll turn it over to Brad to finish up on the business model.

---

**Brad W. Beckham** - *O'Reilly Automotive, Inc. - EVP of Store Operations & Sales*

All right. Thanks, Jeff. Good morning, everybody. I started with O'Reilly 22 years ago in 1996 in a small market in Oklahoma in the Midwest, back toward -- closer toward Springfield. And so, O'Reilly Auto Parts is really all I know. And I grew up in the stores, basically had every store position with our company. And when I started with the company -- this was a couple years before we bought Hi/LO down in Texas, and I had the opportunity to move down to the Texas market when we doubled the size of our company. Back then, was basically 200 stores, and we doubled the size of our company to 400, we went into Texas, Louisiana and had the opportunity to run stores. And I was a single guy, young, mobile and had opportunities just to grow with the company.

And for sure, was in the right place at the right time through a lot of growth. And fortunate for me a promote-from-within company. And so I spent several years in Texas through our expansion of the Texas markets and then had the opportunity as we bought Mid-State to move out East and be involved in our Eastern expansion. I was based out of the Atlanta, Georgia, market for the longest when we ended up putting a DC in Forest Park, Georgia, a suburb of Atlanta and then worked with a lot of the guys you met earlier in the back of room, had the fortune of working with their teams to develop the East Coast and had a counterpart of mine that several of you met on the West Coast, Keith Childers, that retired this last year.

And then when Ted Wise retired here a few years ago that several of you knew and Jeff took more responsibility, I had the opportunity to take on all the operations and move back to Springfield. So good or bad, this is all I know is selling parts for O'Reilly, managing stores and leading our teams and focused on sales.

One of the things, when I was speaking about this presentation and I think back to my start with O'Reilly back in the mid-'90s was -- at the time, being a young man, I really didn't know I'd really never worked for anybody else other than part time in high school, but one thing that was very clear to me when I went to work for O'Reilly was the culture. And back then, we didn't readily have our culture documented. A lot of companies have this culture word. It's kind of buzzword, and people think it may be touchy, feely and something that's just posted on a wall somewhere, but when I think back even before we had our culture documented, everything that makes up our culture today was what I fell in love with as a young man selling parts in 1996.

The level of ownership that our store manager, our district manager, and all the guys and gals that were in the store that I first met, the level of ownership they took, you would have thought it was really just a mom-and-pop independent parts story, and at the time, we had a couple hundred stores. And I didn't know at that time, I didn't know the O'Reilly family. I didn't know Ted Wise. I didn't know Jeff Shaw, who was 1 of our 3 regional managers back then. All I knew was I went to work for a team that really cared about me as a young man, and they truly cared about the customer.

I remember one thing that was told to me on my first week on the job was there's not a lot of ways to lose your job at O'Reilly Auto Parts, but saying no would be one of them, say no to a customer. That just doesn't happen on our watch. We're here to take care of customers, and that's how the company was founded, and that's just what we did every day.

So that level of ownership and really just that passion for winning, as I started to move around to different markets and had the opportunity to run my own stores, really, all I knew is what I learned in Oklahoma working for -- fortunate for me, some good mentors that had grew up around Jeff and Ted and the O'Reilly family. And all I really knew is, back then, I think we somewhat had our mission statement documented, but it wasn't like it was today.

I mean all we really did and all we really knew, through good years and bad years, was we'd go to new markets and take existing share. And that's, really when you think about it, that's still what we do today. If you talk to any of our operators and ask him about weather or what the macro trends are, ask him what SAAR stands for, any of those type things, they're really not going to be able to help you much because in their -- day in the life of running O'Reilly stores, that's really not in our vocabulary. They're not focused on how much the market's growing. All they're really programmed to know is that there's $90 billion out there we do not. And so every market we go to, we're just focused on really what the competition is doing. We focus on our really -- our playbook at O'Reilly, which we're really proud of, it's simple, but it works, and we go out there and take share on both sides of the business.

The other thing is I'm going to talk about promote-from-within here just a minute because we feel like that that's something that we really have special within the automotive industry is our promote-from-within culture. It was very clear all the way back to my early beginnings and just a few years after O'Reilly went public and, really, at the time, Ted Wise, again, a lot of you knew before Jeff, Ted ran store operations, and he basically grew up with the O'Reilly family. And their vision was always to make sure that everybody had opportunities, that the parts people had opportunities to go on and run their own stores, the store managers had the opportunity to run districts, district managers had the opportunity to run regions. And while that means we have to focus that much more on leadership development and making sure they really understand the business, I personally feel, and I'm biased a little bit, but I feel that's been a competitive advantage of us learning the business from the O'Reilly family. Ted and Greg teaching it us. Now Jeff and Greg in the way we have ran our company to us internally has obviously been a huge part of what we do.

We have an intense focus on the fundamentals. When we talk about that, whatever analogy you want to use, I use sports analogies a lot, but our business is pretty simple. We're not focused on a lot of gee whiz type things, and the message and marching orders don't change week to week. The same things that were important in 1996 when I started still hold true today: top-notch delivery service; get the car off the rack for those installers that make their money by turning bays; having the part available; hustle; sense of urgency; having the right store leadership and all those type things that you have to put in place to make sure you have top-notch retail service and top-notch professional service.

Again, we talked about the guys in the back of the room. Basically, how we have our operations broke up in the U.S. is we have 3 Senior Vice Presidents of Store Operations and Sales. Robert would be 1 of those 3 based out of Atlanta, Georgia. Robert has responsibility of all the Eastern -- kind of the Easton seaboard basically from the kind of old Mid-States markets over to the Mid-Atlantic down through the Southern Florida expansion, then also up through the New England expansion. And then we have a guy that's based out of Springfield, Missouri, that takes care of the center part of the country from the Upper Midwest all the way down to the former Hi/LO markets in Texas. And then we have a guy that's based out in California on the West Coast that takes care of basically the old CSK footprint.

And when I look at those guys and think about where our industry is and the experience it takes to really replicate our success, obviously, I'm very proud of those guys that I grew up with in knowing that they have roughly 25 years' experience each, and it's really all with O'Reilly or a company we acquired. And so we're very proud of that. The 10 division vice presidents that operate under those guys, each of those guys have 4, 3 and 3 divisions, and those division vice presidents all equal over 75 years of experience in our industry.

You've all heard us talk about our mission statement. And again, kind of like our culture, that can be kind of a touchy-feely thing, and I know every company probably has a mission statement. But to me, when I think about our mission statement, being the dominant auto parts supplier in all our markets, again it kind of goes back to the underdog mentality that I think our company's always had. We don't worry too much about the macro trends or what's going on in our environment. There's always share to take. And while it's a changing environment. There's new competitors. Greg talked earlier about some of the consolidation, really what's happened is the strongest survive and the weak will go away, and I think that'll always be the case in our industry, at least from my lifetime. And we have $90 billion worth of share to take.

Top-notch customer service. We use a lot of kind of catchphrases, but these are very important to us at O'Reilly. A few that I like to talk about is professional parts people, being the friendliest parts store in town, and out-hustle and out-service the competition, and when our store managers that are newer to running an O'Reilly store, every single one of those managers comes to Springfield for manager development. We could do that type training out in the field in Atlanta, in New England, in California, but we bring them to Springfield to feel the culture, to really feel what it's like to be in the market where O'Reilly started, see our first store, meet all our leadership that grew up within the industry and really feel that culture. And one thing I always talked about, I asked them if they know where those catchphrases or those sayings came from, and they came from Charlie O'Reilly that was our -- the oldest brother. Charlie was always kind of people guy. David O'Reilly that was our CEO from the time that we went public up until Henslee and then Larry O'Reilly was our COO, kind of the brimstone and fire sales and operator.

But Charlie was the people guy. He was the guy that was on the front line. He was the face of the company. He was in the stores. I had the fortune to meet Charlie a few times when I was running a store, and he was just a special guy. But he was very simple the way he looked at how we treat our customers and how we treat our team members, and that's a big part of how a company culture got documented is through Charlie, but he always talked about being professional parts people in everything we do, and that's never changed. The landscape's changed. The competitors have changed, but we focus on what we do, then we go out and we take share by doing these simple things. Friendliest parts store in town may sound simple, but in today's environment, not only from a competitive standpoint, but from a retention of great team members, we're constantly having to get better at the way we operate. It's a people business.

People buy from people and people buy from people they know and trust, and to do that and to retain solid parts people, it's a challenge, especially, with the new generation, with millennials and even Gen Zs that are coming up, we have to think of new ways to make sure that working behind a parts counter is something fun to do, something that they -- something that they are attracted to. When I was in high school, I had an old '68 Camaro, and I raced a dirt track car. So I naturally kind of understood cars. I learned pretty quick getting behind a parts counter, I don't know near as much as I thought I did as a 17-year-old kid.

But today, it's a little bit different. Today, not every young teenager coming up in early 20s type individual grew up with her father working on their cars. Things are changing a little bit, and I think there's a misconception that the younger generation doesn't want to work on their car or whatever. But we don't find that to be the case. We're very fortunate to be able to find team members that want to learn, and that's the key is they want to learn how. They want to learn and so a lot that has to do with our training platforms and what we do with that.

The last thing I want to talk about was the professional side of our business. I think most of you know but not everybody does that the professional side of our business is really where we got started. In the '50s and '60s, '70s and really all on into the 80s, O'Reilly was the traditional family-ran company based out of Missouri. They were the Bond. They were the Bennett Auto Supply down in Florida. They were the APH up in Minneapolis/St. Paul. Some of those top-10 chains that Greg showed earlier, that was us. We were a traditional company. We remember the alliance, the buying group with auto value, and those were our peers, the Bennett's, the Bonds, the APHs, the Pro Burlingames, those type competitors.

And over time, as AutoShack back then and Otasco and some of the other type retailers were coming into the Midwest, obviously, before my time, but the O'Reilly family saw an opportunity with all of our great parts people and our best-in-class availability even back then, why not open up the front door and sell retail not just to shift the mix of business, but really, it's worked out so great, to Jeff's point, on our dual market strategy, for lack of better words, retail helps us be a better wholesaler. Obviously, the margin opportunities and staffing our stores and going the markets to Jeff's point that we may not be able to go to with 100% professional store or go to and be 100% retail store from a profitability standpoint. We can go in a small market that may have a little independent and maybe one retail competitor, and we can go after 100% of both and have a nice little profitable store.

But the professional side of our business is really our -- even though we've shifted a little bit more to the cash side, after we bought CSK, it wasn't that we lost any wholesalers, it's just we gained a lot of retail volume per store when we bought CSK on the West Coast. But professional is what we know. It's how we built our company. Retail has been so great for so many reasons, but it really just helps us ensure that we can invest in things like delivery trucks, obviously, technology, having the right parts people, staffing those trucks, all those things that we do -- obviously, inventory. So the professional side is really where our company was founded. It's our bread-and-butter. Retail has been great for us, but we feel like we're best-in-class when it comes to understanding, that again, that people buy from people.

I know that's kind of an intangible, but if you were to go out and call on some shops and garages in municipalities and all these type accounts that we go out and service, that NAPA services, GPC, that AutoZone and Advance are starting to service more of that business. But really, over half the share in the U.S. is on the professional side is done by the independents that most of you may not even know. The White Brothers in Atlanta, Fast Undercar out West, APH up in Minneapolis, Bond and all these type companies, XL in Houston and Dallas/Fort Worth. Those are actually our primary wholesale competitors when you get into these metro markets. Obviously AutoZone and Advance from a sheer store count, when you add up their volume per store, they're a pretty big player. But when you go to a secular market, when you go to Atlanta, it's White Brothers and ATS. When you go to the West Coast, it's somebody else. When you go to Minneapolis, it's somebody else. And so -- not that we don't have a tremendous amount of respect for our retail competitors, and they're doing a really nice job growing their professional business.

But really, the majority of the share is still held by these independents, and our background coming from that background really lends to us understanding how people buy from people. They're buying -- they're not -- when you go calling a shop, they're not buying from O'Reilly or AutoZone or Advance or CarQuest or Napa or WORLDPAC or White Brothers, they're buying from Bob that's in the back of the store. For those of you that hit the stores later this afternoon, you'll see that the guys and gals that we have in the back of the store, that's who they have a relationship with. That's who they're trusting their every phone call or their every transaction on our B2B website to make sure that part gets pulled. It's accurate. It's the right part. And it's shot down to there in 5, 10, 15 minutes. It is a time-is-money world when it comes to that professional business. And any good shop, whether it be the national accounts or the regional or Bob's Garage that has 5 bays, the best shops in the U.S., that's how they make their money is turning bays. They actually have a people business, too. Their business is only relied upon them having the best technicians that are coming out of school and keeping those technicians, and the only way that they can retain those technicians is by turning their bays. Those technicians that work for the shop owner, they get paid what they call flak time, which means that if Mitchell says that it's a 5-hour job and they can do the job in 3, because they got the part fast and they got the car off the rack, they get paid for 5 hours, and they can do another job.

And so these technicians that are coming out of school, if the shop's doing their job and grabbing those techs and turning their bays because of the availability, they're going to retain the tech and they're going to grow their business. The technician's not going to go to an OE dealer or whatever the case may be, and the shops that are just looking for price to buy better, we have to be their consultant and help them along and make sure they're not focused on waiting on a part for a day or 2 and most of those shops, unfortunately, are the shops that if we don't help them along, they're either going to get bought up or they're not going to be here in 10 years. They're the ones that we have to get in there with our professional sales force was and show them how to make money by getting the car off the rack. And so it's a people business, and it's a service business. It's pretty simple.

Last thing I wanted to talk about before I turn it over to Tom is the other part of the relationship that, on the professional side that we're very proud of is our -- what we call our real-world training, which will not be in-house training of our team members, it would be when we partner up with our vendors to train -- help our shops train their technicians. We did 1,342 training classes in 2017, and we're backing that up this year with we're on pace to do 1,367, and we'll train over 30 -- 35,000 techs. And so that's a huge part of that relationship is this room, a lot of times during nights, during the week will be filled with technicians. And we'll be in here with our vendors and doing what we do making sure that they're trained on new technology, what tools they need to keep up with late-model coverage and things like that. So that's a big part of what we do.

And then our professional programs -- all our professional programs are built around helping that shop owner be a better shop owner. Certified auto repair. You'll see that name a lot on a lot of our stuff. Basically, what certified auto repair is, is that's just a way for us to make sure that Bob's garage that is an independent shop owner can continue to stay in business and compete with the national guys; the Firestones, the Goodyears, the Kauffman Tires, the Midas, et cetera, et cetera. And so we use these programs to make sure that they have nationwide warranties, to make sure that they have great signage, that their buildings look up to par, they're staying on top of advertising and things like that, that add up to their success.

So with that, I will turn it over to Tom.

---

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

Thanks, Brad. I got the short end of the stick. Not only do I have to follow Brad, but I have the boring financial side we have to put in. That said, they're great-looking slides, right. The reason they're great-looking slides is all the things that Greg and Jeff and Brad talked about. I'll touch on a few points on the slides, and then we'll get to Q&A.

So our store and revenue growth, our comparable store sales, it seemed like some people missed our press release for the second quarter in our second quarter call, our guidance is 2% to 4% for the third quarter just in case anybody missed that. Operating profit. We answer a lot of questions about percentages. Our goal as a company is to continue to drive sustainable operating profit dollar growth, which generates our EPS. Free cash flow. Over the years, I think that Jeff touched on it, becoming -- when we bought CSK, we were an asset-backed loan. That was the only way to get money in 2008. Have converted to investment grade debt, has driven our vendor-financing program and created the ability for us to have our suppliers help us finance all the inventory that needs to be closer to the customer. So we've reduced our working capital quite a bit, generated a lot of operating profit dollars and returned a substantial amount of dollars to our shareholders over time.

This one I'll spend a little bit of time on. When we look at the use of capital, I guess, it changed in 2011, but it's been consistent across our company. We just added an additional leg in 2011, but our company has always been committed to invest in our existing store base. It's a very competitive market, always has been a very competitive market. Greg talked about the number of parts stores out there has been pretty similar for the last 20 years. So every market you go into is competitive. We need our team members to have the right tools and the right inventory to be productive to provide great customer service to earn that customer's business every day, whether it's on the DIY or professional side of the business, so that will always be our #1 use of capital.

Two is greenfield growth. Our company has a proven track record of being able to go into new markets, open great new stores and drive business. As Jeff has talked about, we're on pace to open our 200 this year in the pipeline. It's looking good for next year. In our next conference call, we'll talk about what that number is.

Third item is opportunistic acquisition. So we get a lot of questions about, gosh, what's the environment like for acquisitions out there? And typically, it's kind of like, well we're working on them, and you thought that maybe this year with the jobs and tax act that maybe some additional people would decide to cash out and they had to pay lower taxes, but we're seeing more of the same. The businesses that are left are good businesses that have weathered the storm of consolidation, and typically, for the chains that we're looking to buy to be up for sale that are more than 1 or 2 stores, there's got to be a driver within that typically family-owned business that they've reason to sell. Their store around there providing great service and good inventories, very tough competitors. So when those come for sale, it's usually not us that's driving it. We're always looking, but we have to have a willing seller.

And the last item is the item that changed in 2011. We became an investment grade, and we're generating more free cash flow than we could effectively put back into the businesses to run our share repurchase program, which you can see the chart on the bottom. Only thing different than last year is that our stated EBITDA to -- our stated leverage target debt to adjusted EBITDA, we moved up to 2.5x, which is consistent with others in our industry. At this point, we felt like we were a seasoned-enough issuer that the investment rating agencies would be comfortable with that change. We continue to view ourselves to be conservative and will always maintain enough dry powder to do the acquisitions that we think are appropriate to help drive the business long term.

And with that, I'll turn it over to Greg or Mark. Who am I turning it over to? Let me turn it over to Mark for the Q&A session.

---

**Mark Merz**

Okay, guys. Thank you very much. We appreciate that. Like Tom said, we'll start the Q&A session now. Eric and I will just go back and forth through the room. Again, for the webcast participants offsite, please wait till you get the microphone to ask the question so they can hear at home. We'll try to get through the room. We've got about a full hour of Q&A, and I know all 4 of you guys are very excited to answer your questions. Robert and Chris are in the back, and they can chime in to help as well. We're just going to do a panel-type of Q&A session. So the guys are going to just kick back and get comfortable and just fire away, and they'll just take turns answering the questions what's ever applicable for each one of them.
.

One point I would like to make. There's a reason why the bulk of the presentation today was from Jeff and Brad. That's what our business is. I know the financial section Tom went over in actually less than 5 minutes. That's a record for Tom. Good job. Every year, he wants us to take the financials out because he doesn't want to talk about them, but we tell him he has to take a few minutes.

There's a reason the financials look like our financials. There's a reason we've been successful for 50 years as a business. It's because of what the operators do. And those of you who are -- take the opportunity to take over DC tour today and go out and see our stores, that's why we're successful. It's our culture. It's our promote-from-within. It's never say no. It's everything that Brad and Jeff talked about. That's what makes us different.

I know it's an intangible thing and I know everybody in this room and everybody who's listening offsite just wants to take and crunch a bunch of numbers and say this is why you should buy or sell this company. The reason we're successful is because of our team, our operators. They're the best in the business. We couldn't be more proud of them. We appreciate them taking time out of their day to come and help me do my job.

So with that, we'll go ahead and get -- kick it off. Simeon, since you raised your hand first, I'm not going to let you ask the first question.

---

## QUESTIONS AND ANSWERS

**Mark Merz**

So we'll start over here with Brian.

---

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

Brian Nagel from Oppenheimer. Thanks for all the color. The question I have is on the overall environment right now, we spent a lot over the last couple of years bemoaning weather, and some issues in the Car Parc. I think both those issues among others have gotten better. As you think about the backdrop right now for your business, how good is it? And with -- so how good is your overall backdrop? And how well is O'Reilly now performing in that backdrop?

---

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

I'll start, Brian. And let Jeff and Tom and Brad chime in. You mentioned a couple of things from last year we talked about, weather being a big factor in our performance last year. We also talked about political influences, the Hispanic hibernation. We talked about the SAAR. We've been talking about the SAAR for a number of years, the SAAR bubble. We feel like this year has obviously started off much better than last year. We feel like if fuel prices don't just become unreasonable, which negatively impacts miles driven, we feel like we've started off a good year and expect our business to continue to perform well. As to what's driving that, we've executed our business model really not much different this year than we did last year. If you talk to Brad, you talk to Jeff, you talk to the guys in the stores today, they're going to tell you they were digging just as hard to get business last year as they dig today. Our store operators don't really care if we are generating a 7% comp or a 1% comp. Their goal is to go out and take as much share of that $90 billion pie as they can, day in and day out. So I'll tell you, we are optimistic. Again, barring some -- just, again, fuel prices just going through the roof, which negatively impacts miles driven, if those things remain stable, we've got a pretty solid business outlook for our business.

---

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

What I would add to that is if you look at the slide that Greg started with, we've all been in the industry for a lot of years. And our industry is underpinned by miles driven in the U.S., that's the long-term driver and the age of vehicles. So when you look at it, the other thing that happens is, there are some cycles in our industry, we've all been through ups and downs. But it remains in a pretty constant range. So if we look at this year, for example, more normal weather, goes positive. Negative is, gas prices are coming up, miles driven are as much of a driver year-over-year. And if we go back to '14 and '15, people were going back to work, miles driven were growing a lot, comps were on the high end, right. But if we go back to 4 years before that, our comps were 3 and there were industry items that were against us. We'd tell you this is kind of the normal cycle of our business, we'll trade in a relatively narrow range and we'd consider this year to be, thus far, a pretty average year.

---

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

Speaking as an operator and Brad could add to this, but I mean, there are, again, no matter what's going on with the macro issues, our job in operations is to execute. One customer and one store at a time. And when you look at the entitlement in our market, I mean, we are very optimistic about the entitlement. We've just got to do our job and execute.

---

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

Simeon Gutman, Morgan Stanley. So my -- I have 2 parts, the first is a follow-up to that question, thinking about demand. One of the things that we struggle with is that the months, there have been some tough months during this year, despite, and you showed your 4% comp year-to-date. Do you recall in first, the debate whether it's sort of weather or other things, has that been resolved? And what we struggle with is you have some of these bad months that still occur. And I don't know how you would characterize or contextualize some of these tough months, when weather is not -- if it's not weather. And the second part is on inflation. We are starting to hear some manufacturers talk about in the context of both the tariffs and then just general inflation coming through. So could we get to a scenario if you get 1 to 2 points of inflation down the road in 6 months, 1 year from now?

---

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

Sure. I'll address the inflation first and then I'll let these guys chime in on the first part of your question. We have been talking for, I guess, 2 quarters now, really going on 3 quarters, that we've started to see some inflation, mostly on commodity driven type products. Products that the fuel prices are driven by input costs from commodities. We're hearing some pressure from suppliers on labor rates now, but still most of what we're hearing is related to commodity. Thus far, that number would be somewhere just under 1%, from what we've seen. We -- as we've said over and over, historically, we've done -- our industry has done a nice job of being able to pass that along to the consumer. And if it stays within that 1% to 2% range, that should be something we'll be able to continue to pass along. Tariff rates are -- the talk is tariff rates are going to be much more substantial than those levels. And to date, really nothing has changed since the call. Our merchants and our product managers that work with our suppliers are on the phone with our product managers daily trying to understand what the impact of tariffs will be. And thus far, there's still a lot of uncertainty within our supplier base in China as far as what those tariff rates will be. We've gotten definitive answers from 4 or 5 of our suppliers. We've had 2 tariffs go into effect thus far this year. Those were both well under the 25% rate because they were either a component cost or parts of like a tool that's a part of a set, that only a certain part of that set of tools is impacted. And then there's a couple more that are coming later this year. But again, those are only component costs that are a part of that. If the direction we are going in with the 10% being much more broad, if nothing changes there, we will expect to see some tariff pressure from some of our suppliers in China. And right now, probably 35% to 40% of our product comes from China and -- but one of the things about our industry is it's not like O'Reilly is buying this product from China and our competitors are buying it somewhere else. If we're buying it from China, it's highly likely that our competitors are getting those same product categories from China, many times manufactured in the same factories. So we -- our plan is to try to pass as much of that along as we can. Can we definitively say we'll pass 100% of that on? No, but we're going to try to pass as much of that along as we can and maintain our gross margin dollar rate.

---

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

On the monthly variation, the distinction I'd make is, one, there's weather-driven demand. Most of the business that we do is driven by just cars getting run and wear and tear on the vehicles. There are specific pieces that hot or cold weather drive incremental demand. The other part of weather is really on the DIY side of the business. Does that DIY customer, who typically does not have a garage, have the ability to go outside and work on their vehicle? So what we've seen this year is steady demand or a normal demand for weather-related items and where we've seen disruption of bad months, it's not because of demand, it's the ability of that DIY customer to go out and do those repairs, so they deferred. On our shop side of the business, it's been pretty consistent.

---

**Unidentified Analyst**

[Kevin] (inaudible) from [Medici]. My biggest worry is about O'Reilly still being a growth company when you probably hit your target store count, maybe in 5, 7 years. So what are the efforts that you guys are putting right now to make sure that in 5 to 7 years, you are still able to grow double digits?

---

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

I'll speak operationally a little bit to that and then let Tom talk from a financial perspective. We've stated that we feel like we can open 6,000, 6,500 stores in the U.S. And you've done the math, you know that there's a runway out there to hit that number, to your point. But you also have to factor in the opportunity for international expansion, which we are looking aggressively at ways we can expand, either through acquisition or opening new stores in markets outside of the U.S. So I think part of that long-term growth strategy, you have to include not only domestic store growth, but also international store growth. And I'll let Tom speak to the financial perspective on that.

---

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

Why don't you jump in, Brad?

---

**Brad W. Beckham** - *O'Reilly Automotive, Inc. - EVP of Store Operations & Sales*

Yes, I think our -- when you are in my shoes and the operators in the back room, we obviously still feel optimistic there's so much, a tremendous amount of share in the U.S., even with -- on top of, I guess the way I would think about it, on top of 200 stores a year for the next many years, and then some international opportunities. I think the other thing that we'd make sure that we don't miss is how much share is still left in existing markets, because we still see a tremendous amount of opportunity to consolidate the business on the DIFM side, whether it be through acquisition or simply taking share from those guys each and every day or a combination of both. And so Tom could probably talk a little better to long-term financial strategies, but I think we feel really good about the next many years from a growth standpoint, on not just new stores, new distribution, international, but also making sure we keep in mind the share that's left in all our existing markets. We -- all of you know we average roughly $1.8

million a store and so does AutoZone and so does Advance. And you don't even start tapping into the numbers that NAPA and all the independents run on the professional side. And so we still have a tremendous amount of opportunity to consolidate the market and no telling what our average per store could be by that time.

---

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

To echo those comments, we're going to continue to invest in existing stores. Growth is an important part of our company DNA and I would tell you that ultimately, we will, looking at the Car Parc for Mexico and Canada, it's very similar, and those are opportunities for us to grow into those markets over time.

---

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

It's Matt Fassler from Goldman Sachs. I want to follow up on some of the comments you made on e-commerce. It sounds like you made a number of changes and upgrades to your e-commerce offering. As you look at the customers who are taking advantage of that, who is choosing to shop e-commerce? And as you look at their path to purchase, how are they thinking about price as a factor, particularly given the transparency available to them online?

---

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

Sure. So price -- I'll start off with price transparency. Obviously, the internet and e-commerce has created a great deal of price transparency. That price transparency has been there on the DIFM side for a long, long time. Our DIFM customers, our B2B side, First Call Online, our customers that buy from us have similar systems that they buy from our competitors. So we fought price transparency for years on that side of the business, and we won, frankly, with service on that side of the business. We just over-serviced our customers to the point, and developed relationships, to Brad's point earlier, that we're able to maintain and grow that side of the business. On the retail side, the DIY side, a lot of the product that's sold online, we still contend is product that was sold online years ago, maybe not through e-commerce, but through catalog business, things like that. It's not as much application hard parts as it is a lot of accessory-type items, easy to repair items. We talked about some of the things we are doing on, on how to repair -- to help the consumer, to value add, how to help the consumer do the repairs and show them how to do the repairs. A lot of times, it's not only price and it's not only knowing how to do those repairs, it's being able to diagnose what repairs need to be made. I think that's a critical point. And you can walk into our stores, or our competitors' stores and we'll have a code reader and we'll plug that up to your car and we can give you a general idea. There are certain things we can tell you definitively what's wrong with your car, but more often than not, we can point you in a direction and typically refer you to a professional installer to do that repair for you. But it's not easy to definitively diagnose that repair with these pretty basic code readers. That requires a professional shop. They've got much more robust systems. So for the average consumer that's out there making a repair, if there is a price point difference, and there is, between brick-and-mortar and online frequently, it's do I want to take a chance? And I went to my O'Reilly store or where have you, or I have a $30 code scanner that I bought that I plugged into my onboard diagnostics port and it says it could be an oxygen sensor or it could be this or it could be this. Am I going to take a chance and buy one of those products and spend $40 and install it, and not be able to return it, or am I going to talk to someone who is more knowledgeable and help me through that process? And Matt, as evidenced, we've talked a lot about this, but even though we have historically run promotions for the last year most of the time, and now we're testing some on-off promotion strategies, but more often than that, we have discounts for buy online, ship to home customers. And those customers, 60% of the time plus, are forgoing that discount to pick up that product in store. And we believe there's several reasons for that, but the 2 primary reasons are: Immediacy of need, they need to get their car fixed so they can get back on the road; and two, they need to interact with our professional parts people on the counter. They either need -- want to make sure they are getting the right part, make sure they're getting all the parts they need to complete the repair or just get help with the repair itself. So Brad or Jeff, do you have anything to add?

---

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

Well, I mean, just to expand on that a little bit. I mean, a category that is a heavy DIY category is brakes, and you know, you can easily buy brake pads online and some customers do. But I mean, on a brake job, I mean, you really don't know what you need until you get into it. You can say, "Well, it's metal on metal, I need a pair of rotors," buy a pair of rotors. But once you get in there, you could find out that you need hardware based on the wear of the pad. You may have a sticking caliper, you need a caliper. There could be a worn brake hose. It could be – there's a sealed hub bearing gone bad. There is so many ancillary items that go with that core component sale that many times you just don't know you need until you get in there. And do you want to buy all of that online and then have to return a good portion of it. The same with cooling systems. You can have a radiator leaking or a water pump leaking, but until you get in there, I mean, do you need a thermostat? Do you need lower hose? Do you need clamps? Do you need -- everything that goes, the ancillary items that go with that sale. I mean, there is a lot more to those core items being sold.

---

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

Matt McClintock, Barclays. Brad, you talked a little about changing with generational preferences when you hire new employees. And I was wondering if you could elaborate a little bit on that today, with the unemployment rate being as low as it is and the labor market being as tight as it is. And overall, Tom, you did a really good job, the company did a good job of being proactive with employment compensation this year. And I was wondering if you could maybe talk, as we get through 2019 and beyond, is this something that you see more of an elevated pressure going forward, given where we're at?

---

**Brad W. Beckham** - *O'Reilly Automotive, Inc. - EVP of Store Operations & Sales*

Yes, what I would say, Matt, is that when I think about our staffing, one of the things we're most proud of, we measure our store level turnover and obviously, our office and DC turnover, against peers, against other retailers the best we can. And our turnover, we're very proud of. And one of the reasons I feel like we really do a good job, while we have our opportunities, to your point, with the ever-changing market and generations, is that people are looking for opportunity and what's become a challenge a little bit different than when I started over the last 20 years, is that somebody that's young may not think about O'Reilly or the automotive aftermarket for a career, but we really have been the only one in our sector that really offers a career, that somebody can come in and fast track from a parts person to an assistant store manager to a store manager to a district manager. So above and beyond pay and the things that are going on in a lot of our markets with rising wages and things like that, we have to pay competitively. But any market we operate in, there's a factory or somewhere else or another retailer that may pay more. It's not always about the hourly wage, it's about being that much better of a place to work. And so what me and my team and the SVPs and DVPs on down to the district managers focus on every day is making sure that we're that much better of a place to work. Jeff might turn my mic off when I say this, but one thing that's very important to millennials and Gen Z, is different than when I came up, and it's different than when Jeff and Greg came up. And so in my age kind of being between the generation of Jeff and Greg, and a lot of our team members today, I have spent a lot of time cusp-ing and making sure that we are making some changes we need to make where somebody can come in and really enjoy their job. They can collaborate, they can be involved in social media. One of the things that ties into what our other Matt asked a while ago, when it comes to e-commerce is, when we talk about omni-channel, I think a lot of people jump to our B2C business, when we are talking about omni-channel. But omni-channel means a lot of things and it ties into our B2B business, it ties into our stores. We have a tremendous amount of opportunity to grow our e-commerce business B2C. We do a tremendous B2B business. But part of that omni-channel, and really what millennials and Gen Z want is they want the tools at their fingertips so they can better help a customer, even though the customer does have a phone, does have a tablet, whatever the case may be. And so a lot of the wins that Greg talked about when it comes to search and attributes and the content work that we're doing, it's not only benefiting our B2C business. Really, the biggest benefit is it's benefiting the 79,000 team members, the majority of those being out in our stores, giving them better tools to be comfortable, them not knowing as much about cars. And so a lot of our content work, search work and then our training work, is around making the younger generation more comfortable. And I think we're really doing a nice job on that.

---

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

Yes, if I could add to that -- I'm sorry, Tom -- if I could add to that a little bit to what Brad said. Every -- we don't just talk about promote from within. I mean, we represent promote from within and we are all examples of promote from within. We talk about it, our team members see promote from within. Every week, we have leadership groups come to the corporate office for training. In the morning at 7:30, I'll be speaking to a group of manager development program class attendees. Those probably haven't seen the itinerary, but there's probably going to be 60 or 70 store managers in that room and we do this every week and Brad talks to them, Jeff talks to them, Tom talks to those team members every time they're in the office. And I haven't looked, but I guarantee you, tomorrow when I start that presentation and I ask them, "How many of you started off at an entry-level job, as a driver or a parts specialist in our stores," more than half the room's hands will go up and the rest of them will be strategic hires from competitors or peers in our industry. And that's powerful. And then our ability to tell our story and just demonstrate that if you look around our executive team, the table at our executive team, our VPs and up, 90% of the people in that room started off working in our distribution centers or in our stores. I started off in 1982 stocking shelves at a distribution center. So we are -- our company embraces and promotes from within and our team -- our team members know that. And as we recruit team members, we talk about that from day 1, we talk about opportunity that they can have. And the people that they're interacting with day in and day out are examples of that. And I think that's very powerful for our company.

---

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

What I would tell you is we spend a lot of time on compensation and we will always be a competitive payer, but as a company, we have always focused on paying on performance and paying people to take ownership. And that hasn't changed from a concept standpoint, we continue to make tweaks all the time to make sure that we are paying to recognize performance. When we look at this year's plan, a little bit different year, right. Because all of a sudden, most retailers were getting big tax breaks, decided to invest more in wages. When you look at that, we had a savings and we're really not driving that through in cost. To the extent that we continue to see significant wage pressures, we had anticipate having more inflationary pricing to help support those wage pressures going forward. But making sure that we can provide great customer service is critical to our long-term business success.

---

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

Scot Ciccarelli, RBC. You guys talked earlier about geographic expansions, but with your size and distribution capabilities, I was wondering if you had opportunities for product line expansion, whether it was in the crash parts, you mentioned the windshields, et cetera? And what would prevent you from getting into some of those product lines if the answer happens to be no?

---

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

Yes, we really haven't talked a lot about those categories recently. The problem with crash parts, and when I was at Mid-State, we didn't sell crash parts, but one of the companies we acquired in Alabama did sell glass and then we acquired companies over the years that sold tires. And the problems with glass and crash parts and tires is one, they're typically lower margin; and two, they're very difficult to handle and take up a lot of space. So to ship windshields, things like that, for example, you've got to have specialized equipment. You just can't put that on one of our tractor-trailers, deliver it to a store and it not being broken. So the handling characteristics are different. Handling characteristics are different for crash parts, too. Typically those body panels are very large and bulky and we just up to now have not opted to get into any of those channels.

---

**Brad W. Beckham** - *O'Reilly Automotive, Inc. - EVP of Store Operations & Sales*

Scott, what I would say is that we see a lot, especially on the professional side, we see a lot of competitors and parts type companies that get too many irons in the fire and they're trying to be all things to all people. And we actually on purpose stay disciplined to really our key categories. Some of the things, a little bit different than your question on glass, is that we have, like medium- and heavy-duty parts for 18-wheelers and we have marine parts for boats and we have some paint body and equipment. But we, in a disciplined way, we wait until we are very mature in a particular market and we're starting to run out of runway with comps and growth. So when we go to a particular market, just because the NAPA store or independent store has parts and heavy-duty and paint, we on purpose may go in with just auto parts and go in and focus solely on that share of light-duty and automotive. And then over the years, as we get more mature and start -- our comps start slowing down as our base gets bigger, then we pull maybe medium-duty out of the toolbox and have one more thing we can go hit that competitor. And by then, we've already taken their auto parts business. They're living on one thing and then we can take the other. And so, I would -- there may be some opportunities for us, but it would be way down the road towards the $90 billion, where we feel like with our model, with our current way we go after a market in a disciplined way with our categories, we are better off taking share in those categories. And if we ever run out of runway, maybe there is some opportunities. But there's a lot of risks there, to Greg's point, and we also in some of those categories, we would start to compete with our professional business. There's some professional customers that sell those type things through other warehouses, but that's part of their service and we wouldn't want to compete with those guys.

---

**Michael David Montani** - *MoffettNathanson LLC - Senior Research Analyst*

Mike Montani, MoffettNathanson. Just wanted to ask a 2-part question around B2C. So the first part, maybe for Greg, would be on availability and fulfillment. You mentioned that, that was a critical way O'Reilly differentiates. So if we think about it down the line, do you see ship from store being a solution? Or is it more about getting the 27 DCs to be able to break down pallets and ship eaches? And then like a follow-up question would be around price transparency. So if you think about B2C pricing versus an Amazon, you're looking at mid-teen to sometimes 20% or 30% price differentials there. O'Reilly doesn't price match today in store. How do you think about filling that need? What percentage of consumers are asking for that? What was that 5 years ago? And where do you think it would be in 5 years?

---

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

Sure, I'll take the first part, Mike, and let Brad and Jeff talk about the price transparency piece and what they are seeing in the stores. From an availability fulfillment standpoint, as I said earlier, this time last year, we were shipping product out of 7 to 8 distribution centers. We have expanded that this year and we completed that expansion in the first quarter to fulfill out of all 27 of our distribution centers. UPS tells us that by doing so, we have the ability to reach approximately 90% of the U.S. population, shipping UPS Ground and 1-day service. The reason that we haven't really advertised that is we're working on a solution to be able to give the consumer shipping options other than just UPS that we offer today, including FedEx and USPS and SurePost which is a combination of the 2. Not only that, but to be able to show the customer pricing if they don't meet minimum purchase thresholds and tracking information very concisely, like best-of-breed e-commerce companies do. So we are working on that solution and expect that to roll out in the fourth quarter. At that point, we'll be able to do a better job of promoting how quickly we can get the product in the customers' hands. From a fulfillment standpoint, it's -- most of the product we ship, we ship in eaches out of our DCs. So I don't want to add additional concern, from my earlier comments, but there are chemical lines, there are spark plugs that we sell in the DC, for example, a spark plug in sleeves of 4, 6 or 8, to our stores, and we just don't break those. So if a consumer needs 1 lawn and garden plug, we would have to break that down, ship them 1 piece out of that package, and then sell those additional 3, 5 or 7 to a store. So we opted to shift those broken quantities from a DC that had a store presence within the DC. That gives us the ability to immediately transfer those broken quantities to a store there in that building. There's not much handling involved with doing that. That's worked very well for us since we started this process. But we've -- from a -- both from a shipping cost and a handling cost and a time to get that product to the customer, we are in the process of expanding that to other DCs. And frankly, when we did it for the initial DC, it was hardcoded in there and some custom logic, as far as how that sourcing works. We have since built in some more generic logic to enable us to roll that out to additional DCs. And also, in markets where we don't have DCs, or stores in the DC, like on the West Coast, we've rolled that out to hub stores. So I feel confident that between a few hub stores where we don't have stores within a DC to ship broken quantities, and a combination of our DCs with a store presence, we can be able to get product very quickly to our stores, both in warehouse shipping units and store shipping units, without the need to ship from a lot of stores. Again, we do a lot of business that's pick up in store because of our immediate store inventory availability that we have. But actually shipping from all of our stores, have we talked about it? Yes. Have we considered it? Yes. Is it something that's on our short-term road map? No, we want to get this fourth quarter piece out there and see how that impacts our online business and being able to show our customers that we can get that product to them in 1 day. We feel like that will get us across that hurdle.

---

**Brad W. Beckham** - *O'Reilly Automotive, Inc. - EVP of Store Operations & Sales*

I think on the pricing part of it and the way we run our stores, what I would say is that when you run 5,000 stores, and you have 5,000 store managers and over 500 district managers, price match type policies aren't a black-and-white thing. It's kind of like we talked about in our presentation, is we expect our store managers and our district managers to totally own their business. They have full responsibility of both the retail and the professional side of the business, and they have full responsibility of the entire P&L. And so -- and they're very heavily incentivized on the top line. They're incentivized to sell parts and then they're incentivized a little bit less to make sure that, that's profitable and they're managing all their top line expenses that are controllable. And so there's a lot of gray area with that. There's some new competitors to us that we really don't consider new, just because there's always been somebody that's cheaper. You can take any one of our markets, and there's always going to be somebody cheaper.

You live by price and you die by price. And there's always been that scenario in our industry. Is it changing? Is there new competitors? Is there new threats? I think we talk about it more just because it's been brought up. But if you talk to the guys in the back of the room and you talk to our store managers today, I think what they would tell you, being fully accountable for their P&L, is they want to make sure they can sell. And if they have a customer in the store that we know is a good DIY customer, and they found something online, policies aren't black-and-white. They're going to make sure that we don't walk a customer. We want to make sure that we make an O'Reilly customer for life. And it's not as important to us as much what we put in the policy manuals, it is that our store managers are running the store like they own it, making sure that if there's a cheaper price out there and we're going to walk somebody, we don't want to do that. So we're going to, right there, point of sale, they have full ability to bring that price down a little bit to make that customer happy. Most of time, it's not even matching a price. It's just, "Hey, I would rather not order this and wait on it, not being able to return it or whatever, if you can help me out a little bit here, then that would really be great." We'll get to the appropriate price and we'll make a customer and they'll be back. And so Henslee, I think even year last year, may have quoted our, what the override percentage of our sales is, but that hasn't changed in many, many years. It's a very, very minute number in the whole scheme of things. And where we need to match prices or change a price a little bit for a customer to make sure they keep coming back, is that we empower our store managers to do that.

---

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

And Mike, one other comment that I failed to mention. Our sourcing logic, our fulfillment logic, for our e-commerce orders, most of those orders are 1 or 2 units. They're not a long list of pieces that customers are ordering. More often than not, we source those directly to the closest DC. It's the exceptions that have these broken quantities that have to go to now the hub stores or the DCs in the stores, but most of those orders come from the other DCs. I didn't want to make you feel like it's a bigger deal with these broken quantities. It's a small part of our e-commerce business, but it's something that happens that we have to be able to react to and we are expanding that.

---

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

I might expand a little on what Brad said there talking about price overrides. I mean, that's nothing new for our company. I had the ability to price override when I was a manager 25, 26 years ago. I mean, it's always been there. There has always been the ability -- we're never, we've never built our business on being the cheapest. We built our business on consistent service and solid relationships and being competitive. But you've always, as a manager, as an owner of a business, you always have to have the latitude to be able to massage the price a little bit. And we give our managers and our district managers that latitude, but it's, I promise you, it's closely monitored. And if we've got a manager that gets a little bit out of control or off in a ditch, we get him back on the road pretty quick.

---

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

The other thing I would add to that is, when you're a DIY customer, you're having -- you're doing that repair to save money. Within the store, we also have other offerings that are OE form, fit and function. Because they may be looking at the price for a best product online, which would be a price disparity, because we are typically selling those to the installer. And our store managers will talk to them about what are other offering next. What's a better offering? What's a good offering? So it may be getting that customer to the right value proposition that they're looking for. And when you look at a entry level brake pad versus a brand-name brake pad, the cost -- the retail, either online or in the store, is significantly different.

---

**Seth Mckain Basham** - *Wedbush Securities Inc., Research Division - SVP of Equity Research*

Seth Basham with Wedbush Securities. A follow-up question on e-commerce. If you look at that 40% of your business that's shipped to home versus the 60% that's picked up in store, is there a big difference in product category mix? And then a follow-up, when you look at that ship to home business, what are your objectives for growth? Where do you expect that to be over the next few years? And does that matter that it's much lower margin?

---

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

I'd qualify a bit, but Greg could...

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

Over 60%. Yes, it varies day in and day out, obviously, that number moves, but it is over 60% on average. I think the term I used was 2/3. But it's similar. The mix is not much different on ship to home or pick up in store. Some of the ship to home stuff, you may have a little more of your wipers or lighting or easier repairs. But for the most part, it's very similar, the mix. And as far as growing the ship to home side of the business, again, if someone wants to buy product and have it shipped to their home, we would like them to buy it from us. But our focus continues to be on what I said, where I started my e-commerce slide with, it's building the O'Reilly brand, we're promoting the O'Reilly brand and trying to drive footsteps to our stores. It's beneficial for us to get that customer into our store to end that transaction as opposed to buying online. That said -- or shipping to home, rather. That said, we all know there are consumers that don't want to go to a store, for whatever reason, and they want to have that product on their front porch when they get home. And for those consumers, we want to make sure we're competitive. And if they want to buy those products, we make it an easy shopping experience and give them the ability to buy from us.

**Brad W. Beckham** - *O'Reilly Automotive, Inc. - EVP of Store Operations & Sales*

The only other thing I would say, I can't really speak to the growth, but I can speak to the in-store experience. And for competitive reasons, I wouldn't want to talk about the specifics, but what I would tell you is that we talk to our customers a lot. We see them in person and we have other ways of knowing what we feel our DIY customers and potential DIY customers want. And I think what's most important is I think the generation today and way that retail is headed is, what we are finding out is they want that great experience. And I know in-store experience and all that is a buzzword, but customers that walked in, in the '80s and '90s, and stack it high and let it fly and we'll bill it and ship it, the days -- some of that hasn't changed, but I think what we are learning, is that the same customer, there's days they want to come in and they want to shop for an hour. They want to hang out on a stool and talk to our parts people and they want to -- they have time to do that. Tomorrow, they may need to pick up and be in and out in 2 minutes. And so we have a lot of initiatives underway to make sure that we're thinking about what the retail environment needs to look like in the future in our stores and make sure that every customer is totally comfortable. And that we have a buy online, pick up in store experience where they can still utilize our professional parts people and all these things that built our company, but still when they want and need to, get in and out of a store location very quickly.

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

The thing I would add to that is there cannot be good customer service unless the customer can complete the repair effectively. It could be a great experience, if they get home and they don't solve their problem, you're not going to have a positive impression of that parts store. So because of that, Greg and Jeff both talked about it, people need access to those parts professionals to get that outcome that they're looking for and that's what's going to continue to drive the vast majority DIY customers to parts stores for a long, long time.

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

Chris Horvers, JPMorgan. So 2 questions. First, in terms of the investment cycle, part of the 70 basis points this year is, it's not labor, it's IT and e-commerce. Can you talk about where you are in terms of the investment cycle around that? Are we sort of at a full dollar spend and that dollar spend continues in the future? Or does that spend continue to ramp? And then secondly, on the gross margin, can you talk long term about the gross margin potential, what the puts and takes are in terms of headwinds and tailwinds and your ability to continue to drive gross margin expansion?

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

On the IT investment, what I would tell you is that we accelerated our pace. We're continuing to invest in tools that make our store teams more effective and able to provide great customer service is something we're going to continue to invest in. I'd just tell you, we took a -- we pulled some of that forward and stepped up a level and I'd expect the spend to be comparable next year. So it will not have an impact -- or it may or may not have an impact. Right now, the plan is not to have an impact on our percent of sales. That said, if we have the right projects with the right return, we'd make those investments. On gross margin, our focus is not on the gross margin percentage. It's an increase in our comp gross margin dollars, right. So if we look over the last 5 or 6 years, and this is a constant theme. Our industry has been very effective at reducing acquisition costs without driving same SKU sales price to drive more comp gross margin dollars. What we would tell you is that, that ability to lower acquisition cost by sourcing, private label, scale, is -- there continues to be opportunity, but not nearly the opportunity we've seen in the last 5 or 6 years, and that our industry will drive comp gross margin dollars over the next 5 years with some same-SKU inflation keeping rates similar.

---

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

Can I ask a follow-up to that? (inaudible) and so there actually is (inaudible) next 12 months opportunity to capture revenue (inaudible).

---

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

That would be part of the negotiations, to the extent that the tariffs are imposed.

---

**Colin R. Ducharme** - *Sterling Capital Funds - Sterling Capital Equity Income Fund - Portfolio Manager*

Colin Ducharme with Sterling Capital. I just had a clarification and a question regarding the DIFM business. The clarification is that $90 billion TAM that you quoted, the DIFM component of that, is there built in the wholesale markup that the garages make into that number? And if so, what would that back out figure be? So that would be the clarification. And the question is, really regarding your observations on electronic order penetration, within that space. And so in a recent conversation we had with a smaller regional aftermarket parts competitor in the mid-Atlantic region, the way he -- the head of that business. The way he characterized his experience is this generational difference that you all are talking about in that the more seasoned techs at that garage love Bob in the back office and the ability to get on the phone and take advantage of that relationship. However, the fresher 18-year-old techs, who have never grown up buying anything from a store, really, immediately gravitate towards a computer or a phone to order that part. And so my question is, writ large, given your larger footprint, what are you observing with electronic order penetration? Is that real and what's the trend, in your view? Is it this generational shift that's just a matter of time?

---

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

Brad is closer to that one. So Tom, you want to take the first part?

---

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

Yes, let me answer the clarification. The $90 billion backs out the markup that the shops are putting on parts. That's why the math doesn't work out. I'll let Brad answer the EA question.

---

**Brad W. Beckham** - *O'Reilly Automotive, Inc. - EVP of Store Operations & Sales*

Yes, really, we see the penetration growing and growing on the electronic orders on the B2B side of things. But we see that as a good thing. Our -- the guys that stand in the back of the store, the Bob, so to speak, like you mentioned, that you'll see today if you go on store visits, that's nothing but ramping up their leverage on productivity. And so with rising wages and all those type things, buying more delivery trucks, more SKU proliferation, all these things that our industry has faced, that's actually a good thing. Because we're still tied to that customer in terms of yes, there may be more transactions that aren't on the phone, but there is still a major trust factor when it comes to making sure that they're looking -- that they're double-checking the work, that they're making sure the part's pulled quickly, accurately and that it's routed in a manner where they're going to 5-, 10-, 15-minute delivery service. And so the observations you've made are very accurate, but we don't really see that as a bad thing. The generational things happen on both ends and we feel like as we grow our professional business, we continue to grow our online business. It's really been a good thing and it's been one of the best ways we can leverage our productivity and in turn, expenses.

---

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

But all of our competitors have a B2B platform. I mean, everybody's out there with B2B. It still boils down to the consistent service day in and day out and the high availability. And whether they order it on the phone or they order it online, you still got to get the part there, the right part there, in a very consistent manner to earn that business every day. And when you -- they can order it online, when you don't do that for whatever reason, your service slips, you're going to lose that business.

---

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

And a lot of times, just going back to the relationship aspect, and Brad speaks to this often, is even though they have got the ability to go to the B2B platform, look and see if we've got that part available, a lot of times they end up making that call rather than hitting that button to order it online because of the relationship aspect. Yes, the system shows you've got it there, I just want to call and talk to Joe and catch up with Joe and tell him how important it is that it gets here in 5, 10 and 15 minutes and make sure that part is sitting there for me.

---

**Benjamin Shelton Bienvenu** - *Stephens Inc., Research Division - Research Analyst*

Ben Bienvenu with Stephens. I wanted to ask a follow-up as it relates to the 70 basis points of reinvestment of tax reform proceeds. To what degree has or will sales, top line results, influence the cadence of the spend throughout the year? And then, do you have the latitude, how much flexibility do you have as it relates to the composition of the spend depending on what the backdrop looks like in the operating environment?

---

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

Well, as we talked about on our first quarter call to set up year, the expected spend was pretty consistent throughout the year. The reason for that, you'd think it would scale over time, is that we changed some benefits in the first quarter to retain and recruit team members. And so the spend has been pretty consistent. Could we change the spend? Yes, we're still pretty comfortable with what our plan was and how we are executing it. Your question on the direct relation to sales, that's a hard one, right? What we do know is that great customer service wins and retains business. And that it's the right thing to do for our business, based on our 50-plus years of history.

---

**Harrison Vivas**

Harrison Vivas with Deutsche Bank. So kind of a 2-part question. Last year, there was a lot of talk about Dorman and other suppliers kind of pulling product off of online-only retailers, if they weren't adhering to the MAP pricing or MRP pricing. So I'm wondering if there's been any update with that and how it's affecting your business currently? And kind of as a follow-up to that, they have recently lowered their 3-year sales guidance. So I'm wondering if --and they cited that they lowered sales guidance based off of inventory control measures at their customers. So I'm wondering if there have been kind of any inventory issues with Dorman product at O'Reilly stores?

---

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

On the second part of your question, our relations with our suppliers are very important, but they're also confidential and they're not something we'd speak about, especially for another publicly traded company. So we're going to pass on answering that one. But Greg would be more than happy to answer the first one.

---

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

Yes, last year, we talked about Dorman specifically. And Dorman had migrated from -- they tried a MAP program for a couple years. It didn't bode well, and they moved to an eMRP program. It took Dorman the better part of a year to get that program up and running. There's a lot that goes into these eMRP programs. There's a lot of legal discussions that have to take place. There's a lot of discussions with customers that have to take place. Dorman actually worked with a consultant that called out to myself and our competitors to get input on how we felt the program should work. So it takes time to get those programs up and running. Greg and myself both at our industry event last October, our big message, as we met with suppliers in Vegas was, we need these national branded suppliers to get on the bandwagon and protect their national brands as a premium brand and by doing so, control the price points that your products are being sold at online. And we've got some traction. I can't tell you that there's a lot of suppliers that have, at this point in the year, have implemented ERP programs, but a lot of suppliers are working on eMRP or MAP programs that they are planning to implement. And Dorman has been very open to working with them and sharing their experiences and we talked last year, it's not just Dorman, SYLVANIA Lighting did the same thing. A lot of performance lines, MagnaFlow, Holley, the Holley brands are doing that. So we expect other suppliers to jump on the bandwagon. It just takes a while to get there. It's not something that they can turn around in 60, 90 days. But we do have several suppliers that are working on that.

---

**Jason Daniel Haas** - *BofA Merrill Lynch, Research Division - Analyst*

Jason Haas from Bank of America. So if you look at the vehicles that are going to be entering your sweet spot, they are going to be increasingly complex in terms of electronics and just general parts complexity. And that's a trend that has been going on in the industry for some time. But I just wonder, as it gets harder and harder for your DIY customers to work on their vehicles, how do you think that affects the business? Obviously, there's -- probably going to drive some shift over to do-it-for-me. And then just as a follow-up, any comments on telematics and if that presents any risks to your business as well?

---

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

Sure, I'll start that off and see if these guys want to chime in and add to what I'm going to say. I remember back in the mid-'80s, when the first computer chips were put on cars and when we evolved from carburetors to throttle bodies, we were sitting around the room having discussions about, "Oh my gosh, the DIY-ers are not going to be able to work on these vehicles anymore. They're going to become so complex that they just, everything is going to have to go to the professional installer." And these consumers that are challenged for cash and they have just evolved and learned how to make a lot of those repair themselves. We offer service, as I said earlier, helping troubleshoot those issues, reading diagnostic codes. There are things that the consumer can do and there are things that the average consumer can't or wouldn't want to do. So I would tell you that our expected growth would be to grow the DIFM side of the business faster than the DIY site for that very reason, the complexity of the vehicles. We just don't know, as vehicles become more complex, a lot of the things that are changing in our industry is a lot of sensors, crash avoidance things that are just coming into the aftermarket. If you think about it, if you're able to diagnose which of those sensors are bad, I would think that the consumer would be able to install a lot of those things themselves. The key is the ability to diagnose some of those issues. Now there are more complex repairs that Brad or Jeff can go into details that the average consumer just doesn't want to tackle. And then there is the issue with the whole diagnostics piece, that is it a repair that I can definitively run a trouble code on and say this is what's wrong with my vehicle? Or are the scan tools that I have available to me such that I get a list of possible options that could be causing the issue with the vehicle? And am I willing to pick and choose one of those to try to see if that solves my problem? Brad, do you or Jeff have anything to add?

---

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

No, I mean, really, our -- if you think -- I think about my time in the business, there's been a tremendous amount of change in the evolution of technology of cars. I mean, I can remember when you'd walk back, somebody would come in and want points and condensers and a cap and rotor for a GM and you knew the part numbers off the top of your head and you'd run back and get them. Then we implemented electronic transmission in the '70s and then it was fuel injection. There has just been constant evolution. But through that, the DIY customer has continued to be able to work on their cars, out of economic necessity, many times.

---

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

When you look at the growth of the DIY versus professional, you expect professional to be a little bit higher because of that. The core DIY items that they repair, belts, hoses, fluids, filters, batteries, rotate electrical brakes, very similar. Where cars have become much more complex is how fuel is entered into the engine, combusted and exhausted, always a bit difficult repair. So the economic need is why DIY customers are doing repair themselves and they will continue to figure out how to do them going forward to save that money. But there's a lot of difficult repairs and sensors that will result in the professional side growing faster. On the telematics, that's a Greg question.

---

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

Yes, I'm sorry, I failed to answer the telematics. Telematics is a threat to our industry, without a doubt. The -- Greg Henslee is on an organization called CARE board, Coalition for Auto Repair Equality. And that's our industry organization that really fought for rights to repair a few years ago and are working with the OEs to try to equalize the data that the dealerships are getting with the aftermarket. So really, medium-duty and heavy-duty trucking companies have had telematics for a little longer than light-duty and they've done a really nice job of integrating and making that data available to consumers. In our DOT delivery fleet today, through our onboard technology, we have got access to some of that diagnostics data. Now we don't make our own repairs, so it doesn't help us a whole lot, but they are making that available. On the light-duty vehicles, the trend is that these -- this data, I think the dealers' vision for this is to be able to pass this data from the vehicle back to the dealerships and the OEs and give them the ability to predict repairs and notify the consumer that those repairs are needed or will be needed in the not-too-distant future. Our challenge as an industry, and what we're fighting really hard for, is equality there and making that data available not only to the dealerships, but also to the aftermarket. And we're still working on how that would happen. But ideally, there would be a shared data platform that both the OEs and the aftermarket will be able to access to see that data from the vehicles.

---

**Brad W. Beckham** - *O'Reilly Automotive, Inc. - EVP of Store Operations & Sales*

Yes, the other thing I would say on your question about retail growth is, and I know we probably sound like a broken record, but our proof that we can take share in markets where the average is whatever it may be, is going to be our future as well. I feel like we have a tremendous opportunity to execute better when it comes to being a retail business. Again, that's coming from the professional side. Even though we have been in the retail business for a while, we continue to learn from our competitors, from other great retailers, on how we can be a better retailer. And in our world, it's operators. A pretty typical scenario would be that we'd have a store set in wherever, North Carolina, and we're doing $1.8 million and we're doing it 50-50 and we may have one or both of our retail competitors sitting right down the street doing, one of them specifically doing $1.8 million, and doing $1.6 million in retail and a couple hundred grand in professional. And so there is still a tremendous amount of opportunity. We have some great retail competitors that we have a tremendous amount of respect for. But on the streets every day, we have a huge opportunity to consolidate the retail side and to all their points, we still see it very good.

---

**Unidentified Company Representative**

[Brian] (inaudible).

---

**Unidentified Analyst**

[Brian Cowan], BofA Merrill Lynch. Tom, you mentioned the benefits of the vendor financing program and that's supported, obviously, by the IG rating. Can you talk a little bit or discuss sort of the impact of rising rates, LIBOR's move on that program recently? Is there any change in the outlook in terms of the working capital benefit? And then maybe flip it around, if -- how do you defend it if the market tightens on your suppliers?

---

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

Luckily, I have a lot of experience doing this with our suppliers. LIBOR is like the speed of light, right? It's the same for everybody. So to the extent that LIBOR goes up, whatever funding mechanism they are using to fund their business typically will have an impact on their funding rates. LIBOR for us, our interest rate cost in general, are an input cost into the products we sell. So if interest rates go up 3%, we'd expect to see acquisition price increases, because it's more expensive to run their business. Vendor financing and why they're giving us [dating] is about 2 things. It's about what that incremental rate is over LIBOR. So can they borrow better on our investment grade rating than they can on their own? And the second is to manage their own working capital to reduce their working capital. So those are the 2 benefits. So to the extent that LIBOR goes up, and we've seen this in the past, AutoZone's run a big program for a long time, their AP-ed inventory days didn't go back, but they probably experienced some pressure on their cost of goods.

---

**Mark Merz**

Okay. Well, that concludes the formal part of the presentation for today. At this time, everyone who is listening offline, you may disconnect and we'll end the webcast here.

---