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PRESENTATION

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

I'm Matt Fassler from Goldman Sachs, and I have the honor and the privilege of introducing members of the management team of O'Reilly Automotive and to moderate a fireside chat. O'Reilly, as you know, is one of the leading automotive aftermarket retailers in the U.S. and in the world, with a stellar long-term track record and very strong performance of late as well. This has been a fascinating industry to cover, I'd say, over time, and in particular, over the past 3 years because it was viewed as a foolproof industry and then the sky was falling, and now we're back to, I think, a healthier medium. Certainly, the operating performance of all the companies across the space. We've heard from a couple on the edges of the aftermarket, and we're going to hear from both O'Reilly and Advance today, operations in the space are more stable and the stocks have certainly come back from whence they were. And obviously, last July 5 was a tough moment, the summers are tough moment for all of retail, and as we spoke yesterday in our conference introduction, what a difference a year makes and that was our comment on the retail industry, macro wise, performance wise and stock wise, that's probably no more true for any industry than it is for the automotive aftermarket. And quite frankly, what's interesting to me is how little your business actually did change both to the softer side and to the stronger side, the volatility actually was quite subdued and particularly, for margins relative to most of the rest of retail.

I'm delighted to have with us 2 members of the management team. First of all, to my far left, Tom McFall, Executive Vice President and CFO. He has been at O'Reilly for 12 years, joined the company with the acquisition of Murray's at that point in time, am I getting that, right?

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

I joined from CSK, which had bought Murray's, and 2 years later, we bought CSK.

QUESTIONS AND ANSWERS

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

Fair enough, okay. And then, there's a lot of fine print in your bio here, sorry. And I'm going to be more careful with you, Greg. So Greg has been with O'Reilly since 2001, and to be very precise, on May 8 of 2018, Greg became the CEO as well as Co-President of the enterprise, and I'm so happy to have both of you here today, and we all are, thank you for making the trip and spending time with us. So I would like to start off by talking about the industry's growth rate, particularly the differences between DIY and DIFM and how you expect -- what kind of interplay you expect between those segments going forward?

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

Over the long term, we'd expect our DIY business to grow in the 1% to 3% range and the professional business to grow in 2% to 4% to 2% to 5%. The DIY side of the business is more cyclical, the professional side, because of the demographics of the customers is more consistent. When we look at the difference in growth rates, 2 real factors there: One, vehicle complexity, especially as it relates to how fuel is introduced, burned and exhausted from the engine and the aging vehicle population will grow the do-it-for-me side of the business faster than do-it-yourself and again, the do-it-yourself is a more cyclical side of the business.

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

And when you talk about its cyclicality, and greater cyclicality, why would that be the case? What are the fundamental drivers of the more cyclical element there?

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

Sure. So in the short term, weather is a big driver in our business over the short term, it'll equal out over the long term, when we look at the DIY side of the business, those customers are performing those repairs because they can't afford to have somebody else to do the repairs. And when we go into environments where the economy is more challenging, those tend to be the customers that are impacted the first. The rising gas prices hit the low-end consumer first. So they will defer maintenance. Weather is also a big impact because most of those customers are doing the repairs in their garage or apartment parking lot. So when we look at deferred maintenance, which is a big, kind of, number in our industry that tends to fluctuate based on the economic conditions of our customers and their outlook to the extent that they are pinched in the pocket book they're going to push off repairs. To the extent that they feel like they're going to keep their vehicle longer or they're better off economically, they're going to do those repairs. So that's a swing on the DIY side that makes it more cyclical.

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

I'll come back to some industry dynamics in a moment, but I want to speak for a moment about your growth and your store footprint in particular. You have continued to add stores. You're more of a national player than you ever were. How will your footprint evolve and what are the additional opportunities for store growth?

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

From an evolution standpoint, we started off in the Midwest as a single distribution center, handful of stores. It actually started off obviously, as 1 store, but we grew contiguously as a company, and we developed a business model that was really based on the needs of the professional customer, the DIY side of our customer. Over the years, we've expanded our footprint. We now operate 27 distribution centers across the U.S. close to 5,200 stores across the U.S, and we feel like we can grow that footprint to between 6,000 and 6,500 stores across the U.S. Our biggest opportunities, as of today, the markets that we're not in are the extreme northeast and from Central Florida down into Southern Florida. So within the U.S., we think we got a lot of growth opportunity, not only in those new markets but in our existing markets as well. And then beyond, and not necessarily sequentially, but beyond growing within U.S., we are looking for opportunities to grow our company outside the U.S. borders, initially looking at markets contiguous to the U.S. We will probably look at Canada, Mexico for several reasons, a couple of which is, they have a similar car park, they are cars that we're already stocking parts for we're familiar with. And another reason would be just synergies with existing suppliers, the supplier base is very similar in those markets, whereas if we had moved to a Europe or an Asia, we wouldn't see those same synergies.

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

A couple of follow-ups to that. So one question that has not come up a lot relates to the notion of how much room there is and the dynamics in markets that have multiple retailers in them. And there are now more and more markets, particularly, frankly, as you build out your distribution footprint, as you said, in Florida and the Northeast, there are more and more markets that would have 3 or even 4 of the larger public integrated DIY, DIFM players. How is performance in your view impacted by the number of operators in the market?

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

Well, I mean, the number of stores in the market, there's only so much business to be had and the number of stores you have in a market, there's only so much of that market share that each of the 1, 2, 3 or 4 competitors can get. We dig, and we scratch in every store every day to grow market share in every market we are in. There's some really small markets out there that none of us are playing in, where we may have an independent job or customer that's buying from us, it's a town of 1,000 or less people. And as those markets continue to grow, we look to move into those markets and it's a great transition strategy for us, because we're frequently able to acquire those independent customers and turn those into O'Reilly stores, which positions us to be the first, and sometimes, only player in those markets. And the larger markets, we -- both our National account competitors are strong as well as our regional competitors, and we're out there every day, scratching and digging, trying to establish relationships and grow market share.

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

What I would add to that is the top 4 chains have about mid-40% of the market share. But there is not a market that we open a new store in that isn't very competitive. And it's been that way for a decade. So our goal, and what we've been successful at doing, is opening new stores, assembling great teams, having great product availability and going out there rolling up our sleeves and outcompeting our competitors and taking share.

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

And as you think about the marketplace, I mean, you are -- one of the reasons I ask this question, this is the only vertical that I cover that has as many retailers, all mostly, by the way successful, highly profitable retailers, especially -- specialty retail nameplates, and I think, that's really a function I think of the industry's moat and the way you all collectively come to market and Walmart has not been a real factor in hard parts, and to date, it seems like some or the other disruptive players have not really achieved a significant traction in hard parts. Is there anything on the horizon or on the flank that you think is starting to change in that regard? In terms of new entrants into the hard part space?

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

It's a very SKU-intensive business, and as vehicles stay on the road longer as the number of nameplates that are in the OE market expand as the push to rising miles per gallon requires tighter engine compartments and more specific parts to more specific [feature] vehicle. We're going to continue to see the number of SKUs you need to be in this business continue to go up and that's going to continue to be a pressure on our turn. As an industry, we turn our parts about 1.4x and that goes from high turn oil parts to super slow turning under car parts, but you got to have those parts to compete. So for someone new to get into the business, they would need a tremendous amount of slow turning inventory to be put in place close to the customer and that doesn't seem likely.

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

And then, how do you think -- as you can contemplate overseas growth, how do you think about organic versus acquisition be it a large or small deal and also there are often pitfalls less so for Canada though there are some companies that have stumbled pretty badly, trying to get into Canada. How do you think about the pitfalls of global growth and safeguarding against some of those factors as you consider what you might do abroad?

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

Yes, so within the U.S, we look for -- we continue to grow new store growth. We're opening our 200 new stores this year and plan to continue our new store growth rate. But we're always looking for strategic and opportunistic acquisitions within the U.S. When you look outside of the U.S. borders, I think, Matt, our preference would be to move into those markets through acquisitions, simply because part of our requirement of an acquisition outside of the U.S. borders would be to maintain the people and the relationships that we don't have in those markets. O'Reilly is not well-known, even though we advertise on the Mexican Soccer League, a lot of those people know who we are, but as a retailer, they've never seen our stores, they don't know our brand that well, so we would want to leverage relationships and the people and acquisition will be the way that we'd desire to move into those markets.

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

Do you advertise in the Mexican Soccer League basically to drive U.S. business?

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

We do, yes.

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

Interesting. I want to move on to a question on the financial front. Some of your operating metrics, particularly margins and to some degree financial returns are leveling off at the best levels, I think, in retailing. I think, you and Home Depot and AutoZone, in our world, are kind of, substantially above most others. One of the questions we get quite often relates to the sustainability of margins and financial returns. So do you feel good about holding these margin levels over time? And if you could talk to some of the other opportunities for efficiency and profitability.

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

Our focus is on dollars and increasing operating profit dollars year-over-year, the percents are nice but the dollars pay the bills. So our focus is on growing sustainable, profitable business and controlling our expenses. When we look at the last 5 years, we as an industry have been successful in reducing acquisition costs through scale, private label and sourcing, but we haven't seen same-SKU inflation really until this year. If we look at the next 5 years, we would expect to see more of a historic inflationary environment, we'd like to be in the 1.5% where we can maintain our gross margin percentage and drive more comp gross margin dollars. We think that's a probably more realistic view going forward based on our history. Our opportunity is to continue to grow that business in each of our stores, both new and mature stores, to leverage our occupancy cost, leverage our distribution and continue to profitably grow the brand to deliver those operating profit dollar gross -- growth that we've seen historically.

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

Now also on product, where do you think your private-label penetration can get, just remind us where it is and is there more margin to be had from other private-label penetration or from your sourcing efforts in general?

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

Yes, I would say, today, we've grown our private label or proprietary brand offering up to about 45% of our volume, and we've done that for a number of reasons, but one, we want to control our products. And a lot of our private label or proprietary brands that we have today were previously National brands that we now own the rights to brands like Precision and Murray. One of the things that is somewhat of a misnomer is, is our private-label or proprietary brands are not always our entry-level brands. We have a good, better, best offering, and a lot of times, our private-label proprietary brands are our premium product offering. So proprietary brands that the lower end the good, better portion, typically are the products that our DIY customers would buy and the premium, private label and National brands are what our professional customers tend to buy. So really, the consumer drives a lot of that Matt, what's the price point, what are our suppliers doings to protect their brands online and the pricing for their brands? I would say that we would definitely desire and continue to build out our proprietary brands over time. As far as the margin impact, it really depends on the category and which categories are bringing product in and if we are displacing a National brand by doing so.

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

I want to now move the commerce -- the conversation, Freudian slip towards e-commerce, and I want to start off with B2B e-commerce, which I think, is -- has been a little more plumbing if you will, than marketing, and you can correct my premise if I'm wrong. How is your B2B e-commerce today different from your prior B2B relationships and is it a marketing tool? Does it put more business up for grabs or serve as a share capture vehicle for you?

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

On the B2B side, we've been -- we've done a better job with our B2B offering than our B2C offering over time. It's a much more mature platform, our first call online platform. And with that platform brings, a high degree of price transparency. It's not just us, it's our competitors as well. We all -- it's easy to go out there and see who has the part and who has the price. But on the B2B side, with our professional customer, what's most important to them is inventory availability and immediacy of needs, speed of delivery. So our job is to continue to provide the highest level of service and maintain those relationships with our customers to drive our growth and profitability on the DIFM side.

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

Okay. And is it a differentiator for you, do you find that there's an assumption that B2B connectivity is going to be there?

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

It's a requirement today. It's most of our bigger customers pretty much demand having access to electronic information, be able to order electronically. Now saying that, a lot of our customers will check price and availability but they still have that relationship with the ISS on the back counter, and they still want to call and say, "hey, Joe, I'm going to order this part, just want to make sure you have it, and I've got 2 cars stacked up, can you get it to me quick?" That sort of thing, the relationship component is still there. But it's an expectation today of most shops to have B2B connectivity.

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

Now -- and by the way, what is the -- is the road into -- if you're looking to break in with new account either in a new market or an existing market, is B2B connectivity an angle of the pitch, or again, is that just sort of a given and it's really that face-to-face?

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

Again, I think it's more of a given, more of a requirement. When we go in and try to take business in a new market. We just try to get our foot in the door. Our strengths are our service level and our inventory availability. Those are key strengths of ours, and if we can get our foot in the door as second or even third call and demonstrate that we've got the part more frequently than our competitors, we can consistently get that part to the shop within that 20- to 30-minute time frame, over time, we move up the call chain.

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

I want to move on though to B2B e-commerce -- B2C, excuse me. Who is shopping via this channel, and are they, I'll start off, asking, who is shopping and whether they are new to O'Reilly typically?

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

When we look at our B2C business, there was a lot of discussion about B2C last year. Parts have been available online for a number of years, from a number of different sources. Obviously, when Amazon gets involved, it's something to pay attention to. But from our perspective, in the past, the current and future, the vast majority for our DIY customers are going to get driven to the store because that's where they're going to find their value equation. They want to have the part now. They want to get technical assistance. They want to have loaner tools that they need to do the job without having to pay for them. They want to have on-car testing. Our DIY customers typically shop 3x a year. What is success for a DIY customer is effectively being able to get the repair done. So I can get my car back on the road, so I can commute, so I can take the kids to school, so I can do all of those things. So how we interact with that customer continues to change. People used to call solely, now people are using their phones to digitally look and see what you have. But that is going to continue to be the main focus, to make sure we have happy customers. Because a happy customer is a customer whose car now works. And that's going to continue to drive people to the stores.

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

To really add to what Tom said. I think, when you look at e-commerce as a whole, the customer that's shopping and buying online is a very small percentage of our customers. But the customers that are using e-commerce to make buying decisions, they look to see if we've got the part in stock at the local store, check price and availability, whereas they may have picked up the telephone to call a few years ago, they are now using their cell phones to check that online.

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

Are you seeing more penetration for e-com for hard parts or for accessories and consumables?

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

Certain things in our industry are great online products but before they are great online products, they were great catalog products. So anything that's dress up or performance, anything where you have that -- it doesn't determine whether your car runs or not, but you might want to take off a perfectly good part and put on a cooler part, those are great e-commerce items. Items that people can wait for. But that's not really been a key to our business because those were great catalog businesses beforehand. So when we look at what kind of parts are being sold online, it's less about the kind of part, it's more about the kind of customer. So some customers have the ability to diagnose their problem, they are going to buy online. Some customers are really good at maintaining their vehicles and staying on a routine maintenance cycle and fixing things before they broke -- break, now that's not the majority of our customers, but it's a very actually small portion of our customers. So those are the type of customers that we see that have bought online but again, it's a very small segment of the types of parts that we carry and stock in the stores for a long period of time.

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

How important is price discovery in your business? Oftentimes, and maybe there is an exception here, the penetration and the impact and influence of the e-commerce correlates with the nature of price discovery and price discovery will often relate to ticket commoditization, tactile elements, et cetera, in other words, how important is that price and your ability and what is the consumer's ability to discern it, so how have you seen the role of pricing evolve, if at all, in the automotive aftermarket?

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

When you look at online pricing, most of the online parts are brand-name parts, which are going to be better or best parts, which are typically either enthusiast or primarily, shops. When we look at the entry-level do-it-yourself customer, those branded parts are not the primary parts they buy. They buy private-label entry-level parts, which -- when you look at the price of a brake pad, that's a entry-level at ourselves or our competitors, it probably is going to be about half of what a branded part is. So that value equation to go to the store, to get a branded part is still less expensive than buying and waiting online for a part that you hope is the right part from a online retailer.

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

Okay. And one other question on e-commerce. So historically, e-commerce success, for any given industry, was viewed as sort of a mixed blessing. If it worked for any old -- for any incumbent retailer, it was ultimately going to work for Amazon as well or could be. So is that the case in this sector, in other words, are there ways -- you've spoken about store and the omni experience and all the things you can offer the consumer through that direct interaction and physical presence. So to the extent that you see your online business grow, does it ever (inaudible) to say, "Hey, this actually shows that our perception of e-commerce and, I guess, another way to ask this is, have you been surprised by anything you've seen in your e-commerce that business that would lead you to change your perspective on its ultimate potential, for you or for anyone else?"

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

Yes. So what I would say is, from an industry standpoint, Tom spoke to the number of SKUs required to be competitive in the hard parts world. It's just a tremendous number of SKUs low turn, so that's a challenge. I'll separate this into 2 different explanations, I'll separate DIY versus DIFM. On the DIFM side, that's an easier analysis. Our customers, our professional customers, the shops that install the parts, their technicians are paid based on what the job pays, if the job pays 4 hours, they get paid 4 hours, even if they can do the work in 2 hours. So the best technicians want to do as many jobs in a day as they can. They may do 8 hours of work, and they want to get paid 14 hours in labor. For them to be successful in doing that, it is critical that they're able to turn their bays and get their parts there in a timely manner. So one of the most important things to the professional side of the business is to be able to get that part in the shop within 20 to 30 minutes. And that's very, very difficult for online. It's difficult for brick-and-mortar for us to do. We've done it for a number of years. So I think that protect us. There may be a few shops that stock inventory that could do some replenishment, but for the most part, until you get that car in a rack and you start the job, you don't know what you need to complete that job. And it's critically important that those parts get delivered in a very short time window. On the DIY side, Tom mentioned the knowledge and the experience that our stores provide. I think, that's a key component. A lot of times, it's not as simple as going out online and buying the part you need to fix your car, it's knowing what part to buy. You know your car is making a noise, you know your car is not running smooth, you know this or that, but you don't know what parts you need to buy. So you have to come into our store and talk to our professional parts people to help diagnose those problems. We'll hook up a code scanner, help you rediagnose the trouble codes to direct you in the direction of repairs, and if the repairs are too complex for the average DIY customer, we'll refer them to our professional shop.

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

Now I want to switch gears, and I'm sorry to ask all these risk-oriented questions, but I guess the...

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

The way I think about it. It's your time, Matt. Ask any questions you want.

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

What do you give an industry that has everything, I guess, tough questions about what could change and that's the way I'm thinking about it, and at your meeting in Greensboro, in late August, you all did speak about telematics. And this was one that you all identified as a potential long-term challenge. I think, defining telematics would probably be helpful to some of the lay persons in our audience and talking about how that might play out and what you can do to resist that challenge.

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

Sure. Telematics is basically onboard connectivity between the vehicle and today, the OE or the dealership. So while, not many dealers are fully utilizing telematics, more and more vehicles are coming out equipped with telematics. And what that -- the reason that's a threat to us, is if there is a one-way communication between that vehicle and the OE or the dealership, that's a threat to the aftermarket. A similar threat to what we saw a number of years ago, when the industry was able to get Right To Repair passed.

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

Okay. So your car is speaking back to the OEs and telling it how it's running, if it has repair issues, all of that data, whether you know it or not, your car is sending it back to the OEs, what RPMs you ran, how far you went, all kinds of data.

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

Yes. So -- and again, we don't know how the OEs, for sure, are going to use this data but it's a competitive advantage for them to have that data. Theoretically, if your brakes were wearing to the point to where there was a sensor about to go off, that OE could use that data to communicate with the consumer proactively and provide them some kind of a special deal to come in and get a brake service. So within the automotive aftermarket, there's a board called the CARE Board, the Coalition for Automotive Repair Equality that's working with different organizations, trying to get a similar result we saw with the Right to Repair in that, we have equality with the OE, so rather than that being a one-way communication between the vehicle and the OE or the dealership, we envision that being a communication between the vehicle and some cloud-based solution, where both the OEs and aftermarket have access to that data.

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

Now is it the aftermarket or the customer, in other words, who decides who in the aftermarket gets that insight?

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

It could be either-or.

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

And does it get democratically distributed to any member of the coalition, for example, and how does that play out?

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

Our push would be from a customer standpoint, that computer that's gathering that information about your vehicle is something that you paid for. So who gets that data should be up to you. Now the OEs, we don't dispute that the OEs should get that data because they do, in fact, use it for engineering and safety purposes, to make sure that vehicles are running as intended, and we want everybody out there to be safe. But as a consumer and a rights of a consumer, we are sticking up for being able to say who should get that data. It's your data. It's been accumulated by you, where would you like it to go, that so we are in favor of consumer options.

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

And then again, practically speaking, there are those options, I mean, there's 1 OEM for any given car and there is a beehive of prospective aftermarket solutions in their ZIP Code district call it what you will, is the challenge here in the principle or is the challenge in the details of who ultimately, gets that data?

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

Both.

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

Both.

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

Fair enough. And is this happening yet, in other words, how far back do we have to think about in the car park for when this information started to make its way to the OEM?

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

I think it's been going on for a number of years. I don't know the exact dates that they started putting telematics. It really started in medium-duty vehicles, earlier in European vehicles. And then the medium-duty space, like on DOT class trucks, we, as a customer, we operate about 700 trash trailers across the country. We do have access to see that data on the medium duty but on the light-duty, that data today is only available to the OEs.

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

Got you. I want to ask 3 financial questions. The first is just your updated thoughts on capital allocation.

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

Capital allocation remains the same. First thing is we're going to invest in our existing store base and distribution network to make sure our teams have the tools to continue to grow market share in existing markets. Two is, continue to open stores. Three is, opportunistic acquisitions. We've been very successful in acquiring businesses, but we have to be disciplined in what we'll pay, so we need a willing seller. So those happen when they happen. And then lastly, to the extent that we have capital left over, we will return it to shareholders via the buyback.

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

And I want to ask you about your expectations for the operating environment in the second half of this year versus the first half of this year. And we know your third quarter and fiscal year guidance, so we know where you're guiding. I'm asking about the environment, which has been -- have an element of volatility associated with weather and other things I particularly want to ask about it with regards to gas prices, which you called out as a risk, as you gave your Q3 guidance, just said, hey, let's just be watchful and understand kind of where this is. As you talk about the second half outlook, maybe talk about how gas prices have played out relative to what you had seen and expected at that time?

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

Well, we're nice enough to give quarterly and full year guidance. Isn't that good of us? So expectations are still the same. We're not going to update our guidance. Gas prices have gone up a little bit. We will see how that impacts miles driven. We continue to feel good about our guidance and we'll continue to work hard. The thing that we talked about on the call is that we have an extra Sunday in the third quarter. And for us, that's a headwind because half of our business on the shop side isn't open on Sundays, so having an additional Sunday is a drag to our business, about 50 basis points. We do pick that Sunday up in the fourth quarter but it gets into the holidays and it's not as meaningful. The last thing we talked about on the call is that we have 2 tough fourth quarter compares in a row. Last year, we had some of our winter in the fourth quarter. Two years ago, we had the only winter in the fourth quarter. So we're going to have a tough compare come December. As we get through the middle of November, it becomes Christmas shopping season and people will defer parts purchases, if they can. We keep trying to do a holiday flyer and get people enthused about going out and buying O'Reilly stuff for Christmas gifts. But it's a little tough sledding. So the last half of our fourth quarter is very weather-dependent. It's also the by far lowest per day volume store because of that. So we'll see, but the fourth quarter should be a tough compare, which is built into our 2 to 4 guide for the year.

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

And then we spoke about margin a moment ago. We are asking most of the companies here whether they expect margin to increase next year from this year's level. What I kind of heard you say is we're focused on dollars, less so on margin, but you are not directional in your margin color longer term. And I consider this a long-term question. So I understand, you've given kind of half of the answer already, but I'm going to ask it again.

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

We typically don't give guidance going forward beyond the year we're in. That said, this has been an unusual year. We had a big tax reform, which we were a big beneficiary of, and decided to invest part of that tax cash savings back in, primarily to store pay roll and technology, so our operating profit guidance came down this year versus last year. We would expect going into next year that we'll get some leverage on that spend and that we'll also continue to work on gross margin, work on SG&A expense, and that will incrementally improve our operating profit percentage over time.

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

And on the tariff front, this is a question that we've been asking and has been getting kind of conditional answers, well you tell us what happens, we'll tell you what -- if you look at -- I mean, obviously, if this all fades away, it will all fade away. You spoke about not having had inflation, tariffs would be -- provide most likely a form of inflation. We can incorporate this into a broader inflationary question, are you really seeing more of it tariff aside and do you feel like you're well positioned to absorb tariffs primarily through pricing if need be, should there be a more rigorous implementation of a tariff regime?

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

I'll take the tariff and let you take the other input cost. From a tariff perspective, when tariffs were first announced, we went out to our suppliers and tried to understand what the impact was to our cost structure, and it's taking quite a while for our suppliers to get their arms around what the impact is, whether it's a component price, whether it's a fully assembled price. To date, we've seen very little input cost movement based on tariffs. During the fourth quarter, we expect with this third round of tariffs to see some cost pressure from tariffs but nowhere near a full 25%. Most of it's component cost increases, and we feel confident that we'll be able to pass those along.

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

When we look at our inflation year-to-date, driven by commodity prices and rising interest rates, so when we look across the spectrum of the parts that we sell, we are seeing inflation because interest rates are going up. It's an input cost for all of our suppliers. And payroll -- both payroll and health are going up, and that's an input cost for all our suppliers. We have not seen inflation and we'll -- from the tariffs yet, but we will address that appropriately, if and when it occurs.

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

Next up, we have Advance Auto Parts here and our apparel panel in the Terrace room downstairs. Please join me in thanking the team from O'Reilly for their remarks.

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

Thank you, everybody. We appreciate the time.
