

THOMSON REUTERS STREETEVENTS

# EDITED TRANSCRIPT

ORLY - Q4 2018 O'Reilly Automotive Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 07, 2019 / 4:00PM GMT

## OVERVIEW:

Co. reported 2018 EPS of \$16.10 and 4Q18 EPS of \$3.72. Expects 2019 EPS to be \$17.37-17.47 and 1Q19 EPS to be \$3.92-4.02.



FEBRUARY 07, 2019 / 4:00PM, ORLY - Q4 2018 O'Reilly Automotive Inc Earnings Call

## CORPORATE PARTICIPANTS

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

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

**Thomas G. McFall** *O'Reilly Automotive, Inc. - Executive VP & CFO*

## CONFERENCE CALL PARTICIPANTS

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

**Christopher James Bottiglieri** *Wolfe Research, LLC - Research Analyst*

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

**Daniel Robert Imbro** *Stephens Inc., Research Division - Research Analyst*

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

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

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

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

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

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

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

## PRESENTATION

### Operator

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

---

**Thomas G. McFall** - *O'Reilly Automotive, Inc. - Executive VP & CFO*

Thank you, Vanessa. Good morning, everyone, and thank you for joining us. During today's conference call, we'll discuss our fourth quarter 2018 results and our outlook for the first quarter and full year of 2019. After our prepared comments, we'll host a question-and-answer period.

Before we begin this morning, I'd like to remind everyone that our comments today contain forward-looking statements. And we intend to be covered by, and we claim the protection under, the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. You can identify these statements by forward-looking words, such as estimate, may, could, will, believe, except, would consider, should, anticipate, project, plan, intend or similar words. The company's actual results could differ materially from any forward-looking statements due to several important factors described in the company's latest annual report on Form 10-K for the year ended December 31, 2017 and other recent SEC filings. The company assumes no obligation to update any forward-looking statements made during this call.

At this time, I'd like to introduce Greg Johnson.



## FEBRUARY 07, 2019 / 4:00PM, ORLY - Q4 2018 O'Reilly Automotive Inc Earnings Call

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

Thanks, Tom. Good morning, everyone, and welcome to the O'Reilly Auto Parts fourth quarter conference call. Participating on the call with me this morning are Jeff Shaw, our Chief Operating Officer and Co-President; and Tom McFall, our Chief Financial Officer. David O'Reilly, our Executive Chairman; and Greg Henslee, our Executive Vice Chairman, are also present.

To begin today's call, I would like to recognize the hard work and commitment of all of our team members throughout 2018. Your commitment to our dual market strategy and the O'Reilly culture values drove a 3.8% comparable store sales growth, which was at the top end of our annual guidance range of 2% to 4%, which we set at the beginning of the year. Your dedication to exceptional customer service and expense control yielded a total sales increase of 6.2% over the prior year and an operating profit of 19%, which was also at the top end of our annual guidance range. For the year, we generated our 26th consecutive year of comparable sales growth, record revenue and operating income, every year since becoming a public company in 1993. And I would like to thank Team O'Reilly for your many contributions to support our growth and success in 2018.

Now we will cover our fourth quarter results and key expectations supporting our 2019 guidance. Our comparable sales for the fourth quarter grew 3.3%, which is in line with our expectations. From a comp store sales progression standpoint, October and November were strong, with December being weaker and slightly negative. The December results fell short of our expectations due, in part, to seasonal business that was pulled forward into November as we experienced cold weather earlier in the quarter in 2018 than the prior year, coupled with the lack of harsh weather in December, which we were facing difficult compares for the past 2 Decembers. We also faced stronger-than-expected headwinds from Christmas and New Year's Eve falling on Monday as opposed to Sunday in 2017. For the quarter, both DIY and professional were contributors to our comparable sales -- store sales growth, with professional contributing -- continuing to outperform DIY. Average ticket value drove comparable store sales growth due to increasing parts complexity, same SKU inflation of approximately 2% and a higher mix of hard parts on the DIY side as customers attempt to defer noncritical repairs and maintenance as pricing increases across the economy put pressure on many of our DIY customers' wallets.

For the full year 2019, we're establishing our comparable store sales guidance at 3% to 5%. We anticipate that the demand drivers for the automotive aftermarket industry will remain solid as miles driven grows at a modest pace, supported by continued record high levels of employment, with gas prices remaining in reasonably positive range. We expect the continuation of the trend we have seen for several years, where average ticket growth is driven by increasing complexity of parts on newer model year vehicles and also expect additional top line growth from same SKU inflation, similar to what we saw in the fourth quarter. This level of inflation is based on known input cost pressures and does not take into account additional tariffs or other unknown factors. We expect DIY ticket counts to continue to be under pressure as our more economically constrained customers feel the pinch of rising prices across the economy and react by attempting to defer repairs or maintenance when possible. We expect continued solid growth on the professional customer ticket counts as we continue to consolidate the market and these end user consumers tend to be better able to cope with increasing prices. As normal, we expect pricing in the industry to be rational and weather patterns to be average.

For the first quarter, we're establishing a comparable store sales guidance range of 3% to 5%, which is in line with our expectation for the full year. We remain extremely confident in our team's ability to provide industry-leading customer service and gain market share and are pleased with a solid start to 2019 we have seen thus far in the first quarter.

For the fourth quarter and the full year, gross margin, as a percent of sales, was 53.3% and 52.8%, respectively. The fourth quarter gross margin is higher than the full year due to normal seasonality and sales mix related to winter weather. Full year gross margin was in line with our guidance throughout the year. For 2019, we're setting our guidance range for gross margin at 52.7% to 53.2% of sales, which is a 20 basis point increase from our 2018 guidance range. Assumed in our guidance are continued incremental improvements in supplier agreements, our continued ability to pass along acquisition cost increases to the end consumer and the leverage on our fixed distribution cost and higher sales volumes. These gains will be partially offset by continued pressure from distribution wages and freight costs. Tom will provide more additional gross margin details in his comments.

Fourth quarter operating profit, as a percent of sales, came in at 18.5%, and the full year was 19%. Both were at the top end of our expectations. On a year-over-year comparison, operating profit declined by 19 basis points as we directed approximately 30% of our tax savings from the Tax Cuts and Jobs Act of 2017 back into the business with a focus on our in-store and omnichannel efforts. For 2019, we anticipate our operating profit will be in the range of 18.7% to 19.2% of sales. Jeff will discuss our SG&A expectations in more detail. However, we expect to see leverage on our



## FEBRUARY 07, 2019 / 4:00PM, ORLY - Q4 2018 O'Reilly Automotive Inc Earnings Call

fixed cost on higher sales offset by a more inflationary cost environment and continued focus on strengthening our in-store customer service and omnichannel experience.

For the fourth quarter, earnings per share of \$3.72 represented an increase of 5.7%. And for the full year 2018, earnings per share of \$16.10 was an increase of 27.1%. Excluding the impact of the excess tax benefit from stock options on our tax rate and the revaluation of our deferred tax liability in the fourth quarter of 2017, our quarterly and annual earnings per share increased 34.5% and 35.8%, respectively. Tom will provide more information on our tax rate in his prepared comments.

For the first quarter of 2019, we're establishing our earnings per share guidance at a range of \$3.92 to \$4.02. And for the year, our guidance is \$17.37 to \$17.47. Our quarterly and full year guidance includes an estimate for the excess tax benefit from stock options and the impact of shares repurchased through this call but does not include any additional share repurchases.

Before I turn the call over to Jeff, I would like to again acknowledge the outstanding contributions of our entire team. Our track record of 26 consecutive years of record comparable store sales growth, record revenue and operating income is the direct result of your hard work and commitment, and I have every confidence we will extend that streak in 2019.

I'll now turn the call over to Jeff Shaw. Jeff?

---

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

Thanks, Greg, and good morning, everyone. I'd also like to thank Team O'Reilly for delivering another record-breaking year. Your commitment to consistent, excellent customer service has always been the strength of our company and will continue to be our strength in the future.

At the beginning of the year, we planned to reinvest a portion of our savings from the Tax Cuts and Jobs Act back into the business, with a target of 70 basis points of additional SG&A spend. We successfully executed on that plan. And through solid expense control and better leverage from a solid 6.2% increase in sales, our SG&A only delevered 46 basis points, coming in at 33.8% of sales for the year. For the full year, SG&A per store increased 3.4%, which was near the top end of our beginning-of-the-year guidance of 3% to 3.5% of sales and is consistent with what we would expect with comparable sales at the higher end of our guidance range. The increase is primarily attributable to variable expenses and variable compensation at virtually every level of the company as we structure our pay plans for our team members to run it like they own it. For 2019, we're expecting SG&A to continue to grow at a rate higher than our historical norms of 1.5% to 2%. Looking at our 2019 G&A spend, we expect to continue to aggressively pursue our in-store and omnichannel goals and anticipate continued pressure to variable cost, especially payroll, from the current inflationary environment and record low unemployment rates, which we expect to partially offset by better leverage on our fixed cost. As a result, we're establishing our initial G&A guidance at a 2.5% to 3% increase per store.

For the year, we successfully achieved our goal of opening 200 net new stores. We set our 2019 new store goal to open between 200 and 210 net new stores on our third quarter call. Since that time, we purchased Bennett Auto Supply in South Florida. And because of the additional work it will take to convert those stores, we'll end up in the lower portion of the new store opening range, excluding the Bennett stores. For the acquired Bennett stores, our plan is to merge 13 of these stores into existing O'Reilly stores and convert the remaining 20 into O'Reilly stores in the first half of the year. Due to the impact from transitioning business during the merger process, the remaining 20 stores will not enter our comparable store sales base until January of 2020. We expect to incur between \$4 million and \$5 million related to closing down the 13 stores, the Bennett DC and the offices. And these costs are an additional headwind built into our SG&A growth per store assumptions.

Our capital expenditures for the year were \$504 million, which was squarely in the middle of our beginning of the year CapEx guidance of \$490 million to \$520 million. For 2019, we have a number of large projects, and we expect CapEx to increase to a range of \$625 million to \$675 million. This is a big step up from 2018 and would represent our CapEx investment in company history. So I'll provide a little color around the additional projects that are creating the sizable increase.

First, we have our 2 announced and ongoing distribution projects. A new location in Twinsburg, Ohio, just south of Cleveland; and an upgrade in Lebanon, Tennessee, just east of Nashville. The new larger Nashville DC will allow us to convert the current Knoxville DC into a super hub and then

## FEBRUARY 07, 2019 / 4:00PM, ORLY - Q4 2018 O'Reilly Automotive Inc Earnings Call

consolidate both the existing Nashville and Knoxville DCs. Our CapEx plan also includes an additional DC project starting during the year, and we'll provide you the details once we close on that property later in the year.

Second, with the conversion of the Bennett stores, we'll have new store CapEx for between 220 and 230 new stores this year.

Next, we continue to invest heavily in our omnichannel experience. This includes, but is not limited to, our online functionality, our in-store experience and distribution systems to facilitate multiple delivery options to meet customers' desires. And finally, as both our installed store base and distribution network grow, we're committed to spending the CapEx required to keep these assets operating at peak performance and investing in new tools and technology to continue to take market share. We have always geared our business model to generate long-term, sustainable growth that is solidly profitable. We're very confident our SG&A spend and our capital investments in 2019 will put us in a great position to continue our history of success. However, we're an extremely proactive and detail-oriented company. And should situations change or additional opportunities arise, we'll make changes to our investment strategy on a store-by-store, project-by-project basis.

As I conclude my comments, I'd like to, again, thank the entire O'Reilly team for a solid year in 2018. We're well positioned in 2019 to capitalize on the solid macroeconomic factors that underpin our business. And we look forward to continue to

(technical difficulty)

of strong results in 2019 by rolling up our sleeve and earning our customers' business by providing excellent customer service each and every day in all of our stores across the country.

Now I'll turn the call over to Tom.

---

### **Thomas G. McFall** - O'Reilly Automotive, Inc. - Executive VP & CFO

Thanks, Jeff. Now we'll take a closer look at our quarterly results and our guidance for 2019. For the quarter, sales increased \$124 million, comprised of \$71 million increase in comp store sales, a \$50 million increase in non-comp store sales, a \$6 million increase in non-comp non-store sales and a \$3 million decrease from closed stores. For 2019, we expect our total revenues to be between \$10 billion and \$10.3 billion.

Our gross margin was up 41 basis points for the quarter, as we experienced stable merchandise margins and benefited from the LIFO comparison to the prior year. We do not see a LIFO charge during the quarter versus a \$3 million charge last year. For the full year, we did not experience a LIFO charge versus a \$22 million charge in the prior year. For 2019, we do not anticipate a LIFO charge as we expect inflation will continue to put upward pressure on aggregate acquisition costs. On a year-over-year basis, we expect gross margins for the first 2 quarters of the year to see the largest improvement as we receive a benefit from selling through beyond and inventory that was purchased prior to the recent tariff-driven acquisition price increases and corresponding retail and wholesale price increases.

Our fourth quarter effective tax rate was 23.6% of pretax income and was comprised of base rate of 24%, reduced by a 0.4% benefit from share-based compensation. This compares to the fourth quarter 2017 rate of 19.8% of pretax income, which was comprised of a base tax rate of 37.4%, reduced by a 3.5% benefit for share-based compensation and a benefit of 14.1% or \$53 million related to initial measurement -- remeasurement of our Federal deferred tax liability from a tax rate of 35% down to the new 21% rate, in accordance with the Tax Cuts and Jobs Act of 2017. For the full year, our effective tax rate was 21.8% of pretax income, comprised of a base rate of 23.9%, reduced by 2.1% for share-based compensation. For the full year of 2019, we expect an effective tax rate of 23.5%, comprised of a base rate of 24.1%, reduced by a benefit of 0.6% for share-based compensation. We expect our base rate to be relatively consistent, with the exception for the third quarter, which may be lowered due to the totaling of certain open tax periods. Also, variations in the tax benefit from share-based compensation will create fluctuations in our quarterly tax rate.

Now we move on to free cash flow and the components that drove our results for the year and our expectations for 2019. Free cash flow for 2018 was \$1.2 billion, which was a \$300 million increase from the prior year. The increase was driven by higher operating profit and lower cash taxes, offset, in part, by higher capital expenditures and cash interest. In 2019, we expect free cash flow to be in the range of \$1 billion to \$1.1 billion, with



## FEBRUARY 07, 2019 / 4:00PM, ORLY - Q4 2018 O'Reilly Automotive Inc Earnings Call

the year-over-year decrease due to higher CapEx and higher cash taxes, offset by increased operating profit. Inventory per store at the end of the quarter with \$612,000, which was a 2% increase from the end of 2017. The increase was at the top end of our guidance as cost increases and the year-end acquisition of Bennett pushed the metric to the top end of the range. That said, our gross inventory levels were well managed throughout the year as our ongoing goal is to make sure we grow per-store inventory at a lower rate than the comparable store sales growth we generate. For 2019, we expect per-store inventory to grow between 2% and 2.5%, with the acquisition cost increases and the fourth quarter opening of the Cleveland DC putting pressure on the growth percentage.

Our AP to inventory ratio at the end of the quarter was 106%, which is where we ended 2017. We were slightly below the anticipated level of 107% as the acquisition of Bennett and slower December sales pressured the ratio. For 2019, we expect to remain flat at 106% of inventory.

Moving on to debt. We finished the fourth quarter with an adjusted debt-to-EBITDA ratio of 2.23x as compared to a ratio of 2.12x at the end of 2017. The increase in our leverage ratio reflects the \$750 million 10-year bonds we issued in May and the incremental borrowings on our \$1.2 billion unsecured revolving credit facility. We're below our stated leverage target 2.5x, and we'll approach this number when appropriate.

We continue to execute our share repurchase program. And for 2018, we repurchased 6.1 million shares at an average share price of \$282.80, for a total investment of \$1.71 billion. Subsequent to the end of the year through the date of our press release, we repurchased 0.7 million shares at an average price of \$341.20. We remain very confident that the average repurchase price is supported by expected discounted future cash flows of our business. And we continue to view our buyback program as an effective means of returning excess capital to our shareholders.

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

This concludes our prepared comments. And at this time, I'd like to ask Vanessa, the operator, to turn on the line, and we'll be happy to answer your questions.

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) And we have our first question from Christopher Horvers with JP Morgan.

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

Can you talk a little bit about the regional performance that you saw during the quarter, and how did that compare to earlier than -- earlier in the year? And related to that, can you expand upon your quarter-to-date comments? Obviously, a lot of variability around the winter, some tough compares. But overall, what are you seeing quarter-to-date? And how would you assess the winter so far compared to sort of history and last year?

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

Yes. This is Jeff. Let me take the first half of that and then flip it over to Tom or Greg. As far as regional performance, really, our regional performance was in line with our expectations and pretty solid across majority of the country. The central part of the country was a little bit softer than the rest, really, due to just lack of winter weather in lot of those markets. And also, we had a little bit of headwind down south from the post-hurricane numbers that we compared against.

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

Yes. So Chris, from a cadence standpoint, what -- although we don't disclose what our actual comp numbers or trends are on a month-by-month basis, what I would tell you is we feel good about our 3% to 5% guide. We talked about December being the softest month of the quarter. And as



## FEBRUARY 07, 2019 / 4:00PM, ORLY - Q4 2018 O'Reilly Automotive Inc Earnings Call

we moved into 2019, we've seen a more typical weather pattern. We would view this winter as a more normal winter. We've had ups and downs, we've had spikes along the way in different areas of the country. And as normal, where we have those spikes, we have improved sales related to the winter weather spikes. But overall, we feel -- we continue to feel good about our 3% to 5% guide for the quarter.

---

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

Understood. And then, as my follow-up, can you -- Tom, can remind us of what the inflation was for -- in totality, for 2018? And you mentioned 2% in the fourth quarter. What was that over the year? And how are you thinking about the overall inflationary environment in 2019?

---

**Thomas G. McFall** - *O'Reilly Automotive, Inc. - Executive VP & CFO*

It ramped up through 2018. No significant numbers in the first and second quarter. So we ramped up to 1%, 1.5% in the third quarter too. So I'd say little above 1% in total. When we look at 2019, in Greg's prepared comments, our expectation is we're going to see a similar number that we saw in the fourth quarter, which was 2%.

---

**Operator**

We have our next question from Seth Sigman with Crédit Suisse.

---

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

I want to follow up on that inflation point. So the 200 basis points of same SKU inflation that you're expecting in '19. Just to clarify, is that -- that's the net impact on comps or -- so in other words, are you considering the volume offsets within that as well?

---

**Thomas G. McFall** - *O'Reilly Automotive, Inc. - Executive VP & CFO*

So that would be our expectation for what's going to drive our total inflation number that goes into our average ticket. As we've seen over the last 10 or 15 years, as the new model years roll on, they have more expensive parts, primarily based on technology that's in those parts. And that's been a tailwind to average ticket over the last decade. We think that's going to be augmented by 2% in totality in 2019.

---

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

Got you. Okay. And then, on the DIY trends, you've talked about that for a couple of quarters now, some level of caution around the DIY business suggesting that maybe that consumers have been deferring maintenance. Any signs that, that may be starting to normalize? If you could give us some more color on what do you think is driving that deferral? And what needs to happen for that to change, that would be helpful?

---

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

Yes. I think a big part -- we talked last year about fuel prices maybe impacting discretionary spending. This year, we're cautious that inflation may, again, have an impact on discretionary spending for that lower-income DIY customer. That customer would have to make necessary repairs to keep their car running and to get them to work to a grocery store and what have you. But from a discretionary standpoint, when you get to items like routine maintenance, deferring oil changes, longer extended oil change periods, those things you can push out a little longer. Filters, things like that. And your car still runs fine. You're just not following the manufacturer's recommended schedules for doing those. So I think the DIY customers that are on the lower end of the wage scale and are more economically challenged, as we said, they're going to have to make those breakage-related repairs, but some of those repairs and maintenance things that are somewhat discretionary, they're going to be likely to push those off.



---

**FEBRUARY 07, 2019 / 4:00PM, ORLY - Q4 2018 O'Reilly Automotive Inc Earnings Call**


---

**Operator**

Our next question comes from Elizabeth Suzuki with Bank of America.

---

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

Throughout 2018, you guys have guided to a comp of 2% to 4%, and now you're looking for '19 at 3% to 5%. Given that we still have a fair amount of winter left, which could either end up being favorable or unfavorable versus last year's normal winter, and you mentioned that you think this year is looking fairly normal as well. And what are the other factors that are really driving the outlook for an acceleration in comps?

---

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

Yes. So a lot of things we talked about, Liz. It's we -- fuel cost has come down over the past several weeks. And I think the expectation is that fuel prices will continue to be lower this year than prior year. And that will be supportive of increasing miles driven. If you look at the whole industry backdrop, the fact that employment rates are higher, the economy is more stable, those things just create an industry backdrop that's more favorable. And you add that to, Tom's point about, average ticket growing because of a combination of parts complexity, the cost of the more technology-related parts on newer cars and the inflation tailwind we had, we felt good about 3% to 5% guide. One of the things I would add to that, and it's not really related to the guide, but it sure makes us feel a lot better about where we are is, we had our Annual Leadership Conference in Dallas back in mid-January. And in that conference, we had about 6,900 of O'Reilly team members, all of our store managers, district managers, regional managers were there. And we do that every year, but it sure felt different when we went into conference this year than it has in the past year or 2 because there was just a lot of excitement, a lot of positive attitudes, coming from our store managers when they got there. And we really focused that week on things like ownership, running the business like you own it. We talked about commitment of running and driving a profitable business. We talked about customer service. And our teams left that conference really motivated. And we feel like that they're out there on the streets, driving sales and providing even a higher level of customer service than they may have done last year.

---

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

So in an environment that -- where the industry's potentially growing kind of mid-single digit, because it usually does like 2% to 3% or maybe a little bit better, do you feel like you can continue to gain market share in 2019?

---

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

Yes, we do. I mean, there -- again, to Greg's point, I mean, our philosophy, our business model, our strategic distribution network, I mean, our programs. I mean, we arm our teams with a lot of tools. But what happens, 1 customer and 1 store at a time. We're focused on fundamental execution on both the do it for me and the DIY side each and every day in each one of our markets.

---

**Operator**

Our next question is from Simeon Gutman with Morgan Stanley.

---

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

Tom, I wanted to ask you first about the flow-through. And so in the past, when you guided, you've typically allowed sales to what drives the upside or downside to your forecast. And I want to just ask you about 2019, if there's any likelihood that margins could surprise or it's really dictated by where you end up within that sales guidance?

---





---

**FEBRUARY 07, 2019 / 4:00PM, ORLY - Q4 2018 O'Reilly Automotive Inc Earnings Call**


---

**Thomas G. McFall** - *O'Reilly Automotive, Inc. - Executive VP & CFO*

As a multiunit retailer with relatively high-fixed cost, because of the service component of our business, sales will be the key to leveraging our operating profit performance. To the extent that new sales don't come in as high as we'd like, we have levers to pull, although we won't do anything in the short term that will impact long-term relationships. On the upside, we'll continue to -- we'll see leverage, but we want to make sure that demand is there. We're providing a level of customer service that builds those long-term relationships.

---

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

Got it. Okay. And then secondly, for Greg, I wanted to ask about MAP or whatever they call EMRP pricing that's out there. We're hearing for more brands that -- or some even distributors that more brands are going towards this direction, basically controlling price. Curious if you've seen that, too, sort of what's changing? And I guess, is that price discipline being shown across different channels where we're just not seeing as, I don't know big, or as problematic pricing differences as there could be.

---

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

Yes. I mean, one of our hot bugs with our supplies for couple of years now has been for them to protect their brand and control their pricing online. And there were a couple of suppliers, a couple of years ago, in 2017, that they really pioneered this for the industry. And we really had a slow start to get out other suppliers to come on board. So late 2018, we had 2 to 3 major suppliers come onboard. And so far, in 2019, we've had several additional suppliers to commence. So whether it's EMRP pricing program or a MAP pricing program or a unilateral pricing program, different suppliers are taking different approaches based on recommendations from their legal department or council. We are gaining some traction in that respect. And I think we'll see more tighter controls across the industry for online sales going forward.

---

**Operator**

Our next question comes from Bret Jordan with Jefferies.

---

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

On pricing, I guess, as you get all other brick-and-mortar shops, are you seeing any increased competition, I guess? Anybody rather than passing through some of the inflation holding it and trying to reduce pricing to get more commercial volume?

---

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

Well, I mean, that's ongoing. I mean, that's happened forever. I mean, there's always been suppliers out there when times get tough. They cut the prices a little off or rebate to try to buy the business. That's normally a short-term strategy. I mean, it's really -- as long as I've been in the business, it's been a service and relationship business. And you really build the business and keep the business through solid service, availability and then solid relationships, partnering with that shop to help them grow their business. But pricing comes and goes depending on how tough business is.

---

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

Okay. And then, I guess, within your omnichannel initiatives, do you have any sort of data as far as maybe increase of buy online, pick up in store? Or where the trajectory is there? I mean, obviously, you've ramped it up?

---



FEBRUARY 07, 2019 / 4:00PM, ORLY - Q4 2018 O'Reilly Automotive Inc Earnings Call

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

Sure. Overall, it has increased specifically. I'll tell you that from a breakout standpoint, ship to home; buy online, pickup in store; it fluctuates slightly, Bret. But we're staying right around that 2/3 of our online sales or pickup in store, which is where we want. We want to end up that customer inside our store, where we can make sure that we provide the highest level of service and make sure they have everything they need to complete the job.

**Operator**

We have our next question from Mike Lasser with UBS.

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

So as we think about modeling the course of your guidance of 3% to 5%, it sounds like the start of the year has been good, in part, because of inflation progressively over the course of the year of inflation compares are getting it more difficult and you're going to no longer likely see the benefit of some of the tariff-related price increases. And you probably have less visibility into the second half of the year. So as we model the year, should we take a more cautious view on the second half of the year? And along those lines, what happens if a 20 -- how will our models be affected if the 25% tariff goes through?

**Thomas G. McFall** - *O'Reilly Automotive, Inc. - Executive VP & CFO*

Okay. Michael, this is Tom. What we would tell you is that our comps will be relatively consistent on a quarter-by-quarter basis. On a year-over-year basis, as you pointed out, the first quarter will have the most inflationary benefit. We also have an extra Sunday here in the first quarter, which is a 50 bp headwind. When we look at the rest of the year, it should be relatively consistent. We pick up a Sunday in the third quarter. And the fourth quarter the ease going from a weekend to a Monday really were a big headwind for our business. And that, from a calendar standpoint, will help the fourth quarter. So we're looking at pretty consistent comps throughout the quarter.

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

On the 25% tariffs?

**Thomas G. McFall** - *O'Reilly Automotive, Inc. - Executive VP & CFO*

And your second question was -- I'm sorry. And your second question Michael, was...

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

On the 25% tariffs.

**Thomas G. McFall** - *O'Reilly Automotive, Inc. - Executive VP & CFO*

On the 25% tariffs. Yes. As Greg pointed out, our expectations are, we're going to be in the same state we are now for the year. And obviously, things have changed a lot. To the extent that we saw those additional tariffs go in, in March, we'll have to see how the market reacts. But our expectation is that we'll see a larger increase in average ticket driven by those cost increases and then offsetting pressure because of those rising prices on ticket count.



---

**FEBRUARY 07, 2019 / 4:00PM, ORLY - Q4 2018 O'Reilly Automotive Inc Earnings Call**


---

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

And if I could ask a follow-up on the SG&A and investment side. This will be the second year -- another year where SG&A per-store growth is above what it's been historically. Is this a function of maybe the cost of doing business within the auto part retail sector becoming more expensive for whatever reason, more competition becoming more complicated? Or is this just a catch-up from maybe some different investment philosophies in the past?

---

**Thomas G. McFall** - *O'Reilly Automotive, Inc. - Executive VP & CFO*

Well, I would point you back to our call this year -- or last year this time. And we talked about a rising SG&A cost as people reinvested part of their savings from the new tax laws. And that we would see those costs go up, but we wouldn't see a proportional increase in average ticket from inflation on the top line. And at that time, we said when we look at next year, if we continue to see cost inflation in the expenses to run the business, we'd expect to feel that tailwind in our top line same SKU inflation. And that's what we're seeing this year. Given that unemployment is very low, wages are going up very quickly, costs are going up, interest rates are going up, we're seeing that inflation run through all of our expenses and getting the top line tailwinds. So we don't think the business itself is changed. We think that we're just more in an inflationary environment that we've seen in the last 5 to 8 years.

---

**Operator**

We have our next question from Chris Bottiglieri with Wolfe Research.

---

**Christopher James Bottiglieri** - *Wolfe Research, LLC - Research Analyst*

One quick follow-up and then I got one bigger picture question. So is there a way to walk us on the 10 point tariff to a 2 point price increase? What percentage of SKUs were impacted? Product cost percent as percentage of COGS? Or where the opposites are? I mean, just the amount of bridge there.

---

**Thomas G. McFall** - *O'Reilly Automotive, Inc. - Executive VP & CFO*

Yes. So all of our products are produced overseas. It's a portion of them. And even for some lines, some are here in the States and some are not. We're not going to get into breaking down the individual numbers. We push back on all the price increases we get, whether they're tariff-related, interest rate-related, health care-related, raw commodity-related, but that ends up being the blended number. And we didn't take full 10% increases on most of our products.

---

**Christopher James Bottiglieri** - *Wolfe Research, LLC - Research Analyst*

Got you. Okay. And then a bigger picture question was just from your just recent strategy. You talked about the super hub that you referenced after you consolidated the TDCs. The nomenclature though of our super hub, I think, is different not to be confused with what your peers are doing to replace DCs with larger hub stores. So is this like more equivalent to your master DCs? Or maybe just walk us through kind of what you're doing there would be helpful.

---

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

We basically have our Spoke store and then we have a hub store that would be in the 45,000 SKU range. And then we have super hubs, where we don't have DCs in a large metro market. That would be in that 80,000, 90,000 SKU range and then our ADC would obviously, have in that 160,000, 170,000 SKU range.

---



---

**FEBRUARY 07, 2019 / 4:00PM, ORLY - Q4 2018 O'Reilly Automotive Inc Earnings Call**


---

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

Chris, if I could add to that a little bit about why we're making that change. We're facing some pretty significant capacity issues in both Middle Tennessee where national DC is located and our East Tennessee market in Knoxville. And we had to make a move. And we decided to consolidate those 2 facilities into a much larger facility that allow DC to have a larger breadth of SKUs for the some of that customer base. But because that market in Knoxville is a market that's had a DC inventory presence for a number of years now, we wanted to supplement that markets for same-day service by converting that DC into a super hub and making sure that we maintain that same-day parts availability in the Knoxville market.

---

**Christopher James Bottiglieri** - *Wolfe Research, LLC - Research Analyst*

Got you. Lastly, is this a one-off just specific to that market? Or do you foresee or envision creating more of these super hubs throughout the country?

---

**Thomas G. McFall** - *O'Reilly Automotive, Inc. - Executive VP & CFO*

We've always used a super hub strategy, but in the case of Knoxville, I mean, Knoxville was just a -- it was an old mid-stage DC. And it just didn't -- it wasn't big enough to have the capacity that we needed to truly service that market.

---

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

Jeff, we got 340-ish hub stores and how many super hubs of those are super hubs?

---

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

40. 40, give or take.

---

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

We've got several...

---

**Operator**

Our next question is from Seth Basham with Wedbush Securities.

---

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

My question is around the gap between DIY and Pro comps. Could you provide some color as to how that trended for each quarter through 2018? And how you're looking at that through 2019?

---

**Thomas G. McFall** - *O'Reilly Automotive, Inc. - Executive VP & CFO*

We've spoken to it on each quarter and you can find that information in our Q. We don't give the actual number. What we would tell you is that when we look at 2018, we've been pressured on the DIY customer count. Pro has grown each year -- or each quarter. Average ticket is up on both and we would expect that trend to continue in 2019.

---



---

**FEBRUARY 07, 2019 / 4:00PM, ORLY - Q4 2018 O'Reilly Automotive Inc Earnings Call**


---

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

But you wouldn't expect the sales gap to widen between DIY and commercial in 2019?

---

**Thomas G. McFall** - *O'Reilly Automotive, Inc. - Executive VP & CFO*

We're anticipating a relatively similar difference with professional business continuing to grow faster based on our ability to consolidate the market, based on net consumer being less impacted by general rising prices and based on other macro factors to our business, slightly aging population and more expensive repairs that are more technical in nature and late-model vehicles being expensive.

---

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

Got it. Perfect. That's helpful. And then secondly, looking at your CapEx budget for 2019, you provided some color on some of the things that are driving the increase. Could you give a little bit more granularity, which are the factors, DCs, new stores IT projects, maintenance, are changing the most from 2018 to 2019?

---

**Thomas G. McFall** - *O'Reilly Automotive, Inc. - Executive VP & CFO*

Biggest change is our -- number one is DCs, DC projects, number two is in-the-store technology.

---

**Operator**

Our next question is from Matt McClintock with Barclays.

---

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

I'd like to follow up on Michael's question a little bit, maybe parse it out in a different way. Just the end store and omnichannel investments in 2018 that you're continuing to do in 2019. I know you invest for long-term sustainable growth, but can you give us some sense of when the payback is on those investments or when we should expect the payback on those investments, whether that be through increased sales accelerating sales or margin or whatever the payback is?

---

**Thomas G. McFall** - *O'Reilly Automotive, Inc. - Executive VP & CFO*

What we would tell you is that most of these changes are just consumer expectations. Consumers shop outside of auto parts that many retailers and their expectation of what great services changes over time. And our job is to continue to make sure that our customer service levels are up there to maintain our business. It's hard to parse out what that is from a sustaining standpoint versus additional business. It's part of the factors that go into customer service that drive our comps to be higher than the industry growth rates.

---

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

Matt, just to add on to that, I'm not going to go into any details about what the initiatives are for competitive reasons. But from an omnichannel perspective, we're primarily focused on improving content, improving online search, improving -- customers buying decisions, where do they buy online, ship to home, buy online, pickup in store or research online, by in store, a lot of those transactions and buying decisions are made based on research online. So we're just focused on making sure that we are providing the highest level of searchability, so to speak, for our products, for our customers. And we think that's going to pay dividends long term from a sales perspective. How we quantify that? It's very difficult to do.

---



FEBRUARY 07, 2019 / 4:00PM, ORLY - Q4 2018 O'Reilly Automotive Inc Earnings Call

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

I understand that. And just on my follow-up. Just the seasonal pull forward in November, were there any margin implications for the quarter from that?

**Thomas G. McFall** - O'Reilly Automotive, Inc. - Executive VP & CFO

No. There wouldn't be.

**Operator**

We have our next question from Scot Ciccarelli with RBC Capital Markets.

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

So I'm curious, in your business plan for 2019, are you expecting any industry trend change based on the Car Parc? And kind of how are you thinking about the Car Parc? It's obviously, an investor topic but as company operating in that industry, I'm curious, how you guys are thinking about it.

**Thomas G. McFall** - O'Reilly Automotive, Inc. - Executive VP & CFO

As the bubble years go through from the Great Recession, that's part of the reason that 2 years ago was kind of the biggest headwind for those year vehicles entering our sweet spot and hit the professional business more in 2018 as part of the reason that there was a more of a gap between the DIY and professional. We'd expect that, that will continue to -- as that moves through to the older vehicle years that much higher DIY to continue to: one, be a positive on the professional side because there's not the headwind and it'll start to be more of a headwind on the DIY side.

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

And so are you expecting those trends to become exaggerated in 2019? In other words, aren't there just more vehicles, kind of, coming into that repair stage? And have you factored that into your expectations for 3% to 5% comp guide?

**Thomas G. McFall** - O'Reilly Automotive, Inc. - Executive VP & CFO

We wouldn't expect it to accelerate because it pressures the DIY side of the business. That's also side of the business that's growing from a longer tail of vehicles and vehicles staying on the road longer. Those 10-, 12-, 14-, 15-year vehicles are primarily DIY side business, and that's helping offset the pressure from those bubble years.

**Operator**

Our next question is from Daniel Imbro with Stephens.

**Daniel Robert Imbro** - Stephens Inc., Research Division - Research Analyst

On the gross margin guide, you guys mentioned, as far as cadence, the expansion to be front-half weighted. And I think you identified freight pressures as a potential headwind to growth margins. Can you talk about when you really saw freight pressure step up in 2018? And is there



FEBRUARY 07, 2019 / 4:00PM, ORLY - Q4 2018 O'Reilly Automotive Inc Earnings Call

anything different about those cost pressures that would inhibit you from passing them through in the form of price like you would any other form of inflation?

**Thomas G. McFall** - *O'Reilly Automotive, Inc. - Executive VP & CFO*

Well, it seems like we've been on the 3-year run for freight cost has continued to go up. And that's a population of jobs that there's a very, very tight market. And that tight market is driving increases. When we look at our distribution cost, obviously, we deliver nightly at all the stores so there's quite a bit of pressure there. And we build that into our cost, but we've got to be market competitive. So to the extent that we're a higher distribution-intensive company that's more exposed to this, we're going to have a little more pressure that we're not able to pass on.

**Daniel Robert Imbro** - *Stephens Inc., Research Division - Research Analyst*

Got it. And then, just within that expectation, are you expecting a similar price increase that we saw in 2018 and 2019?

**Thomas G. McFall** - *O'Reilly Automotive, Inc. - Executive VP & CFO*

2018 was pretty high for freight. The incremental year-over-year increase is less, but the numbers still a higher rate than we experienced in 2018.

**Daniel Robert Imbro** - *Stephens Inc., Research Division - Research Analyst*

Got it. That's helpful. And then for my follow-up, when I think about December, you guys mentioned a few negative impacts, the holiday calendar shifts, weather, a tougher compare. Can you maybe quantify some of those headwinds as we think about the deceleration from November to December?

**Thomas G. McFall** - *O'Reilly Automotive, Inc. - Executive VP & CFO*

We can't -- we're not going to quantify them but in that order of magnitude, number one item in December is very weather-driven people fix their vehicles if they have to, otherwise they're going to holiday shopping so that's number one. And then, number two would be the calendar shifts of the Eaves.

**Operator**

We have reached our allotted time for questions. I will now turn the call over to Mr. Greg Johnson for closing remarks.

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

Thank you, Vanessa. We like to conclude our call today by thanking the entire O'Reilly team for our solid fourth quarter and full year 2018 results. We look forward to a strong year in 2019. I would like to thank everyone for joining our call today. And we look forward to reporting our 2019 first quarter results in April. Thank you.

**Operator**

And thank you. Ladies and gentlemen, this concludes our conference. We thank you for participating. You may now disconnect.



## FEBRUARY 07, 2019 / 4:00PM, ORLY - Q4 2018 O'Reilly Automotive Inc Earnings Call

**DISCLAIMER**

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

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

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

©2019, Thomson Reuters. All Rights Reserved.