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# EDITED TRANSCRIPT

## ORLY - Q1 2019 O'Reilly Automotive Inc Earnings Call

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**OVERVIEW:**

Co. reported 1Q19 EPS of $4.05. Expects 2019 total revenues to be $10.0-10.3b and EPS to be $17.37-17.47. Expects 2Q19 EPS to be $4.55-4.65.



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## PRESENTATION

**Operator**

Hello, and welcome to the O'Reilly Automotive, Inc. First Quarter 2019 Earnings Conference Call. My name is Michelle, and I will be your operator for today's conference. (Operator Instructions) As a reminder, this conference call is being recorded.

I will now turn the call over the Tom McFall. Mr. McFall, you may begin, sir.

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

Thank you, Michelle. Good morning, everyone, and thank you for joining us. During today's conference call, we'll discuss our first quarter 2019 results and our outlook for the second 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, expect, would consider, should, anticipate, project, plan, intend or similar words. The company's actual results could differ materially from any forward-looking statements due to several important factors described in the company's latest annual report on Form 10-K for the year ended December 31, 2018, and other recent SEC filings. The company assumes no obligation to update any forward-looking statements made during this call.

Greg Johnson, our CEO and Co-President, is unable to be with us today due to a very serious health issue involving a close family member. For today's call, Greg Henslee, our Executive Vice Chairman and Former CEO, will be participating in Greg Johnson's absence.

At this time, I'll turn the call over to Greg Henslee.





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**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

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

I'd like to begin our call today by thanking Team O'Reilly for their unwavering commitment to providing consistently excellent levels of service to our valued customers. This dedication to our customers is what drives our long-term success, and I'm extremely proud that the job we do each day taking expert care of both our professional and DIY customers.

As we discussed in the past, the timing of weather patterns in our first quarter can cause the most volatility during the year. This was especially true this past quarter as we saw extended periods of harsh winter weather that are positive for our business and should support solid demand throughout 2019, but we also encountered significant rain throughout the quarter, which is a headwind for our DIY business.

Additionally, the delay in tax refunds and a reduction of total refund dollars during the quarter contributed to the sales volatility on a comparable basis.

Finally, I would remind everyone that our first quarter included an additional Sunday as compared to 2018, which had a negative impact of approximately 50 basis points of comp store sales as Sunday is our lowest volume day of the week. As a result, our first quarter comparable store sales increase of 3.2% was at the bottom end of our guidance range due to the short-term impact of the headwinds we saw during the quarter.

As we review our results for both our DIY and professional customer business on a day-by-day, region-by-region basis, we remain very confident in our business and the health of the automotive aftermarket and the strength of the underlying trends of our industry.

Considering the sales volatility during the quarter, I'm proud of the effort our team put in to managing expenses and driving profitable sales growth, resulting in a 5.2% increase in operating profit dollars as compared to the first quarter of 2018 and an operating margin rate of 18.5%. In addition to the solid growth in sales and operating profit, we were -- we also benefited from a substantially lower tax rate than expected, which Tom will cover in his prepared comments. This combination of operating performance along with our ongoing share buyback program drove an increase in first quarter earnings per share of 12.2% to $4.05 per share, which exceeded the top end of our guidance range of $4.02 per share and reflects our team's ability to consistently execute our business model and drive solid profitable results.

Now I'd like to provide some additional color on our first quarter comparable store sales results. The composition of our sales results was consistent with our recent trends, with both the professional and DIY sides of our business being positive contributors to our comp store sales increase in the first quarter with professional continuing to exceed DIY.

The typical growth in our professional business outpaced DIY and continued to drive comparable store sales even with the headwind of the additional Sunday in the first quarter. The impact of weather volatility during the quarter was most evident in DIY ticket counts. However, the demand on this side of the business was otherwise consistent with recent trends even as these customers feel the pinch of rising prices across the economy.

Average ticket was a strong contributor to comparable store sales on both sides of the business driven by the increasing complexity of vehicle repairs and a favorable overall business mix. The impact to average ticket from same SKU inflation was in line with our expectations for the first quarter, and we still believe the full year impact will be approximately 2%.

Moving on to the cadence of our comparable store sales growth. As Greg Johnson mentioned during our 2018 Year-End Analyst Call in February, we were pleased with our start to 2019. However, we met softness from a comparable standpoint in the back half of February due to the timing of tax refunds compared to last year and generally unfavorable weather in most of our markets. This was somewhat offset by the harsh winter weather from the polar vortex in many markets. However, business was good in March, and we finished the quarter strong as March was easily our strongest month of the quarter even with the extra Sunday headwind. And I'm pleased to report that this strong trend has continued to this point in April.



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Given the delay in timing of tax refunds and refund dollars down approximately 3%, it's difficult to fully estimate the impact to our first quarter results, but we are confident in the core underlying fundamentals that drive demand in our business moving forward.

On a category basis, our performance matched the trends I've already discussed with strong performance in key categories driven by cold, harsh weather such as batteries and wipers along with good performance in maintenance and repair categories, such as brakes, lighting and drive line.

As we look ahead to the second quarter and the remainder of 2019, our outlook on the strength of our industry and our opportunity to continue to gain market share by executing our business model and providing the best customer service in our industry has remained unchanged since we provided guidance at the beginning of the year. As a result, we are reiterating our full year comparable store sales guidance of 3% to 5% and establishing our second quarter guidance at the same 3% to 5% rate.

For the quarter, our gross margin of 53.1% was a 44 basis point improvement over first quarter 2018 margin and, as expected, was towards the top end of our expectations built into our full year margin guidance. During the quarter, we benefited from continued incremental improvements in acquisition cost, a favorable mix of hard part sales and a rational inflationary pricing environment. Tom will discuss LIFO and the impact of tariffs to our acquisition cost in more details in his comments, but I will add that we've been pleased to see that tariff cost increases in general have been passed along in market prices, and we continue to expect pricing in our industry to be rational moving forward.

We are leaving our full year gross margin guidance unchanged at 52.7% to 53.2% of sales and also continue to expect our full year operating profit to be within our previously guided range of 18.7% to 19.2% of sales.

For earnings per share, we're establishing our second quarter guidance at $4.55 to $4.65 and are reiterating our full year EPS guidance of $17.37 to $17.47. Our full year guidance includes the impact of shares repurchased through this call which does not differ significantly from the impact we included in our fourth quarter call but does not include any additional share repurchases.

Before I turn the call over to Jeff, I would like to again thank Team O'Reilly for their hard work and dedication to our company's continued success. Due to our continued commitment to our customers, we are off to a solid start in 2019, and I'm confident in both the long-term drivers of demand in our industry and our team's ability to capitalize on this demand by providing excellent service to our customers every day.

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

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

Thanks, Greg, and good morning, everyone. I'd like to begin my remarks today by echoing Greg's comments and thanking our team members for their hard work and dedication to providing top-notch customer service. Our team weathered the significant sales volatility during the quarter by remaining dedicated to taking care of our customers while closely managing expenses to drive profitable growth.

Now I'd like to spend a few minutes discussing our SG&A results for the quarter. SG&A as a percent of sales was 34.6%, a deleverage of 52 basis points from 2018. On an average per store basis, our SG&A grew 3%, which is at the top end of our full year guidance but in line with our expectations for the quarter. Within our SG&A for the quarter is a headwind of 12 basis points relating to deferred compensation with a corresponding and offsetting benefit in other income.

We continue to aggressively pursue our customer service and omni-channel goals and face pressures to wages and other variable costs from a low unemployment, inflationary environment. Our expense control focus is a key component of the O'Reilly culture, and each of our managers is held accountable for the profitability of their individual store, DC or corporate department.

We manage our SG&A spend with a long-term focus on building strong relationships with our customers, and we actively scrutinize all of our expenses to ensure every dollar we spend helps to provide excellent customer service. We remain confident in our opportunity to continue to drive profitable growth through diligently executing our business model and continue to expect full year growth in SG&A per store of 2.5% to 3%.



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Next, I'd like to spend -- or next I'd like to provide an update on our ongoing distribution center projects and share some additional exciting DC expansion news. If our decades of experience in executing our dual market business model have taught us anything, it's that we must continue to innovate and invest to lead the industry in parts availability. It's crucial to the economic livelihood of our professional customers and equally critical to our DIY customers who depend on us to get all the parts they need to get their car back on the road. Our ability to provide outstanding customer service in our stores is dependent on the work our 27 distribution center and 342 hub store teams do to get hard-to-find parts in our customers' hands faster than our competitors.

As we previously announced, we have 2 significant DC expansion projects under way with the addition of a new location in Twinsburg, Ohio just South of Cleveland and an upgrade to a new larger facility in the Nashville market in Lebanon, Tennessee. Both of these projects are on track, with the Cleveland DC targeted to open in the fourth quarter and the new Nashville DC set to open in the first half of 2020.

On our last call, we also discussed that our 2019 CapEx plan included an additional DC project starting in 2019, and we're pleased to announce the purchase of an existing facility in Horn Lake, Mississippi, just south of Memphis. The new DC will be approximately 580,000 square feet, and our initial plan is to build our capacity to service 250 stores. We plan to complete the infill work for this new DC in the back half of 2020, and at that time, we'll consolidate the operations and convert our existing DC in Little Rock, Arkansas into a super hub store. The new DC will provide us with additional capacity for store growth in this region of the country and provide flexibility for the surrounding DCs while also accommodating a broader SKU capacity, increasing our breadth of hard-to-find parts and allowing us to provide an even higher level of service to the Memphis metropolitan area markets.

This plan is similar to our strategy for the relocation to the larger Nashville DC, which will allow us to consolidate Nashville and convert the Knoxville DC to a super hub. Now managing 3 major DC projects at one time is a significant undertaking, but it isn't a first for our experienced distribution operations teams. And I'm extremely confident in the ability of this team to successfully build, plan and open each of these facilities.

Finally, before turning the call over to Tom, I'd like to provide a brief update on our store expansion during the quarter and our plans for the remainder of the year. In the first quarter, we opened 62 net new stores, and we continue to be on track to open at least 200 net new stores for the year. We continue to spread our store growth across the country, with new store openings in 27 different states during the quarter as we continue to identify great opportunities to open stores across all of our market areas.

We also have successfully begun the work of converting the Bennett Auto Supply stores, which we acquired at the end of 2018. The acquisition of the 33 Bennett stores will net a total of 20 new O'Reilly locations, with the remaining 13 stores merging into existing O'Reilly stores. We will complete the conversion of the Bennett stores by the end of the second quarter. The Bennett team has been a great addition, and we look forward to continuing to grow our market share in Florida.

Before I finish up today, I'd like to once again thank our store and distribution teams for their continued dedication to providing the best customer service in our industry. We're off to a solid start in 2019, but we're never satisfied and remain highly focused on driving industry-leading results by outhustling our competition to win our customers' business each and every day. I'm confident we have the right team in place to deliver an outstanding year in 2019, and I want to thank Team O'Reilly for their continued commitment to our company's success.

Now I'll turn the call over to Tom.

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

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

For the quarter, sales increased $128 million, comprised of $72 million increase in comp store sales, a $60 million increase in non-comp store sales, which includes the contribution from the acquired Bennett stores, and a $1 million decrease in non-comp, non-store sales and a $3 million decrease from closed stores. For 2019, we continue to expect our total revenues to be $10 billion to $10.3 billion.



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As Greg previously mentioned, our gross margin was up 44 basis points for the quarter as we saw benefit to acquisition costs, mix and pricing. On a year-over-year basis, first quarter gross margins benefited from sell-through of on-hand inventory that was purchased prior to the recent tariff-driven acquisition price increases and corresponding retail and wholesale price increases, and we'd expect this to be a year-over-year benefit to gross margin in the second quarter as well.

As a result of the inflation-driven pressure to aggregate acquisition costs, we did not see a LIFO charge during the quarter and we don't expect to have a -- excuse me, we don't expect to have a charge for the remainder of 2019.

Our first quarter effective tax rate was 22.5% of pretax income and was comprised of a base rate of 24.5% reduced by 2% benefit from share-based compensation. This compares to the first quarter of 2018 rate of 22.9% of pretax income, which was comprised of a base tax rate of 24.5% reduced by 1.6% benefit for share-based compensation. For the full year of 2019, we continue to expect an effective tax rate of approximately 23.5% comprised of a base rate of 24.1% reduced by a benefit of 0.6% for share-based compensation. While the benefit from share-based compensation will fluctuate from quarter to quarter and exceeded our expectations for the first quarter, we expect these variations to even out over the course of the year, and we are leaving our full year tax rate expectations unchanged. We expect our base tax rate to be relatively consistent with the exception of the third quarter, which may be lower due to the tolling of certain open tax periods.

Now we move on to free cash flow and the components that drove our results for the quarter and our guidance expectations for the full year of 2019. Free cash flow for the first quarter was $279 million versus $311 million in the first quarter of 2018 with the reduction driven by increased CapEx and higher credit card receivable balances, offset in part by higher pretax income and a reduction in our net inventory investment. For the full year, we are maintaining our free cash flow guidance in a range of $1 billion to $1.1 billion.

Inventory per store at the end of the quarter was $609,000, which was down slightly from the beginning of the year and up 1.6% from this time last year. We continue to expect per store inventory to grow in the range of 2% to 2.5% this year as a result of 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 first quarter was 106%, in line with where we ended 2018 and where we expect to finish 2019.

Finally, capital expenditures for the first quarter were $153 million, which was up $38 million from the same period of 2018 driven by our ongoing investments in new distribution projects Jeff discussed in his prepared comments as well as CapEx to convert Bennett stores, drive new store growth and accelerate technology investments. We continue to forecast CapEx to come in between $625 million and $675 million for the year.

Moving on to debt. We finished the first quarter with an adjusted debt-to-EBITDA ratio of 2.24x, in line with our ratio at the end of 2018. We are below our stated leverage target of 2.5x, and we will approach that number when appropriate.

We continue to execute our share repurchase program. And during the first quarter, we repurchased 0.9 million shares at an average share price of $347.09 for a total investment of $322 million. We remain very confident the average purchase price is supported by the expected discounted future cash flows of our business, and we continue to view our buyback program as an effective means of returning available cash for our shareholders.

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

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

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) The first question in the queue comes from Christopher with JPMorgan.



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**Unidentified Analyst**

Can you talk a little bit about -- a little bit more about the cadence of the quarter? You mentioned March was by best -- by far the best despite there's probably 150 basis point headwind for that month. So was February negative? And sort of how did January size up relative to those two?

**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

Well, Chris, as we said, March was the strongest quarter. February wasn't negative. January was pretty solid. But clearly, March was our best-performing quarter. It's spring hit and the tax refunds hit. And we had a little bit of a comparison issue in February relative to tax refunds -- customers who'd receive tax refunds and also the size of those refunds, and we think that was a primary driver of the shortfall compared to our plan in February. But those started coming in, in March, and we saw the pickup in business. And as I said, we've continued to experience a solid business trend to this point in April.

**Unidentified Analyst**

Understood. Do you think there was any deferral between the first and second quarter? Or is it all going to sort of washout within the quarters?

**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

Oh, I think there was some push forward into April probably as a result of the tax refunds being delayed and also just the weather that we had in February. People -- DIY customers, if it's pouring down rain outside for several days in a row, just don't have a chance to get out and work on their cars so they pushed that forward. And something else I want to mention relative to weather. As I've read some of the reports over the last couple of months relative to the polar vortex and some of the weather events, I want to make clear that the weather extremes, cold weather and hot weather, those are all good for our business. They drive demand. They because failure of rubber parts and freeze-thaw in cold weather that causes the roads to bust up and creates pot holes does damage to chassis parts and steering parts and things like that. But snow in and of itself is not good for our business unless it's accompanied by just incredibly cold weather that causes the freeze-thaw and bust up the roads. When the snow is hard, schools close, people stay home and our DIY business on those days is soft. And in some markets, we experienced some of that along with the rain in February. So I just want to mention that just for clarity.

**Unidentified Analyst**

Understood. And then on that snow question, do you think -- as you think about -- how would you assess this winter? Did you have that -- was that snow accompanied with that weather extreme in that weather variation? And are you expecting that same sort of lift from corrupted roads, so to speak, in this second quarter?

**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

Yes. I would say that it was a good winter for the auto parts business. Not -- and again, that's not immediate results, but I think that winter that we had would be conducive to good business in the spring/summer as we move into those months.

**Unidentified Analyst**

And sorry, just any particular regions that you're thinking about had a better winter versus others?



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**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

Jeff, do you have any regional?

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

The regional performance is really based on the weather that we experienced throughout the quarter. The makeup throughout the regions would be about what you expect. The -- as Greg alluded to, there is parts in the center part of the country and the southern parts of the country that was just -- they were diluted with heavy rains, which kind of display -- or it slows down that early spring weather. And as everybody has seen on the national news, I mean, there was historic flooding up in the northern parts of the country. The eastern and the northeastern markets probably benefited more from a more normalized winter than anybody.

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**Operator**

The next one in the queue comes from Brian Nagel with Oppenheimer.

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

So first, to follow up on Chris' weather question. But in the past, you've discussed in these type of quarters variance in performance between weather affected and non-weather affected markets. Is there some type of number like that you can give us here for Q1 just to help understand better what maybe the core business was tracking at ex the factor -- ex the impact of weather?

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**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

Yes. Just the difference between our best-performing markets and our worst-performing markets, is that what you're asking?

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

Yes.

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

You got any numbers on it, Tom?

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

What we would tell you, Brian, is that there was some beneficial weather in all of our markets and some headwind weather in all of our market. I think as Jeff talked about, the overriding driver for the little softer sales than we anticipated was how much rain and cool temperatures we received in the center part of the country. We're not disclosing that comp variance at this point. Obviously, when you look at where we are versus our midpoint, it's relatively close performance and to call that out probably wouldn't be appropriate as we expect that to normalize throughout the year and haven't changed our comp expectation or total revenue expectation for the full year.

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

Yes. That's fair. That's fair. Then the second question I want to ask and maybe a bit longer term in nature. In your prepared comments, you spent time talking about both the number of stores you opened in the quarter as well as the integration of the acquisition, I guess, in Florida. So as we



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look at it, how do you view right now the sort of, say, the productivity of the new store as you continue to open at a relatively decent clip? And as you think of that -- because there are -- there do remain a number of smaller chains out there that are at least potential targets for purchase. Do you think about the decision whether to open stores or make potentially strategic acquisitions? How does that thought process take place?

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**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

Tom, you want to talk about it?

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

So our new store performance has been right where we would expect. Obviously, we're putting the Bennett stores, and I talked about that in my prepared comments, goes into the non-comp store sales, which throws out the calculation for a new store performance. But we continue to be very pleased with the performance of our new stores. When we talk about the number of chains that are out there and how we enter new markets, our business philosophy has always been when we're going to enter a new market, what we want to do is find out who's selling parts in the market and see if there's an opportunity to team up with those parts sellers, whether it's 1 store and with CSK, it was 1,300 stores. So that's always our first lead. But what we have to do is be able to find a win-win where they're looking to exit, we're opportunistic in our acquisitions. We continue to do a large number of 1 and 2 store acquisitions. When we look at the Bennett stores, not a huge store count but really a very solid team in the market that we're growing in and an opportunity to leverage those teams and those relationships in the market to really add those stores but also make our new stores that much better.

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**Operator**

And the next question in the queue comes from Scot Ciccarelli with RBC Capital Markets.

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

I know you guys talked about expecting about 200 basis points of part inflation for the year, but two questions related to that. First of all, what was the impact on 1Q? I don't know if you had said that. And then number two, how do you guys measure that? Like is that against kind of year-end or is that a year-over-year figure, et cetera?

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**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

Tom?

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

It's slightly above 2. And what we would tell you is we do a detailed calculation on a SKU-by-SKU basis [outflowed] for the volume that was sold this year versus last year and prices this year versus last year. So as we talked about on our call in the fourth quarter and really we talked about last year's is last year we saw SG&A inflation without as much same SKU inflation as people reinvested in our industry and in retail in general the reduced tax amount, and we talked about it, this year we'd expect our SG&A growth to be similar unless we saw increases in inflation on the top line, and that's what we're seeing as we talked about in the fourth quarter that we're pressured on our SG&A from inflationary standpoint, but we're seeing those price increases flow through really started primarily with the tariffs. But really costs of interest and cost of health care and cost of payroll especially passed through in price increases. So we continue to expect to see about 2% SKU-on-SKU inflation calculated at a detailed level.

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

And if the tariffs did go away based on what's happening on the political front, does your view on that change, Tom?

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

I think we would expect to see some opportunities to reduce prices. But tariffs are only one portion of what's driving inflation. I'd tell you that wage inflation is a bigger driver in aggregate of our price increases. So that's to be determined on how the market prices that through, how fast they come through. Obviously, we're planning our business from a go-forward basis that the tariffs that are in place will stay in place and that we won't see additional tariffs or reductions of existing tariffs to the extent that, that happens, we'll manage the business on day-by-day basis to make sure that we are being competitive in the marketplace.

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**Operator**

And the next question in the queue comes from Simeon Gutman with Morgan Stanley.

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**Unidentified Analyst**

This is Josh (inaudible), on for Simeon. Was the gap between your DIY and DIFM growth in the quarter consistent with how it's been over the past few quarters?

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**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

We tell you, it was a little bit more, which is not unexpected given the weather volatility and some of the headwinds w have seen from weather, which, obviously, when you talk about precipitation, impacts our DIY customers as our professional shops are primarily inside and also the delay in tax returns, which is a bigger impact on our lower-end consumer.

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**Unidentified Analyst**

That makes sense. And then just a quick follow-up. Aside from maybe the weather and the tax for this quarter, if you can sort of push that to the side, are you seeing any change in the sort of number of really old, call it, 11-, 12-, 13-year-old vehicles coming into your stores?

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**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

What we would tell you is that the vehicle population in the United States moves very slowly. We haven't seen a dramatic change in the reported scrap rates and sales have maintained about the same amount. So we haven't seen a big change. And we continue to see the age of the vehicles get older as they're better manufactured and able to go through more routine maintenance cycles and be driven safely on the road at higher mileages. So that's change as the vehicle population we see happens very slowly over time, and we tell you it's pretty consistent.

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**Operator**

And the next question comes from Seth Sigman with Crédit Suisse.

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

I wanted to follow up on the inflation. It sounds like the same SKU inflation is tracking as you would expect. What are you guys seeing from a competitive perspective? Are there others basically doing what you're doing as well? And then any signs of elasticity?

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**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

Yes. So we do a lot of work on making sure that our prices are competitive both on the professional and DIY side of the business. And we would tell you that we continue to be very competitive in the market and adjust our prices appropriately. When we talk about elasticity of products, it really depends on the product itself. For example, batteries have a high lead content and the change in lead prices leads to quarterly changes in the prices of batteries, but it's a very inelastic product. If you go out and your battery doesn't work, your car doesn't start, and people need to replace them. On the flip side of that, our routine maintenance items, for example, oil changes to the extent that you see oil prices go up, people can extend those miles that they drive between oil changes. So it really depends on a maintenance and a failure standpoint.

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

Okay. That's helpful. And then just any more color on how strong March -- the improvement that you saw in March may have been. And specifically the DIY business, you've been somewhat cautious on that business over the last few quarters. How do you think about the macro backdrop for your DIY customer today?

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**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

Tom, do you want to take that?

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

So we saw a benefit in March partially from easing weather and partially from tax returns getting out there. We continue to view our low-end DIY customers as somewhat exposed to price increases. And to the extent that fuel goes up, they're a little more exposed to that. We continue to see it as a great business and a great opportunity for us to grow our market share.

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**Operator**

And the next question comes from Matt McClintock with Barclays.

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

Just I was thinking higher level. You talked a little bit about continued investments in part availability and you discussed the new DCs that you're opening and the new super hub, mega hub, et cetera, that you're going to do. And there's a lot of discussion about investments that some of your competitors and others in the marketplace are making to improve their part availability. And it just seems like it's overlooked sometimes that maybe you're not just sitting down doing nothing while that's occurring. So I was wondering if you can maybe just give us an overview of over the last couple of years some of the things that you've done to increase and continue to build upon your marketing-leading position in part availability?

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**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

Jeff, do you want to take that?



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

Sure, I'll start with it and maybe you guys can chime in. Obviously, it starts with our distribution centers. And you heard us talk on the call here that we've got 3 new distribution centers under way. And putting in that number of SKUs out in the market to provide that availability is just huge for the stores that benefit from that. A couple of those DCs, the Little Rock DC and the Knoxville DC that we mentioned, they were legacy DCs from the Midwest acquisition and through the CarPro acquisition back in 2000. And they just didn't have the footprint to hold the necessary number of SKUs that we needed to hold to support a market and the capacity as well. So that's the reasoning for the new Lebanon DC as well as the new Memphis DC. Obviously, the Akron DC is an expansion these to support greenfield growth. And beyond that, I mean, it would be -- the next level would be the super hubs -- the amount of super hubs and then the hub stores where we don't have DCs in those semi-metro freestanding markets, we want to make sure that we've got the level of SKUs it takes to support the market based on the competition in that market. And that's normally driven by the number of traditional competitors. There's many, many, many solid regional and two-step competitors out there in a lot of these markets that never get talked about. They just do a phenomenal job and really still control the bulk of the do-it-for-me business across the country that we have to go head-to-head with every day. So we're continually evaluating our position in markets from an inventory standpoint and reacting accordingly. We've done that for many, many years.

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

And what I would add to that is we commented that the Little Rock DC and the DC in Tennessee are going to become super hubs. We have stores in those locations. The DCs are relatively small. So what we're trying to communicate is those are important markets for us that we aren't going to step away from and we'll continue to have a high level of parts availability at.

**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

And something I want to add, Matt, this is Greg, is that this is an old discussion here at O'Reilly. If we look back 20 or 30 years that we were talking about how we make more parts available to each store, and the reason it's become more of a discussion in the public forum now is our larger publicly traded competitors have gotten more into the do-it-for-me side of the business and realized that availability is the key to being successful in that business, it's just become more of a topic of the discussion. So we have -- as that has happened, we have worked to improve availability through hub stores and hubs and just better SKU deployment tools in our Spoke stores, we call them, stores that stand alone in the market where you -- they're not supported by hub or a DC on a same-day basis. So a big part of the success in our business, regardless of whether it's us or one of our competitors, is having the part on the shelf or having it available within an hour or 2 when a customer needs it.

**Operator**

And the next question in the queue comes from Chris Bottiglieri with Wolfe Research.

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

One near term and then one long term one. So inflation, given that 2% inflation isn't entirely driven by tariffs, (inaudible) wages, like given the methodologies to calculate it, was there any inflation in Q1 '18 last year? Because I think wages were still up pretty considerably last year?

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

We saw a little bit of inflation. We talked about it in 2018 was the first year in the past 5 years that the saw some same SKU inflation, and we've talked extensively about that. A lot of it was commodity-driven and the first quarter was less than 1%.



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

Got you. Yes, that's helpful. Bigger, longer-term question. In your 10-K, you'vesuggested that as of 12/31, you had the capacity your DC networks support additional 900 stores with Twinsburgh, now you're adding the DC in Mississippi. Historically, at Analyst Days, you've targeted store potential of 6,000 but seems like you're capacitating your business to do a bit more than that, especially if you open any more DCs on the East Coast or whatnot. So I guess, just the question is like have you really thought at all your 6,000 store potential?

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**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

What we'd say is the addition -- some of the additions here are being offset by the closure of Little Rock and Knoxville. What we also continue to see is as you would expect, there's more vehicles on the road, more model years, more parts specific to each model that the number of SKUs continue to increase. So that we need more square footage per store to cover that SKU diversity. But what we'd tell you is that we continue to look for all the opportunities we can to add the stores, and we are probably expecting to have north of 6,000 stores at this point.

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

And additionally, we would expect that some of our smaller regional competitors will continue to be consolidating increasing the number of stores that we would be able to have in the U.S. by replacing those stores with our stores.

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**Operator**

The next question in the queue comes from Elizabeth Suzuki from Bank of America.

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

Actually, that was a perfect lead in to my question because I wanted to ask about further industry consolidations. I mean, how would you categorize the ability of some of your competitors to take share or -- in some of the trends in the last few years of share movement between the large chains, the smaller mom-and-pop operations, auto dealerships and online-only retailers?

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**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

Well, I'll start off, and then Tom and Jeff may have some comments. But what I would say is that the large chains, obviously, have advantage from the perspective that there's this immediacy of need of parts in our business, and we're the best positioned to provide parts to any market. And I think all of us are looking to expand by acquisition when and where it makes sense to do so. So I think clearly, that's an advantage. I think from an online perspective, we're positioned to dominate that over time if there is more of a transition on the DIY side to online simply because of the distribution networks that we have and the availability that we can provide for online purchases, which in many cases are going to be pick-up-in-store transactions. And Tom, I don't know if you have any -- you want to add to that or not?

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

No. Sounds good.

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

Great. And what percentage of the market at this point do you think is still not contained in the large chains that could potentially be up for potential acquisition?



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**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

When you look at the number of stores that are selling auto parts over the last 15 years, it's been relatively consistent at 32,000 to 34,000 outlets. So when you look at the top chains, we continue to consolidate the market, but we're a little less than 50% of the overall market at this point.

**Operator**

And the next question in the queue comes from Michael Lasser with UBS.

**Unidentified Analyst**

This is [Atul Maheshwari], filling in for Michael Lasser. Can you provide some color on the comparison to second quarter? I think April has an easier compare versus May and June. Is that right? And if compares are actually getting tougher over the balance of the quarter, what is giving you confidence on the 2% to 5% comp target for the second quarter?

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

Yes. April is our easier compare of the quarter. (inaudible) confidence is simply the condition of our industry, the gas price is down, miles driven and then, of course, the trend that we've been on for the past several weeks give us confidence in our ability to comp well throughout the quarter. We don't disclose our monthly comps, of course, but there is an advantage in April from a comparison standpoint as compared to May and June.

**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

What I would add to that is when we look at our guidance for each quarter and for the year, we're looking at a daily sales plan and obviously, April is the easiest compare. So our expectations are at the highest and we continue to do well versus our daily expectations for our 3% to 5% guide for the second quarter.

**Unidentified Analyst**

Understood. And as my follow-up, if we look at your result versus a competitor who recently reported, it does appear that the spread narrowed somewhat this quarter. So do you think you're not gaining as much share as you were in the past? Or can the narrowing of the spread this quarter be explained by other factors such as calendar mix or maybe just recent variance?

**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

I think we're still gaining share. What I would tell you is that some of our competitors don't report in the same periods that we report. So we internally look at our business comparing our sales to their period. And I think that, to some degree, paints a little bit of a different story. I think you also have to look at your stack with some of our competitors who have much easier comparisons to what we have. And then you also have to look at the makeup of their comp store sales and the -- and our competitors who have a substantial amount of job or business and how those comp store sales are calculated and so forth. So I still feel confident that we're gaining market share and over time, we'll -- this all plays out with our yearly comps and we'll see how that does.

**Operator**

The next question in the queue comes from Bret Jordan with Jefferies.



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

On that market share question, I guess you got a couple of competitors that seem to be doing relatively better than they were, and you guys are gaining share. Does it seem like that independent network that's just over 50% of the store base is losing share at an accelerating pace?

**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

I don't know if it's an accelerating pace. I know as we look at some of the companies that we've talked about buying and not bought and some of the companies that we have bought, there's definitely some pressure on some of the independent guys as we grow into their markets as some of our primary competitors have improved their ability to be successful on the do-it-for-me side of the business, which is the primary business that most of these independently owned shops. So yes, I think that many of them are under pressure as those of us that have larger have continued to grow and improve the go-to-market strategy.

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

Great. And then I guess, a question on the tax impact. And it really -- it's obviously impactful to DIY. Do you see any evidence that the DIFM business pushed back from tax refunds? Or is that consumer sort of higher socio-economic and could pay for the service anyway?

**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

It was more noticeable on the DIY side. I think that as you said from just a socio-economic standpoint, the do-it-for-me customer typically is not under the same pressure as the DIY customer. Many of which who choose to work on their own cars out of economic necessity as opposed to hobbyists and things like that. So yes, we see more pressure on the DIY side than we do on the do-it-for-me.

**Operator**

And sir, the next question in the queue comes from Seth Basham with Wedbush Securities.

**Seth Mckain Basham** - *Wedbush Securities Inc., Research Division - MD Of Equity Research*

Just following up on that question. If you think about the impact on DIY customer for the delayed tax refunds in February, how do you come to the conclusion that you don't do all of that delayed spending back in March?

**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

Well, I don't think we'd come to that conclusion. We just look at our daily sales and kind of how we compare to the plan that we had for the year. And the trend that we started on in March has continued to this point in April. But it's hard for us to know exactly what the drivers of our comp store sales results are. We just simply look back at what's happened and say, well, this could have been a factor, that could have been a factor. What I can tell you is that March we finished strong and April has been strong to this point. And based on the daily plan that we have, we feel reasonably confident that we'll be able to beat or exceed our plan for the remainder of the quarter, which is what we're trying to do every day.

**Seth Mckain Basham** - *Wedbush Securities Inc., Research Division - MD Of Equity Research*

Got it. And as a follow-up, different topic, omni-channel progress. Can you give us an update on things you've done to improve the site experience, average up-to-home times, pick-up (inaudible) in stores, et cetera?



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**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

Tom, do you want to take that?

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

That's an area we continue to focus on. We want to be able to interact with customers in the way they choose to reach out to us. We've got a way from talking about specific initiatives that we're working on. What we would tell you is we continue to enhance the engagement and our website continue to improve the knowledge that we're passing on the customers from a SKU availability look up and delivery time standpoint. Those are the key focuses for us as 2/3 of the business is pick-up-in-store. So people want to find out, do we have the part? If we don't have it -- well, do we have the part? What part do I need? When can I get it? Can I pick it up in the store? So those are the items that we continue to focus on.

**Operator**

The next question in the queue comes from Daniel Imbro with Stephens Inc.

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

Following up on that last question, on the omni-channel, it does seem like some of your peers definitely are also talking about investing more heavily into that channel. So can you talk about just the online competition. Has that changed at all from either the big chains getting more aggressive there or the online-only competitors? How are legacy online-only competitor responding to you guys' investments?

**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

Well, the legacy online competitors, obviously, their -- the thing they have to offer customers is that the price is typically, or in some cases, lower than what a brick-and-mortar price would be. This immediacy of need thing plays in, getting advice when you buy a part plays in. Just simply the helping people solve problems with their cars is really the business that we're in, in many cases. Our biggest opportunity, and the reason we are investing in this as our brick-and-mortar competitors is that so many people today use their phones to research before they make a purchase. And if we can provide our customers information that they might not be able to get from other sources and help them solve problems with their car, gather information about the part they may be buying, understand how to install the part and what tools it takes, those are all very important factors. And the relationships that we have with our customers, which the reason we're investing as much money as we are in this. The threat from pure online competitors, we don't see as being real significant from the perspective that there are so many parts stores in the U.S. and availability is so robust. And many of these products simply have to be bought same day if people want to drive their car that evening or the next day or whatever the case may be. So we feel like we're in a little bit of a protected business when it comes to pure online exposure, although our efforts and our competitors' -- our brick-and-mortar competitors' efforts are to simply be the best when it comes to content and exposing our availability and the information that they need to repair their cars.

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

Got it. That's extremely helpful. And then, Tom, on the gross margin outlook, I think in your prepared comments, you mentioned that you thought the tailwinds from selling through previously bought inventory would continue into the second quarter. But as we look at the back half and comparisons get more difficult, I understand transportation headwinds could get easier, but how should we think about the cadence of gross margin as we move through the remainder of 2019?



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

We would expect as we saw in the first quarter for our year-over-year growth to be more in the first and second quarters of the year and then to moderate in the third and fourth quarter. Based on that sell-through, we continue to work hard at making sure that we're optimizing our gross margin dollars on a daily basis. But year-over-year, we'd expect to be higher than the midpoint of our range in the second quarter and then moderating to come to our annual guidance.

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**Operator**

The next question in the queue comes from Zack Fadem with Wells Fargo.

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**Zachary Robert Fadem** - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

On the cost side in the quarter, could you talk through the drivers of the SG&A per store up 3%? And how much of this would you categorize as business as usual versus investment spending or maybe the Bennett acquisition? And then given the 2.5% to 3% guide for the year, how much should we expect that level to moderate as we move into Q2 and the back half?

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**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

When we look at our total SG&A spend for the first quarter, we're right on plan. When we talk about the growth level, yes, we decided last year to reinvest large portion of our tax savings into service-related items primarily technology and store payroll. So the first quarter we had an adjustment for some of the benefits that we offer that was a relatively large charge, but we haven't annualized those. What we would tell you is that there was a growth in per-store SG&A would be obviously the highest here in the first quarter moderating in second and third and fourth. That's all dependent on what happens in the -- with unemployment and wage rates, that is the biggest driver of the increase. And as we talked about in relation to inflation, that we're continuing to see inflationary pressures in our SG&A and seen a benefit for that in same SKU inflation.

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**Zachary Robert Fadem** - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Got it. That's helpful. And then just bigger picture, can we talk about the importance of national brands for your customers? Just given the competitive dynamics and rising price environment, are there any categories where your customers either Pro or DIY are shifting to your label brands versus national brands? Any thoughts there?

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**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

Well, I -- we've always viewed national brands or branded products as being extremely important, especially where there's a product difference. And that has been the case in many of the national brands where the product in the box is simply a better product or has some benefits that a private-label brand might not. What we do is we have multiple private label brands which are established as national brands. Some are brands that previously existed as independently owned brands by a supplier that were national brands and we over time have had the opportunity to acquire those brands and represent those exclusively at O'Reilly as national brands. So our strategy is simply that we want to carry the best products in our stores that provide the best service to our customers and give us the best opportunity to run a profitable business. And sometimes that's a brand -- a national brand that's not owned by us, sometimes it's a private-label brand that will represent as a national brand and sometimes it's a private-label brand that represents a significant cost advantage to our customers and would be an entry-level product that we would carry in our shelves and give them the option to trade up to a better product if they're looking for a better product and what our lower-end private labels might be.

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**Operator**

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

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**Gregory L. Henslee** - *O'Reilly Automotive, Inc. - Executive Vice Chairman*

Thanks, Michelle. We just want to conclude our call today by thanking the entire O'Reilly team for their continued hard work and delivering another solid quarter. And I'd like to thank everyone on the call for joining us today. We look forward to reporting our second quarter results in July. Thank you very much.

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**Operator**

Thank you. Ladies and gentlemen, this does conclude today's teleconference. Thank you for participating. You may now disconnect.

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