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# EDITED TRANSCRIPT

ORLY - Q1 2020 O'Reilly Automotive Inc Earnings Call

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**OVERVIEW:**

Co. reported 1Q20 results.





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

**Scot Ciccarelli** *RBC Capital Markets, Research Division - MD & Consumer Discretionary Sector Analyst*

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

## PRESENTATION

**Operator**

Welcome to the O'Reilly Automotive, Inc. First Quarter 2020 Earnings Conference Call. My name is Latif, and I will be your operator for today's call. (Operator Instructions)

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

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

Thank you, Latif. Good morning, everyone, and thank you for joining us. During today's conference call, we'll discuss our first quarter 2020 results and provide a business update on the company's actions in response to the impact for the novel coronavirus, COVID-19. 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 (technical difficulty) 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, 2019, 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.

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

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; and Greg Henslee, our Executive Vice Chairman, are also present on the call. Since we reported our fourth quarter 2019 results and set our full year 2020 guidance on February 5, it would be an understatement to say that the world has experienced a dramatic change with the onset of the COVID-19 pandemic.

As I begin my comments today, it's appropriate to start our discussion on the impact we have felt facing this uniquely challenging time in both the life of our country and for our customers and team members. First and most importantly, I want to express the profound gratitude I have for our dedicated team of hard-working professional parts people. Never have our culture values of dedication, hard work and professionalism meant more. Simply put, the parts and services we provide to our customers are absolutely crucial, whether that means health care providers, first responders, people working in essential industries, or everyday customers who rely on their vehicles to meet their family's basic needs.

Our dedicated team members in our stores, distribution centers and offices have demonstrated extraordinary commitment, flexibility and resilience in responding to the COVID-19 crisis by adjusting how we operate our business to keep all of our stores open to take care of our customers in the safest way possible. I want to thank each member of Team O'Reilly for your unwavering commitment to providing excellent customer service during these challenging times.

We've undertaken many measures during the course of the COVID-19 pandemic to promote the continued health and safety of our customers and team members, while keeping all of our stores open to service our customers. From the beginning of the response to COVID-19, our industry was deemed to be an essential service in the executive orders that have been issued by the various governmental entities, including the federal memorandum issued March 16. Since that time, we have closely monitored and adapted to the evolving information, recommendations and requirements issued by the Centers for Disease Control and Prevention, World Health Organization and state and local governmental agencies.

The extensive actions we have taken company-wide include significantly increased cleaning and sanitation efforts, the implementation of social distancing practices and the ongoing adjustments of those practices as new recommendations and regulatory guidelines have been issued. We're providing our team members with necessary personal protective equipment and are working hard to continue to replenish supplies, despite challenges in sourcing these products. We have also put in place programs to relax attendance policies as well as advanced sick time to help team members who are sick or need time away to support family members. In addition to all these steps, we have also implemented measures to change how we interact with our customers in our stores, which Jeff will cover in more detail in his prepared comments. As a result of these efforts, all of our stores remain open with only limited disruptions for temporary closures in a few instances where we have determined more extensive cleaning was warranted.

Now I'd like to provide a little more color on the cadence of our sales in the first quarter and the impact we began to see as a result of COVID-19. As noted in our earnings release, sales in January were below our expectations due to the mild winter weather with headwinds in categories such as batteries and antifreeze and that weather headwind persisted in February. As we entered March, sales results strengthened in conjunction with the onset of spring weather, and we were anticipating a solid finish to our quarter. We saw these solid sales trends until the COVID-19 stay-at-home recommendations and orders began to be issued in the middle of March.

Within a short period of time, these orders took effect across virtually all of our market areas, resulting in a somewhat similar headwind throughout our store base. As we noted in our release yesterday, the negative impact caused by COVID-19 beginning in the middle of March and extending through the first 2 weeks of April resulted in a decrease in comparable store sales of 13% for that 4-week time period. The lack of beneficial harsh weather and the significant impact of COVID-19 in the last 2 weeks of March drove our comparable store sales decline of 1.9% in the first quarter.

Sales over the past week have reflected a benefit from the receipt of our customers of economic impact payments under the Coronavirus Aid, Relief, and Economic Security or CARES Act. However, we are uncertain as to the magnitude and duration of this benefit we will receive from these onetime stimulus payments and as a result are being cautious on how we plan for our business moving forward. The composition of our comparable store sales growth for the first roughly 2.5 months of the quarter was similar to the trend we have seen for several quarters with our professional business outperforming our DIY business, driven by continued strong performance in key undercar hard part categories. Likewise, average ticket increases continue to drive our comp results, in line with our expectations as ticket counts were pressured in January and February as a result of the mild winter weather.

As we began to face the headwinds from COVID-19 in the middle of March, we saw pressure on both sides of our business as consumers sheltered at home and miles driven was pressured. However, the impact was more severe for our professional business as we believe the demographics served by our professional customers is more likely to accommodate working from home than a typical DIY customer. The escalation of the COVID-19 crisis and the severity of the slowdown in demand in our business at the time of our first quarter was obviously unanticipated -- I'm sorry, at the end of our first quarter was obviously unanticipated, and a significant impact on our operating profit and earnings per share results, both of which fell below our guided ranges. However, with an operating profit in excess of 17% of sales, we remain solidly profitable.

As the duration of this challenging environment is unknown, we have taken prudent steps to ensure the continued stability and financial flexibility of our company, including appropriate actions to reduce costs, preserve cash and ensure adequate liquidity, which Jeff and Tom will discuss in more detail in their prepared comments. We are confident in our ability to protect the financial health of our company as we navigate through the current challenging environment. But we also recognize that we operate a business with a high fixed cost structure, and we'll continue to see pressure to SG&A and operating results in the short term.

For the quarter, our gross margin of 52.3% was below our expectations as we saw deleverage of fixed distribution cost and a negative mix impact from the sluggish sales of higher-margin cold weather items. Outside of mix differences, product margins continue to be as expected and the pricing environment remains rational. As we reported in our press release last night, we have withdrawn our 2020 operating cash flow and capital expenditures guidance as we continue to evaluate and adjust to the current environment. This isn't a step we've taken lightly. But simply put, we just don't know how long the current crisis will last or what the road ahead will look like as each of the communities we serve navigates the ongoing crisis and begins to plan the reopening process.

While we feel that withdrawing our guidance is the prudent decision because of the significant uncertainty of the current environment, we believe even more strongly that our industry and our business will rebound successfully and return to robust growth as we exit this crisis. The challenges presented by COVID-19 are unique and that they have temporarily changed consumer behavior. However, these changes are not structural or permanent, and we will come out of this public health crisis position for future success.

While the lasting impact of economic damage could persist well after the more restricted stay-at-home measures are lifted, we are well positioned to rebound quickly and return to solid growth, even if the broader economy is still under pressure. A significant majority of the demand in the automotive aftermarket is nondiscretionary in nature as the parts we supply to our customers are necessary for the operation of their vehicles. Historically, we have performed well in different macroeconomic environments as consumers defer the purchase of new automobiles and invest in maintaining and repairing their existing vehicles at higher mileages. And we believe our ability to keep all of our stores open and operating positions us well for the economy -- as the economy begins to reopen.

As I wrap up my prepared comments, I want to again thank Team O'Reilly for their resolving commitment to our customers. This current crisis is unlike anything any of us have seen in our careers, but I am extremely proud of the resilience of our team and their willingness to go the extra mile to take care of our customers, especially now when it matters so much.

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

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

Thanks, Greg, and good morning, everyone. I'd like to begin my comments today by echoing what Greg has already said about the great contributions of our team over the last several weeks in responding to the COVID-19 crisis. Our team of professional parts people in our stores, DCs and headquarters have a long track record of selflessly responding quickly in times of natural disasters, including hurricanes, tornadoes, wildfires and many, many other challenging situations. While this is certainly an unprecedented public health crisis, I see the same resolve and steadfast commitment in all the efforts our team has taken to respond to COVID-19 and keep taking care of our customers. I'm extremely proud and grateful of the sacrifices our team members have made to keep our stores open and operating to meet our customers' critical needs during this crisis.

Excellent customer service has always been at the core of our culture. And if you've ever spent much time in one of our stores, it's easy to see how we -- highly with you rolling up our sleeves, interacting with our DIY customers at the parts counter or with our professional customers in their shops. In light of the information and recommendations by the CDC, WHO and other public agencies, we've taken extensive actions to adjust our operations to make sure our interactions with our customers are as safe as possible.

Inside our stores, we've added signage, counter markers, floor markers and other measures to facilitate maintaining the recommended distance. We're leveraging our omnichannel investments by enhancing our Buy Online, Pick Up In-Store functionality to include curbside pickup, which has been very well received by our customers. We've also modified store services, such as battery and check engine light testing to ensure appropriate social distancing. For sure, the changes we've made to our business to protect the health and safety of our customers and team members has changed the way we interact with our customers, but we're extremely pleased with how well our teams have adapted to the guidance and still provided excellent customer service.

Just as we made adjustments to how we interact with our customers, we've also begun to take the difficult steps to adjust our operations and reduce costs to respond to the lower level of business we've seen as a result of COVID-19. As we began to see the impact across our markets in March, we started to more aggressively manage our store payroll and staffing levels. We also implemented a reduction of store operating hours and began closing most stores at 7:30 p.m. versus the normal closing time of 9 or 10:00 p.m. While we don't like the inconvenience to our customers of an earlier closing time, we felt this was an appropriate move to more effectively deploy payroll and operating costs, given the changes we saw taking place broadly across retail.

We've also reduced distribution and headquarter expenses to bring them more in line with the lower sales volumes. The combined steps we took in March to prudently manage our expenses resulted in keeping our SG&A per store flat, after excluding the impact of an extra day in the quarter from week day and a positive year-over-year benefit related to deferred compensation expense. However, the combination of the significant sales shortfall occurring late in the quarter and the degree of fixed cost in our cost structure drove a deleverage of first quarter SG&A expenses of 61 basis points versus the first quarter of 2019. We saw this pressure despite the deferred comp benefit of 33 basis points, which has an offsetting headwind in other expense.

As we've discussed many times in the past, we do everything we can to manage our business for the long run to ensure we're providing the exceptional customer service and building strong relationships with our customers, which pays off in repeat business in good times and bad. We will not change these core fundamentals of our business, and the consistency of our service to our customers has been and will continue to be the driver of robust growth and profitability for our company. However, as the current crisis has extended well into April, we've continued to take aggressive steps to manage our cost structure in response to the sales pressure we're experiencing.

While these steps may not prevent us from seeing continued deleverage of SG&A expenses, if current conditions persist, we remain highly confident the adjustments we're making both preserve our company's financial strength and position us to return to our long track record of industry-leading profitable growth. We're also reviewing our capital expenditure plans in all areas of our business to ensure both continued stability and financial flexibility as well as strong returns on our investments. Through the first quarter, we opened 73 net new stores, and we're well on our way to our target of 180 net new stores in 2020.

As the measures to combat the spread of COVID-19 have been implemented, including restrictions on travel and various other services, we've begun to see delays in the development schedules of new store properties slated for opening in 2020. Additionally, we're being very judicious about how we're proceeding forward on new store development in a period of such significant economic uncertainty. Both of these factors make it unlikely we will open our previous target of 180 net new stores. So at this time, we're also withdrawing our 2020 new store guidance.

Our #1 priority in opening a new store is to be able to identify a great store team and equip that team to provide excellent customer service from day 1. We will monitor conditions in our planned development markets and make adjustments as we move forward to ensure that we're achieving that priority. On the DC expansion front, we successfully opened our newest distribution facility in 11 in Lebanon, Tennessee, an eastern suburb of Nashville on March 9. Nashville and its surrounding markets have been very strong growing markets for us, and the additional capacity in the new 408,000 square foot facility will allow us to take advantage of continued profitable growth in the region and accommodate a broader SKU capacity to provide an even better breadth of hard to find parts to our stores in this market.

The Nashville team did a great job getting up and running without missing a beat, and we're extremely proud of the excellent team we have in place, providing outstanding, enhanced customer service. As we have with our new store development, we're continuing to evaluate the development schedule for our other major distribution project, our new facility in Horn Lake, Mississippi, just south of Memphis, which was slated to open in the fourth quarter of 2020, but will now likely be pushed into 2021. At this stage, it's too early to tell what impact or potential delay we'll see as we move forward, but we will make the appropriate adjustments as conditions change to ensure we have a successful completion of this project.

Outside of new store and DC growth, we're also taking a cautious approach in scrutinizing other planned capital projects for 2020. As we discussed when we outlined our plan for capital investments on our last earnings call, we have several exciting projects and initiatives, which will enhance the service we provide to our customers and drive strong returns. The ultimate opportunities presented by these projects hasn't been diminished, and we will continue to move forward, where appropriate, including our initiative to convert the hardware that runs our stores.

In other instances, we will monitor our business and resource needs, and we're electing to defer certain projects for a period of time to ensure a successful rollout. The strength of our business and the consistency of the cash flows we generate allows us the ability to weather a storm like the one we're in right now. without having to make drastic and severe cuts to our operating and capital plans. This type of financial flexibility puts us in a solid position. But we remain committed to being good managers of our shareholders' capital, and we'll make prudent decisions to ensure continued financial strength. To close my comments, I'd like to again express my deep appreciation to Team O'Reilly for your hard work, dedication and commitment to meeting our customers' needs during these challenging times.

Now I'll turn the call over to Tom.

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

Thanks, Jeff. I would also like to thank all of Team O'Reilly for their hard work and dedication to taking care of our customers in the midst of this extremely difficult environment.

Now we'll take a closer look at our quarterly results. For the quarter, sales increased $66 million, comprised of $44 million decrease in comp store sales, a $52 million increase in noncomp store sales, a $34 million increase from Leap Day, a $26 million increase in noncomp nonstore sales and a $2 million decrease from stores permanently closed in line with our 2020 plan. For clarification, these store closures were planned and are broken out consistent with our past reporting practices. As Greg previously discussed, we have withdrawn all 2020 guidance.

Our first quarter effective tax rate was 20.9% of pretax income, comprised of a base rate of 21.8%, reduced by a 0.9% benefit for share-based compensation, both of which were better than our expectations. This compares to the first quarter of 2019 rate of 22.5% of pretax income, which was comprised of a base tax rate of 24.5%, reduced by a 2% benefit for share-based compensation. The first quarter of 2020 base rate as compared to 2019 benefited from solar tax credits, which were in line with our expectations in total dollars, and drove a lower effective tax rate on pretax income that was below our expectations. Changes in the tax benefit from share-based compensation can create fluctuations in our quarterly tax rate, and we continue to expect our rate for the remainder of 2020 to be lower in the fourth quarter as a result of the totaling of certain tax periods.

Now we'll move on to free cash flow and the components that drove our results for the quarter. Free cash flow for the first quarter of 2020 was $227 million versus $279 million in the first quarter of 2019, with the reduction driven by lower pretax income and investments in solar projects, offset in part by lower credit card receivable balances compared to the same time in 2019. The investment in solar projects generate investment tax credits, which will benefit cash taxes paid in the remainder of 2020, but the timing of these investments can create unevenness in our quarterly cash flows.

Inventory per store at the end of the quarter was $643,000, which was up 1.6% from the beginning of the year and up 5.6% from this time last year. The increase reflects the additional inventory investments we have planned for 2020 as well as increases resulting from soft first quarter sales. Our AP to inventory ratio at the end of the first quarter was 105.7%, which was above our expectations and the 104.4% we finished 2019. Finally, capital expenditures for the first 3 months of the year were $133 million, which was down $20 million from the same period of 2019, driven by the prior year level of investment in new distribution projects versus the first quarter of 2020. As Jeff previously discussed, we continue to monitor the impact of COVID-19 and will adjust our CapEx plans as appropriate given the environment.

As the COVID-19 crisis worsened and we began to see pressure to our operations in the middle of March, we took appropriate steps to preserve capital and liquidity, including drawing down $250 million on our line of credit and holding that balance in cash. We were also very pleased to further strengthen our liquidity position through the successful issuance of a $500 million 10-year senior note at a rate of 4.2% on March 25, in the midst of a market challenge by the COVID-19 crisis. We finished the first quarter with an adjusted debt-to-EBITDAR ratio of 2.59x as compared to our ratio of 2.34x (sic) [2.24x] at the end of 2019 and above our stated leverage target of 2.5x. Excluding the incremental borrowings, we elected to hold in cash at March 31, our leverage ratio was 2.49x.

As a further step to conserve liquidity, in the middle of March, we temporarily suspended our share buyback program. Our year-to-date repurchases prior to this decision totaled 1.5 million shares at an average share price of $386.71 for a total investment of $574 million. As of yesterday, we had $1.1 billion of total liquidity in cash and available borrowings under our $1.2 billion revolving credit facility, and we feel we have ample liquidity under this existing facility. As we evaluate our liquidity, leverage, use of capital and share repurchase program moving forward, we'll continue to prioritize maintaining our strong financial position, including the investment-grade rating on our public debt. We have a long history of conservatively managing our balance sheet, and we'll continue to take prudent steps to ensure the long-term health and stability of our company.

Before I open up our call to your questions, I'd like to thank the O'Reilly team for the resilience they've shown over the last several weeks and for their continued dedication to our company and our customers.

This concludes our prepared comments. At this time, I'd like to ask Latif, the operator, to return to the line, so we'll be happy to answer your questions.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Greg Melich from Evercore ISI is on line with a question.

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**Gregory Scott Melich** - *Evercore ISI Institutional Equities, Research Division - Senior MD*

My core question is on the actions to both reduce costs and position the business to help customers and associates. How should we think about the variable margin of the business as you are getting into that position? I'm thinking that it's probably around 40%, if we look back to prior downturns. I just want to see if you still think that's a fair benchmark. And then I had a follow-up.

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

Tom, do you want to take that one?

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

Greg, this is a situation that we haven't seen before with miles driven significantly down, people staying at home, something very unusual and the sales are down much more than we've experienced in the past. As Greg talked about in prepared comments, we have a very high fixed model when you look at multi locations opened from 7:30 in the morning till 7:30, 8, 9, 10 at night. We have to staff all of those hours. So given that, we have a high fixed model, and we're seeing a pretty significant reduction in sales. We would expect to have more pressure and more of a negative -- less of a positive flow through on those sales. So we'd expect it to be a more restrictive number.

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**Gregory Scott Melich** - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Got it. So more than 40% is -- would be reasonable just given the nature of this downturn being so unique?

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

Yes.

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**Gregory Scott Melich** - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Got it. And then the follow-up would be on the uniqueness of this. What are you guys seeing in terms of -- you mentioned that geographically across the stores, it's pretty similar. Have you seen any change in terms of potentially less urban or more rural stores behaving differently? I'm just thinking about where there might still be movements of activity given that miles driven are probably down 40% or 50%. Anything on that would be helpful.

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

Jeff, do you want to take that?

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

Yes. Greg, as we mentioned in the prepared comments, we really didn't have much of a winter in January and February. So our cold weather market started off pretty slow. And then business picked up in the first half of March that we talked about, and then the COVID pandemic really hit. And with 90% of the population really all across the country understand home areas, impact was fairly widespread across all of our chain. The one thing that I would say in general is that the large metro markets appear to have been impacted to a greater degree than the rest of the markets in our chain, and we assume that would be driven by the better adherence to the stay-at-home orders.

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**Operator**

We have a question on line from Scot Ciccarelli of RBC Capital Markets.

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**Scot Ciccarelli** - *RBC Capital Markets, Research Division - MD & Consumer Discretionary Sector Analyst*

Are you guys able to provide us with at least a general range of what your profitability was during that 4-week period where you posted a negative comp of about 13%, I guess, kind of a derivative on Greg's question?

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

Well, first of all, it bridges accounting periods, but we don't give profitability metrics on short periods of time. What we would say to echo the comments we made regarding Greg's question is that the negative flow through will be higher because we have to staff the stores for the hours open, and we'll see quite a bit of SG&A headwind, given a negative 13% comp run rate.

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**Scot Ciccarelli** - *RBC Capital Markets, Research Division - MD & Consumer Discretionary Sector Analyst*

Okay. All right. I got it. Just -- I'm sorry. That's okay.

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

Obviously, that depends also on what the sales look like for the rest of the quarter and how many miles are driven. But given that rate, it will be a significant headwind.

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**Scot Ciccarelli** - *RBC Capital Markets, Research Division - MD & Consumer Discretionary Sector Analyst*

Got it. Okay. And then I guess a follow-up question then is, just given kind of the magnitude of impact on your industry with the miles driven being down, you think this could lead to a more aggressive M&A posture from O'Reilly? Or is that just not where your heads are at, at this point, given the current downturn in business?

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

Scot, we -- as a company, we always look for strategic acquisitions. And right now, it's really no different. I wouldn't say we're focusing any more or any less on looking at strategic acquisitions. Frankly, we've been really business -- we're all really busy running the business and coping with what's going on, but we would certainly be open to looking at strategic acquisitions, if any of them presented themselves.

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**Operator**

Our next question on line is from Simeon Gutman of Morgan Stanley.

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

My first question more of a -- first, more of a housekeeping. The -- through mid-April data point that you provided, does that include the stimulus period? And then the minus 13% broadly, it sounds like the back half of March was weaker, and we've seen improvement. Can you share how different the weeks in April have been so we can have a sense to glean on how to think about the world going forward?

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

Yes. We're not going to quantify that, but I'll kind of walk you through the quarter with a little more color than what I did in prepared comments, Simeon. As we said, we started the quarter very similarly to where we commented back in February. January, mild winter that led into February. Comps for both January and February were positive. Although they didn't meet our expectations, they were both positive. Then we moved into March and in the first couple of weeks of March, things improved. Weather improved. Sales were more typical of what we would expect to see with normal weather patterns in our business. So we saw improvement in the first 2 weeks. And then the middle of March, when COVID really started to present itself and stay-at-home and shelter-in-place orders were issued. For that next 4-week period, we saw consistent negative comp trends fairly consistent across all 4 of those weeks. And then over the past week, once the stimulus checks have started coming out, checks and electronic payments, we've seen improvement over those prior 4 weeks.

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

Simeon, this is Tom. To add to that, the reason we picked the last 2 weeks of March and the first 2 weeks of April were the performances were pretty consistent. Stay-at-home orders and companies converting people to working at home was pretty consistent. We want to give you what the baseline was. As Greg talked about, we have done better since the stimulus checks were issued, but we are uncertain the duration of that benefit.

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

Got it. Yes, that's really helpful. I guess I'll put my question and just maybe a reaction to that, if I understood it properly, because miles driven, seems like it's down significant, not to be able to figure it out by market, but who knows maybe 40%, 50%. It implies that pre stimulus then your business was run rating at a much, much healthier rate than that. I think it's -- you're implying minus 13% before stimulus, which is quite decent. So I know, Greg, it is prudent to be cautious, which is how you laid it out. And it's hard to think about pent-up demand here versus what stimulus is going to do. But does the minus 13% inform you at all relative to that -- the degree of miles driven that there is maybe more insulation here than you would have thought? Or I don't know how you think about it.

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

Yes. Well, what we're uncertain now is how much of the improvement is related specifically to the stimulus. We feel like a significant amount of the improvement we saw over the prior 4 weeks was stimulus related. As time goes on and these stimulus checks and the money runs out, we'll just have to see how our performance does over the next few weeks. And it's unknown what future stimulus will hit and the timing of that. So we're being very cautious and conservative as we look forward.

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

To add to Greg's comment, the stimulus checks hit, in essence, a week or 10 days ago. We didn't want to include that in our comments because we're not sure of the duration. From a miles driven standpoint, we haven't seen the national data on that yet. I know there's a lot of assumptions out there on the gas usage of calculating miles driven, but that hasn't been always a great indicator for us. What we also tell you is that there are a lot of auto parts that are sold by somebody that's not O'Reilly. And our opportunity is to go out and make long-term relationships with customers and gain more market share. Our goal has always been to never settle for what the industry growth rate is, but to go out and earn additional market share growth beyond that.

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

And I want to add word on that is that's why we've done our best to keep all of our stores open in all of our local markets. And maybe that was with the skeleton crew, but at least we kept the doors open to be there for our customers.

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**Operator**

Our next question on line comes from Michael Lasser of UBS.

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

So the large aftermarket players have put a lot of emphasis on miles driven as a key factor that drives the industry. As you look out over the next 9 months, what's going to be more important to determining demand for the aftermarket, miles driven or the fact that many consumers are going to be under economic pressure and new car sales are likely to be weighed down, which matters more?

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

Yes. Michael, great question. I think it's all of the above. The biggest driver in our industry continues to be miles driven. That's what causes breakage, wear and tear, more maintenance cycles on vehicles. So I would add more weight to that. Obviously, this period that we're approaching more so than normal. There are other factors that you mentioned that would impact that. But I would say that miles driven would be the most significant. As I said in prepared comments and we comment on frequently, most of our purchases in our industry are nondiscretionary. Most of the people come into our stores to buy parts, to repair or maintain their vehicle. They just really don't have a choice. Whether it's getting their kids to school or getting themselves to work, they have to have their vehicle. So because of being nondiscretionary in nature, economics definitely plays into this, but consumers have historically done a good job of prioritizing their spending on a weak economy, and our industry has performed well. So I think the single most important factor would continue to be miles driven.

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

If you look back to the recession in 2008, 2009, what categories did you see the biggest acceleration? And would those be the leading indicators for how the next few quarters could unfold? And also, could you add a comment on what you expect inflation or deflation for the auto aftermarket is going to be through the back half of the year?

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

So when we look back at 2008, not surprising as people determine they were going to keep their vehicles longer, want to maintain their roadworthiness, key drivers were hard parts. Vehicles were -- people want to keep their vehicle, maintaining it on the road well. It wasn't a dress up, wasn't in performance. It was those key hard parts. The second question was -- can you repeat the second question? I'm sorry, Michael.

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

What's the outlook for inflation or deflation as you move through the next few quarters, Tom?

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

Sorry about that. Yes. So our expectation is unchanged. We had anticipated no inflation -- no new inflation, and that we would be anniversarying increases from the tariffs from last year. So same expectation.

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**Operator**

Our next question on line comes from Brian Nagel of Oppenheimer.

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

So the first question I have, I guess, a relatively simple one, but you had mentioned in your prepared comments not surprising that the DIY business here is performing better than the commercial DIFM business. Could you give us some more details as on how that's -- how large of spread between the 2 sides of your business is currently tracking?

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

Yes. What we said is that, first of all, we're not going to break out what the spread is between those 2. But we have seen less pressure on the DIFM side over the past week or so, as we called out in our comments. And we think a lot of that is because of the consumer that is the typical DIFM customer is probably more able to work from home and driving fewer models than perhaps that DIY customer might be. Tom, do you want to add to that?

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

In the last week or 10 days since we've seen the stimulus checks, we've seen those -- both sides of the business improve. We would tell you that the DIY has -- over this period of time since the significant outbreak and the crisis has gotten worse has performed markedly better.

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

Okay. Got it. And the second question I have, going back to echo the comments someone else made in their question, which was, if you look across retail, down 13%. You talked about the mid-March to mid-April while not consistent with normal O'Reilly practices is actually not bad at all relative to a lot of retailers out there. As you look at the makeup of your business, to what extent is O'Reilly benefiting right now from new traffic, new customers coming to the store, potentially reflecting dislocations within the broader retail landscape? And to the extent that it is happening, how do you think about the retention of these customers, once the pandemic or the crisis begins to abate?

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

So I guess the first thing I'd say is any time we put up a negative comp quarter, it happened so rarely, it doesn't feel very good, despite the comparisons. On the traffic, it's very hard to determine. We can look at some of our O'Rewards data because -- and we can look at that over a period of time to see how many new customers we sign up. And when we look at our shops because their business is suffering, it's hard to know if you're losing more or less than the other numbers they have on the line and whether you're moving up the call list or not. Ultimately, we feel good that we've been able to keep our stores open and perform comparatively well. Over time, we feel like those customer interactions where we get a new customer in the door because the parts store that they normally go to hasn't been open that we're going to provide great customer service, and that's going to be sticky. Same thing on the professional side, which we know for sure from past experience.

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

Yes. Brian, I would add one thing to that. Our -- most of our e-commerce business does result in that customer coming to our store as Buy Online, Pick Up In-Store. Over the past several weeks, we have increased functionality there to roll out buy online ship to store functionality, which opens up our supply chain to provide often same-day service to our stores, either from a distribution center or a hub store nearby. So we've added that functionality and our e-commerce sales have picked up, especially on the pick up in-store side.

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**Operator**

Next question on the line comes from Chris Horvers of JP Morgan.

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

So my question is on the gross margin line. So can you talk a little bit about how lapping tariff price increases played out? Did that end up being a headwind and related to that LIFO? And did Mayasa end up being a headwind to your gross margin rate? And while you've pulled guidance, as you think about all the puts and takes of what you're seeing so far, any comment on the gross margin going forward?

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

Well, I've seen the tariffs has played out as we expected. On our last call, when we laid out our gross margin guidance at the time, LIFO was more of a headwind. This year, we're not seeing as much of a benefit as we saw last year. But that, again, is tracking as we'd expect. As we talked about on the call last time, Mayasa runs a big independent jobber business. So they're selling to other part stores. So they have a lower operating cost, but also lower gross margins. So that's a drag also. When we look at our gross margin for the first quarter versus our expectations, it's really less high-margin winter items and then we have a relatively high -- we have quite a bit of high fixed cost in our distribution center, when you look at management, occupancy and routes that we run transportation. So when our volume is down, that's going to be a drag.

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

Yes. To add a little more color in distribution to what Tom said. The fixed cost, as Tom said, they are going to be a drag on low volume. One of the uniquenesses of the timing of the impact of the virus to us is it's in a period of time where we're ramping up for spring volume. So if you look at a distribution center and you look at the labor in the distribution center, you got to look at the inbound side -- inbound volume as well as the outbound volume. So over the past several weeks, our inbound volumes have been higher as a result of ramping up for the spring season, while our outbound volumes have been softer. So the DCs have been impacted and you would think that they would be able to reduce hours and cut some labor. They haven't been able to do that as much as you might think because of the inbound volume in keeping up the spring inflow of product.

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

Got it. So basically the 1Q gross margin played out as your thought sans the sort of top line impact. And so it's a good guide going forward. And 2 quick follow-ups -- 2 follow-ups. One is, what was the inflation impact the comp in the first quarter? And then just big picture, the 2009 analogy. How would you compare the puts and takes to what occurred back then? The peak repair factor seems like weather was better, the new car sales dropped off, sort of, sustained dropped off was much bigger. But then on the other hand, you've got higher share now. Your smaller players are probably suffering capital pressures, and there's 15,000, 16,000 small shops out there to take share from, but you don't have the dealers closing. So a lot of puts and takes. How are you thinking about that in comparison to that '09 time frame?

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

Yes. So I'll take the first part and then I'll let Tom speak to the inflation question. Chris, a lot of things are similar, and then there are some things that are definitely different. When we went through '08, '09, there was a lot of things we called out that were drivers. We talked about the SAAR. We talked about miles driven. We talked about Hispanic hibernation and other things. The one thing that's unique about the situation we're in now is the fact that the potentially dramatic impact to miles driven so far. With all of the stay-at-home orders, consumers have just not been driving their vehicles at all in a lot of markets. So miles driven we feel like is going to be significantly drawn down. We think that was a driver of a lot of the negative impact to our first quarter results. And it really just depends on how this thing plays out. Miles driven is going to be a key factor in what our business does going forward. And it really just depends on the timing of when the stay-at-home orders are released and people are able to go back to work and get back to their normal lives.

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

On the inflation, it was a little over 2.5%, which is pretty much exactly where we expected it to be, all driven by anniversarying sale price increases from last year -- really to last year's tariffs. We'd expect that to be the highest number of the year and to decline as we anniversary the last year's tariffs.

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**Operator**

Our next question on line comes from Bret Jordan of Jefferies.

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

Quick question. I guess when you think about the payables programs and, I guess, leverage ratio is likely to go up as EBIT comes down in the coming miles driven contraction. Do the banks get any more, I guess, or less credit available or higher rates on the payables programs in the next couple of quarters? Or is that pretty well understood if you want off and worked out?

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

So our vendor financing program is primarily akin to what our rating is. And our expectation is that, that will not change, and we'll be very conservative in our balance sheet, although we will see pressure from a operating standpoint, given the current environment. We generate a significant amount of cash, and we expect to be able to very effectively manage our leverage ratios.

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

Great. And then I guess a question as far as the broader industry. Obviously, a lot of doors, when you think about independent distributors and all. Do you think that we're going to see meaningful contraction in the total number of doors, just given the magnitude and the abruptness of this decline, independents or buying group members that may go away?

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

Bret, I really don't think we've got a good feel for that yet. We've got -- when you look at the shops that are out there, a lot of those shops are strong financially. When you look at a layer above that, the WDs, those guys are strong financially. I think it would be naive to think that there wouldn't be some doors closed throughout all this. But I just don't think at this point, we've got a scope -- an idea of the scope or the magnitude of that.

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**Operator**

Next question on line comes from Daniel Imbro of Stephens, Inc.

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

I wanted to ask -- and apologies. I hopped on late. Sorry if you discussed this in your remarks. But have you seen an uplift in sales through your online channels relative to the last few quarters as we've seen this work-from-home environment? And if so, has it exposed any weaknesses or area that need investment in your infrastructure? Has it given you guys any new learnings around where future investments could drive incremental sales on the online side?

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

Yes, Daniel. So we -- I did say earlier that we have seen improvement in e-commerce sales, although it's still a very, very small percentage of our total sales. Throughout the last several weeks, the stay-at-home orders clearly have driven more consumers to shop online. The one thing that hasn't changed during that process is how those customers are buying from us. Consistently, over the years, customers have erred to the side of -- even to forgo discounts to Buy Online, Pick Up In-Store, and that just speaks to the urgency of need in our industry. And we've seen an uptick in sales, but we haven't seen a change in those buying habits. And that most of those purchases do resolve in the team -- or the customers coming to our stores. We have advertised our curbside delivery. And I think that's been very popular with a lot of consumers that just are not comfortable going in and socializing with people during this pandemic. So we have done a lot of business through that channel. But most of our volume continues to be -- our e-commerce volume continues to be Buy Online, Pick Up In-Store.

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

Got it. That's helpful. And then just a follow-up on the working capital question earlier. Tom, as we look at the balance sheet, inventory did grow pretty meaningfully. Can you help us parse out how much of that was the proactive $100 million inventory investment you had planned for this year? And any early signs that, that is helping gain incremental share? Can you parse out the impact that's having on the rest of the P&L?

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

So about half of it was the additional growth that we planned for this year and half of it was -- we just didn't move as many winter goods and end of spring, as Greg talked about, the inbound keeps coming. So we're planning for business, and it was very rough going the last 2 weeks. As far as are the additional SKUs making a difference, that will take time to determine. And there is so much disruption out there in the market right now that, that is -- clouds everything else from a testing perspective.

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**Operator**

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

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

Thank you, Latif. We'd like to conclude our call today by thanking the entire O'Reilly team for their continued selfless dedication to our customers. I'd like to thank everyone for joining our call today, and we look forward to reporting our second quarter results in July. Thank you.

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**Operator**

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

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