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ORLY - O'Reilly Automotive Inc at RBC Global Consumer & Retail Conference (Virtual)

EVENT DATE/TIME: MAY 28, 2020 / 3:00PM GMT



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PRESENTATION

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

Hello, everyone. This is Scot Ciccarelli, senior hardline broadline analyst at RBC, once again, thanking everyone for taking time out of their schedule to dial in to day 2 of our virtual consumer conference. I think we had a very productive day yesterday. And we're not done. We still have a large number of corporate partners and expert panels to go.

With us for this session, we have the senior management team of O'Reilly Auto Parts, including CFO, Tom McFall; Senior VP of Finance and Controller, Jeremy Fletcher; and Director of Financial Planning and Treasury, Eric Bird. Guys, really appreciate the time that you're providing us today as well as our investment partners.

QUESTIONS AND ANSWERS

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

Tom, you and I have known each other for a long time. You've been in the auto parts business even longer. Auto parts has always been a pretty steady business. You don't tend to see massive fluctuations. But have you, in your career, ever experienced the kind of swings in business as what you guys saw in the first quarter?

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

This has been a once-in-a-lifetime, hopefully, experience, and we have not. From normal business in the beginning of March to the beginning of shutdowns, both on a government level and a company-by-company level, we saw a dramatic drop-off in business. And as we talked about on our call, when the stimulus checks went out, we saw business come back as people made up for lost time, and the swings have been significant.

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

Can you help people better understand the magnitude of swings? I mean I know you provided some color previously about the down 13% comp for that 4-week period. But was the middle part of that even worse? Or was it all kind of went down 13% and just kind of stayed there?

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

Well, we were running -- we kind of looked at the first quarter, January and February, below our expectations as we didn't have much winter weather. As spring broke in the beginning of March, business was strong. As the pandemic widened and started on the West Coast, and it wasn't just where the government issued stay-at-home orders, companies were taking proactive steps across the country, we saw business slow down dramatically middle of March through our call in the middle of April. And we were pretty consistently down the 13% we reported on a week-by-week basis.



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

Yes. Yes. Understood. And I think we've certainly heard from you as well as your competitors, definitely, a larger impact on the commercial business. I guess the question is, as business start to recover kind of as the stimulus checks went out, did they both kind of -- did DIY and commercial both come up a similar ramp? Or was there some sort of widening or narrowing in that relative performance?

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

We talked about it on our call, the business improved on both sides but more on the DIY side as we believe that our professional customers and user tend to be consumers who can telecommute more easily than the average DIY consumer.

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

So as we continue to kind of open up the states, I mean would your expectation be, let's call it, a greater ramp from the commercial side? Or would you expect the work-from-home mandate to still kind of overrule that, and you're kind of stuck with -- or not stuck with but encountering better DIY than commercial sales?

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

Well, Scot, this is unprecedented times, and we'll have to see how everything rolls out. I think it's too early to tell what the ramp-up looks like of both sides of the business and how long it's sustained.

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

Okay. You had -- but I mean, I can say I don't really know, but you guys have to plan your business around it. So I mean you have to have -- I would think you would have some sort of at least speculation or plan. Or is it purely just kind of playing the reactive game?

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

Well, as we said on our last call, business got better when the checks got issued, but how sustainable that is, is uncertain. So given that we know the business picked up dramatically when the checks were issued, it would be difficult to just assume that, that was going to continue to carry forward. So we continue to be conservative in our deployment of capital, staffing of stores, inventory levels, pursuit of initiatives because as we reopen, we would expect business to get better. However, there is the potential that if markets are open too soon, if there's a resurgence of COVID that, potentially, we could have items close back down. So we're going to be conservative in how we approach our business.

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

Okay. Now from a geographic perspective, it seems to be pretty common experience that the middle parts of the country performed better during the shelter-in-place mandates than those around kind of the urban centers, mid-Atlantic, Northeast, et cetera. So I guess kind of a derivative on the previous question, as you start to open up the states, et cetera, do you think you have that kind of pent-up demand catch-up, if you will, from these previously underperforming areas? Or do you think the middle of the country is just going to remain kind of the better performer?



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

Well, we'll see what happens with the spread. It started on the coast and there has, looking at the news, been more new cases in the middle of the country, although not nearly as significant. The other thing I think that we want to remember is this is not just necessarily a government-driven process. Individual companies have a big impact on how they manage their workforce and what steps they're going to take to protect their workforce. So as an example, as an essential business, our headquarters never had to close. However, that wouldn't have been prudent to just have everyone come in, and we're still on rolling weeks for people that can work at home. So I think it gets down to -- so although Missouri has lifted restrictions, we're still operating, from a corporate standpoint, along the same lines. And I think that there's companies everywhere and a lot of people on this call who work for institutions that aren't going to necessarily want to immediately bring everyone back just because the ban has been lifted.

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

Right. Well, I think we're just talking about I've been working out of my basement for almost 3 months, and I'm not sure when I would go back. Regarding that mandate...

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

And to that end, Scot, I think that's why it's uncertain when we look at the demographic, the telecommuter would tend to skew towards more the professional installer. That's why we're a little cautious on how fast that business comes back.

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

So that gets to a slightly different question. So I kind of understand the ability for that typical commercial customer to maybe telecommute more than the typical DIY customer if we want to generalize. But we've also heard that even though some of these businesses were deemed essential, the garages, your customers on the commercial side had decided to close anyway. Like was that another inhibitor, another factor in the commercial business trends in the first quarter and early part of the second quarter?

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

I would say that for the time period that we reported against, our shops were not closing out of safety concerns. Some closed or reduced hours based on less demand.

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

Got it. Okay. So it's a function of not necessarily willing to staff the store, et cetera, it's -- you just don't have any business coming in.

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

Right.

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

So what have your stores done to basically enforce social distancing? And do you think that has had any impact on your sales?

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

Well, I think we want to be -- one, there are a lot of municipalities and state governments out there, all with different rules, and there's been a tremendous amount of work for our team to make sure that we are complying with those to be able to stay open. So we have worked extremely hard at that throughout our organization, and being there to take care of customers when they need help is critically important. Requirements vary by area, and some are quite contradictory. Some areas feel like gloves are important. Some areas feel like gloves are a problem because people don't wash their hands with gloves on. But it's crossed the gambit from social distancing to number of people in stores to protective gear to how we staff the stores, what hours we can be open, and we've tried to adapt to that in a market-by-market basis.

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

Do you think that the requirements that you've put on -- I understand some of them are contradictory, but let's call it, customer limitations, et cetera, do you think there's been any kind of negative impact on your sales or the demand just really hasn't been there to be able to say that's been an incremental factor?

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

Based on our traffic flow, size of stores, we haven't had a huge issue of having lines outside the store. For anybody who's been on the list, who's gone to Home Depot lately, you stand outside for a 0.5 hour waiting to get in. We haven't had a lot of that.

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

Okay. Got it. And then just 1 or 2 more kind of demand questions. Have you been able to correlate the changes in your sales trends to the timing for when the state starts to open up? I mean I know you guys are very analytical, so I'm just wondering if there's some sort of direct correlation you can draw to the states opening up as opposed to it's just, you know what, yes, our business starts to pick up.

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

Well, no states were open when we issued. What I would tell you is going back to -- it's not just the states opening up, it's what do those individual businesses decide to do. And then also the sentiment of the consumers in that market, markets that have had less disease and less of the negative impact, I would anticipate would more readily go back. Areas that have been really hard hit, New York, for example, people are going to -- the consumers are going to choose to be cautious would be my expectation.

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

I think that's more than a fair statement. So we talked a little bit about kind of the potential for more permanent work-from-home arrangements. In theory, that would be a negative for driving activity. On the flip side, I suspect that to the people -- to the degree that people are mobile, there's probably a greater likelihood of usage of personal vehicles rather than public transportation, planes, trains, et cetera. I mean have you guys kind of considered or thought about kind of how to net out those 2 opposing forces?

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

That is a very interesting question. I'm not sure how we quantify it besides sitting and watching. Your point of how many people are not going to want to take mass transit could have a positive impact on our business. I'd also will be watching how companies staff their offices, and do they try to disperse some of their functions into multiple locations. If people don't want to ride mass transit, is there more of a move to the suburbs. Those things will all be interesting to see. I think that we'll -- the first telltale sign of that is what happens to new car sales because, typically, when we go into a downturn, we would expect that new car sales would drop, which typically means more miles are driven on cars outside of warranty, which

is our bread and butter. In this case, we'll be watching to see what new car sales are and do we have actually a growth in the -- a step-up growth in the vehicle population as more people want to control their own transportation.

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

So that brings up an interesting parallel. And so again, a lot of people have kind of referred to or tried to draw parallel between this event as well as kind of 2008, '09, '10, '11. And as you're aware, the industry as a whole ran well above kind of historical growth rates for a couple of years. So how would you compare today's situation to the '08-'09 time frame?

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

So there's been discussion of the miles driven dropping off, and our reported sales were much less than the reported miles driven that dropped off. The thing we got to remember is that, at any point in time, there's a huge amount of unperformed or underperformed maintenance in the vehicle fleet. And when we see ourselves go into difficult times where people are worried about their finances, they start making decisions that, gosh, I'm not going to buy a new car or a new car to me for the foreseeable future, I better take care of the one I got. So what we see as people be more proactive in making sure they take care of their maintenance on their vehicles because their expectation is they're going to hold them longer, and that's a big tailwind for us. And that's -- I think that's something that's similar from '08, '09 to now.

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

And so is it just a matter of kind of watching what happens with new car sales? Or is there another way to kind of get an idea of if there's a behavioral change occurring with the consumer?

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

Well, watching new car sales to -- our expectation is people are going to hold on to their cars longer and maintain them better. To the extent that new car sales stay relatively strong, what we would think is that, that is going to result in a growth of the vehicle population and more vehicles per household, which is a good thing for our industry.

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

Right. Okay. I think everyone has kind of talked about whether it's in the food area, whether it was auto parts, we had seen a pretty significant change in terms of e-commerce penetration. I guess my other question for you is can you provide a little bit more color on -- in terms of what you saw on e-commerce for O'Reilly? And then do you think that creates kind of a permanent or secular change in terms of the demand for e-commerce fulfillment?

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

No. Actually, I think it strengthens our belief that the way most consumers receive the most value is to be able to go to their local auto parts store, get knowledgeable advice from a professional parts person and have quick access to the parts to fix their vehicles. And what I'd say is when business got bad, we saw our online activity pick up, but really, it's skewing even more towards Buy Online, Pick Up In-Store as people need immediate access to that -- those parts to fix their vehicle and are using the Buy Online, Pick Up In-Store with curbside service to limit their exposure but still get parts same day. And just as a reminder to everyone on the call, if you want to go on oreillyauto.com or one of our competitors and you want to ship to home, typically, you can get a 15% discount to have it shipped to your house. If you go online and choose to pick it up in the store for O'Reilly, there is no discount. So consumers are clearly choosing a higher value to be able to get same-day access to those parts.



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

And what is the delivery window today that you guys -- is it usually 2 days, still?

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

It depends on -- if we're going to ship to home?

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

Yes, sir.

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

It's typically 2 days, next day or 2 days, depends on how close it is to the distribution center.

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

Got it. And so some of your competitors also kind of rolled out the curbside service. And yet, to -- man, they pretty much all commented that people still came in the store. They want to know if the product was there but still came in the store even though they could receive the product that they already ordered curbside. Have you experienced something like that? Or was your experience a bit different?

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

Well, it's a very small number. So significant growth on small numbers are still small numbers. So the vast, vast majority of our consumers that want to come into the store to get that knowledgeable parts person to help them to do it, a tool owner to have testing on their car. So yes, still -- although we've seen an improvement and we offer that service to try to make sure we're keeping people safe, if they so choose to not come in the store, most do want to.

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

Got you. Okay. Now given the sales pressures that we had seen -- and look, once upon a time, you worked for a much smaller auto part company. How much pressure -- sales pressure do you think some of these smaller, less capitalized competitors can withstand, number one? And number two, do you think we could actually end up seeing a bit of an additional shakeout of the industry or consolidation of the industry just given some of the financial pressures these small businesses are under?

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

Well, that all comes down to duration. What's the duration of the pressure on sales. And clearly, we're less consolidated on the professional side of the business. There's many more players out there. So potentially, it could open up an opportunity for consolidation. Again, it will depend on the duration. When the stimulus checks came out, that helped. How long does that help or how long is the professional business challenge will be a determinant of what kind of pressure they come under. Most of the players that are out there that haven't succumbed at this point are good performers that tend to be well capitalized. So we're not anticipating like a rush of industry consolidation based on this, but that could change if it lasts a while.



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

Right. Okay. So you guys have run like a machine in terms of your capital allocation plan. You've always been a big buyer of your stock. You put it on pause, like virtually every other company in the country has. But I guess the question is, given the volatility in your results over the last few months, some of the uncertainty that is clearly kind of hanging over you just given this conversation, does that make you think you should run at kind of lower debt levels than you previously did?

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

I'll make a comment and then turn it over to Jeremy. What I'd tell you is that we put a lot of thought into the way we finance the business and have always had a long-term perspective and are not overly aggressive in doing so. So I'm uncertain that we're going to change them. That said, we did stop our share buyback and made other changes to ensure that we had ample liquidity and flexibility, and Jeremy can speak more to that.

Jeremy Adam Fletcher - O'Reilly Automotive, Inc. - Senior VP of Finance & Controller

Yes. I think really just to follow up on Tom's point, as much as anything, the period that we've seen reinforces the confidence that we've had in how we've approached capital structure, how we've approached debt levels and access to liquidity. So I think in line with a lot of companies in the retail space did, when we started to see the impact from COVID, we shored up those liquidity avenues that we had to ensure that we would be in good shape. But -- including we're able to issue the bond in the back half of the month of March, we're able to pause the buybacks and start looking at capital expenditures and delaying some of what we had, had planned for this year, started looking at other cost measures from an operating standpoint. But really, we're in a strong liquidity position. When we saw that, we took those measures to be safe, and we're very, very comfortably able to respond and never really be in a position where kind of the worst-case scenarios that would have played out would have caused us to have any less confidence about our capital position.

So it really kind of validates that we were in the right place and feel probably more confident after having seen it, even though we, like a lot of other companies, were asking all, I think, the right questions and taking the right measures to preserve capital liquidity as appropriate. Now obviously, we evaluate, as we continue to move forward, our credit facility. And we'll be at the end or a couple of years from now, we'll identify what measures we have in place. But we feel good with the experience that we've had over the course of what we've seen here with the COVID crisis.

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

Okay. That's very helpful. And I know before the U.S. basically shut down because of COVID-19, tariffs have been a major topic. One of our other companies that reported earlier this morning is still talking about kind of the tariff pressure. So I guess the question is for you, what are you guys expecting for the balance of the year from tariffs? And then kind of related to that, any reason to believe we're going to see any kind of big swings in either inflationary or deflationary pressures?

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

Our expectation is that the tariffs that are in place will continue to be in place, and it will be unchanged. To the extent that there are changes, we'll adjust to those. But predicting what's going to happen on that front is not something that we're the experts in doing. From our standpoint, because we turn our inventory slower than most -- much slower than most retailers, we don't have that immediate impact, and we're able to react after they're issued, and we understand what's going to happen because of the time frames on our supply chain.



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

So if there's no further changes, though, just from a year-over-year perspective, I guess, we would expect to see less of an impact in 2Q and then basically no year-over-year impact by the time we hit 3Q, 4Q?

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

We'll still have some anniversary-ing of increases that happened in the third quarter of last year, but essentially that, what you said.

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

Okay. All right. So much less than what we've seen in the last couple of quarters. And anything else you're seeing on the, let's call it, inflationary and deflationary part?

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

Not that significant.

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

Okay. Then hopefully, 2 more questions here.

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

But everybody seems to have a lot more things on their mind than trying to change price.

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

Yes. That's fair. That's more than fair. When you guys kind of think about all the changes you've had to implement with extra cleaning and sanitation, et cetera, are there any kind of key expense buckets that you're targeting to help offset some of those additional costs?

Jeremy Adam Fletcher - O'Reilly Automotive, Inc. - Senior VP of Finance & Controller

Scot, this is Jeremy. I'll go ahead and take that one, Tom.

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

Thanks.

Jeremy Adam Fletcher - O'Reilly Automotive, Inc. - Senior VP of Finance & Controller

Obviously, the -- we've talked quite a bit about our cost structure when we released results. And the fact that we're operating as many locations as we do and having such a focus on customer service that we're going to be conservative in how we make short-term changes in what we do with -- obviously, store payroll principally being the primary driver of costs in our operating model for our stores. So that's really the area that we spend a lot of time and focus on being sure that we are managing both for the -- for what we have seen in the current environment. But then also, we've always had a very long-term focus about providing great customer service and have -- in many, many periods like this, in much more isolated stages



where maybe we've had a disaster in a local market or something like that, have found that being able to continue to provide great service to our customers has been a long-term positive for us.

So that's really what we focus on kind of through what we've looked at. For sure, in the short term, we're making those evaluations, and time will tell what kind of permanent changes we would have to see in our business. Ultimately, I think -- we don't know what the new normal is going to look like, but we would, I think, hope to be able to get back to an operating procedure, set of protocols within our stores that allows us to still efficiently and effectively take care of our customers.

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

Yes. And then just one more quick one, if I can squeeze it in. A big part of the investment world these days is a lot more AUM flowing into ESG-type strategies. So I guess the question for you guys is, how important is ESG and sustainable to your corporate strategy? And are there any kind of recent initiatives that you would like to highlight for the group? Hello?

(technical difficulty)

Jeremy Adam Fletcher - O'Reilly Automotive, Inc. - Senior VP of Finance & Controller

We may have lost Tom there. Tom, are you there?

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

I'm sorry, Jeremy. I'm back. I started, and I didn't realize I was on mute while you were answering, Jeremy. The push on the ESG front from our perspective is a reporting push. Since we were founded by original 13 team members and 2 O'Reilly's, the team has always been the thing that drives us. When the company went public, it was really so that we could issue stock options and team members could share in the success of the business. And our business is driven by growing great people, growing great leaders, promoting from within. And that's our biggest asset. So that level of respect for team members has always been there for us.

From an environmental standpoint, we'd tell you that, gosh, everybody thinks of us as a company that supports burning fossil fuels. But we tell you, gosh, we support burning fossil fuels more efficiently: how do we make the cars run better so that they're more environmentally friendly, how do we keep vehicles on the road as opposed to taking the resources to build new vehicles more often; and our industry is also into recycling, whether it's oil, whether it's batteries, also into recycling parts where specific parts -- specific components of the part fail. Let's take them back, let's remanufacture and let's sell them again so that we don't have to cast the new outside for an alternator when it's the brushes that fail. So these are items that always have been important to us. It's just the reporting requirements that we now face that is the push. That's how we view it.

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

Got it. All very helpful. So I think we've kind of run to the end of our time frame. But I want to, once again, just thank you, guys. Great job. Appreciate it from myself and on behalf of RBC as well as our clients. And that concludes today's call. Thank you.

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

Thank you.



Jeremy Adam Fletcher - *O'Reilly Automotive, Inc. - Senior VP of Finance & Controller*

Thank you.

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