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PRESENTATION

Operator

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

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

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

Thank you, Bridgette. Good morning, everyone, and thank you for joining us. During today's conference call, we'll discuss our second quarter 2020 results. 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, 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.

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

Thanks, Tom. Good morning, everyone, and welcome to the O'Reilly Auto Parts second 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.

The 5 of us on the conference call today have a combined over 170 years experience in the automotive aftermarket, and we have collectively experienced many, many ups and downs in our industry. But in the 63-year history of our company, I can safely say we've never seen a quarter like this year's second quarter.

As we begin our prepared comments today, I'd like to start with the most important comment first, which is to thank Team O'Reilly for your amazing dedication and performance during one of the most difficult and challenging periods in our company's history. The communities we serve continue to face significant ongoing challenges from the COVID-19 pandemic, but our team has remained steadfast in executing our protocols to protect the health and safety of our team and our customers while providing outstanding customer service. It has never been more evident just how essential our role is in providing our customers with the critical parts they need and the service they expect to keep their vehicles on the road.

This quarter, we experienced the most dramatic swing in demand our business we have ever seen. And we're extremely proud of how our team stepped up to the challenge and delivered a record breaking quarter, highlighted by a comparable store sales increase of 16.2% and a 57% increase in earnings per share, combined with the year-to-date increase in operating cash flows of over $700 million. The numbers are a reflection of the tireless dedication and hard work of our team. And I want to congratulate all of Team O'Reilly on your incredible performance in the second quarter.

Before we dig further into the results for the quarter, I would like to provide a brief update on how our teams are responding to COVID-19 to ensure their continued health and safety of our team members and our customers. As we discussed on last quarter's call, with the onset of COVID-19, we very quickly implemented numerous safety protocols across our companies based on recommendations by the CDC, WHO and state and local governmental agencies. These measurements -- these measures include significantly increasing cleaning and sanitation efforts, the implementation of social distancing practices and the utilization of appropriate personal protective equipment.

Our teams did a great job working through the initial period of rapidly evolving recommendations and have remained diligent in their execution as the pace of change in requirements have slowed and best practices have emerged. We remain committed to constantly evaluating and revising our safety protocols and currently, all team members company-wide are wearing face covers. Throughout the course of the crisis, our dedicated Team Members in our stores, distribution centers and corporate offices, have demonstrated extraordinary flexibility and resilience in the face of extremely difficult circumstances.

Now I'd like to provide some details on our robust performance in the second quarter. We are extremely pleased with our top line sales results in the quarter and even more pleased with the incredible execution of Team O'Reilly in delivering these results. As we announced in our first quarter press release, the beginning of our second quarter was marked by a significant COVID-19 headwind, which was a continuation of the pressure we saw in our business starting in the middle of March, coinciding with the implementation of stay-at-home recommendations and orders. As we discussed on last quarter's conference call, this trend continued through the middle of April, as sales in the third week of April improved as our customers began to receive economic impact payments under the CARES Act. At that time, we had no way of forecasting the magnitude and the duration of the benefits from these stimulus payments nor could we anticipate what other factors would impact our customers and our business moving forward. As a result, we took a cautious stance on how we plan for our business and maintain ample flexibility to respond to further headwinds.

Simply put, our sales performance from the third week in April through the remainder of the quarter exceeded all expectations. During this time frame, our DIY business was the stronger contributor coming on quickly in the middle of April, improving in May and staying very strong in June. We're also very pleased with the performance of our professional business. Sales on that side of the business also began to see improvement in the middle of April, but at a more gradual pace than the immediate turnaround at DIY.

However, as we progress through the quarter, professional sales continue to strengthen, generating robust comps above our expectations in May and June as state home orders began lifting and the broader economy began reopening. As a result of this cadence on both sides of our business, total comparable store sales were similar for May and June, and have remained strong thus far in July.

Next, I would like to provide a little color on the drivers of our record-setting sales results. For us to be able to produce a 16.2% comp increase in the second quarter, we obviously had a very favorable industry environment. However, just as it would have been tough to predict the sales results we've seen, it's also very difficult to quantify the magnitude of each of the positive macro factors. But I'll discuss in general terms what we've seen as the positive supporting demand in our markets.

To begin, it's evident from the sharp turn in DIY business that the receipt of governmental stimulus payments under the CARES Act was the first catalyst supporting our sales growth in the quarter. However, given the degree of which robust sales trends have persisted, it's clear to us that enhanced unemployment benefits have also been a tailwind to the business, and we're likely more prominent in driving demand as we move through the quarter. We also believe that reopening of the economy and the partial recovery of miles driven was a positive factor, especially in our professional business as our customer service demographic that is more likely to have worked from home during March and April.

Although the impact of weather gets a little lost in the world of double-digit comps, in any other year, we'll be talking about the hot weather we've had, and this likely has been another positive for our industry. There are other beneficial industry dynamics we believe could have contributed to the strong demand in the quarter, but are also difficult to measure over a short period of time. We have long-held the times of economic uncertainty motivate consumers to make more cautious financial -- have a more cautious financial outlook, often leading them to postpone the purchase of a new vehicle and invest in maintaining their existing vehicle.

Consumers with safety concerns about other modes of transportation either for a daily commute or vacation travel, could also be focusing more on maintaining and repairing an existing vehicle. It's difficult to have a clear picture yet of the magnitude of benefit we could be seeing from an increased vehicle age or catch-up of underperforming maintenance, but we're seeing some benefit.

Finally, we could be seeing shifts in customer demand benefiting our business either in share gains from smaller competitors of big-box stores or a more general shift of demand dollars in the automotive aftermarket and away from discretionary expenditures for activities not possible in a COVID environment.

From a ticket perspective, we saw robust ticket count increases during the second quarter, but average ticket size also increased significantly. With average ticket, same-SKU inflation was in line with our expectations. So the increase in ticket size is being driven primarily by larger jobs or more items on the ticket. On a category performance basis, we saw strong performance throughout our product offerings, including especially good results in appearance and accessory categories. These ticket and category dynamics suggest some of the strong demand we realized in the second quarter as a result of our customers having the ability and desire to work on larger projects as they have more time to spend repairing and maintaining their vehicles.

As we look forward to the balance of the year, we remain very cautious in our sales outlook and recognize the significant uncertainty that still exists concerning duration of the current positive market backdrop. In particular, we can't project the potential impact and expiration of the enhanced unemployment benefits would have and can't speculate as to whether there will be additional government stimulus or the degree to which our demand would benefit. We also remain concerned that continued pressure to miles driven from a difficult economic conditions and increased work-from-home arrangement could be a headwind if other positive catalysts prove to be temporary.

Ultimately, we expect to see a moderation of the record-setting sales pace at some point in the back half of 2020. We feel very confident our company to continue to deliver solid sales growth even if the broader economic conditions deteriorate. As important as general market factors were the catalyst for our growth in the second quarter, we could not have delivered such outstanding top line results without the incredible execution by our team. It's one thing to have strong demand. It's another to live up to the challenge of having the right part at the right time to take care of customers, while the business is on fire and we're allocating additional time to safety precautions. It takes a tremendous amount of hard work to handle the extra volume we saw this quarter and the outstanding contributions of our team were reflected in the strongest profit margins in the history of our company.

For the quarter, our gross margin of 53% was a 12 basis point improvement over the second quarter of 2019 margin and above our expectations. Our gross margin benefited from the heavier DIY mix in our business, which carries a higher gross margin in our professional business as well as strong leverage on DC expenses on the robust sales volumes and incremental cost improvements. Partially offsetting these positive gross margin factors is a small LIFO headwind driven by acquisition cost decreases during the quarter, which Tom will discuss in more detail in his prepared comments.

For the second quarter, our team generated an operating profit margin of 23.8%, which exceeds our previous best single quarter performance by well over 300 basis points. As we reported in our press release yesterday, we don't view these levels of SG&A leverage to be sustainable over the long term. And Jeff will more fully cover these dynamics when I turn the call over to him in a moment.

But before I do that, however, I just want to congratulate Team O'Reilly on these great results and your ability to provide excellent customer service, even while tightly controlling expenses. Your extraordinary contributions to our company's success have never been more apparent, and I feel comfortable speaking for all of our shareholders and saying that you -- and saying thank you for an incredible performance in the second quarter and your unwavering commitment to serve our customers.

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

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

Thanks, Greg, and good morning, everyone. I'd like to begin my comments by joining Greg and expressing my extreme gratitude to Team O'Reilly for their amazing performance in the second quarter. The results you were able to generate validate both the strength of our model and the deep quality of our team and culture. Your ability to capitalize on a positive market-wide catalyst and generate comparable store sales growth of 16.2% and operating profit dollar growth of 48% is truly incredible. And I continue to be extremely proud of what our team working together can accomplish.

Now I'd like to provide some color on our SG&A expenses for the quarter and further describe the remarkable performance of our team. As we discussed at length in our first quarter conference call, we undertook several steps in March and April in response to the impact COVID-19 was having on our business. Throughout our company's history, we've been active and detailed managers of the variable expenses of our business, with our store payroll spend, representing the largest driver.

As we analyze the trends we were seeing in our business beginning in the middle of March, we made adjustments we felt were appropriate to rightsize our model for the existing and expected environment caused by the pandemic. As we progress through the month of April and began to see the stark sales improvement Greg discussed in his prepared comments, we remain very cautious in our forward-looking sales outlook. At the time, we didn't know how long the positive sales trends would persist, especially since the initial sales tailwind were so closely aligned with the initial wave of the $1,200 stimulus payments under the CARES Act.

We've had a lot of experience with similar spikes in demand during tax refund season and since we know researches tend to be short time in nature, we were prepared for the positive trends to refer to the pressured sales environment we encountered from mid-March to mid-April. The positive trends didn't reverse, but instead strengthened in May and June and we began to slowly increase our SG&A spend as we progress through the quarter to more closely match our service levels due to the demand that we were seeing.

As a result, we exited June at a higher rate of SG&A spend than we saw in April and May. The net result of this cadence in SG&A spend during the quarter resulted in a decrease in average SG&A per store of approximately 1% compared to the second quarter of 2019. This exceptional expense control discipline combined with the immediate drastic sales rebound, drove a truly remarkable profitability in the second quarter, highlighted by a reduction in SG&A expense as a percentage of sales of 447 basis points.

While our team deserves all the credit for the great performance in the second quarter, we also recognized that the impressive numbers were driven in part by the timing and unique circumstances of how our quarter played out. As Greg previously mentioned, we know to provide the consistent level of customer service required to build our business over the long term, this level of SG&A productivity is not sustainable. Our priority for the past 3 months has been to do everything in our power just to take care of the next customer. But we have enough experience throughout all levels of our company to understand that we can't neglect the other fundamentals of our business.

As we move through the back half of the year, we will refocus on the important details of our business that gets deferred when we're running double-digit comps, such as the image and appearance for our stores and store, team member, training and development. However, we will leverage the lessons learned through this process. while we expect to see our SG&A dollar spend and navigate back towards historical levels, we will be diligently focused on driving strong leverage and robust top line growth.

Next, I'd like to touch briefly on our capital expenditure and expansion plans. Through the first 6 months of 2020, we opened 123 net new stores, in line with our original plan to open 180 new stores in 2020. And we successfully opened our newest distribution facility in Lebanon, Tennessee. These new properties were well underway prior to the onset of COVID-19 and the disruption from the stay-at-home orders so we were able to complete development pretty much on schedule. However, we've seen delays in the development schedules for our planned new store openings in the back half of the year, especially as the required approvals for design and permitting have slowed as local cities implemented health and safety measures. At the same time, we were very judicious in how we move forward with both our store expansion plans as well as our other capital project priorities in line with the significant economic uncertainty we were facing.

As market conditions improved, we began to see our local communities open up in May and June, we were able to resume the pace in our new store development. However, given the delays we experienced in the first half of the year, it was prudent to withdraw our original 2020 new store guidance. And we would now expect to open between 150 and 165 new stores this year.

We've been pleased with our ability to open great new store locations in 2020, but where we ultimately fall within that range will be somewhat out of our control as we anticipate seeing further localized delays in final permitting approvals. Outside of our new store and distribution growth, we have restarted the exciting projects and initiatives that we identified coming into 2020 to enhance the service we provide to our customers and to drive strong returns. While we haven't spent the planned level of CapEx for these initiatives in the first 6 months of the year, we will begin to close that gap as these projects gain steam in the remainder of 2020.

We continue to make great progress converting the hardware that runs our stores, and we're continuing to invest in projects to modernize our distribution vehicle fleet, improve the image and appearance of our stores, implement enhanced safety measures in our store vehicle fleet and to enhance our omnichannel capabilities. None of our high expectations on the opportunities presented by these projects has diminished based on our experience so far in 2020, and we're excited to reap the benefits from these initiatives moving forward.

Finally, before I turn the call over to Tom, I want to once again thank Team O'Reilly for their tremendous efforts in the second quarter. For a number of different reasons, 2020 has been a very challenging year. But our team has stepped up and met every challenge and really proved they're the cream of the crop in our industry. I'm especially proud of the commitment that our team has shown to our customers. Their diligence in executing best practices to protect the health and safety of everyone in our stores, DCs and offices, while keeping our business running efficiently to provide our customers with the essential parts they need is truly world class.

Now I'll turn the call over to Tom.

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 in taking care of our customers and driving the phenomenal performance in the second quarter.

Now we'll take a closer look at our quarterly results. For the quarter, sales increased $502 million, comprised of a $412 million increase in comp store sales, a $70 million increase in noncomp store sales, a $21 million increase in noncomp nonstore sales and a $1 million decrease from stores permanently closed in line with our 2020 plan. For a clarification, these store closures were planned and are broken out consistent with our past reporting practices. As a reminder, we previously withdrew our 2020 guidance and given the ongoing uncertainty related to COVID-19, we are not resuming guidance at this time.

As Greg previously mentioned, gross margin for the second quarter increased 12 basis points to 53.0%, which includes the benefit from mix, DC leverage and acquisition cost benefits, partially offset by a LIFO charge headwind of $4 million. As a reminder, coming into 2020, we anticipate that we would continue to see a gross margin benefit from the sell-through of on-hand inventory that was purchased prior to the tariff-driven price increases during 2019. However, this benefit was reduced as we saw acquisition cost decreases in the second quarter, which although they represent a short-term headwind to gross margin will benefit us throughout the remainder of the year in higher POS margins.

At this point, we have realized the full benefit of the pre-tariff inventory and any further acquisition cost reductions moving forward will result in a LIFO charge. But again, will benefit our future POS margins. This is similar to our LIFO situation prior to the cost increases in 2018 and 2019. The pricing environment remains rational, and we expect that to continue.

Our second quarter effective tax rate was 24.1% of pretax income, comprised of a base rate of 24.5%, reduced by a 0.4% benefit from share-based compensation. Both of which were in line with our expectations. This compares to the second quarter of 2019 rate of 23.9% of pretax income, which was comprised of a base tax rate of 24.4%, reduced by 0.5% benefit from share-based compensation. Changes in the tax benefit from share-based compensation can fluctuate quarter-to-quarter, and we continue to expect our rate for the remainder of 2020 to be lower in the fourth quarter as a result of the tolling 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 6 months of 2020 was $1.2 billion versus $539 million in the first 6 months of 2019, with the increase driven by an increase in net income, a reduction in net inventory and increase in taxes payable as a result of the deferral tax payments under the CARES Act and a reduction in CapEx, partially offset by investments in solar projects. These investments 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 $632,000, which was even with the beginning of the year and up 3.5% from this time last year. The increase reflects additional inventory investments made in the first quarter of 2020, partially offset by a reduction in inventory balances in the second quarter as a result of the strong sales volumes. Our AP to inventory ratio at the end of the second quarter was 112%, which is the highest ratio in our history and heavily influenced by the extremely strong sales volumes and inventory turns in the second quarter. We still anticipate growth in per store inventory in the remainder of 2020 as we resume our inventory enhancement initiatives, and this will moderate the increase in our AP percentage over time.

Finally, capital expenditures for the first 6 months of the year were $244 million, which was a $51 million decrease from the same period of 2019, driven by the prior year level of investment in new distribution projects versus the first 6 months of 2020. As Jeff previously discussed, we resumed deferred CapEx projects, which were on pause due to the impact of COVID-19 and will continue to adjust our CapEx plan as appropriate given the current environment.

Moving on to liquidity and capital structure. We continue to have ample liquidity as a result of the measures we took earlier in the year to preserve capital and liquidity, coupled with the extremely strong cash flow performance in the second quarter. As a result, we finished the second quarter with an adjusted debt-to-EBITDA ratio of 2.24x as compared to the first quarter ratio of 2.59x, and our end of 2019 ratio of 2.34x. This calculation excludes the $872 million of cash we held as of the end of the quarter.

As one of the measures to preserve liquidity at the onset of COVID-19, we temporarily suspended our share buyback program in the middle of March. We continue to evaluate business conditions and liquidity. And as a result of this evaluation, resumed our share repurchase program on May 29, 2020. Year-to-date, we've repurchased 1.7 million shares at an average share price of $390.14 for a total in of $651 million. Subsequent to the end of the second quarter and through the date of our press release, we repurchased 0.1 million shares at an average price of $423.09.

As a result of the strong performance in our second quarter, we finished the quarter with $2 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 will continue to prioritize maintaining our strong financial position, including the investor-grade rating on our public debt. We have a long history of conservatively managing our balance sheet and will continue to take prudent steps to ensure the long-term health and stability of the company.

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

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Matt McClintock with Raymond James.

Matthew J. McClintock - *Raymond James & Associates, Inc., Research Division - Research Analyst*

I have to say outstanding results. Congrats on the execution.

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

Thanks, Matt.

Matthew J. McClintock - *Raymond James & Associates, Inc., Research Division - Research Analyst*

Regarding that, I'm trying to conceptualize or at least trying to figure out how such strength could occur with miles driven still being a little bit pressured, right? And clearly, over history, that's been the main driver of this industry. So when you talked about strength in apparel -- or appearance and accessories, was that a large factor in the outperformance? And could you kind of help us try to think through or parse through what might be onetime or -- versus sustainable growth in the industry?

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

Sure. So I'll start that and let see if Jeff or Tom want to add on. So first, on a appearance and accessory, that was -- that's not typically a real strong category for us. When you think about car care, cleanup, waxes, the accessories and trinkets that you can buy in our stores are, frankly, online. Those are typically not real strong sellers for us. And what we found this quarter is those type items as well as performance-related items, hobby-related items, items people are tuning up, their hot rides, their street rides, the cars that may have been covered up in the backyard or in the garage for a number of years, and we've seen a spike in sales in some of those categories that are typical -- typically maybe average performing categories.

And we think part of the reason for that is just consumers are -- they have more time. And in a lot of cases, they have more discretionary money to spend because they're not doing a lot of the peripheral family activities that they might have done in prior years because of closures, sporting events not taking place, things like that.

Tom, did you want to add anything?

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

Matt, what I'd add to that is we saw strength across all our categories. We spoke to that particular set of categories because it acted unusually for what we usually see in downturns, as Craig talked about. When we look at downturns, we look at people deferring new vehicle purchases and when we look historically, what we see is people catching up on unperformed or underperformed maintenance. And that was the biggest driver, we feel like in the outperformance for the quarter.

Matthew J. McClintock - *Raymond James & Associates, Inc., Research Division - Research Analyst*

But to try to take this to a step further and I don't want to take away from the outstanding performance you did this quarter. But as we look to next year, I'm not trying to get ahead of ourselves, but how do you think about growth on top of the growth that you've seen this year just because we've never seen anything really like this in history. So just anything you can say to keep what we're trying to think about next year and what the growth to compare this year means for next year?

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

Matt, I think you hit the nail on the head there. This is an unprecedented time, and the results are quite dramatic, how they've turned around. We've got a lot of water to go under the bridge. And we're still in the middle of this pandemic. So for us to speculate on next year, I think, would not be appropriate at this time.

Matthew J. McClintock - *Raymond James & Associates, Inc., Research Division - Research Analyst*

I really appreciate the color. Congrats, guys. Great job.

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

Thanks, Matt.

Operator

Our next question is from the line of Liz Suzuki with Bank of America.

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

Could you just go through some of the puts and takes on where you expect SG&A dollar growth to run year-over-year in the next 2 quarters? And just whether any of the reductions that were made in March and April can be maintained as you kind of get back to the normal run rate of SG&A as a percent of sales?

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

We know that we ran a very skinny SG&A and deferred some of the work we need to do in the stores in the second quarter, just to take care of customers. So we anticipate that it will ramp up our staffing to meet the demand. Obviously, we pared back our staffing significantly based on a negative 13% comp that thankfully didn't persist. So we know we're going to have a higher SG&A spend. We're going to continue to detail, manage that on a day-to-day basis. And the biggest discretionary for us is store payroll, and I'll let Jeff speak to that.

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

Well, there again and we've always managed our payroll one store at a time, and we always really try to do our best to tie our staffing levels to what our business has done. And when the pandemic hit and we have a drastic drop in volume in mid-March that persisted for a few weeks, we obviously had to react to that and adjust our payroll accordingly as we always would in seasonal downturns or things like that. I mean this was more dramatic than we would normally see.

So we obviously implemented the procedures that we have in place to manage our payroll, starting with the hiring freeze and just not hiring. And then adjusting hours based on the demand in the store, adjusting part-time hours, reducing overtime, transfer people between stores, I mean, all the things that we would normally do to manage our payroll appropriately for the volume of the business.

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

Liz, to add a little bit more color to what Jeff's saying. I think we've run our stores just on a very, very tight budget over the last several weeks. And we have got to get back, as Jeff said in his prepared comments, that some of the fundamentals on store appearance and some of the things that, frankly, have suffered over the past few weeks. So we're going to have to put some more SG&A dollars back into the stores. We've already started that to make sure that our stores, appearance and the customer experience is as high as it ever has been.

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

Great. And just one follow up on investments in labor and in the stores. I mean, it's still early in election season, but there are some policies getting more airtime than others, one of which is the potential increase in the corporate tax rate. So back in 2017, '18 when Tax Cuts and Jobs Act went into effect, O'Reilly invested a lot in -- of those tax savings into wages and technology. But if tax rate goes up, do you think there are areas where the company can make some reductions or cuts to mitigate those effects?

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

Liz, what we would tell you is on a year-over-year basis, we do our best to create an environment and model in a company that can increase operating profit dollars year after year, which is what we've done. To the extent that the tax system changes, that's out of our control. And we need to be focused on how we continue to generate increasing operating profit dollars.

Operator

Our next question comes from the line of Bret Jordan with Jefferies.

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

On the share gain, I guess, you've talked about potentially having taken some share from big-box retailers or other smaller competitors. Could you maybe bucket what you think -- who you think the bigger donors were. And obviously, a lot of stress for smaller parts distributors during the quarter. Do you think we've seen any real change in the population of some of those smaller players?

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

I don't think we've seen a lot of change yet on the parts store side or the professional installer side of our business. We've seen a little bit, but nothing material. As far as market share gain, Bret, it's really hard to say until the next few weeks, and we see what all of our competitors report, it's hard to tell what their sales look like. We know our sales were strong. We're very, very pleased with the performance of our store and DC teams to drive the results that we drove this quarter. We feel like we've taken some market share, but we won't know for sure until we see the earnings releases.

When you look at big box specifically, that comment is centered around myself and others have seen a lot of product outages, not necessarily only in the auto parts sector, but just the big box and the pure e-commerce players have struggled somewhat over the past several weeks due to pandemic. And they've had challenges staying in an in-stock position, and we're very, very proud of our supply chain because we've been able to maintain an in-stock position both for our brick-and-mortar and our online customers and we've seen some shift.

It's no secret that our e-commerce business, our online business, has improved through this pandemic as it has for most retailers, but the trend has continued that the majority of that volume continues to end up in our store, either in a pickup in-store, shift to store or curbside pickup that we've implemented.

So I think that a lot of consumers have regained confidence in some of the brick-and-mortar players, especially those that have strengthened their supply chain, and it performed really well through the pandemic.

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

Okay. Well, my second question was online, so you already answered it. So my second question is going to be regional performance. I guess could you give us a feeling for the spread between the weakest markets and the strongest markets and where they were?

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

Yes, Jeff, do you want to take that one?

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

Yes. I mean really, the COVID pandemic has impacted us in every market across the country. And we -- as we talked about in the prepared comments, I mean, we saw pressure across the entire chain starting in mid-March, and it persisted for several weeks. But then when the stimulus checks started hitting there in the third week of April, I mean we've seen a dramatic uptick in our business, really all across the country and in all markets. And it really exceeded our expectations on both sides of the business.

And as we've mentioned several times in our prepared comments, I mean, demand is one thing, but we're extremely proud of the way our team members have really stepped up to the plate and taking care of our customers, satisfying their needs through these challenging times.

Operator

And our next question comes from the line of Chris Horvers with JPMorgan.

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

So my question has to do with commercial versus DIY. You talked about robust trends in May and June in the commercial side of the business. Can you maybe define what exactly robust is? And can you also talk about how the gap between DIY and do-it-for-me evolved over the months of the quarter and if you could, into July?

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

Yes. We're not going to break out the numbers between DIY and DIFM. What I would tell you is, as we said in our prepared comments and on our prior call, I think everyone realizes that April started out really slow. And as the government subsidies kicked in, I would say that the DIY side of our business ramped up much more quickly than the DIFM side of our business. I would tell you that for April, May and June, overall, we comped positive in all 3 months, with May and June being stronger of the 3 months, and those trends have continued into July.

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

But presumably, did the gap between commercial and DIY narrow into June? It doesn't sound like DIY -- commercial ever exceeded DIY over the quarter?

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

So yes, the DIY side of the business was the bigger contributor to our comps. The DIY business really took off as soon as the stimulus checks started. The professional business really didn't start to turn around in a dramatic fashion until the stay-at-home orders started to lift. So inherently, there was a narrowing of those 2 throughout the quarter, but both remain very strong.

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

Understood. And then a follow-up on the gross margin. You mentioned some comments around the benefits of the tariff price increases being fully baked in through 2Q and had potential headwinds ahead on LIFO. So ex the potential leverage from very strong comp trends in the cost of goods line, how are you thinking about those other components? Will they -- do you expect them to be a net headwind in the back half of the year?

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

Well, that will depend on what happens with pricing. We're always trying to reduce our acquisition costs through scale and sourcing and to some extent, private label. So that will be pending. When we look at the second quarter itself, when we looked at our plan, we were anticipating continuing to get a LIFO benefit in the second quarter. But because of negotiated price decreases, we actually offset that and had a headwind. So that was a headwind to margin for the quarter, but with an annuity attached to it as we have lower acquisition costs. Otherwise, we would have had a higher year-over-year improvement in gross margin, driven by the higher DIY mix and the leverage on the distribution cost.

When we look forward, we would anticipate pricing -- acquisition prices to be relatively stable through the end of the year and our expected plan benefit was less as we theoretically sold through the pre-tariff goods. So we'd expect to be relatively neutral for the remainder of the year.

Operator

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

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

I wanted to ask on the DIFM side. It sounds like -- and I'm going to put words out there. It sounds like you're running double digit. Do you have a sense where the market is running and how much market share you're taking in that channel?

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

That's difficult to say. As Greg mentioned earlier, our competitors haven't reported, although, I guess, one's reporting now. We're out on the street calling on customers, trying to take care of our customers when the market is difficult. And as Greg talked about, the strength of our supply chain and we're able to provide parts that perhaps normal supplier can't come up with. That's a benefit for us and ability to get our foot in the door and build long-term strength. We're happy with how our business is trending. We continue to call in our shops in a very safe way with the safety protocols and then try to help them through this, which has been a difficult environment for them also.

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

I would -- Simeon, this is Jeff. I would just add to Tom's comments on really the strength of the supply chain availability. As you know, availability is key to grow in the professional business. And we've always prided ourselves and our service level's a big part of that being availability. And when you have the part on the shelf and maybe somebody else doesn't, that maybe was a primary supplier, you could move up in the call list in that shop.

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

Yes. No, that makes sense. I think it's important in that, right, miles driven is down a lot and understanding, let's say, where you're running versus the industry. Maybe could tell you how sustainable things may be. And that leads into my next question, which is you mentioned you're cautious for the rest of the year, and it does seem like you exited about the same level. It seems like double digits in both sides of your business. And so I'm curious if the cautiousness is, look, we just don't know what we're going to get in terms of stimulus. Because in theory, if we do, that should continue some of the momentum and maybe the pent-up demand side, which is harder to understand how that flows through. So I just want to connect the dots on the cautious comments despite exiting on your own strength.

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

Yes. Simeon, one thing that is for sure is the trends we're seeing won't last forever. We know this is not typical. It's a unique time for the world right now and it's not going to last forever. If you look at this on -- you talk about miles driven and will it persist, if you break that down to the short term and long term, my opinion on that is long term, I think miles driven will come back. I think people will drive their cars more miles again, as they've done in the past. I think there's a lot of consumers that are still concerned about mass transit systems from a health and safety perspective. You read about more and more people moving to the suburbs and out of the major cities, which is better for miles driven, more automobile traffic, less mass transit.

So I think all those things long term will support growth in miles driven. The caveat to that is from a short-term perspective, none of us know what's going to happen with stimulus, none of us know if there'll be another round of shelter-at-home orders in some of these markets, all of those things would potentially negatively impact miles driven for the short term. So because of the degree of uncertainty with all that, that's the reason for our cautiousness and called that out in our prepared comments.

Operator

Our next question is from Seth Sigman with Crédit Suisse.

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

I wanted to follow up on commercial. And wondering if you'd talk about what you're seeing across your commercial customer base. So I think many of them were essential, but I'm sure there was some disruption over the last few months as well. Some cases, furloughs and in some cases now labor shortages. So I'm just curious, what are you seeing? Is that a limiting factor at all on the commercial side? I'd just love to get your thoughts on that.

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

Yes. This is Jeff. I'll speak to that one. No doubt it was early on when the pandemic broke out and all the shelter-in-place orders were in place. I mean there were shops that reduced hours, that there were some shops in some of the markets that actually closed during that period. And obviously, there's been a shortage of techs in some shops. But it seems like -- I guess this is kind of a broad statement that, that has rebounded coming into May and June.

Now with these new outbreaks, COVID outbreaks in several states, we are hearing some comments about maybe some shops have slowed back down just a little bit from where they were when it kind of opened back up.

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

And on essential, we worked with a lot of industry organizations early on to ensure that most, if not all, markets would make sure that auto parts supply and repair remains essentially.

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

Got it. And then just to follow-up on that point around the shops and what's happening now. Are there signs of moderating growth in markets where COVID is picking up now?

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

It seems like it's spotty. I mean we're hearing from a few places where it seems like maybe the shops have slowed down just a little bit.

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

And again, it goes to the comment I said before. I've heard this multiple times from our sales teams as some of these shops are saying in those markets, I think there's still some degree of concern for safety with taking your car to a shop, perhaps for some of the tasks that you might want to tackle at home, oil changes, breaks, things like that, where you may have traditionally taken that car to a shop for those jobs. Now you got more time to perform those tasks, and you're just not totally comfortable yet dropping that car off and having someone you don't know inside your car from a safety perspective. I think there's still some degree of concern there.

Operator

And our next question is from Michael Lasser with UBS.

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

So based on those comments, has your DIFM business in July slowed relative to where it was running in June?

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

We're not going to comment on 3 weeks within the quarter, Michael.

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

Okay. And Tom, if you were to take what you've seen from a category perspective and overlay it with 2008, 2009, does it look identical, suggesting that, that period is a good parallel for how to think about demand for the aftermarket from here? Or are there any major differences?

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

Well, Greg commented in the prepared comments. And the reason we brought out appearance and -- appearance-type products is that's very unusual. Compared to 2008, 2009, appearance and performance and all of those more discretionary categories in 2008 took a big hit and maintenance and failure parts went up quite a bit. So that's different this time. I think it has to do with the stimulus and the people staying at home.

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

Right. I mean if you look back in '08 and '09, we thought consumers extending service interval is delaying some of these repairs that they could. We haven't seen the same thing this time around.

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

So based on those comments, would you consider this to be more temporary whereas '08, '09 was a longer-lasting tailwind that the sector experienced?

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

That's a great question. And I wish we had a great answer for that. We just -- with the uncertainty of where this pandemic goes from here, it's really difficult to answer that, Michael.

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

Mike, what we would point you to, though, is the magnitude of the pickup in this particular economic downturn is significantly more and more immediate than 2008, 2009.

Operator

Our next question comes from the line of Scot Ciccarelli with RBC Capital Markets.

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

So you talked about adding SG&A back into the stores, and obviously, head count is down quite a bit. So first, do you guys have a target you're thinking about from an SG&A per store growth perspective? And then kind of related to that, do you plan on bringing back some of those same employees? Were any of them furloughed? Or do you kind of have to start fresh and go out and hire and train people? And obviously, that takes a while to kind of ramp them up on a productivity basis.

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

Yes. Scot, I'll start with that. Tom, do you want to chime in? But obviously, on the average SG&A per store, I would think that we -- as we talked about in the prepared comments, we would move back toward what we stated as our goal early in the year. We've already -- I mean, there's, again, we're talking about something that happened 90 days ago. And when the pandemic hit and the business took a dramatic downturn, we had to react to that. And we had to adjust our staffing by store to what the sales demand was. And we've been cautious as businesses ramped back up. We had no idea how long this would last. And it's really uncertain times.

And as we've seen, week by week, as we've seen the business, the demand continue to stay in place, we've ramped back up our staffing accordingly. No doubt, maybe not as much head count as we normally put in, knowing that this is unsustainable, as Greg mentioned, and we've leveraged over time, things like that to maybe compensate for head count. But we'll always -- we've always managed our business for the long run and staffed to provide the customer service that's going to grow our business and build those relationships, and we'll continue to do that.

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

Scot, the other thing -- this is Greg. I think sometimes we tend to underestimate the task at hand here. When you look at our stores that are operating shorthanded and delivering the sales volumes there, it just speaks to the professionalism in our stores, and that's where we've built our success on. And so we've got the same situation in our distribution centers. Our distribution centers are operating short handed. They're working long hours. They're working weekends in a lot of cases to keep up with demand in our stores. And that's just not sustainable long term. We've got to put some more labor dollars back into our stores and DCs.

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

And Scot, I think to address the other part of your question, our intent is to focus on professional parts people that are full-time and bring back the right people. If we look at the employment environment, pre-COVID, unemployment was extremely low, got higher -- much higher now. And we're going to be very selective in who we bring back or who we hire to make sure that we're building the core full-time professional parts people we need to win business.

Operator

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

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

Thank you, Bridgette. 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 the call today, and we look forward to reporting our third quarter results in October. Thank you.

Operator

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