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PRESENTATION

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

Good afternoon, everyone. Welcome to the RBC Consumer and Retail Conference. Virtual, of course. We'd all rather be in Boston having a beer doing this. But we're still virtual because of the COVID scenario.

With us today, we have for this session, the senior management team of O'Reilly Automotive. We're fortunate enough to have the CEO and Co-President, Greg Johnson; as well as Jeremy Fletcher, who's Senior Vice President of Finance and the Controller; as well as Mark Merz, who's Vice President of Investor Relations and Planning. I think got all those titles right. That's always one of the challenges. So guys, thank you so much for being here. I always love to hear from you guys, the team, et cetera. And look, I'll jump right into it.

QUESTIONS AND ANSWERS

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

You guys had, obviously, an incredibly first quarter, good start to the second quarter. Greg, if you were to kind of rank order what you think the key drivers of the business are today, kind of 1, 2, 3, what would you point to?

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

Scot, great question. I think there are several drivers. Some are more traditional drivers. Some are somewhat of anomalies that we experienced in the last 12 years -- or 12 months, excuse me. I think that the government stimulus, first, was definitely a tailwind for our business and much of retail, especially on the DIY side of the business. So I would attribute some of our sales increase to that.

I think there was -- and has been and generally, it's not uncommon for there to be underperformance or under-maintained vehicles or lack of maintenance, and there were some pent-up demand there for that. And as some of our consumers were stuck at home, working from home, I think they caught up on some of that maintenance. And the other thing for our business in particular, I think we took some market share from our competitors.

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

So that all makes sense. But the truth is like we're like 3 standard deviations higher than we've ever been in terms of kind of sales pace. So maybe the -- and obviously, it's due to a lot of reasons. I think we probably argue a lot more personal vehicle usage because people don't want to be exposed to public transportation. And one of the other topics we're starting to hear about, and I'd love your perspective is, rising used vehicle prices, right? So now all of a sudden, like you're actually getting priced out of the market on another car that you're going to buy, so you start to fix your own vehicle. Are you carrying that from any of your stores and any of your commercial customers?

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

We are. We've heard that there is a return. During the peak of the pandemic, a lot of the jobs the shops were getting were tougher jobs to perform. They were the jobs that they may have turned down in the past or the jobs that they're big register rings, but they weren't the typical maintenance. They weren't the oil changes. They weren't the brake jobs. They weren't the undercar jobs that -- that our professional customers really build their business and their reputation on. They were the oddball jobs that, frankly, the DIY customers and light DIFM customers didn't want to perform themselves.

So with used car prices -- well, first of all, there's a supply and demand issue, as we all know, new vehicle inventory, much of which is related to the semiconductor shortage. But on our -- on the used car market, gosh, there's a lot of 1-, 2-year old vehicles, low mileage that are being sold at, at or above new car prices. And that's great for our business. The more -- the more maintenance cycle or the more miles that are driven, the more maintenance cycles, the more wear and tear that are on those vehicles. So we are hearing that there's more maintenance being done. It's more of the traditional type maintenance. And some of that's probably attributed to used cars. Some of that may be attributed to having a more normal winter earlier this year, putting more wear and tear on the cars themselves, things like that.

Mark Merz - *O'Reilly Automotive, Inc. - VP of IR, Reporting & Planning*

Yes. Scot, whenever you see used car pricing go up and we're seeing kind of historic highs in used car pricing right now, people think hard about transitioning to a new vehicle, and they make conscious decisions to maintain their existing vehicles for a longer period of time. And I think we're seeing that right now, and that's a benefit to the aftermarket.

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

It's the exact same dynamic we're seeing in the housing industry, right? Like people won't buy a new house, they want more room, they want an office, whatever it is. And now all of a sudden, what -- you have been priced out of the market so you're going to add on to your home.

So I'm not looking for an official forecast. This is purely an opinion. We will put as many disclaimers as you want around it. But when you look at all the factors playing into your industry right now and the elevated trends, how sustainable do you think it is? Like how much longer will we have these, like I said, 2, 3 standard deviation type kind of growth rates versus what we've historically seen?

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

Jeremy, you haven't taken one yet. You want to take that one?

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

I gave him the softball.

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

Yes. I mean that's obviously the million-dollar question. How long do I think a lot of folks are focused on. For sure, we have seen a tailwind, and Greg has spoken to it, from government stimulus dollars. We saw that at different points in time in 2020 and 2021. And I think the sense would be is that we're going to moderate from some of the peaks that we see when those dollars flood in. And to the extent that a lot of those get pointed to some of the things that we've talked about in terms of catching up on underperformed maintenance, working on projects, more discretionary things then that may revert, over the course of time, back to some norms.

I think for us, what's been a positive that we've seen, I think there are a few dynamics that are pretty consistent with our history in market environments like this. Even as we talk about -- about the used car market and the shortage of new vehicles and the willingness for people to continue to invest in their existing vehicles, there's a little bit of that dynamic that's built into the current vehicle market. But a lot of that also points to, I think, the resiliency of demand and people willing, in more uncertain economic times, to hang on to their vehicles and invest in them at higher mileage.

And we've seen in cycles in our industry historically, that as customers or as consumers go through that, it really does prove the value proposition of owning a higher mileage vehicle, that the interiors and exteriors, they hold up well, they look good, being able to keep those vehicles on the road, it's an investment that pays back. And as customers are pushed to that for whatever reason, be it uncertainty about the economy or the prices of used cars, whatever it might be, as they have invested in those types of activities to keep their vehicles on the road, it's given a good payback, and it's a good value proposition.

On the other end of it, I think we've certainly, over the last 12 months, seen shifts of demand into our sector. And I think that's a big question for us as we think about some of the business that we've picked up that -- whether it came from larger players or smaller players, we think there's some stickiness to that because of the value proposition that we provide, particularly on the DIY side as we've seen that surge.

So I can't really give you a prediction on where that sits. But especially as we move through 2020 and started to get further and further away from the stimulus events during the course of the year last year, we're pleased -- and we talked about being pleased with how our business had remained strong. And I think we've got the opportunities for some of that stickiness to keep us in strong business as we move through this year.

Obviously, all the caveats come into play, right? We obviously see lots of things that we don't know about.

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

Yes.

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

Scot, additionally, let me just add one quick thing. As we've said for a few years now, as we exit the pandemic and the strength we saw in DIY last year, our expectation is the DIFM will come back and come back to where it's outperforming DIY. That continues to be our long-term settlement.

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

So that was actually one of my questions just regarding like, have you started to see, let's call it, any kind of correlation between a pickup in commercial sales where you've seen economies start to reopen, like relaxing restrictions, et cetera? Like can you kind of point to a direct correlation on that?

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

I don't know that I can point to a direct correlation on a market-by-market perspective. But I'll tell you, generally, we remain pleased on both sides of our business at this point.

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

So if you were -- it makes sense that commercial outperformed just because you're going to be coming up against magnitudes of difference in terms of kind of comparisons. If we're to look at it on, say, a 2-year stack basis or a run rate basis, would you still expect commercial to outperform in the balance of the year? Or is that probably more of a '22 event?

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

Well, as I said, it's more of a long-term play. I'm not going to speculate on exactly how the DIFM versus DIY perform during the year 2021. But as we've said for a number of years now, our expectation, due to complexity of vehicles and other reasons, would be long term for DIFM to outperform DIY. And considering the hurdles that we faced from our past 12 months or so on the DIY side, it's a lot easier compares on the DIFM side short term.

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

Yes. Not only -- go ahead, Mark, you were going to say something?

Mark Merz - *O'Reilly Automotive, Inc. - VP of IR, Reporting & Planning*

So inherent in our initial guidance that Greg and Tom in our press release that we had back in February was our underlying assumption that professional business would outperform DIY over the course of '21. We saw extraordinary strength on both sides of the business, but especially on the DIY side through our first quarter.

As Greg mentioned earlier, we attribute a lot of that outperformance or performance above our expectations to the 2 rounds of government stimulus that we saw. December, January piece and then the piece in March. Our assumptions, like Greg said, is that DIY will come back, to some degree, over the levels that we've seen, and professional will outperform. We didn't see that during the first quarter and through April. But inherent in our updated guidance that we provided back in April was that assumption that the professional business would perform better over the course of '21 than DIY. We'll have to see how that ultimately turns out, but that's baked into our projections for the year.

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

Yes. That all makes sense. And then one of the confusions, I think, with -- for investors is, historically, you guys have had some correlation, even if it's a loose correlation, with miles driven and kind of repair activity. And yet we've seen miles driven starting to come back now. People are starting to get back to work, a little less work-from-home activity, et cetera. But how would you guys best frame that massive divergence we've seen between accelerated auto part sales and O'Reilly's has done a great job, but it's not just you, right? We're seeing it from Zone and the online guys, the Vance, you name it, and yet miles driven are down. Like how do you guys kind of connect those dots?

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

Yes. In a normal world, which we haven't experienced for the past 12 years, miles driven is a significant driver of sales in our industry. The more miles you drive, or as I said, the more maintenance cycles, the more wear and tear on vehicles. I think when you look at 2021, you have to look a little deeper and break down where those miles were driven. And in 2021, our DIY customers, most of them continue to work. Most of our DIY customers work blue-collar jobs. They continue to drive back and forth to work every day and continue to put miles on the road.

In contrast, a lot of the white-collar workforce that may move a lot of their volume to the DIFM channel probably didn't drive the same number of miles. They're working from home. They're not driving to and from work. They're taking fewer vacations, entertainment venues are shut down. So I think there was a bigger impact to miles driven on the white-collar workforce DIFM segment than perhaps there was on the DIY segment.

So as people begin to go back to work, there's a lot of speculation on what percentage of that workforce goes back to work versus continues to work from home. But undoubtedly, a significant portion of that will. We feel like miles driven will improve, and it will get back closer to normal growth than miles driven.

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

That makes sense. And then shifting gears a little bit. One of the big topics kind of throughout our conference with a number of verticals has been inflation. And I know you guys kind of talked about that, but you just had Advance literally update their inflation expectations 5 weeks later, right? They did a pre-announcement, provide guidance and then they decided to update their guidance because the amount of inflation that they're seeing, like whatever you're comfortable saying, like what's your latest thoughts on inflation? And is there any end to it? Or is this something that is just going to continue to build and build throughout the course of '22 -- or '21, excuse me?

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

Yes, I can probably jump in first on that and then Greg or Mark could can maybe add on. I want to be a little bit careful here. We really -- after our press release, we don't want to talk about what we've seen since then. But for sure, as we -- as we talked about on our call, inflation has been a little bit higher than what we've seen and have some expectation we could continue to see similar inflation really driven by all the types of things that everyone has talked about, the transportation costs, wage rates, those types of things that we're experiencing pretty widely.

None of us, I think, are inflation prediction experts. We know those pressures are there. It will be, I think, interesting to see for how long they persist and what doesn't look particularly with some of those drivers. But I think from our perspective, we feel pretty comfortable with the ability of our industry for sure, but especially of our company to manage through those cycles to be able to pass through price increases, to have control price increases from the perspective of what we'll take from our suppliers, and then just to be rational in how we think about how those pass through to our customer base.

And I think we have a lot of confidence in how that works, for sure, for what we've seen over the course of the history of our company and our industry. But especially as we think back to just recently with the tariff increases that came through and the success of the industry still maintain gross market rates and passing that through, it gives us pretty good indication that, that will continue to hold as we think about what we might see for the balance of this year and past this year.

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

Is there any concern that you're seeing anything but rational pricing in the industry? And the reason being asked that is one of your big competitors talked about some admittedly very strategic or surgical price investments on some of their commercial business. I'm just curious if that's anything that you guys have encountered or hearing anything else from the channel.

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

Yes, Scot. We constantly monitor pricing and price movements of all of our competitors, our larger national competitors, our regional competitors. And there's always someone out there that's testing, that's moving prices around. And really, I know who you're talking about. I know what they said, and we monitor their pricing and they monitor our pricing. And we feel like we all maintain and remain very rational in our pricing and continue to pass along any input cost increases that we see. We've been very successful in doing that. So I haven't seen any material changes.

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

Got it. That's helpful. And then taking another step further. I mean, Jeremy, you actually mentioned this in terms of wages. So most people think of inflation as kind of the price of the widget I happen to be selling, but we're seeing price pressures on lots of different things. Mark mentioned the distribution costs, obviously. But wage is a big topic. I guess the question for you, you know what, how much of an incremental pressure are you expecting on wages for this year? And is it something that, you know what, with the turnover rates that we're seeing, we may have to go a little bit higher than what we originally thought.

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

Yes. It's obviously something that we're monitoring pretty closely. I think it's gotten a lot more attention here recently. But frankly, we've been existing in a lower turnover tighter employment market really prior to the pandemic for a little while now. And have responded well, particularly in certain jurisdictions for some of the regulatory changes around minimum wages. And that's a process that as we thought about our workforce is always kind of a key for us. What do we need to do to make sure that we're operating stores to provide the very best possible customer service? And that's something that will continue to be a focus for us, and we'll have to respond as we need to move forward.

Having said that, I think we operate a fixed cost model. We've had the ability to manage well over the course of time to be sure that we -- we've got the right teams in place to take care of our customers. We don't know that we would anticipate anything is going to be significantly how we would execute that strategy as we move forward this year. But it's certainly -- it's an item that I think everybody is keenly aware of and focused on as we want to make sure that we're doing the right thing for our teams and for the long term of our business. And that's really how we think about how we staff and the people we have in our stores.

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

Do you have a -- I mean -- it's something that's been publicly talked about a lot, but it's really not a new phenomenon. There's a lot of markets out there that have been moving towards or above that $15 mark for a few years now. And if that were to change federally, it's going to change over time, and we would address it as we have in those markets where we've seen the pressures thus far.

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

That all makes sense. And that was actually my next question. One of the things you guys have talked about, and you actually started out some of the conversation is, you guys have been gaining market share. And you know what, I guess the first question is, I think I understand why you've been gaining market share, but where do you think it's coming from, right? And because you look at the other kind of big public guys, and you all are talking about kind of market share gains. I mean, is it all coming from warehouse distributors? Why do you think it may be occurring, et cetera? I think that would be helpful for the audience.

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

Yes. I think especially over the past 12 months with the pandemic, it's coming from 2 primary areas. One would be some of the smaller WDs that have struggled. They don't have the strength, buying power, supply chain power that we have. So I think some of it will be coming from the smaller regional players.

And frankly, I think some of it is coming from big box retail. I mean I think that a lot of consumers, rather than walk into the -- walk 200 yards to the back corner of a big box store to buy a battery, has figured out that they can walk into our store, or do this transaction curbside in our parking lot and not only by a quality battery at a competitive price, but we'll put it in the car for them free. We'll do the install. So I think most of that has come from those 2 channels. It's hard to tell exactly where it comes from. But that's where we feel like a lot of that market share gains come from.

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

And that was actually -- I think you started to reference it actually there, Greg, is we have heard about product shortages in lots of different verticals. And if you get one more set of brake pads coming off a production line, you're not selling it to auto parts, I'm sure, right? It's going to go to an O'Reilly or one of your big competitors. How long do you think that lasts? Do you think you can potentially see some of those share gains that you've been able to gather once the supply chain start to straighten out? Or do you consider those share gains more sticky?

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

Well, we hope they're sticky. We're working hard. If you ask Brad Beckham, our EVP of Store Operations and Sales, he's telling you that his guys are out there on the street every day and making sure that as much of that volume we retain as we can.

It's a tough market. It's very challenging, both with our national competitors and our smaller regional competitors. But we lead with service, and we provide a very high level of customer satisfaction in our stores, and we'll continue to do that and continue to try to not only retain that volume but grow our volume year-over-year.

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

Is the inventory flow or supply challenges getting any better than, say, 6 months ago? Or is it the same? Or is it getting worse?

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

We didn't face as many inventory challenges as many might think. We had a handful of suppliers that had issues. Now there's containers that are backed up in the ports. There's -- the lead time from China is greater than it once was. But as I said, we require most of our international suppliers to buffer inventory here in the state for us. So that is not a direct import for a lot of our larger suppliers. It comes from whatever country into the states, into their distribution center and then they replenish us from there. So we've got a buffer built in.

Now to say -- again, I've said this before as well. Our supply chain wasn't built for the volumes that we've experienced. So we've created some problems within our own supply chain with our DCs getting backed up on volume. I will tell you that is improving a great deal. So product will continue to flow. And we're still 5 to 7 suppliers that are having fill rate issues.

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

Got it. Okay. And then I did want to shift towards e-commerce. I think, Greg, before you chimed on, we do have at our conference a couple of e-commerce, kind of e-commerce-only players in the auto parts segment. I guess one of the questions is, and I know e-commerce is still a small part of the business for you guys. A, could you start to size the force, number one? Number two, you have talked about growing faster than the bricks-and-mortar channel, which makes sense to me. Do you think that accelerated growth pattern is kind of here to stay? Or is it kind of a onetime pandemic-type phenomena?

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

Well it definitely escalated growth during the pandemic, not only for our industry but in retail as a whole. I think we all know that. Scot, what I would tell you is when you look at the growth that we had in e-commerce, 75% of our e-commerce volume was pick up in store, ship to store or curbside. So that means that 75% of the customers that chose to transact with us online did not get the discount that we offered online to ship that product to their home, but paid a full price to transact in our stores.

So that tells us there's still that component of immediacy of need that they need that product before tomorrow morning, and they still need our assistance to make sure they've got the right part. They've got everything they need to complete that job before they start the job at home. It's really the same thesis we've been talking about for a number of years. But the percent of our business that ends up in our store and either ship to store or pick up in store or curbside now has grown from about 2/3 to about 3/4 during the pandemic.

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

Got it. So when you look at your DIY sales, I mean, how much of those sales would you view as immediate need, right? Like I need a starter, alternator battery or whatever. Versus I could order something on Tuesday and work on it on my Saturday project.

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

Yes. There's really -- we don't sell iPhones and G-Wiz items. So we sell parts to solve problems. And there's really 2 types of products you buy. You either buy product because your car is broken and you have to fix it now, or you buy a product to complete the repair that a part is failing. It's a maintenance item or something that you can plan for. I don't know what that breakdown is because frankly, because in any given segment, there are parts in those segments that may fall into either category. But based on the trends of customers continuing to come to our stores, I'm going to say that immediacy of need is a significant part of that.

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

Got it. And just because we're starting to run out of time here, unfortunately, I would love another hour. One of the big topics for investors these days is ESG. And I guess one of the questions for you guys is, what are the top kind of 2 or 3 ESG initiatives you'd really like to highlight for the investors listening in to that?

Mark Merz - *O'Reilly Automotive, Inc. - VP of IR, Reporting & Planning*

Well, Scot, when we think about ESG as a company, it's kind of interesting that over the last couple of years, reporting around ESG has become top of mind for investors. But for O'Reilly, the concepts of ESG, we just have and always will be part of our culture.

So from an environmental standpoint, we do massive amounts of recycling. We're constantly looking at ways to improve fuel economy in both our over-the-road fleet as well as our store vehicle fleet. We look at -- we've made significant investments in solar and wind farms, and we continue to look at opportunities to invest in those type of renewable energy sources.

From an S standpoint, human capital is our single most important asset as a company, and we're always investing and promote from within training, recruiting, giving all of our team members the opportunities. From a diversity inclusion standpoint to work-life environment, training to better do their jobs.

From a governance standpoint, good and corporate governance has always been a part of everything we do. Over the last several years, we've made significant enhancements in of the structure of our Board. We have 4 new Board members in the last 4 years. 3 of the new Board members are female. One of the new Board members is ethnically diverse. We continue our outreach with our shareholder base. At least once, if not twice a year, we proactively reach out to at least 1/3 of our outstanding shareholders to discuss items they would like to see in our sustainability report.

We're very happy that we produce 2 sustainability reports, and we're currently working on a third. Our first sustainability report was more focused on environmental because that was the engagement focus that we had at the time. The second one was more focused on human capital, additional human capital disclosures because that was the engagement. And through the process of the current sustainability report, which we hope to release in early fall, diversity inclusion is a larger focus of that report, again, because that's the engagement process and things that our shareholders wanted to see. So we'll continue that process into the future. But those are some of the high-level items that we're working on right now.

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

That's fabulous. And unfortunately, like I said, we're out of time. But thank you again for spending some time with us and our investors, and best of luck in today's afternoon meetings.

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

Thanks, Scot.

Mark Merz - *O'Reilly Automotive, Inc. - VP of IR, Reporting & Planning*

Bye, Scot.

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

Thank you.